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Open letter to all clients

On December 22, the President signed into law the Tax Cuts and Jobs Act of 2017 (TCJA). TCJA is the largest tax overhaul since the 1986 Tax Reform Act and it will affect almost every individual and business in the United States. Generally, the new law goes into effect in 2018, with many of the provisions relating to individuals expiring at the end of 2025.

I'm writing to give you a brief rundown of what's in the new law.

Overview of TCJA Changes Affecting Businesses

For businesses, highlights of the TCJA include: (1) an increase in amounts that may be expensed under bonus depreciation and Section 179; (2) a 21 percent flat corporate tax rate; (3) a new business deduction for sole proprietorships and pass-through entities; and (4) the elimination of the corporate alternative minimum tax (AMT)

Corporate Tax Rates. TCJA eliminates the graduated corporate rate structure and replaces it with a flat 21 percent. It also eliminates the higher tax rate for personal service corporations and repeals the maximum corporate tax rate on net capital gains. It reduces the 70 percent dividends received deduction to 50 percent, and the 80 percent deduction from a 20 percent owned corporation to 65 percent.

Corporate Alternative Minimum Tax is Repealed after 2017.

Enhanced Bonus Depreciation Deduction. TCJA extends the "bonus" depreciation allowance and increases it to 100 percent for property placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023. The 100-percent allowance is phased down by 20 percent per calendar year for property placed in service, and specified plants planted or grafted, in taxable years beginning after 2022 (after 2023 for longer production period property and certain aircraft).The additional first-year depreciation deduction is expanded to include used property.

TCJA also maintains the bonus depreciation increase amount of $8,000 for luxury passenger automobiles placed in service after December 31, 2017, that had been scheduled to be phased down in 2018 and 2019.

TCJA also expands the definition of qualified property eligible for the additional first-year depreciation allowance to include qualified film, television and live theatrical productions, effective for productions placed in service after September 27, 2017, and before January 1, 2023.

Enhanced Section 179 Expensing. For property placed in service in tax years beginning after Dec. 31, 2017, the maximum amount a taxpayer may expense under Code Section 179 is increased to $1 million, and the phase-out threshold amount is increased to $2.5 million. For tax years beginning after 2018, these amounts (as well as the $25,000 sport utility vehicle limitation) are indexed for inflation.

TCJA expands the definition of Code Sec. 179 property to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging, and qualified real property include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

Depreciation Limitations on Luxury Automobiles and Personal Use Property. For passenger automobiles that qualify as luxury automobiles (i.e., gross unloaded weight of 6,000 lbs or more) placed in service after December 31, 2017, and for which the additional first-year depreciation deduction is not claimed, the maximum amount of allowable depreciation is $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period. The limitations are indexed for inflation for luxury passenger automobiles placed in service after 2018.

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Overview of TCJA Changes Affecting Businesses (continued)

Modification of Like-Kind Exchange Rules. Generally effective for transfers after Dec. 31, 2017, the rule allowing the deferral of gain on like-kind exchanges is modified to allow for like-kind exchanges only with respect to real property that is not held primarily for sale

Other Changes Relating to Cost Recovery and Property Transactions. TCJA makes the following key (not all inclusive) additional changes with respect to cost recovery and property transactions; allows for expensing of certain costs of replanting citrus plants lost by reason of casualty; shortens the alternative depreciation system (ADS) recovery period for residential rental property from 40 to 30 years; allows an electing real property trade or business to use the ADS recovery period in depreciating real and qualified improvement property; shortens the recovery period from 7 to 5 years for certain machinery or equipment used in a farming business.

Repeal of Domestic Activities Production Deduction. TCJA repeals the deduction for domestic production activities.

Passthrough Tax Break. TCJA creates a new 20 percent deduction for qualified business income from sole proprietorships, S corporations, partnerships, and LLCs taxed as partnerships. The deduction is claimed by individuals on their personal tax returns as a reduction to taxable income. The new tax break is *subject to some complicated restrictions and limitations*, but the rules that apply to individuals with taxable income at or below $157,500 ($315,000 for joint filers) are simpler and more permissive than the ones that apply above those thresholds. (***SEE THE SEPARATE NEWSLETTER REGARDING THE DETAILS TO THIS LAW CHANGE ON OUR WEBSITE ENTITLED "2017 TAX REFORM QUALIFIED BUSINESS TAX DEDUCTION")***

Carryover of Business Losses. For taxable years beginning after December 31, 2017, and before January 1, 2026, excess business losses of a taxpayer other than a corporation are not allowed for the taxable year. Instead, if you incur such losses, you must carry them forward and treat them as part of your net operating loss (NOL) carryforward in subsequent taxable years. Thus, TCJA generally repeals the two-year carryback and the special carryback provisions under prior law; however, it does provide a two-year carryback in the case of certain losses incurred in the trade or business of farming. NOL carryovers generally are allowed for a taxable year up to the lesser of your carryover amount or 80 percent of your taxable income determined without regard to the deduction for NOLs.

Relaxed Gross Receipts Test for Various Accounting Methods. TCJA increases the limit for the gross receipts test to $25 million for using the cash method of accounting (including the use by farming C corporations and farming partnerships with a C corporation partner).

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The new law also increases the limit for the gross receipts test to $25 million for exemption from the following accounting requirements/methods:

(1) uniform capitalization rules;

(2) the requirement to keep inventories (allowing taxpayers to treat inventories as non-incidental materials and supplies, or in another manner conforming with the taxpayer's financial accounting treatment of inventories); and

(3) the requirement to use the percentage-of-completion method for certain long-term contracts (allowing the use of the more favorable completed-contract method, or any other permissible exempt contract method).

Additional requirements and restrictions apply to the use of the above-mentioned accounting methods. For most, only the dollar limit for the gross receipts test has been relaxed.

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Overview of TCJA Changes Affecting Businesses (continued)

Interest Deduction Rules Changed for Certain Taxpayers. a taxpayer's deduction for business interest is limited to the sum of business interest income plus 30 percent of adjusted taxable income for the taxable year. Excepted from this rule are certain small taxpayers, certain real estate businesses that make an election to be exempt from this rule, and businesses with floor plan financing, which is a specialized type of financing used by car dealerships, and for certain regulated utilities.

For smaller taxpayers, TCJA exempts from the interest limitation taxpayers with average annual gross receipts for the three-taxable year period ending with the prior taxable year that do not exceed $25 million. Further, at the taxpayer's election, any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business is not treated as a trade or business for purposes of the limitation, and therefore the limitation does not apply to such trades or businesses.

Limitation on Deduction by Employers of Expenses for Fringe Benefits. TCJA provides that ***no deduction*** is allowed with respect to ***an activity generally considered to be entertainment, amusement or recreation;membership dues*** with respect to any club organized for business, pleasure, recreation or other social purposes; or a facility or portion thereof used in connection with any of the above items.

TCJA also disallows a deduction for expenses associated with providing certain qualified transportation fringe benefits. A business may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees during work travel).

Employer Credit for Paid Family and Medical Leave. For 2018 and 2019, under certain conditions TCJA allows eligible employers to claim a general business credit equal to 12.5 percent of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave.

Partnerships. TCJA modifies partnership treatment for withholding on transfers of interests in the partnership, built in loss treatment and repeal of the technical dissolution requirement when 50% or more is traded.

S Corporation Changes. TCJA makes several changes to the tax rules involving S corporations. First, it provides that income that must be taken into account when an S corporation revokes its election is taken into account ratably over six years, rather than the four years under prior law. Second, it allows a nonresident alien individual to be a potential current beneficiary of an electing small business trust (ESBT). Third, it provides that the charitable contribution deduction of an ESBT is not determined by the rules generally applicable to trusts but rather by the rules applicable to individuals. Thus, the percentage limitations and carryforward provisions applicable to individuals apply to charitable contributions made by the portion of an ESBT holding S corporation stock.

International Tax Changes

TCJA makes sweeping changes to the United States' international tax regime through a series of highly complex provisions that are beyond the scope of this letter.