

Recent Developments in Federal Income Taxation

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To obtain today's outline and slides:
<https://tinyurl.com/outline-jan18-fwtu>

<https://tinyurl.com/slides-jan18-fwtu>

Selected Highlights of the Tax Cuts and Jobs Act

- **Individuals**
 - Reduced rates of tax on ordinary income
 - Increased standard deduction
 - No personal exemption deduction
 - Limited deduction for state and local property, income, and sales taxes
 - Mortgage interest deductible on only \$750k of acquisition debt
 - No deduction for interest on home equity loans
 - No deduction for most personal casualty losses
 - No deduction for miscellaneous itemized deductions
 - Overall limitation on itemized deduction (§ 68) repealed
 - Increased child tax credit
 - No deduction for alimony
 - Increased AMT exemption amounts and phase-out thresholds

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- **Business**
 - No deduction for entertainment
 - New deduction for 20 percent of “qualified business income” for sole proprietors, partners, and S corporation shareholders
 - Limited deduction of business interest expense
 - Repeal of § 199 deduction for domestic production
 - Increased limits and expansion of property eligible for § 179
 - 100 percent § 168(k) bonus first-year depreciation

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- Corporations
 - 21% flat corporate tax rate
 - Repeal of corporate AMT
 - Reduced corporate dividend-received deduction

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 - Three-year holding period for carried interests
 - No more technical terminations of partnerships
 - Legislative reversal of Tax Court's *Grecian Magnesite Mining* decision, which held that a foreign partner was not subject to U.S. tax on the sale of a U.S. partnership interest

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- Estate and Gift Taxation
 - Increased basic exclusion amount (\$11.2 million for decedents dying in 2018)

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Entertainment Expenses and Dues Disallowed 2017 TCJA § 13304

Outline: item D.1, page 3

- TCJA § 13304 amends Code § 274(a) to disallow business deductions for:
 1. Costs “[w]ith respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation.”
 2. Membership dues with respect to any club organized for business, pleasure, recreation or other social purposes.
- Applies to taxable years beginning after 2017.

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20% Deduction for Qualified Business Income 2017 TCJA § 11011

Outline: item D.2, page 3

- TCJA § 11011 adds Code § 199A, which generally allows a 20% deduction for “qualified business income.”
- Available to individuals, estates, and trusts for taxable years beginning after 2017 and before 2026
- Applies at the individual level
 - At partner or shareholder level for partnerships and S corps
 - Deduction is on Form 1040
 - Deduction is *not* an above-the-line deduction
 - Deduction reduces taxable income
 - Deduction is available both to those who itemize and those who take the standard deduction
 - Does *not* reduce self-employment tax

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20% Deduction for Qualified Business Income 2017 TCJA § 11011

Outline: item D.2, page 3

- Qualified business income is produced by a “qualified trade or business”
- QTB is any trade or business *other than*:
 - Trade or business of performing services as an employee, or
 - A specified service trade or business
 - (Note: SSTB exclusion does *not* apply if taxable income is below specified thresholds—\$315,000 for MFJ and \$157,500 for all others)
- Specified service trade or business:
 - “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”
 - Note architects and engineers are excluded

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20% Deduction for Qualified Business Income 2017 TCJA § 11011

Outline: item D.2, page 3

- Qualified business income:
 - Generally is net income from a qualified trade or business
 - Does *not* include:
 1. Income not effectively connected with the U.S. trade or business
 2. Specified investment-related items of income, gain, deduction, or loss
 3. Amounts paid to an S corporation shareholder that are reasonable compensation
 4. Guaranteed payments to a partner for services
 5. To the extent provided in regulations, payments to a partner for services rendered other than in the partner's capacity as a partner
 6. Qualified REIT dividends, qualified cooperative dividends, or qualified publicly traded partnership income

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20% Deduction for Qualified Business Income 2017 TCJA § 11011

Outline: item D.2, page 3

- Determining the amount of the § 199A deduction:
 - Sum of 3 buckets
 - Apply 2 limitations
- Bucket 1: for each qualified trades or business, the lesser of:
 1. 20 percent of the qualified trade or business income, or
 2. The greater of:
 1. 50 percent of the W-2 wages, or
 2. The sum of 25 percent of the W-2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.

Note: this W-2 wages and capital limitation does *not* apply to taxpayers whose taxable income is below the \$157,500/\$315,000 thresholds.

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20% Deduction for Qualified Business Income 2017 TCJA § 11011

Outline: item D.2, page 3

- Bucket 2: 20 percent of the sum of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income.
- Bucket 3: lesser of
 1. 20 percent of qualified cooperative dividends, or
 2. Taxable income reduced by net capital gain.
- Limitation 1:
 - Sum of Bucket 1 and Bucket 2 cannot exceed 20 percent of the amount by which the taxpayer's taxable income exceeds the sum of the taxpayer's net capital gain and qualified cooperative dividends.
- Limitation 2:
 - Sum of Buckets 1, 2 and 3 cannot exceed taxpayer's taxable income reduced by the taxpayer's net capital gain.

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20% Deduction for Qualified Business Income 2017 TCJA § 11011

Outline: item D.2, page 3

- Key consideration:
 - Is the taxpayer's taxable income (without the § 199A deduction) below or above the \$157,500/\$315,000 thresholds?
 - If below:
 - Specified service businesses are still eligible for the deduction
 - Limitation of W-2 wages/capital does not apply
 - If above:
 - Portion of income from specified service business eligible is phased out (and disappears at \$207,500/\$415,000)
 - Limitation of W-2 wages capital phases in and fully applies at \$207,500/\$415,000.
- Observation: if the wages/capital limit does not apply, there's an incentive for S corporation shareholders to minimize salary

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Increased Limits Under § 179

2017 TCJA § 13101

Outline: item E.1.a, page 5

- Basic limit: \$ 1 million (increased from \$520,000)
- Phase-out threshold: \$2.5 million
- Limit for SUVs remains at \$25,000
- Applies to property placed in service in TY beginning after 2017
- Definition of qualified real property revised

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Bonus Depreciation Under § 168(k)

2017 TCJA § 13201

Outline: item E.1.b, page 6

- 100% for property *acquired and placed in service* after September 27, 2017
 - Percentage declines beginning in 2023
 - Property acquired on or before September 27, 2017, is eligible for only 50% if placed in service in 2017, 40% in 2018, 30% in 2019
- Used property is now eligible for bonus depreciation if *acquired and placed in service* after September 27, 2017

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Miscellaneous Itemized Deductions

2017 TCJA § 11045

Outline: item H.1, page 7

- For taxable years beginning after 2017 and before 2026, miscellaneous itemized deductions are not deductible.
- Includes:
 - Investment-related expenses
 - Unreimbursed employee business expenses
 - Tax preparation fees

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