

Lut+zz

MIND WHAT MATTERS

LUTZ LEARNING LIVE:
TAX CUTS AND JOBS ACT +
TAX REFORM OVERVIEW

PRESENTED BY: STEVE KENNEY & DEYNA ROUSE

AGENDA

- Introduction to the Tax Cuts and Jobs Act
- Individual taxation
- Business pass-through entity taxation and the 20% deduction
- Other business provisions
- C Corp vs. S Corp analysis
- Nonprofit organizations
- Question and Answer session

INDIVIDUAL TAX

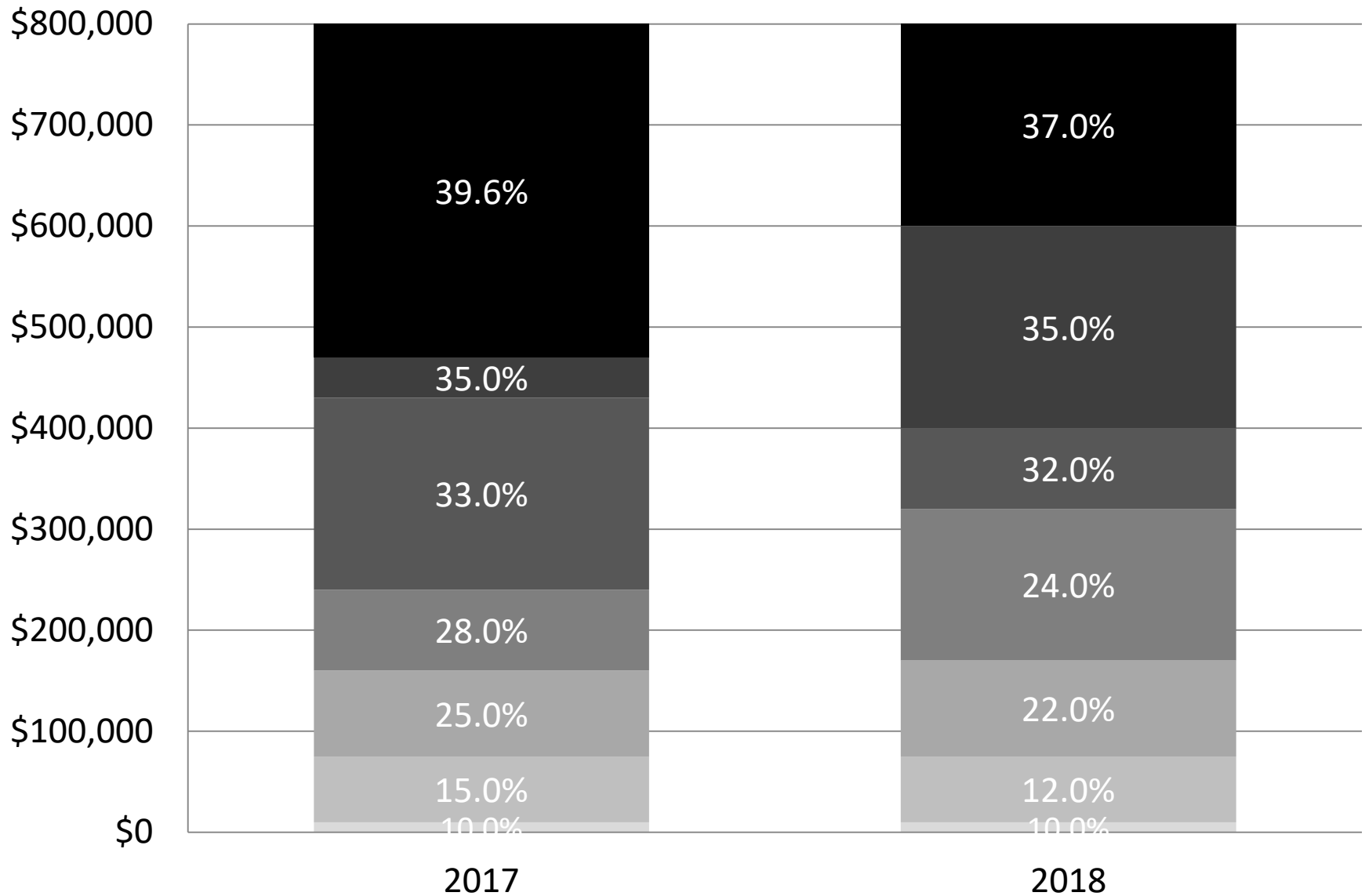
SUMMARY OF KEY INDIVIDUAL CHANGES

- Lower tax rates but fewer deductions
- Most individuals will see a tax decrease in 2018
- Many individuals will now use the standard deduction, particularly if they have no mortgage or a small mortgage
- Consider “bunching” charitable contributions every other year to be able to itemize deductions
- Many provisions “sunset” at the end of 2025

INDIVIDUAL TAX RATES- SUNSET ON 12/31/25

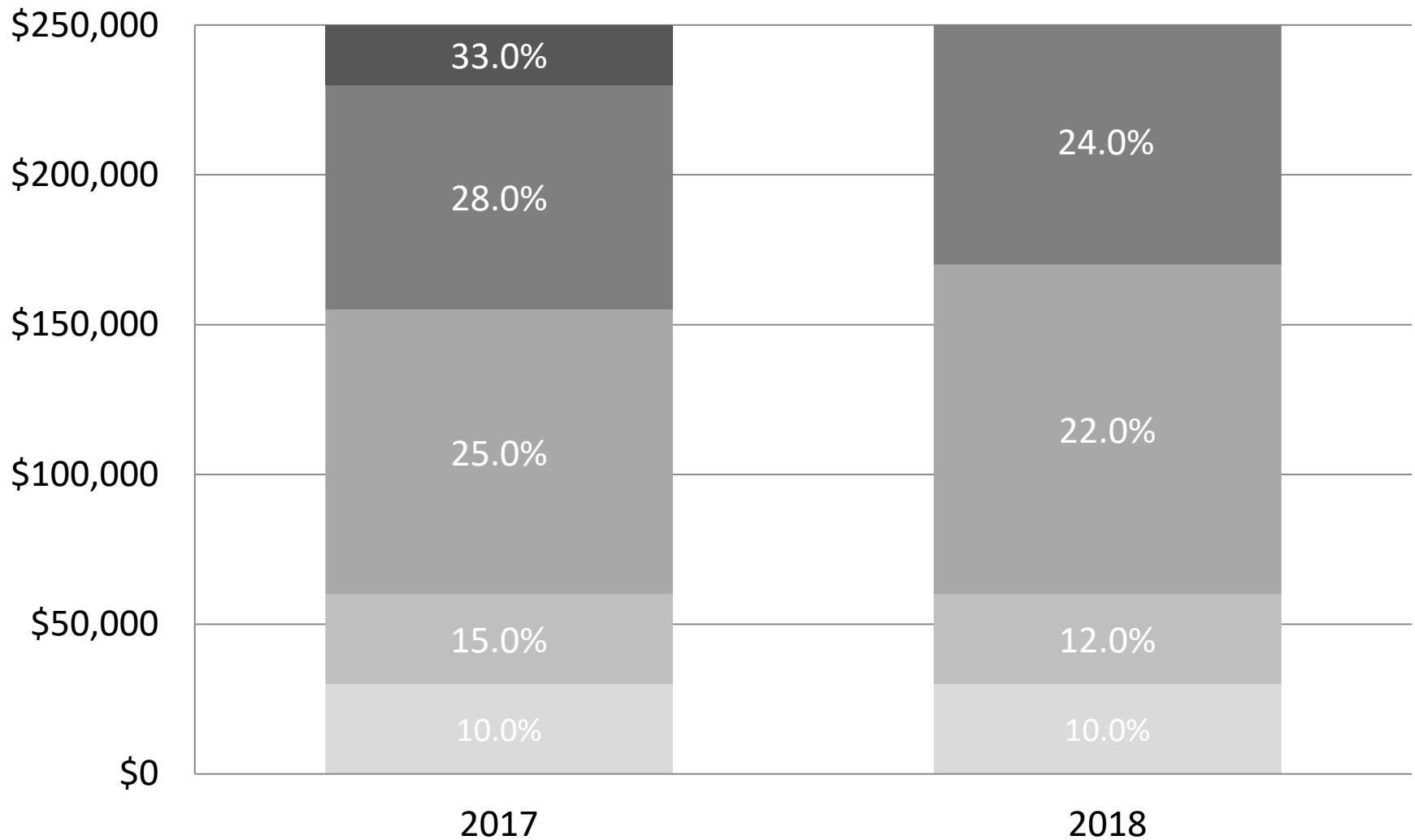
Rate	SINGLE		MARRIED	
	TAXABLE INCOME	TAX	TAXABLE INCOME	TAX
10%	\$0 - \$9,525	10% of Taxable Income	\$0 – \$19,050	10% of Taxable Income
12%	\$9,525 to \$38,700	\$952.50 plus 12% of excess over \$9,525	\$19,051 to \$77,400	\$1,905 plus 12% of excess over \$19,050
22%	\$38,701 to \$82,500	\$4,453.50 plus 22% of excess over \$38,700	\$77,401 to \$165,000	\$8,907 plus 22% of excess over \$77,400
24%	\$82,501 to \$157,500	\$14,089.5 plus 24% of excess over \$82,500	\$165,001 to \$315,000	\$28,179 plus 24% of excess over \$165,000
32%	\$157,501 to \$200,000	\$32,089.50 plus 32% of excess over \$157,500	\$315,001 to \$400,000	\$64,179 plus 32% of excess over \$315,000
35%	\$200,001 to \$500,000	\$46,689.50 plus 35% of excess over \$200,000	\$400,001 to \$600,000	\$91,379 plus 35% of excess over \$400,000
37%	\$500,001 or more	\$150,689.50 plus 37% of excess over \$500,000	\$600,001 or more	\$161,379 plus 37% of excess over \$600,000

INDIVIDUAL INCOME TAX RATES



INDIVIDUAL INCOME TAX RATES

Comparisons- \$250,000 & Lower



CAPITAL GAIN RATES & MEDICARE/NET INVESTMENT TAX

Rate	Taxable Income			
Single	Married	Capital Gain/Qualified Dividend	Medicare Tax on Earned Income	Medicare Tax on Net Investment Income
\$0	\$0	0%	2.9%	0%
\$38,600	\$77,200	15%		
\$200,000	\$250,000		3.8%	3.8%
\$425,800	\$479,000	20%		

CAPITAL GAIN RATES & MEDICARE/NET INVESTMENT TAX

- **Married Filing Jointly Thresholds**

- 15% : \$77,200
- 20% : \$479,000
- 3.8% Net Investment Tax: \$250,000

- **Single Thresholds**

- 15% : \$38,600
- 20% : \$425,800
- 3.8% Net Investment Tax: \$200,000

STANDARD DEDUCTION/EXEMPTION

- **Married Filing Joint – Increased from \$12,700 to \$24,000**
- **Single - Increased from \$6,350 to \$12,000**
- **Repeals Personal Exemptions**

CHILD AND FAMILY CREDITS

- **Child Tax Credit**

- Increases it to \$2,000, with refundable amount of \$1,400
- Child under 17
- Must have SSN for refundable
- \$500 nonrefundable credit for non-child dependent
- Phases out \$200,000/\$400,000

ITEMIZED DEDUCTIONS

- **Repeals overall limitations on itemized deductions**
- **Prior law (Pease Limitation)**
 - Itemized deductions were limited to the amount overall deductions exceeded 3% of AGI
 - Thresholds - \$261,500/Single and \$313,800/Married

ITEMIZED DEDUCTIONS - MORTGAGE

- **Mortgage Interest Expense**
 - Limits deduction to \$750,000 mortgage principal – applies to mortgages incurred after December 15, 2017
 - No deduction for home equity loans (no exceptions for home equity incurred before December 15, 2017)
 - Refinanced debt can maintain its “grandfathered” status to the extent debt does not exceed amount refinanced
 - Special rule if agreement to purchase entered into before December 15, 2017

ITEMIZED DEDUCTIONS - SALT

- **State And Local Tax (SALT) Deduction**
 - Allows up to \$10,000 for property tax and sales or income tax
 - Can still deduct full amount property and sales tax incurred in carrying on a trade or business – even if on a Schedule C or pass-through income
 - Can also still deduct SALT for C corporations
 - Prohibits pre-payment of 2018 taxes in 2017

ITEMIZED DEDUCTIONS - MISCELLANEOUS

- **2% Miscellaneous Itemized Deductions – Repealed**
 - Unreimbursed employee expenses
 - Tax preparation fees
 - Other expenses
 - *Investment fees and expenses*
 - *Unreimbursed business expenses*
 - *Excess deductions of an estate*

ITEMIZED DEDUCTIONS - CHARITABLE

- **Charitable Contributions**
 - Increases limit to 60% of AGI for cash paid to public charities
 - Removes deduction for amounts paid for right to purchase tickets to athletic events



OTHER ITEMIZED DEDUCTIONS

- **Medical Expenses – Retained at 10% of AGI (7.5% for 2017 and 2018)**
- **Moving Expenses – Repealed except for military**
- **Investment Interest Expense – Retained**
- **Gambling Losses – Includes additional expenses in wagering losses limited to the extent of gambling winnings**
- **Alimony – Repealed for divorce decrees entered into after 1/1/2019**

ALTERNATIVE MINIMUM TAX (AMT)

- AMT is retained but exemption increased
- Married Filing Joint – Increased from \$84,500 to \$109,400
- Single - Increased from \$54,300 to \$70,300
- AMT should be less of an issue due to disallowance/reduction of state and local taxes and 2% miscellaneous deductions

EXAMPLES FOR INDIVIDUALS

ASSUMPTIONS

Married Filing Jointly | 2 Qualifying Children | Only Income is Wages & Salary
No Capital Gains or Other Portfolio Income | No Flow Through Income from K1s

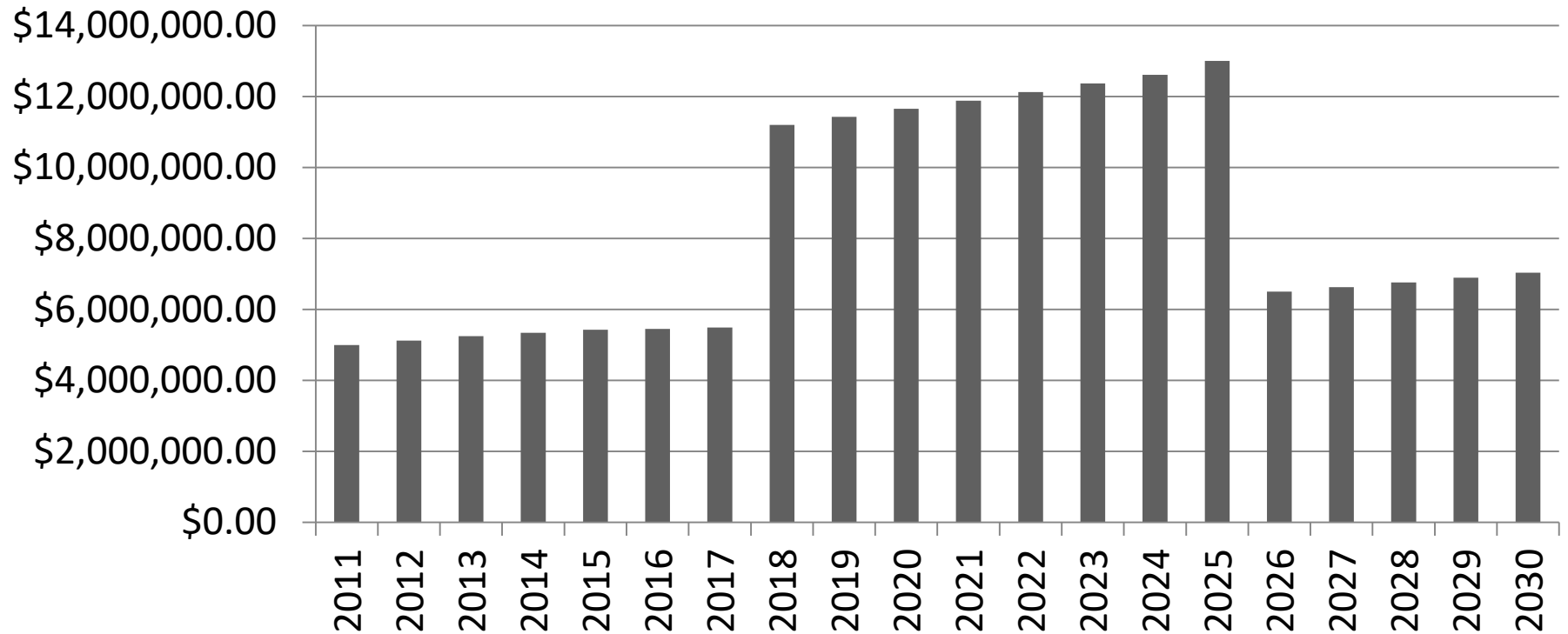
INCOME	STATE TAX @6%	REAL ESTATE	MORTGAGE INTEREST	CHARITY		2017 TAX	2018 TAX	TAX DECREASE %
75,000	Standard Deduction					3,962	1,739	56.11%
250,000	15,000	5,000	8,000	10,000		42,972	37,859	11.9%
500,000	30,000	7,500	10,000	20,000		128,071	114,629	10.50%
750,000	45,000	10,000	15,000	30,000		212,313	201,029	5.31%
1,000,000	60,000	15,000	20,000	40,000		302,673	290,229	4.11%
2,000,000	120,000	20,000	25,000	80,000		675,993	652,579	3.46%

ESTATE/GIFT/GST

- Increase the basic exclusion to \$10 million for estates and gifts, indexed for inflation beginning in 2011
- Exemption for 2018 will be \$11.2M
- Top tax rate is still 40%
- Retain step up in basis
- Increased exemption sunsets 12/31/25

ESTATE TAX EXEMPTION

Estate Tax Exemption – Past & Projected



PASS-THROUGH – BUSINESS INCOME

20% QUALIFIED BUSINESS INCOME DEDUCTION

- New Section 199A for “Qualified Business Income”(QBI) creates new 20% deduction
- Replaces old Section 199 domestic production activities deduction (DPAD) which was approximately 9%
- Essentially provides a top marginal tax rate of 29.6% (80% of 37% top marginal rate)
- Applies to owners of S corporations, partnerships, LLCs, and sole proprietorships
- Deduction from taxable income of an individual taxpayer; applies to trusts and estates too

QBI DEDUCTION LIMITATIONS

- **20% Deduction Cannot Exceed of Greater of:**
 - 1) **50% of W-2 wages with respect to the qualified trade or business OR**
 - 2) **25% of W-2 wages plus 2.5% of the unadjusted basis of qualified depreciable property immediately after acquisition**
 - 3) **Guaranteed payments or intercompany management fees are not considered wages**

QBI DEDUCTION LIMITATIONS

- “Specified Service Trades or Businesses” are not eligible for QBI
 - Any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees, or
 - Which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities
 - Not applicable to engineers or architects
 - We need further definition/clarification from IRS

QBI DEDUCTION LIMITATIONS

- **W2 Wage Limitation and Specified Service Rules Do Not Apply to:**
 - **Married taxpayers with taxable income less than \$315,000 with a phase out at \$415,000**
 - **Other taxpayers with taxable income less than \$157,500 with a phase out at \$207,500**
 - **Applies at the individual level, not the business entity**

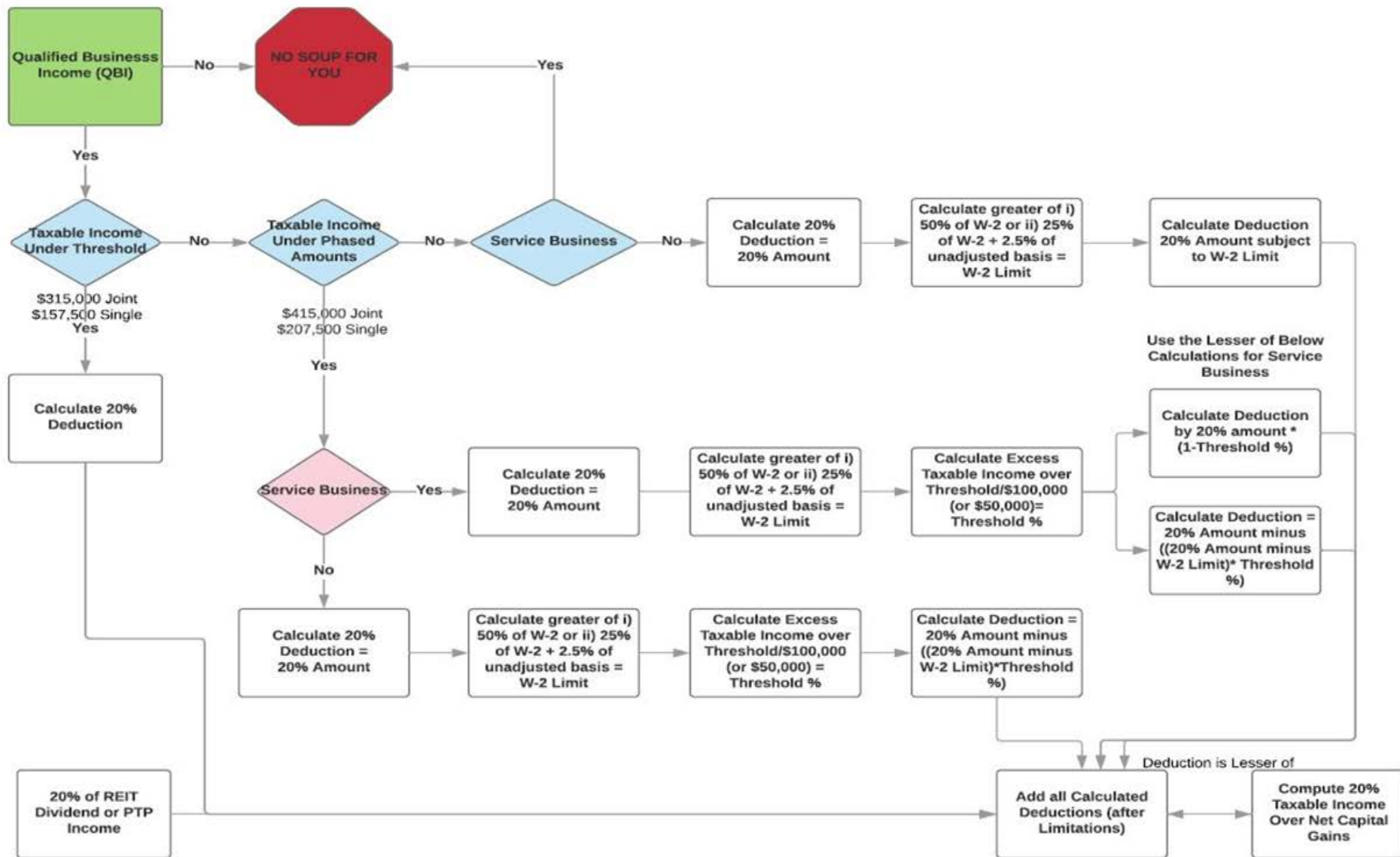
QBI DEDUCTION LIMITATIONS

- **Final Limitation – Deduction cannot exceed the lesser of:**
 - The Combined QBI amount from all businesses, OR
 - 20% of total taxable income for individual, not including capital gains

OTHER QBI DEDUCTION CONSIDERATIONS

- QBI is computed on an entity by entity basis but aggregated on the individual's personal tax return
- Due to wage limitations and other limitations, some businesses may qualify and others may not
- Affiliated companies may want to reconsider wages by entity or potential mergers of entities
- Planning to manage income below \$315,000 income threshold amounts – depreciation, retirement plans, etc.

QBI DEDUCTION- FLOW CHART



QBI EXAMPLE #1

- SOLE PROPRIETOR OF OPERATING BUSINESS (INCOME BELOW PHASE-OUT RANGE)**

- Marv, married and a sole proprietor, has \$125,000 net business income from his flower shop in 2018. Marv and his spouse have \$30,000 of other income and will take the standard deduction (\$24,000) in 2018.
- Based on these facts, below is a summary of Marv's QBI deduction in 2018.

Net business income (a)	\$125,000
Other income	30,000
Adjusted gross income	\$155,000
Less: Standard deduction	-24,000
Taxable income (b)	\$131,000
QBI deduction*	\$25,000

* QBI deduction = Lesser of: (a) 20% of net business income ($\$125,000 \times 20\% = \$25,000$) or (b) 20% of taxable income ($\$131,000 \times 20\% = \$26,200$)

QBI EXAMPLE #2

- 100% OWNED S CORPORATION (INCOME ABOVE PHASE-OUT RANGE)**

- Deyna, married and a sole proprietor, has \$1,000,000 net business income from her software development business in 2018. Deyna and her spouse have \$50,000 of other income and will have \$60,000 of itemized deductions (\$10,000 real estate and state income taxes + \$15,000 in mortgage interest + \$25,000 charitable donations) in 2018. Additionally, Deyna's business has \$250,000 of W-2 wages and \$200,000 of assets (unadjusted cost basis).
- Based on these facts, below is a summary of Deyna's QBI deduction in 2018.

Net business income (a)	\$1,000,000
Other income	50,000
Adjusted gross income	\$1,050,000
Less: Itemized deductions	-60,000
Taxable income (b)	\$990,000
QBI deduction*	\$125,000

*** QBI deduction = Lesser of: (a) 20% of net business income ($\$1,000,000 \times 20\% = \$200,000$), (b) 20% of taxable income ($\$990,000 \times 20\% = \$198,000$) or (c) greater of: (i) 50% of W-2 wages ($\$250,000 \times 50\% = \$125,000$) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets ($[\$250,000 \times 25\%] + [\$200,000 \times 2.5\%] = \$67,500$)**

QBI EXAMPLE #3

- PARTNER IN A PARTNERSHIP INVOLVED IN RENTAL REAL ESTATE (INCOME ABOVE PHASE-OUT RANGE)**
 - Scott, married and a 50% partner in Frostland, LP (a rental real estate partnership), has \$750,000 of pass-through net business income in 2018. Scott and his wife have \$100,000 of other income and \$50,000 of itemized deductions (\$10,000 real estate and state income taxes + 15,000 mortgage interest + \$25,000 charitable donations) in 2018. Additionally, Frostland, LP has \$120,000 of W-2 wages and \$5,000,000 of assets (unadjusted cost basis).
 - Based on these facts, below is a summary of Scott's QBI deduction in 2018.

Net business income (a)	\$750,000
Other income	100,000
Adjusted gross income	\$850,000
Less: Itemized deductions	-50,000
Taxable income (b)	\$800,000
QBI deduction*	\$82,500

* **QBI deduction = Lesser of: (a) 20% of net business income (\$750,000 x 20% = \$150,000), (b) 20% of taxable income (\$800,000 x 20% = \$160,000) or (c) greater of: (i) 50% of W-2 wages (\$120,000 x 50% x 50% = \$30,000) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets ([\$120,000 x 50% x 25%] + [\$5,000,000 x 50% x 2.5%] = \$82,500**

OTHER PASS THROUGH PROVISIONS

- **Excess business loss disallowance**
 - Maximum annual business loss is now \$500,000 for joint filers (\$250,000 single)
 - Excess losses can be carried forward to future years
 - Each separate business activity analyzed separately
 - No guidance on “aggregation” of related businesses yet
 - Taxpayers may want to consider merging related businesses

BUSINESS INCOME – CARRIED INTEREST

- Creates a 3 year holding period for certain partnership interest received in exchange for services in order to qualify for long-term capital gain treatment

CORPORATE TAX

CORPORATE TAX RATES

- Changes graduated rates to a flat 21% tax rate for corporations
- Eliminates special tax rate for personal service corporations
- Blending of rates for fiscal year ends under IRC section 15
- Corporate alternative minimum tax (AMT) eliminated
- Elimination of Section 199 domestic production activities deduction (DPAD) which was approximately 9%

DIVIDEND RECEIVED DEDUCTION

- Modifies 70% dividend received deduction to a 50% deduction
- Modifies 80% deduction for dividend received from a 20% owned corporation to 65%
- Effective 1/1/18



CORPORATE NET OPERATING LOSSES

- Limits NOL deduction to 80% of taxable income determined without regard to the deduction
- Creates indefinite carryforward if disallowed losses
- Repeals carryback in most cases, but retains 2 year carryback for certain farming losses
- Only applies to NOLs created after 1/1/18
 - NOLs generated prior to 1/1/18 still subject to 20 year carryforward and 100% of taxable income

CONTRIBUTIONS TO CAPITAL

- **Modifies current law such that contributions to capital would be included in income if i) the contribution aids in the construction or any other contribution as a customer or potential customer or ii) is a contribution by a governmental entity or civic group.**



OTHER BUSINESS CHANGES

BUSINESS EXPENSING/BONUS DEPRECIATION

- Allows for 100% expensing of qualified property placed in service after September 27, 2017 and before January 1, 2023
- Extended through 2026, with 80% in 2023, 60% in 2024, 40% in 2025, and 20% in 2026.
- Now applicable to used and new property
- Not available for real property trade or businesses that opt to not apply interest expense limitation or businesses using floor plan financing indebtedness
- Property acquired before September 28, but placed in service after September 27 would be subject to old law

REAL PROPERTY BUSINESS EXPENSING

- Eliminates distinctions between qualified leasehold improvement property, qualifies restaurant property, and qualified retail improvement property and provides a general 15 year recovery period for qualified improvement property (with a 20-year ADS period)
- Real property trade or businesses that opt out of the business interest limitation are required to use ADS recovery method.

179 BUSINESS EXPENSING

- Increases expense amount to \$1,000,000
- Increases phase-out threshold to \$2,500,000
- Expands the definition of qualified real property eligible for section 179 to include certain improvements to nonresidential real property:
 - Roofs
 - Heating, ventilation, and air conditioning property
 - Fire protection and alarm systems; security systems

INTEREST EXPENSE

- Limits deduction for business interest to the sum of business interest income plus 30% of “adjusted taxable income” of the taxpayer for the taxable year plus floor plan financing interest
- Determined at “tax filer” level (e.g. LLC and not partner)
- Allows carry forward of disallowed interest deduction indefinitely
- Limitations do not apply to businesses with less than \$25,000,000 average gross receipts for prior 3 years
- Does not apply to floor plan financing
- Real property businesses can opt out of the limitation if they elect ADS depreciation

ACCOUNTING METHOD CHANGES

- Cash method for C-corporations and partnerships
- Cash method for businesses with inventory
- Section 263A/UNICAP rules
- Percentage-of-Completion for long term contracts
- \$25 million gross receipts test

BUSINESS DEDUCTIONS

- Disallowed entertainment, amusement, recreation activities, facilities, or membership dues
- Retains 50% deduction on certain food/beverages
 - Retains 100% deduction for recreational expenses for employees (e.g., Christmas party)
 - Extends the 50% limit for meals provided for the employer's convenience on or near the employer's business premises

R&D CREDITS

- Credit retained
- Beginning in 2021, costs must be capitalized and amortized over 5 years vs. current year expensing

LIKE-KIND EXCHANGES

- Limits like-kind exchange rule to real property only



C CORP VS. S CORP ANALYSIS

FACTORS TO CONSIDER FOR CONVERSION TO C-CORPORATION

- Difference in C corporation vs. pass through tax rates
- Double taxation of C corporations
- Will QBI deduction be limited?
- Can pass through income be managed by 100% bonus depreciation?

COMPARISON OF C CORPORATION VS. S CORPORATION/LLC TAX RATES – NEW LAW

	C CORPORATION	S CORP/LLC PASS THROUGH	SPECIFIED SERVICES
ORDINARY INCOME			
Income	100.00	100.00	100.00
Tax	(21.00)	(29.60)	(37.00)
Net Income After Tax	79.00	70.40	63.00
Dividend Tax at 23.8%	(18.80)	-	-
Net After Tax Income	60.20	70.40	63.00
CAPITAL GAINS			
Income	100.00	100.00	100.00
Tax	(21.00)	(20.00)	(20.00)
Net Income After Tax	79.00	80.00	80.00
Dividend Tax at 23.8%	(18.80)	-	-
Net After Tax Income	60.20	80.00	80.00

COMPARISON OF C CORPORATION VS. S CORPORATION/LLC TAX RATES – OLD LAW

	C CORPORATION	S CORP/LLC PASS THROUGH
ORDINARY INCOME		
Income	100.00	100.00
Tax	(35.00)	(39.60)
Net Income After Tax	65.00	60.40
Dividend Tax at 23.8%	(15.47)	-
Net After Tax Income	49.53	60.40
Income	100.00	100.00
Tax	(35.00)	(20.00)
Net Income After Tax	65.00	80.00
Dividend Tax at 23.8%	(15.47)	-
Net After Tax Income	49.53	80.00

FACTORS TO CONSIDER FOR CONVERSION TO C-CORPORATION

- Retention of earnings in business vs. distributions to owners
- Ultimate plans for getting cash to the shareholders
- Potential future sale of business: asset vs. stock sale
- S-corporation considerations
 - Inability to re-elect S status for 5 years
 - Built-in gain tax if re-elected
- Uncertainty over length of low corporate tax rate given political climate
- Legal issues and ownership structure

PROCESS OF CONVERTING S CORPORATION TO A C-CORPORATION

- S corporations file a letter and statement of consent with IRS to revoke S status within 3.5 months of year end
- Treatment of future C corp distributions
 - Taxable dividend to the extent of accumulated C corporation earnings (C corp earnings and profits or “E&P”)
 - Tax-free return of capital to the extent of “original basis” which would include common stock, paid in capital and retained S corporation earnings (AAA)
 - Capital gain once you have distributed C corp E&P and original basis
- New legislation provides that distributions for 6 years after the S corp termination will be treated as made from the S corp earnings and C corp E&P pro-rata instead of being treated as 100% from E&P first

NONPROFIT ENTITIES

EXCISE TAX ON INVESTMENT INCOME OF PRIVATE COLLEGES/UNIVERSITIES

- Imposes a 1.4% excise tax on the investment income of certain private colleges and universities
- Applicable to colleges and universities who have more than 500 full-time students AND more than \$500,000 in assets per full-time student (other than assets used in the conduct of its exempt purposes)

UNRELATED BUSINESS TAXABLE INCOME

- Increases unrelated business taxable income for any fringe benefit for which a deduction is no longer allowed (e.g., parking or other fringe benefit)
- Separate calculation of unrelated business taxable income for each separate unrelated trade or business

EXCISE TAX ON EXECUTIVE COMPENSATION

- Imposes excise tax equal to corporate rate on compensation in excess of \$1,000,000 paid to a tax-exempt organization's five highest paid employees
- Applicable to parachute payments made to highly compensated employees exceeding the portion of the base amount allocable to payment



QUESTIONS?