Learning Objectives

- To better understand the impact of the TCJA on taxpayer returns and tax planning
- To know how capital gains rates are determined under TCJA
- To be able to explain to taxpayers how changes to tax rates, exemptions, standard deductions, itemized deductions and personal credits impact the bottom-line impact of the TCJA on tax liability
- To create awareness of the taxation of exchanges of like-kind personal property
- To be aware of changes made to depreciation rules for real property improvements, farm assets, Sec. 179 and bonus depreciation
- To understand the conformity of rules for cash basis accounting, the limitation on business losses, and the new rules for net operating losses
- To understand the basic rules for computing the Qualified Business Income and be able to calculate it for the most typical business clients
- To be aware of additional changes to the topography of business taxation so that unexpected tax landmines may be avoided to the extent possible

Individual Rates
Married Filing Jointly

<table>
<thead>
<tr>
<th>TCJA</th>
<th>Prior Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net over $12,850</td>
<td>10%</td>
</tr>
<tr>
<td>19,051 – 77,400</td>
<td>12%</td>
</tr>
<tr>
<td>77,401 – 165,000</td>
<td>22%</td>
</tr>
<tr>
<td>165,001 – 315,000</td>
<td>24%</td>
</tr>
<tr>
<td>315,001 – 400,000</td>
<td>32%</td>
</tr>
<tr>
<td>400,001 – 600,000</td>
<td>35%</td>
</tr>
<tr>
<td>Over $600,000</td>
<td>37%</td>
</tr>
</tbody>
</table>
Individual Rates
Married Filing Jointly

<table>
<thead>
<tr>
<th>TCJA</th>
<th>Prior Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>Bracket Size</td>
</tr>
<tr>
<td>Not over $19,050</td>
<td>10%</td>
</tr>
<tr>
<td>18,651 – $77,400</td>
<td>12%</td>
</tr>
<tr>
<td>77,401 – 165,000</td>
<td>22%</td>
</tr>
<tr>
<td>165,001 – $315,000</td>
<td>24%</td>
</tr>
<tr>
<td>315,001 – $400,000</td>
<td>32%</td>
</tr>
<tr>
<td>Over $400,000</td>
<td>37%</td>
</tr>
</tbody>
</table>

Capital Gains Tax Rate Brackets

- No longer tied to ordinary tax rate brackets
- Based on prior income tax brackets, indexed for inflation

<table>
<thead>
<tr>
<th>0%</th>
<th>15%</th>
<th>20%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint return and surviving spouse</td>
<td>Not greater than $77,200</td>
<td>77,201 – 470,000</td>
</tr>
<tr>
<td>Head of household</td>
<td>Not greater than $51,700</td>
<td>51,701 – 452,400</td>
</tr>
<tr>
<td>Single</td>
<td>Not greater than $38,600</td>
<td>38,600 – 425,800</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>Not greater than $38,600</td>
<td>38,600 – 239,500</td>
</tr>
<tr>
<td>Trusts and estates</td>
<td>Not greater than $2,600</td>
<td>2,600 – 12,700</td>
</tr>
</tbody>
</table>

Adjustments to Gross Income

- No deduction for alimony (not taxable to recipient either) for agreements entered into after 12/31/18
- Moving expense deduction is suspended for tax years beginning after 12/31/17
  - Any reimbursements are taxable income except for active duty members of the Armed Service moving pursuit to a military order and a permanent change of station.
- No deduction for away from home living expenses for members of Congress for tax years beginning after 12/22/17
**Allowances**

- Personal and dependent exemption amounts set to zero
- Employees able to claim “allowances” to achieve proper withholding
- New Form W-4 in the works at IRS National Office
- On-line calculator highly recommended by the IRS

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**Standard Deduction**

<table>
<thead>
<tr>
<th></th>
<th>Prior Law</th>
<th>TCJA</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint returns and Surviving Spouse</td>
<td>12,700</td>
<td>24,000</td>
<td>11,300</td>
</tr>
<tr>
<td>Head of Household</td>
<td>9,200</td>
<td>18,000</td>
<td>8,800</td>
</tr>
<tr>
<td>Single</td>
<td>6,350</td>
<td>12,000</td>
<td>5,650</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>6,350</td>
<td>12,000</td>
<td>5,650</td>
</tr>
</tbody>
</table>
| Blind & Elderly addition:
  - Single, head of household, married filing separately | 1,550 | 1,600 | Inflation adjustment only |
  - Married filing jointly, qualifying widower | 1,275 | 1,300 | Inflation adjustment only |
| Dependent of another | $1,050 or $350 plus earned income | $1,070 or $350 plus earned income | No Change |

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**Marriage Penalty Partially Eliminated**

- The standard deduction for married filing jointly is twice that of single taxpayers — no penalty
- TCJA eliminates the marriage penalty through the 32% tax rate
  - Married filing jointly brackets are twice the amount of single taxpayer brackets through the 32% bracket
  - Marriage penalty still exists for taxpayers in the 35% and 37% brackets
Itemized Deductions

- Medical expense threshold back to 7.5% of AGI after 12/31/16 and before 1/1/19.
- Deduction for state and local, and foreign property taxes; state and local income taxes (or sales tax in lieu of income tax) limited to $10,000 ($5,000 for married filing separately)
- Home mortgage interest deductible on up to $750,000 of acquisition indebtedness ($375,000 for married filing separately)
  - Prior limit still applies to acquisition indebtedness incurred prior to December 15, 2017
  - Refinancing old acquisition indebtedness will not invoke the new lower limits as long as new debt does not exceed old debt.
- Deduction for home equity loan interest is disallowed.

Itemized Deductions - continued

- Prior 50% of AGI limit on certain charitable contributions is increased to 60% for tax years beginning after 12/31/16 and before 1/1/26
- No deduction for charitable contributions to institutes of higher learning made in exchange for right to purchase tickets or seating at an athletic event.
- Casualty and theft losses for personal use property are disallowed unless in a federally declared disaster.
- No 2% of AGI miscellaneous deductions
- But no overall limit (phaseout) for high income taxpayers

Child Credit

- Maximum credit increased to $2,000 per eligible child
- Phaseout income level is increased to $400,000 for married filing jointly ($200,000 for all others)
- Refundable portion is also increased to $1,400 and is increased for inflation.
  - Calculated as 15% of earned income in excess of a threshold amount
  - The earned income threshold for the refundable portion is decreased from $3,000 to $2,500
- Maximum credit not allowed without child’s SSN being provided
- Filing Form 8867 is still required to prove due diligence
Child Credit - expanded

- Partial credit of up to $500 is available to a dependent who isn’t a qualifying child but is a U.S. citizen, national or resident.
- Residents of Canada and Mexico do not qualify unless U.S. citizen or nationals.
- Qualifying relatives do qualify.
- Apparently qualifying children over age 16 do qualify for this partial credit. This would include a qualifying child who is:
  - Age 17 or 18
  - A full-time student age 19 – 23
  - A disabled child
- Partial credit is the maximum for a qualifying child under age 17 who doesn’t have a SSN but does have an ITIN or ATIN.
- No portion of the partial credit is refundable.

Impact on a Family of 4

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGI</td>
<td>60,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Less: standard deduction</td>
<td>12,700</td>
<td>24,000</td>
</tr>
<tr>
<td>Less: exemptions</td>
<td>16,200</td>
<td>0</td>
</tr>
<tr>
<td>Taxable income</td>
<td>31,100</td>
<td>36,000</td>
</tr>
<tr>
<td>Tax</td>
<td>3,756</td>
<td>3,939</td>
</tr>
<tr>
<td>Child credit</td>
<td>2,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Net tax</td>
<td>1,756</td>
<td>(61)</td>
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</tbody>
</table>

Impact on Couple without Kids

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGI</td>
<td>60,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Less: standard deduction</td>
<td>12,700</td>
<td>24,000</td>
</tr>
<tr>
<td>Less: exemptions</td>
<td>8,100</td>
<td>0</td>
</tr>
<tr>
<td>Taxable income</td>
<td>39,200</td>
<td>36,000</td>
</tr>
<tr>
<td>Tax</td>
<td>4,951</td>
<td>3,939</td>
</tr>
<tr>
<td>Child credit</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Net tax</td>
<td>4,951</td>
<td>3,939</td>
</tr>
</tbody>
</table>
## Impact on Couple without Kids, more AGI

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGI</td>
<td>200,000</td>
<td>200,000</td>
</tr>
<tr>
<td>less:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>standard deduction</td>
<td>12,700</td>
<td>24,000</td>
</tr>
<tr>
<td>exemptions</td>
<td>8,100</td>
<td>0</td>
</tr>
<tr>
<td>Taxable income</td>
<td>179,200</td>
<td>170,000</td>
</tr>
<tr>
<td>Tax</td>
<td>37,050</td>
<td>30,819</td>
</tr>
<tr>
<td>Net tax</td>
<td>37,050</td>
<td>30,819</td>
</tr>
</tbody>
</table>

### Someone who pays more

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGI</td>
<td>200,000</td>
<td>200,000</td>
</tr>
<tr>
<td>less:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>itemized deductions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NYSL income tax</td>
<td>8,325</td>
<td>25</td>
</tr>
<tr>
<td>Property taxes</td>
<td>9,775</td>
<td>9,775</td>
</tr>
<tr>
<td>Contributions</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Employee business deductions</td>
<td>2,500</td>
<td>0</td>
</tr>
<tr>
<td>less: exemptions</td>
<td>8,100</td>
<td>0</td>
</tr>
<tr>
<td>Taxable income</td>
<td>151,300</td>
<td>170,000</td>
</tr>
<tr>
<td>Tax</td>
<td>29,302</td>
<td>29,379</td>
</tr>
<tr>
<td>Child credit</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Net tax</td>
<td>29,302</td>
<td>29,379</td>
</tr>
</tbody>
</table>

### Someone who pays more - continued

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGI</td>
<td>200,000</td>
<td>200,000</td>
</tr>
<tr>
<td>less:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>itemized deductions</td>
<td></td>
<td></td>
</tr>
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<td>Contributions</td>
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</tr>
<tr>
<td>Employee business deductions</td>
<td>2,500</td>
<td>0</td>
</tr>
<tr>
<td>less: exemptions</td>
<td>8,100</td>
<td>0</td>
</tr>
<tr>
<td>Taxable income</td>
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<tr>
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</tr>
<tr>
<td>Net tax</td>
<td>29,302</td>
<td>29,379</td>
</tr>
</tbody>
</table>
Kiddie Tax

• Earned taxable income is taxed at single individual rates
• Unearned taxable income is taxed according to the brackets of estates and trusts
• Child’s tax rates will not be affected by income of parents and siblings

<table>
<thead>
<tr>
<th>Income</th>
<th>Ordinary Tax Rate</th>
<th>Capital Gain Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $2,550</td>
<td>10%</td>
<td>0%</td>
</tr>
<tr>
<td>$2,551 - $9,150</td>
<td>24%</td>
<td>$2,601 – $12,700</td>
</tr>
<tr>
<td>$9,151 - $12,500</td>
<td>35%</td>
<td>Over $12,700</td>
</tr>
<tr>
<td>Over $12,501</td>
<td>37%</td>
<td></td>
</tr>
</tbody>
</table>

AMT Exemptions Increased

<table>
<thead>
<tr>
<th>Return Type</th>
<th>Exemption</th>
<th>Phased out at</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint returns and surviving spouse</td>
<td>$109,400</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Single</td>
<td>70,300</td>
<td>500,000</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>54,700</td>
<td>500,000</td>
</tr>
<tr>
<td>Estates and Trusts</td>
<td>22,500</td>
<td>75,000</td>
</tr>
</tbody>
</table>

These amounts are indexed for inflation.

Affordable Care Act

• Individual Mandate permanently repealed
• Shared responsibility payment (penalty) for taxpayers without minimum essential health coverage is gone
• The Employer Shared Responsibility provisions of the Affordable Care Act continue unchanged
Other Provisions Affecting Individuals

• Estate and gift tax exemption increased from $5 million to $10 million with indexing after 2011. Therefore an $11.2 million exemption for taxpayers dying in 2018.
• Student loan discharged by death or total and permanent disability is excluded from income.
• Self-created patents, inventions, model and design are not capital assets. Also applies to taxpayers who received these by gift (having received substituted or transferred basis).

Other Provisions Affecting Individuals – cont.

• Distributions permitted from section 529 plans for tuition at elementary or secondary public, private, religious schools.
  • Up to $10,000 per student per year
  • Distribution may come from multiple accounts held for that beneficiary
• Increased contribution limits for ABLE accounts, saver’s credit is available for contributions by the designated beneficiary of the account, 529 plan amounts can be rolled into an ABLE account (restrictions apply)
• Due diligence preparer penalty of $520 when filing Head of Household

IRA Recharacterizations

• Roth conversions to traditional IRAs made after 12/31/2017 cannot be recharacterized
• Roth conversions made during 2017 can be unwound before October 15, 1018
• Straight contributions to a Roth IRA or a traditional IRA may still be recharacterized.
Corporate Provisions

- Flat corporate tax rate of 21%.
- Corporate AMT repealed
- Credit for Prior-Year Minimum Tax 50% refundable for 2018-2020; 100% in 2021
- 50% of dividends received from other corporations will be included in corporate taxable income (up from 30%)
- 35% of dividends received from other corporations (20% or more owned by receiving corporation) will be included in corporate taxable income (up from 20%)

Like-kind Exchanges for Real Property Only

Exchanges of Personal Property

- Exchanges of personal property are no longer eligible for tax-deferral under IRC 1031
- Trade-in of business vehicles and equipment will now generally create taxable income reportable on Form 4797
- Typically these items will have been held the required holding period but will generate ordinary gain due to depreciation recapture under IRC 1245
- Carryover basis from the traded item most likely will now be eligible for Sec. 179 (or bonus depreciation when acquiring used property)
- The increased depreciation deduction may offset the reportable gain and also reduce self-employment tax
Equipment Trade-in

- Sam Farmer trades in his old pickup truck for a new one with a list price of $37,000.
- Sam had paid $26,000 for his old pickup truck which is now fully depreciated.
- The dealer gives Sam a $12,000 trade-in allowance, and Sam writes a check for the remaining $25,000.

Equipment Trade-in - continued

- Sam must report $12,000 of ordinary gain on Form 4797, Part III.

<table>
<thead>
<tr>
<th>Sale Price (Trade-in allowance)</th>
<th>$12,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Adjusted Tax Basis (ATB) of trade</td>
<td></td>
</tr>
<tr>
<td>Original cost</td>
<td>$26,000</td>
</tr>
<tr>
<td>Less: Acc. Dprn</td>
<td>-26,000</td>
</tr>
<tr>
<td>ATB</td>
<td>0</td>
</tr>
<tr>
<td>Gain</td>
<td>$12,000</td>
</tr>
</tbody>
</table>

- Sam can depreciate the full $37,000 of cost basis for the new truck.
Section 179 Expensing

1. Annual expensing limit increased from $500,000 to $1 million – indexed
2. Investment limit increased from $2 M to $2.5 M – indexed
3. Inflation adjustments to both will remain in multiples of $10,000
4. The $25,000 Sec. 179 limit on SUVs will be indexed for inflation after 2018
5. Expanded eligibility for certain buildings and structural components

Qualified Real Property

Qualified improvement property (by election)
- now includes prior building classes:
  - Qualified leasehold improvement property
  - Qualified retail improvement property
  - Qualified restaurant property (but not building itself, elevators and escalators)
- But also has no restriction on type of business or
- That the improved space be leased space
- That the building being improved had been placed in service at least 3 years prior to the improvement
- And, Certain Structural components such as roofs, HVAC, fire protection, security and alarm systems – qualify even if not qualified improvement property

Qualified Improvement Property

- Must be:
  - Improvement to the interior
  - Non-residential
  - Placed in service after the building is placed in service
- Cannot:
  - Enlarge the building
  - Be an elevator or escalator
  - Be attributable to internal structural framework of the building
Residential Rental and Lodging Property and Sec. 179

- Prior law excluded most otherwise eligible property except utility service types of property (water, sewer, electrical)
- TCJA removes this exclusion so that items such as the following qualify for expensing:
  - Bed and other furniture
  - Refrigerators, stoves and other major appliances
- Improvements to residential rental and lodging property still do not qualify

Bonus Depreciation

- Changes generally apply for purchased property placed in service after 9/27/17
- Used property eligible (unless previously used by taxpayer or purchased from relative)
- Increased the deduction to 100% of qualifying property
- The deduction is reduced as follows for property placed in service after 9/27/2022:
  - 80% for property placed in service during calendar year 2023
  - 60% for property placed in service during calendar year 2024
  - 40% for property placed in service during calendar year 2025
  - 20% for property placed in service during calendar year 2026
  - 0% for property placed in service during calendar after 2026
- Different phase-down schedule for certain aircraft and long-production period property
- Could elect to stay with 50% for first tax year ending after 9/27/17

Bonus Depreciation (continued)

- Qualified film, television and live theatrical productions added to qualified property
  - Deduction is claimed at the time of initial release, broadcast or performance
  - Taxpayers who elected to expense under IRC 181 might consider revoking that election
- TCJA excludes two classes of property from bonus depreciation
  - Public utility property
  - Vehicle dealer property having floor plan financing
Real Property Depreciation

• Qualified Improvement Property
  • Presumably, 15 year MACRS Recovery Class
  • SL method
  • As 15 year property, would be eligible for bonus depreciation
  • Eligible for Sec. 179
  • Commercial building depreciation is unchanged at 39 years, residential rental at 27.5 years, both SL
  • Residential rental recovery period under ADS is shortened to 30 years (remains at 40 years for commercial buildings)
  • General purpose farm building depreciation is unchanged at 20 years, single purpose agricultural buildings at 10 years, bulk storage of a fungible commodity at 7 years
  • Use of ADS is required if a taxpayer elects not the apply the business interest deduction limits

Farm Equipment

• Farm equipment is typically 7-year property
  • New farm equipment placed in service during 2009 was classified as 5-year property if it was not a grain bin, cotton ginning asset, fence, or other land improvement
  • TCJA removed the “placed in service during 2009” restriction in the Internal Revenue Code for this 5-year property class.
  • Effective for qualifying new farm equipment placed in service after 12/31/2017
  • This means trucks, vehicles and farm equipment will all be in the 5-year class when making decisions to use bonus depreciation, or to elect out of it

Farm Asset Depreciation Methods

• Prior to TCJA, maximum rate of depreciation on farm assets was 150% DB
• TCJA increased this to 200% for most farm assets placed in service after 12/31/17
• Fruit trees and vines must still be depreciated using SL
• 15 and 20 year property is still subject to a maximum of 150% DB
• Taxpayers may elect less depreciation using 150% DB, SL, or ADS
• Taxpayers may be required to use ADS due to electing out of either, or both, the uniform capitalization rules, or the interest expense deduction rules (both now applicable only to taxpayers with gross receipts exceeding $25 million)
**Tax Accounting Rules**

**Method of Accounting**
- TCJA expanded the list of taxpayers eligible to use cash accounting
  - Most businesses whether corporation, partnership (LLC), or sole proprietor with no more than $25 million average annual gross receipts may use cash method (conformity).
- Inventory accounting is not required for businesses meeting the gross receipts test
  - Taxpayer may treat inventory as non-incidental materials and supplies
  - Or, file tax return which conforms to taxpayer’s method of accounting reflected in an applicable financial statement, or taxpayer’s books and records.
- Same threshold exempts taxpayers from Uniform Capitalization Rules (IRC 263A) and Percentage of Completion Method for construction contracts
- Form 3115 will accommodate any resulting changes
- Tax Shelters must still use the accrual method, percentage of completion method, and account for inventories.

**Excess Business Losses**
- Prior to TCJA, the current year deduction for a farm loss was limited to $300,000 (joint return) if the taxpayer received any applicable subsidy payment that year
- TCJA expanded this loss deduction limitation to all non-C corporation businesses and removed the requirement that a subsidy be received by the taxpayer
- The taxpayer’s allowable net loss from all trades and businesses for the year is limited to $250,000 ($500,000 joint return)
- Any disallowed loss is treated as an Net Operating Loss (NOL) and is carried forward
  - A maximum of 80% of taxable income in the carryover year may be offset
  - Excess Farm Loss under prior law was a Sch F deduction in the next year
  - As NOL, prior offset to Self-employment tax is gone
- The loss limitation is indexed for inflation
- This provision will only impact taxpayers with more than $250,000/$500,000 of non-business income (wages, dividends, capital gains, etc.)
Excess Business Loss Example 1

- George’s Widget Company generated a $638,000 loss during 2018.
- He had no other sources of income.
- George has an excess business loss of $388,000 (638,000 - 250,000)
- However, since George has no other source of income, the excess business loss is simply included in his $638,000 NOL for the year.

Excess Business Loss Example 2

- Assume George’s parents had arranged his marriage to Georgina who earns a $600,000 salary.
- They still have no other sources of income and George still has the same loss.
- On their joint tax return they would appear to have no taxable income and an NOL of $38,000 (600,000 - 638,000)
- However, George is only allowed to offset $500,000 of Georgina’s salary, leaving them with AGI of $100,000.
- They will pay tax even though George had this large loss.
- They have an excess business loss of $138,000 (638,000 - 500,000) which can be carried forward as an NOL to 2019.

Excess Business Losses (continued)

- For partnerships and S corporations, loss limitation is applied at the partner/shareholder level
- Passive Activity, Basis, and At-Risk Loss rules are applied before determining if taxpayer has any Excess Business Loss
Excess Business Loss Example 3

Passive Rules

- George has a brother (Gherkin) who is a successful cucumber producer with a Schedule F net profit of $20,000.
- Gherkin already holds a passive interest in a real estate LLC which passes through $30,000 of income per year.
- George and Gherkin form an LLC to operate the Widget Company so that Gherkin will infuse much needed capital.

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Excess Business Loss Example 3 - continued

Passive Rules

- Gherkin is allocated 50% of the $638,000 loss, or $319,000.
- Although Gherkin is single, he will not have an excess business loss by exceeding his $250,000 allowance.

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Excess Business Loss Example 3 - continued

Passive Rules

- Gherkin's loss from the Widget Company is passive –
  - He is only an investor
  - His allowable passive loss is limited to his passive income from the real estate LLC $30,000.
  - His Form 8582 will be completed to show this limitation and the passive loss carryover of $289,000 ($319,000-30,000)
  - As a PAL, the unallowed amount will be deductible against future passive income or when Gherkin disposes of his entire interest in the Widget Company (in a fully taxable transaction)
  - Gherkin has no excess business loss or net operating loss. He must pay tax on his $20,000 of Schedule F cucumber profits.
Net Operating Losses (NOLs)

- TCJA eliminates the carryback of NOLs except for:
  - Farm NOLs which are carried back 2 years (rather than the 5 years permitted under prior law)
  - Insurance companies which still have a 2 year back, and 20 year forward rule
  - Carryovers continue indefinitely until used
  - Maximum of 80% of taxable income can be offset in the carryover years
  - The special (longer) carryback periods for special liability losses and casualty losses are eliminated
  - Effective for losses arising after 12/31/17

Net Operating Loss Example

- Assume George doesn’t take his parents’ marriage advice, or form an LLC
  - He therefore has a $638,000 NOL in 2018.
  - The NOL cannot be carried back but must come forward to 2019
  - In 2019, he has a $600,000 profit from the Widget Company
  - He will still have AGI of $120,000 (600,000-480,000) for 2019
  - His NOL deduction is limited to $480,000 (80% x $600,000)
  - He will carryover the balance of $158,000 (638,000-480,000) to 2020 and beyond, until used

Qualified Business Income (QBI) Deduction
QBI Deduction Overview

• IRC 199 for the DPAD is gone
• Enter IRC 199A – through 2025

QBI Deduction Calculation

Generally a deduction for the lesser of:
• 20% of QBI, or
• the greater of
  • 50% of W-2 wages
  • or 25% of W-2 wages plus 2.5% of unadjusted basis of all qualified property

QBI Deduction Limitations

• QBI deduction then further limited to no more than 20% of the taxpayer’s taxable income in excess of net capital gain
• The wage limit only applies to taxpayers whose taxable income exceeds $157,500 ($315,000 on a joint return)
  ➢ This limit is phased in for taxpayers with income above thresholds
• QBI deduction is phased out for taxpayers in service businesses with taxable incomes above these same levels
Simple but Typical Example

• Farmer Smith generates a Schedule F profit of $120,000.
• Farmer Smith has W-2 wage expenses of $40,000.
• His wife has wages of $70,000.
• They file a joint tax return using the standard deduction.
• The wage limitation on the QBI deduction does not apply since the Smith’s taxable income is only $166,000 (120,000+70,000-24,000).
• The QBI deduction is therefore $24,000 (20% x 120,000).

QBI Deduction Overview (continued)

• The deduction reduces taxable income rather than adjusted gross income.
• For partnerships and S corporations, deduction is calculated at the owner level; for trusts, at the beneficiary level.
• Not available to C corporations.
• Cooperatives and trusts allocate the components of the deduction between themselves and their members/beneficiaries.

QBI

• QBI must be effectively connected with a U.S. trade or business. Business income from Puerto Rico is included if subject to tax in the U.S.
• QBI from qualified trades or businesses does not include:
  • Capital gains and losses whether long- or short-term
  • Dividends
  • Interest income unless properly allocable to a trade or business
  • Annuity income
  • Reasonable compensation paid to the taxpayer by the business
  • Guaranteed payments to partners/members
  • Qualified REIT dividends
  • Qualified publicly traded partnership income
  • Other less frequently encountered items.
Qualified Trade or Business - Appears to be quite inclusive

Any trade or business other than:
1. The business of performing services as an employee
2. A specified service business – performing services in the fields of
   - Health
   - Law
   - Accounting
   - Actuarial Science
   - Performing Arts
   - Consulting
   - Athletics
   - Financial Services
   - Brokage

Also considered a specified service business:
- Any business that participates in investing and investment management, trading, or dealing in securities, partnership interests, or commodities.
- Any business where the principal asset is the reputation or skill of one of its owners or employees

An Exception to the Exclusion for Service Businesses

- Income from service businesses is not excluded for taxpayers with taxable incomes of $157,500 or less ($315,000 on a joint return)
- This exception is phased out for taxpayers above these threshold amounts
- The phase out is complete at $415,000 for joint filers; $207,500 for all others

QBI Example for an Accountant

- John is an astute CPA who manages his taxable income to $314,000 on his joint return.
- His Schedule C profits are $350,000
- He has W-2 wage expense of $620,000
- Tentative QBI deduction is simply 20% x 350,000 = 70,000
- Service exclusion is irrelevant, as is wage limit
- But still limited to no more than 20% of taxable income, so $62,800 (20% x 314,000)
W-2 Wages Limit

- Only applies to taxpayers above taxable income thresholds
- Wages for this limit include elective deferrals
- Only the wages allocable to QBI count
- Wages must be properly reported to Social Security Administration on or before the 60th day after the due date of such report (including extensions)

Qualified Property for 2.5% Limit

- Tangible trade or business property
- Subject to IRC 167 depreciation allowance
- Held by, and available for use in, the qualified trade or business
- Is used during the tax year in the production of QBI
- And, the depreciable period of the asset has not closed by the end of the tax year (depreciable period closes the later of:
  - the end of 10 years after the placed in service date, or
  - the last day of the last full year of the asset’s MACRS recovery period)

Wage and Asset Limit Example

- Wilda files a single tax return with taxable income of $400,000
- She has trade or business income totaling $300,000.
- Her equipment was purchased for $500,000 2 years ago and expensed.
- She pays wages of $40,000.
### Wage and Asset Limit Example continued

- 20% of QBI = 20% x $300,000 = $60,000
- Limited to the greater of
  - 50% of wages = 50% x $40,000 = $20,000  
  or
  - 25% of wages + 2.5% cost basis = 25% x $40,000 + 2.5% x $500,000 = $10,000 + $12,500 = $22,500
- Tentative QBI deduction is $22,500
- Limited to 20% of taxable income - $80,000 (20% x $400,000)

### Complicated Phase-in of W-2 and Asset Limit

- Applies only to
  - taxpayers who exceed the threshold amount by less than $50,000 ($100,000 joint return)
  - Where the wage and asset limit reduce the deduction to less than 20% of QBI
  - The limitation to the deduction is prorated by a ratio of the excess of the taxpayer’s taxable income in excess of $50,000/$100,000 divided by those amounts

### Specified Service Trade or Business

- Included in QBI only for taxpayers with taxable incomes below $157,500/$315,000 thresholds
- Phaseout applies for up to $50,000/$100,000 excess
- Carve-out for engineering and architecture
- Otherwise, performance of services (legal, accounting, investing, medical, performing arts)
- **Note**: At the same time that the amount of qualified specified service income is phased out by higher taxable income, the general wage/investment limitation is being phased in.
Combined QBI Amount

The “Combined QBI Amount” includes:

• 20% QBI deduction for each qualified trade or business (as limited by thresholds, phase-outs, and phase-ins, coop adjustment), plus
• 20% of qualified REIT dividends (not including any capital gain dividend or qualified dividend income), plus
• 20% of qualified PTP income (including any gain from the disposition of a PTP interest treated as the an amount realized from property other than a capital asset)

Finally, the Sec. 199A Deduction

The final Sec. 199A deduction is the lesser of:

• The combined QBI amount, or
• 20% of the excess of taxable income over net capital gains

Plus: Sec. 199A from qualified cooperatives, limited to taxable income (not including capital gains)

Agricultural Cooperatives

• Original law created a frenzy of controversy
• Provided a better deal for farmers who conducted business with cooperatives rather than independent dealers – 20% of patronage was available as a deduction
• Cargill and others voiced concerns
• Numerous financial advisors were recommending formation of cooperatives to maximize tax benefits
• Rules were refined (and complicated) by March legislation
• If you deal with ag coops, you are well aware of this situation
• For most of us, it’s just a matter of knowing what our clients may be bringing to us from their coops next tax season.
Accuracy Related Penalty

Tighter rules, lower threshold for imposing
- Penalty can be applied if claiming an incorrect Sec. 199A deduction
  understates tax liability by more than 5%
- Usual threshold is an understatement of more than 10%

Impact on Choice of Entity

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Other Tax Tidbits for Businesses
Business Issues

- Luxury car limits are increased $10,000 for year 1, plus an additional $8,000 if bonus depreciation is claimed.
- Computers are no longer listed property.
- Expanded ability to expense the cost of replanting citrus groves.
- Exclusion of bicycle commuting reimbursements was eliminated so these will now be additional wages.
- Limitation of interest expense deduction to 30% of business taxable income before deductions for depreciation, amortization, or depletion – but only applies to businesses with average gross receipts in excess of $25 million – unless a tax shelter. Exceptions and options.

Business Issues - continued

- Business entertainment expense eliminated.
- 50% limit on meal expense is expanded to included meals provided through in-house cafeterias, or otherwise on premises of employer.
- Deduction for employee transportation fringe for parking and mass transit are eliminated but these are still excluded from employee income.
- No deduction for expenses that are the equivalent of commuting unless safety is a concern.
- Penalties for violating law are non-deductible (some exceptions for restitution and remediation) and will be subject to 1099 reporting if $600 or more.

Business Issues - continued

- List of excludible employee achievement awards (in the form of “tangible personal property”) has been shortened. Taxable awards include:
  - Cash or cash equivalents
  - Gift cards, coupons, or certificates
  - Vacations, meals, or lodging
  - Deductible compensation limited to $1 million
- Exception for commissions and performance-based compensation are repealed.
- Definition of covered employee is revised to include:
  - Principal executive officer
  - Principal financial officer
  - And, the three other highest paid officers
- Transition rule for unmodified plans in effect on 11/2/17.
Business Issues - continued

- Rehabilitation credit revised
  - 10% credit for pre ’36 buildings eliminated after 12/31/17
  - 20% credit applies for certified historic structures – claimed ratably over 5 years beginning in the year that the rehabilitated historical structure is placed in service
- New credit for employer-paid family and medical leave
  - For wages paid for tax years beginning after 12/31/17, but not beginning after 12/31/19
  - 12.5% of wages paid while on FMLA if rate of payment is 50% of normal wage
  - Credit rate increases by 0.25% for each 1% of wage payment above 50%, up to a 25% rate of credit
  - Full-time employees must be given at least 2 weeks of leave

Partnership Issues

Partnership Taxation

- Technical terminations under IRC 708 eliminated
- Look-through rule applied to gain on sale of partnership interest
- “Substantial built-in loss” rules modified
- Charitable contributions and foreign taxes paid are included in partner’s share of loss
- Special rules for taxation of income from a profits interest received for performance of investment services
## Learning Objectives

- To better understand the impact of the TCJA on taxpayer returns and tax planning
- To know how capital gains rates are determined under TCJA
- To be able to explain to taxpayers how changes to tax rates, exemptions, standard deduction, itemized deductions and personal credits impact the bottom-line impact of the TCJA on tax liability
- To create awareness of the taxation of exchanges of like-kind personal property
- To be aware of changes made to depreciation rules for real property improvements, farm assets, Sec. 179 and bonus depreciation
- To understand the conformity of rules for cash basis accounting, the limitation on business losses, and the new rules for net operating losses
- To understand the basic rules for computing the Qualified Business Income and be able to calculate it for the most typical business clients
- To be aware of additional changes to the topography of business taxation so that unexpected tax landmines may be avoided to the extent possible

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