Tax Reform Update: Individuals, Estates, Trusts, and Sole Proprietorships February 24, 2018

Presented by:

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WELCOME

Moderated by:

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Principal

Panelists:

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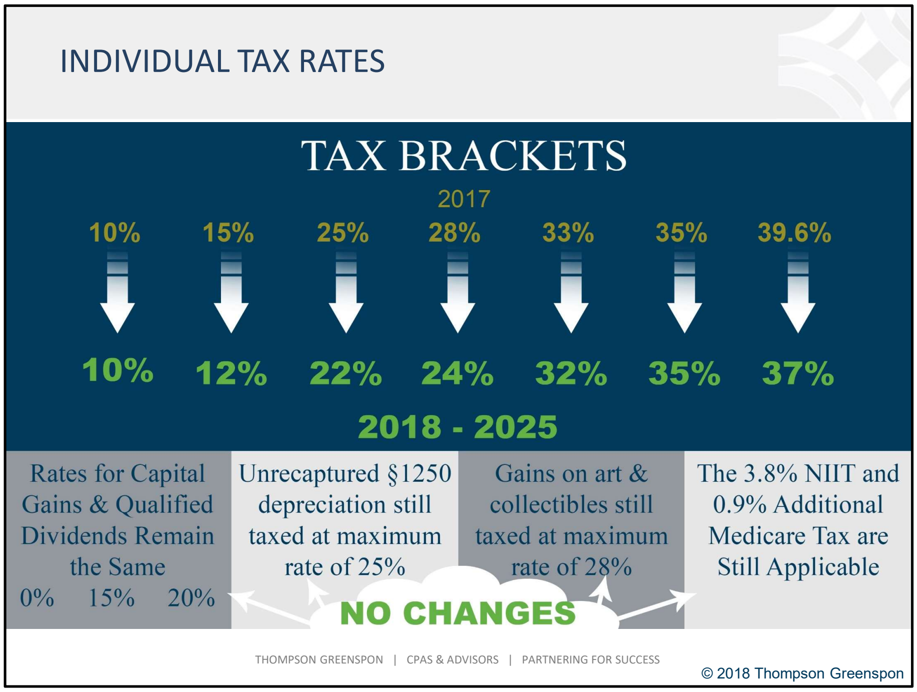
Principal

AGENDA

- Individual Changes
- Estate and Trust Changes
- Sole Proprietor Business Changes
  - Depreciation
  - Qualified Business Income
  - Business Loss Limitations
  - Other Business Changes

OBJECTIVES

- At end of this session, attendees should be familiar with the following:
  - TCJA changes affecting individual taxpayers
  - Some changes affecting estates, trusts, & nonprofit activities
  - TCJA changes affecting sole proprietors & owners of passthrough activities including the new Qualified Business Income Deduction



- Tax rates have been revised to seven brackets: 10%,12%, 22%, 24%, 32%, 35%, and 37%
- These new brackets apply for tax years 2018-2025
- Rates for capital gains and qualified dividends remain the same: 0%, 15%, 20%
- Unrecaptured §1250 depreciation still taxed at maximum rate of 25%
- Gains on art and collectibles still taxed at maximum rate of 28%
- The 3.8% NIIT and 0.9% Additional Medicare Tax are still applicable

COMPARISON OF MFJ TAX RATES OLD LAW / NEW LAW

Income Range	Rates Under Old Law	Rates Under New Law
$1 to $19,050	10%	10%
$19,051 to $77,400	15%	12%
$77,401 to $156,150	25%	22%
$156,151 to $165,000	28%	22%
$165,001 to $237,950	28%	24%
$237,951 to $315,000	33%	24%
$315,001 to $400,000	33%	32%
$400,001 to $424,950	33%	35%
$424,951 to $480,050	35%	35%
$480,051 to $600,000	39.6%	35%
Over $600,000	39.6%	37%

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Highlight 9% rate drop

Marriage Penalty Relief

"KIDDIE" TAX & ESTATES & TRUST RATES

Estates & Trusts	
If taxable income is:	Then income tax equals:
Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

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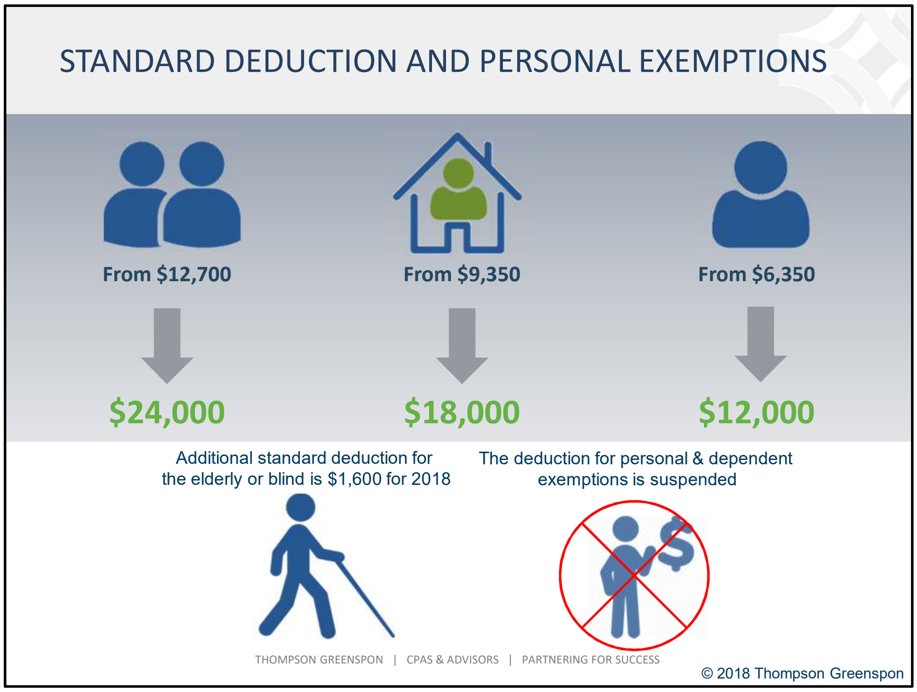
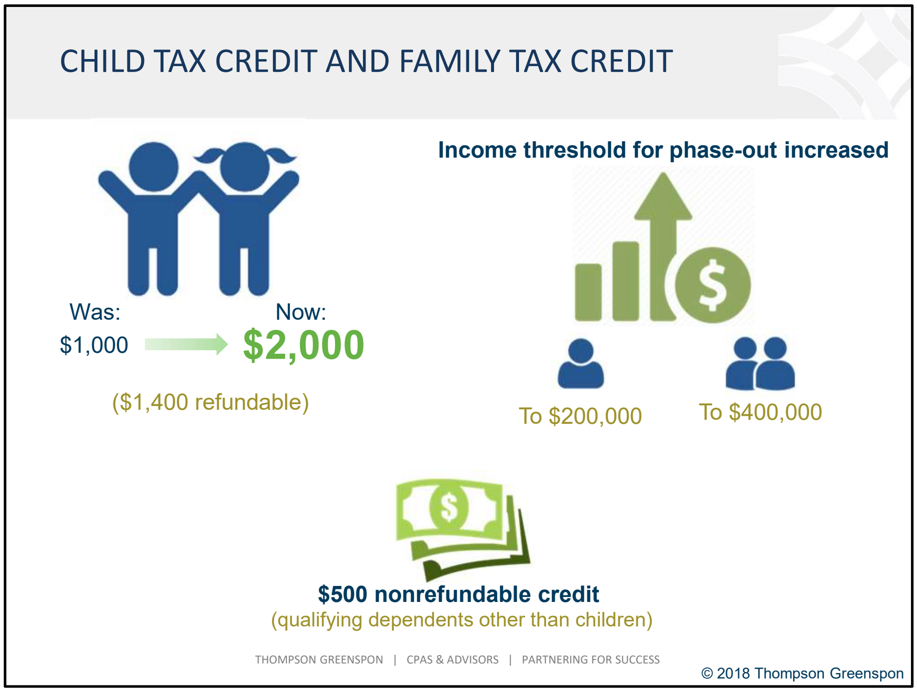
Estates and Trust Info

Kiddie Tax Info:

- Tax on unearned income of children simplified by applying trust and estate rates to the net unearned income of a child
- Applies both to ordinary rates and special capital gain preferential rates
- Earned income taxed according to unmarried taxpayers' brackets and rates
- Child's tax is now unaffected by the tax situation of parents and siblings
- Applies to taxable years 2018-2025

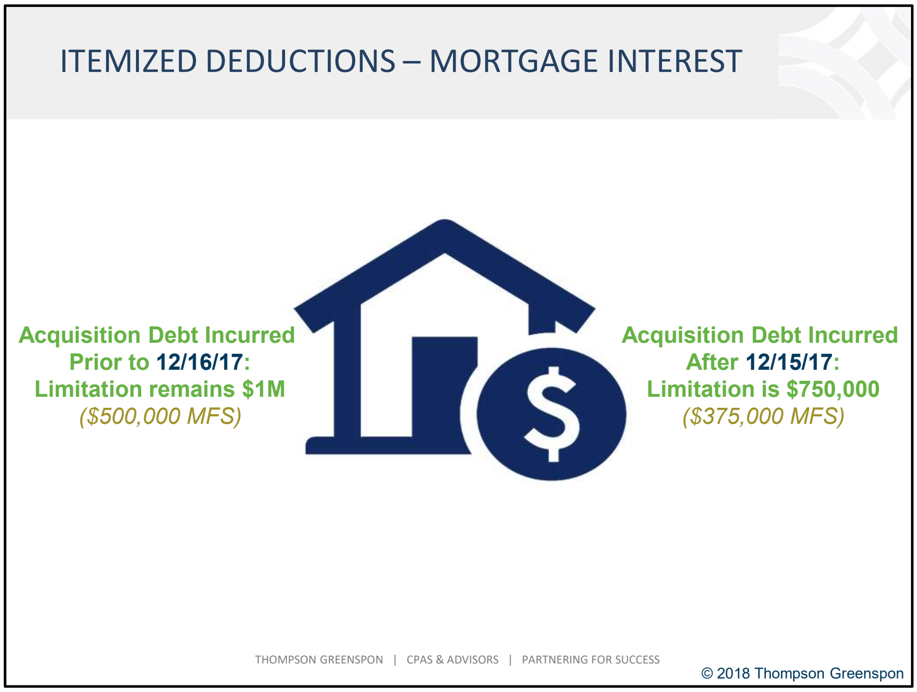


- Standard deduction increased:
  - $24,000 for MFJ
  - $18,000 for H of H
  - $12,000 for all other taxpayers
- Additional standard deduction for the elderly or blind ($1,600 for 2018)
- The deduction for personal and dependent exemptions is suspended
- Applies to tax years 2018-2025

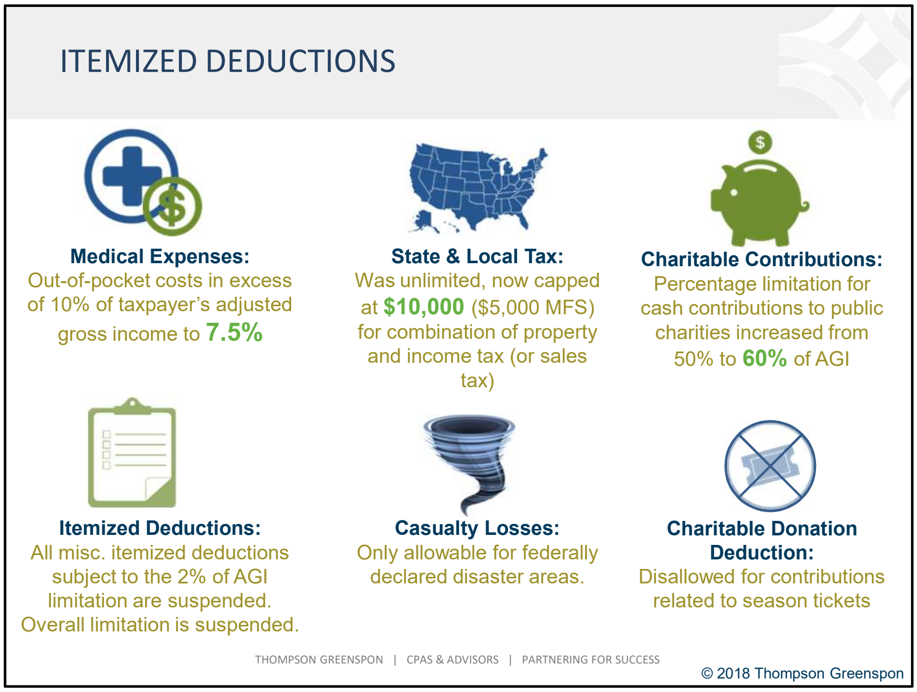


Effective for tax years 2018-2025:

- Child tax credit increased to $2,000 per qualifying child
- $500 nonrefundable credit for qualifying dependents other than qualifying children
- No change in definition of qualifying child or dependent
- Maximum amount refundable may not exceed $1,400 per qualifying child
- Income threshold for phaseout increased to $200,000 or $400,000 for a joint return



- For acquisition debt incurred prior to 12/16/17, the limitation remains $1 million ($500,000 MFS)
- Interest deduction limited to $750,000 of acquisition indebtedness ($375,000 MFS) for debt incurred after 12/15/17
- Refinanced debt is treated as incurred on the date of the original loan to the extent that the resulting debt does not exceed the refinanced debt
- Deductions related to home equity indebtedness suspended
- Applicable for tax years 2018-2025



- For 2017 and 2018 the threshold for deduction of medical expenses is reduced from 10% of AGI to 7.5% of AGI
- Deduction for non-business income and property taxes capped at $10,000 ($5,000 MFS)
- Percentage limitation for cash contributions to public charities increased from 50% to 60% of AGI
- Charitable Donation Deduction disallowed for contributions related to season tickets
- All miscellaneous itemized deductions subject to the 2% of AGI limitation are suspended (tax prep fees, investment expenses, unreimbursed employee business expenses)
- Overall limitation on itemized deductions is suspended
- Casualty losses are only allowable for federally declared disaster areas

Applicable for tax years 2018-2025

ALTERNATIVE MINIMUM TAX ON INDIVIDUALS, TRUSTS, AND ESTATES

2017	2018
- Exemption (MFJ): $84,500	- Exemption (MFJ): $109,400
- Phase-out of exemption begins:	- Phase-out of exemption begins:
- $160,900 for MFJ	- $1 million for MFJ
- $54,300 for Single or HOH	- $500,000 all others
- $42,250 for MFS	
- Estates: $75,000	- Estates: $75,000*
- Trusts: $22,500	- Trusts: $22,500*

* now indexed for inflation

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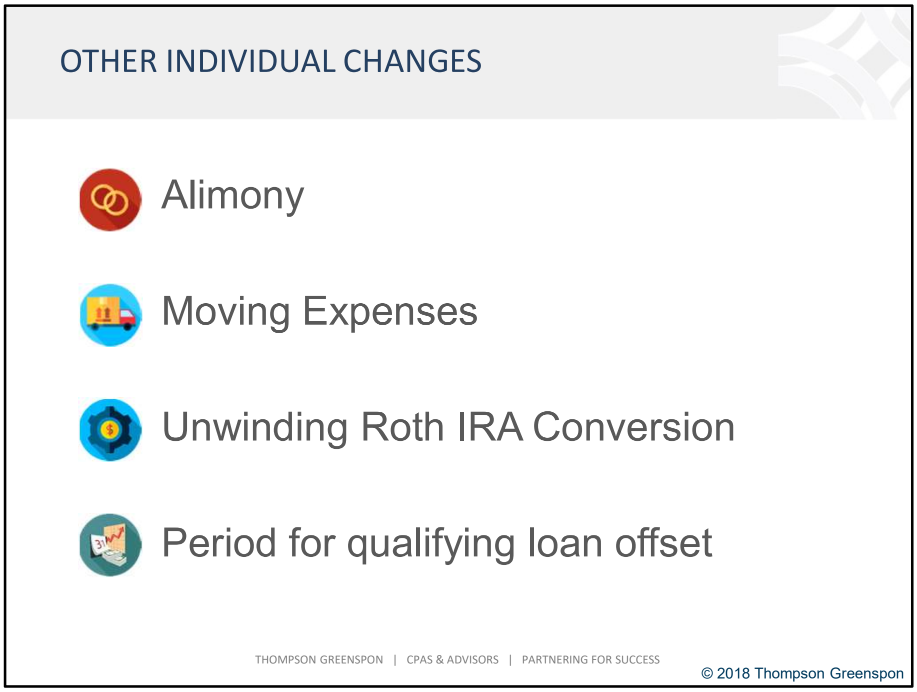
- Both the exemption amount and the phase-out thresholds temporarily increased
- Exemption amount raised to $109,400 for MFJ ($54,700 for MFS), and $70,300 for all other taxpayers other than trusts and estates (amount not subject to AMT)
- The exemption will be phased out beginning at $1 million for MFJ and $500,000 for other unmarried individuals
- The exemption amount and phase-out threshold for trusts and estates remain at $22,500 and $75,000, respectively (these amounts are indexed for inflation)

Applicable for tax years 2018-2025



- Alimony payments provided in instruments executed after 12/31/18 are no longer deductible by the payer or includible in income of the recipient; changes to existing decrees will require specific language referencing TCJA law to be treated under the new law. Depending on which side of alimony, you may want your divorced finalized sooner rather than later.
- Moving expense deduction suspended for tax years 2018-2025, except for active duty military due to permanent change in station
- The ability to re-characterize or unwind a Roth IRA conversion repealed after 10/15/18 – explain what this is
- The period for contributing a qualified plan loan offset to an eligible retirement plan is extended to the due date (including extensions) for filing the Federal income tax return for the year in which the plan loan offset occurs

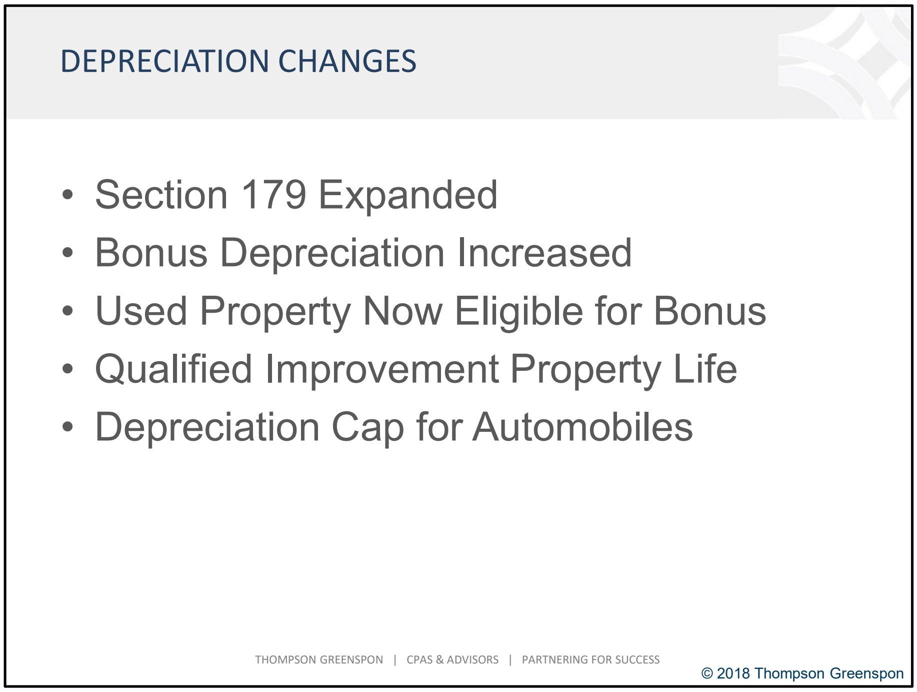
LIKE-KIND EXCHANGES

For exchanges completed after 12/31/2017 only real property will qualify for tax-free exchange treatment
There is a transition rule that provides an exchange is subject to the pre-TCJA rules if a taxpayer disposes of the relinquished property in a forward exchange, or receives the replacement property in a reverse exchange before 1/1/2018

- The basic estate tax exclusion amount is increased from $5 million to $10 million for estates of decedents dying after 2017 and before 2026
- The basic exclusion is indexed for inflation (Projected to be $11.2 million for 2018) -
- Generation Skipping Tax exemption is equal to the basic exclusion
- The step-up in basis of assets to fair market value at the date of death is still applicable

SMALL BUSINESS & RELATED CHANGES

- Depreciation
- Meals and Entertainment Expenses
- Transportation Fringe Benefits
- New Inventory Rules
- Capitalization of Production Costs
- New Qualified Business Income Deduction
- Net Operating Losses/Excess Business Loss



- §179 expensing expanded
- Bonus depreciation increased to 100%
- Used property now eligible for bonus depreciation
- 15-year depreciable life for Qualified Improvement Property
- Depreciation cap for automobiles increased

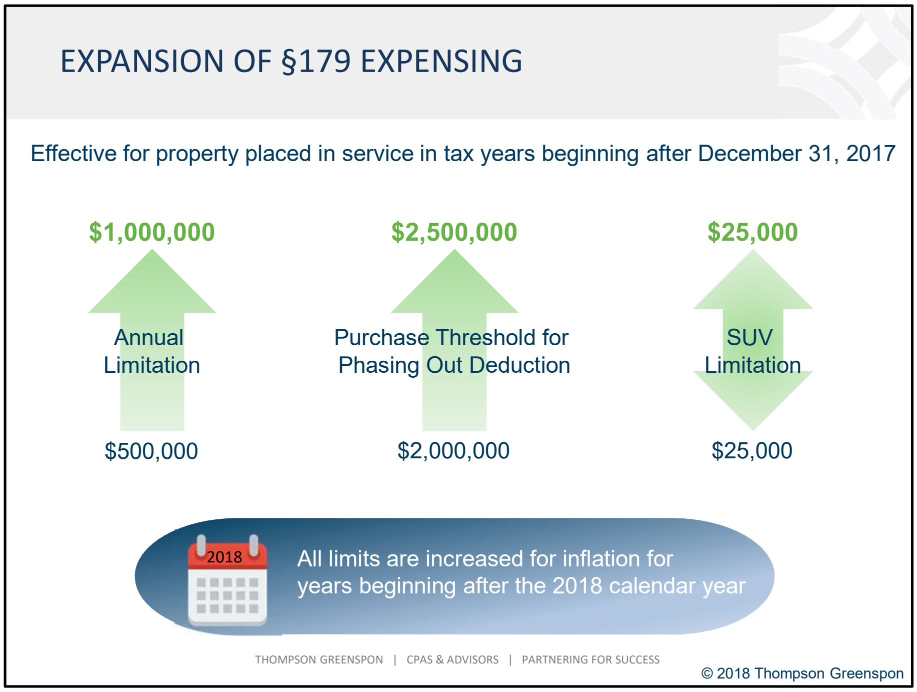
Depreciable tangible personal property that is purchased for use in the active conduct of a trade or business

Also includes off-the-shelf computer software, and

Qualified real property:

- Qualified Improvement Property
- Certain Structural Components (roofs, HVAC, fire protection, alarm systems, and security systems added to non-residential real property after the building is originally placed in service)
- Qualifying Residential Property (personal property used to furnish lodging or in connection with the furnishing of lodging - e.g., beds, refrigerators, ranges, furniture)

Restrictions on non-corporate lessors still apply



Expanded §179 expensing for first year asset

- Effective for property placed in service in tax years beginning after December 31, 2017
  - The annual limitation is raised to $1,000,000 from $500,000
  - The purchase threshold for phasing out the deduction is increased to $2,500,000 from $2,000,000
  - The SUV limitation remains at $25,000
  - All limits are increased for inflation for years beginning after the 2018 calendar year

QUALIFYING BONUS DEPRECIATION PROPERTY

- Life of 20 years or less
- Placed in service between **9/27/2017 and 1/1/2027**
- Certain computer software
- Qualified film, television, & live theatrical productions
- Required ADS property NOT eligible

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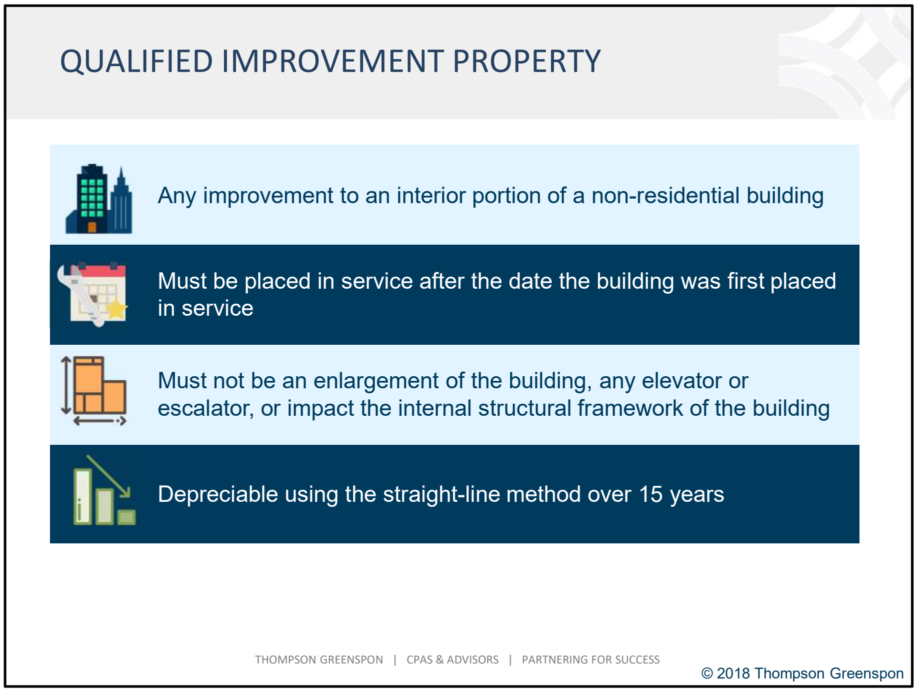
- Depreciable property with a depreciable life of 20 years or less
- Placed in service between 9/27/17 and 1/1/2027
- Certain computer software
- Qualified film, television, and live theatrical productions
- Used property is now eligible
- Property required to be depreciated using ADS is **not** eligible

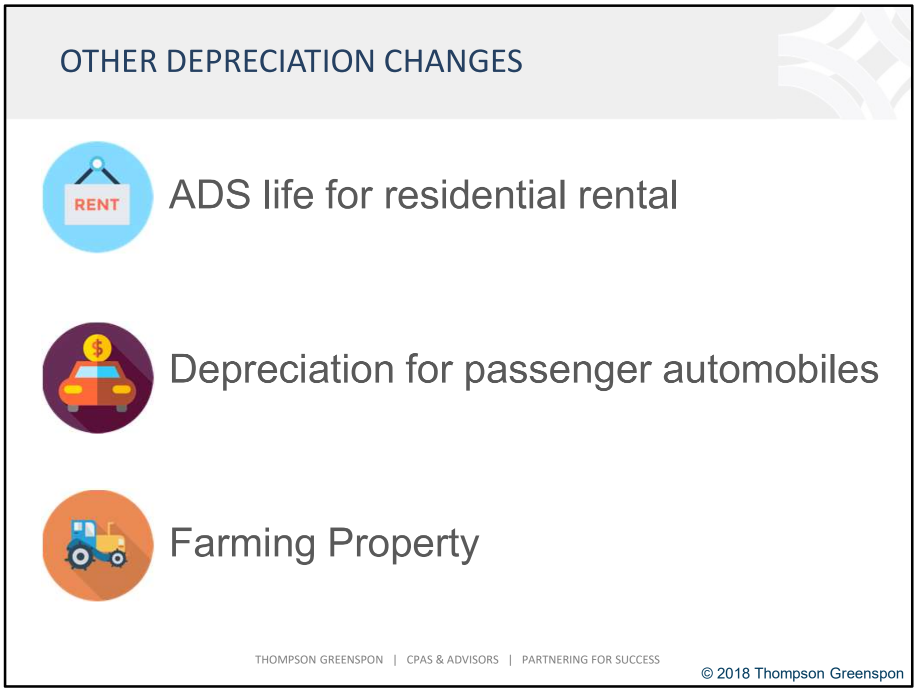
BONUS DEPRECIATION

Portion of Basis of Qualified Property Acquired After September 27, 2017

Placed in service year	Qualified Property in General/Specified Plants	Longer Production Period Property & Certain Aircraft
Sept. 28, 2017 – Dec. 31, 2022	100%	100%
2023	80%	100%
2024	60%	80%
2025	40%	60%
2026	20%	40%
2027	None	20%
2028 and thereafter	None	None



- Any improvement to an interior portion of a non-residential building
- Must be placed in service after the date the building was first placed in service
- Must not be an enlargement of the building, any elevator or escalator, or impact the internal structural framework of the building - tenant build out example
- Depreciable using the straight-line method over 15 years (according to Joint Explanatory Statement)



- ADS life for residential rental property shortened to 30 years
- Depreciation cap for passenger automobiles increased ($10,000 – 1st year, $16,000 – 2nd year, $9,600 – 3rd year, and $5,760 for remaining life with an additional $8,000 for bonus depreciation assets)
- 5-year depreciable life for most farm machinery and equipment
- 200% declining balance depreciation available for farming property

MEALS & ENTERTAINMENT EXPENSES

2017	2018
Meals with clients, customers, or prospects at an entertainment activity	
50% deductible* *Only if discussing business	Nondeductible
On-Premise meals provided for the convenience of the employer (such as meals for employees while working)	
100% deductible	50% deductible
Free meals to employees from an on-site dining facility	
100 % deductible	50% deductible* *Until Jan 1, 2026

To Be Determined:
- Meals with clients, customers, or prospects with substantial business discussions

No Changes:
- Meals with clients, customers, or prospects without substantial business discussions (still nondeductible)
- Meal reimbursements for employees while traveling on business (still at 50%)
- Holiday party or similar social events for employees (still at 100%)

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The new law provides that no deduction is allowed with respect to amounts incurred or paid after December 31, 2017 for:

1) An activity generally considered to be entertainment, amusement or recreation;
2) Membership dues with respect to any club organized for business, pleasure, recreation, or other social purposes; or
3) A facility or portion thereof used in connection with any of the above items

ALLOWABLE ENTERTAINMENT EXPENSES:

- Food and beverages furnished on the business premises of the taxpayer primarily for employees
- Expenses treated as compensation and included in an employee's W-2
- Expenses paid or incurred in performing services for another that are reimbursed
- Recreational expenses for employees
- Employee or stockholder business meetings
- Meetings of business leagues
- Items made available to the general public
- Entertainment sold to customers for adequate and full consideration

- Expenses includible in wages or persons who aren’t employees

- BUSINESS MEALS
- Taxpayers may still generally deduct 50% of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel)

- EMPLOYEE DINING FACILITIES
- For amounts incurred and paid after 12/31/17 and until 12/31/25, the Act expands the 50% limitation to expenses of the employer associated with providing food and beverages to employees through a dining facility that meets the requirements for de minimis fringes and for the convenience of the employer
- Such amounts incurred and paid after 12/31/25 are nondeductible

DISALLOWANCE OF DEDUCTION FOR QUALIFIED TRANSPORTATION BENEFITS

- Still excluded from employee's income
- Applies to amounts incurred or paid after 12/31/17
- Disallows the deduction for the employer for expense associated with qualified fringe transportation.

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- The Act disallows deductions for expenses associated with: providing any qualified transportation fringe to employees of the taxpayer; except as necessary, for ensuring the safety of an employee; any expense incurred for providing transportation (or any payment or reimbursement) for commuting between the employee's residence and place of employment
- Does not change the employee's exclusion of the benefit from the employee's income
- Applies to amounts incurred or paid after December 31, 2017

SMALL BUSINESS ACCOUNTING METHOD REFORM AND SIMPLIFICATION

- The Act exempts certain taxpayers from the requirement to keep inventories
- Taxpayers with gross receipts less than $25 million not required to use Percentage of Completed Contract method

Taxpayers/business owners may want to consider some type of tracking to ensure that products are priced correctly and to track profit margins.

For tax years beginning after December 31, 2017, taxpayers that meet the $25 million gross receipts test are not required to account for inventories, but rather may use a method of accounting for inventories that either:

1) Treats inventories as non-incidental materials and supplies, or
2) Conforms to the taxpayer's applicable financial statements (AFS); if there is not an AFS, then the method must conform to the taxpayer's books and records prepared in accordance with the taxpayer's accounting procedures

- Taxpayers are relieved from maintaining a formal cost of goods sold schedule in the tax return

UNIFORM CAPITALIZATION RULES (UNICAP)

- For tax years beginning after December 31, 2017, the Act expands the exception for small taxpayers from the uniform capitalization rules
- Under the provision, any producer or reseller that meets the $25 million gross receipts test is exempted from the application of UNICAP rules
- The Act retained the exemptions from the uniform capitalization rules that are not based on a taxpayer's gross receipts

NEW DEDUCTION FROM TAXABLE INCOME FOR BUSINESSES

- Deduction from *taxable* income
- Based on Qualified Business Income (QBI)
- Limitations apply
- Complex calculations

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QBI :

- Defined as the ordinary income - less ordinary deductions - earned from a sole-proprietorship, S Corporation, or partnership
- Does not include any wages earned as an employee or guaranteed payments
- Does not include capital gains or losses, dividend income, or interest income
- Must be income effectively connected with the United States (and possibly Puerto Rico)

QUALIFIED BUSINESS INCOME DEDUCTION

- Available to all Taxpayers except C Corp
- Must be computed with respect to each separate business owned by a taxpayer
- Available for rental “trade or business” income
- QBI losses carry over and reduce QBI in succeeding years
- Income from Publicly Traded Partnerships and Real Estate Investment Trusts get the 20% deduction
- Apparently will “pass-through” allocable income, expenses, W-2 wages, and unadjusted basis in depreciable property through tiered entity structures

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- Generally 20% of a taxpayer’s qualified business income from a partnership, S Corporation, or sole proprietorship
- Is available to all taxpayers other than C Corporations
- Must be computed with respect to each separate business owned by a taxpayer
- Apparently will “pass-through” allocable income, expenses, W-2 wages, and unadjusted basis in depreciable property through tiered entity structures
- Is available for rental “trade or business” income
- Income from Publicly Traded Partnerships and Real Estate Investment Trusts get the 20% deduction
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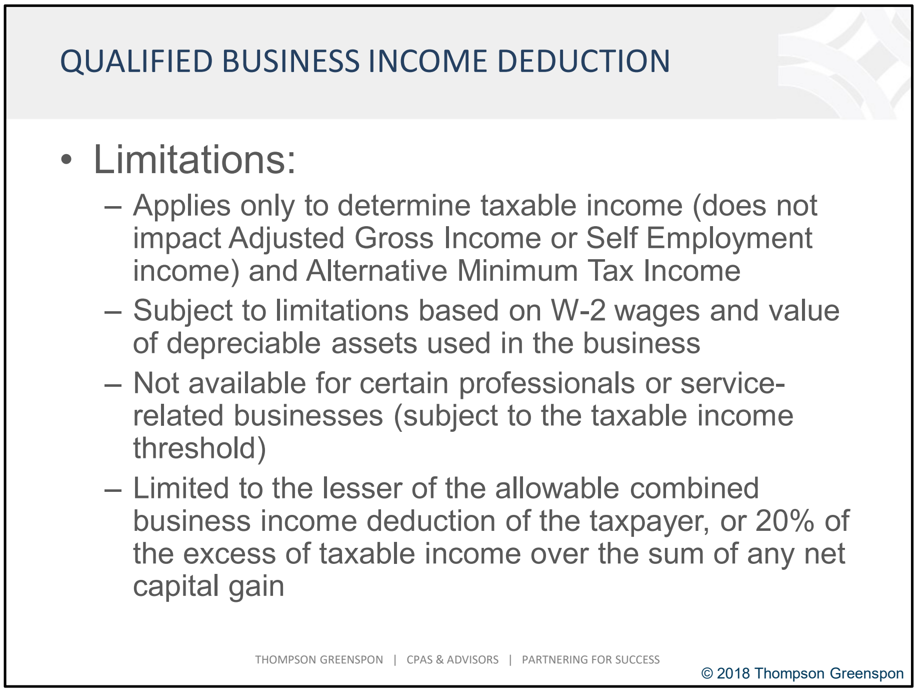
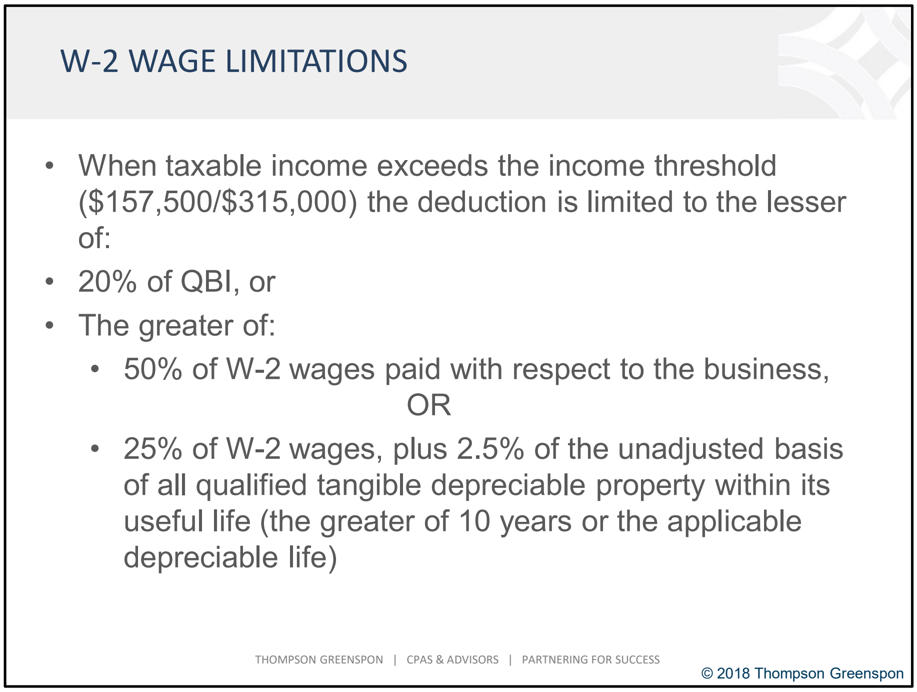
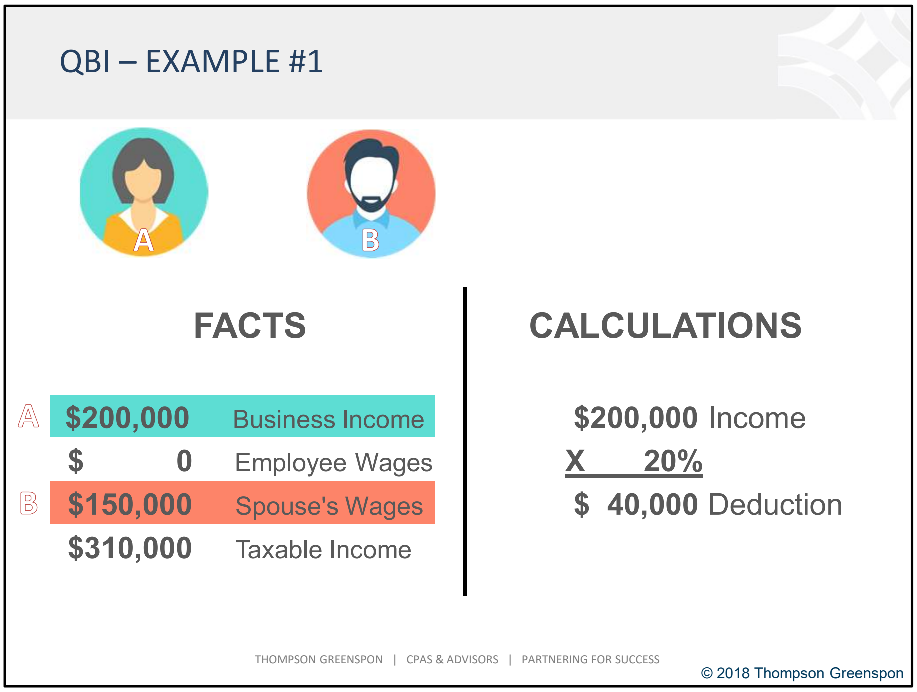


- Applies only to determine taxable income (does not impact Adjusted Gross Income or Self Employment income) and Alternative Minimum Tax Income
- Subject to limitations based on W-2 wages and value of depreciable assets used in the business once the taxpayer’s taxable income exceeds $157,500, or $315,000 for a joint return. This limitation is phased in over the next $50,000 of income, or $100,000 for a joint return
- Not available for certain professionals or service-related businesses (subject to the taxable income threshold)
- Apparently will “pass-through” allocable income, expenses, W-2 wages, and unadjusted basis in depreciable property through tiered entity structures
- Is available for rental “trade or business” income
- Income from Publicly Traded Partnerships and Real Estate Investment Trusts get the 20% deduction
- Is limited to the lesser of the allowable combined business income deduction of the taxpayer, or 20% of the excess of taxable income over the sum of any net capital gain
- QBI losses carry over and reduce QBI in succeeding years

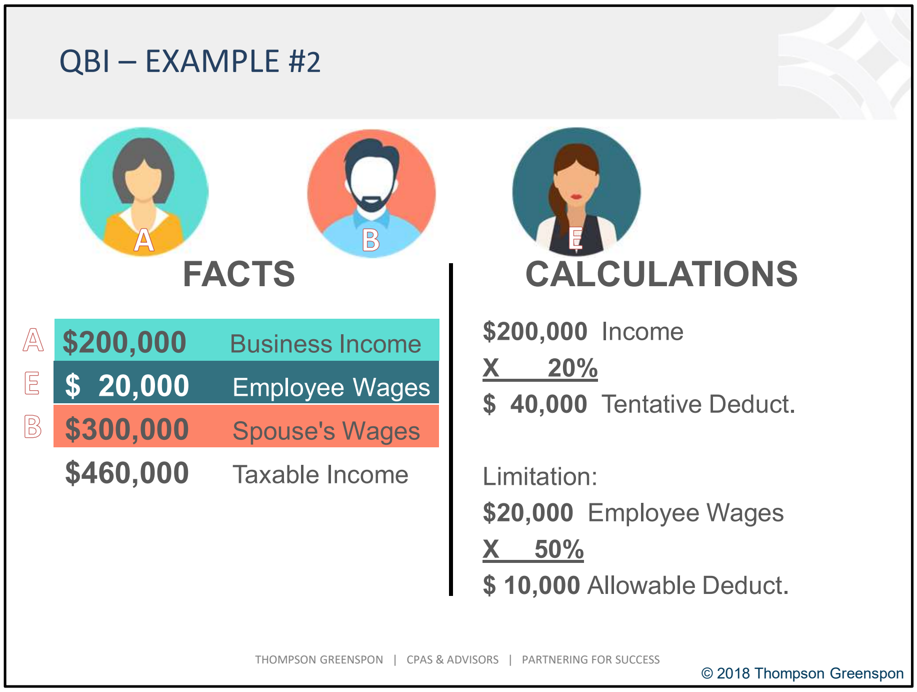


- When taxable income exceeds the income threshold ($157,500/$315,000) the deduction is limited to the lesser of:
- 20% of QBI, or
- The greater of:
  - 50% of W-2 wages paid with respect to the business, or
  - 25% of W-2 wages, plus 2.5% of the unadjusted basis of all qualified tangible depreciable property within its useful life (the greater of 10 years or the applicable depreciable life)

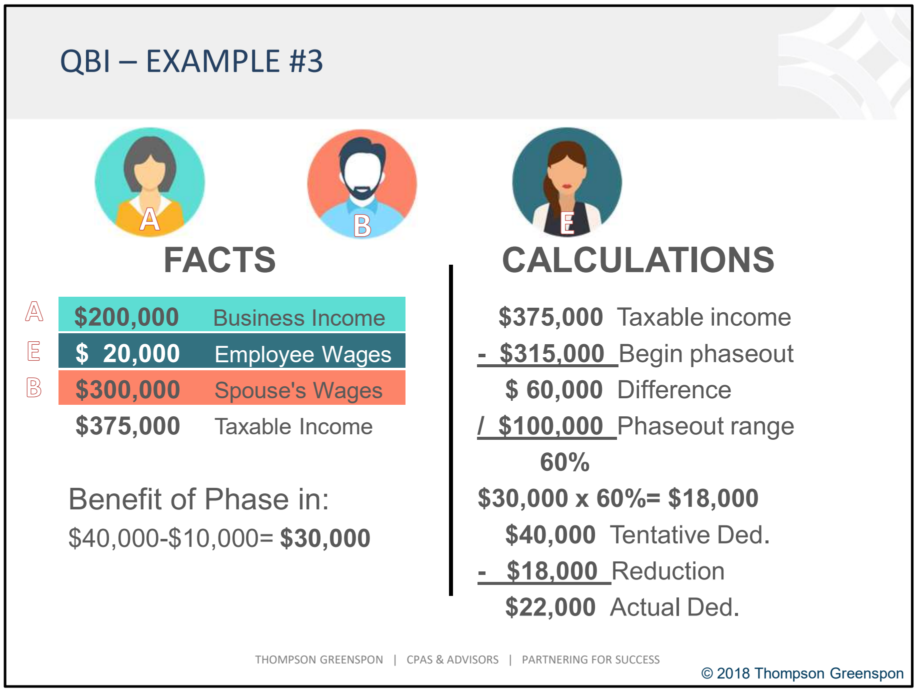


- A is a sole proprietor who sells rare books through an online business she operates from home, and she earned $200,000 from the business in 2018
- A works alone in the business and does not pay any employees
- A is married to B; B earned $150,000 from a W-2 job
- A and B report taxable income of $310,000 without respect to the QBI deduction

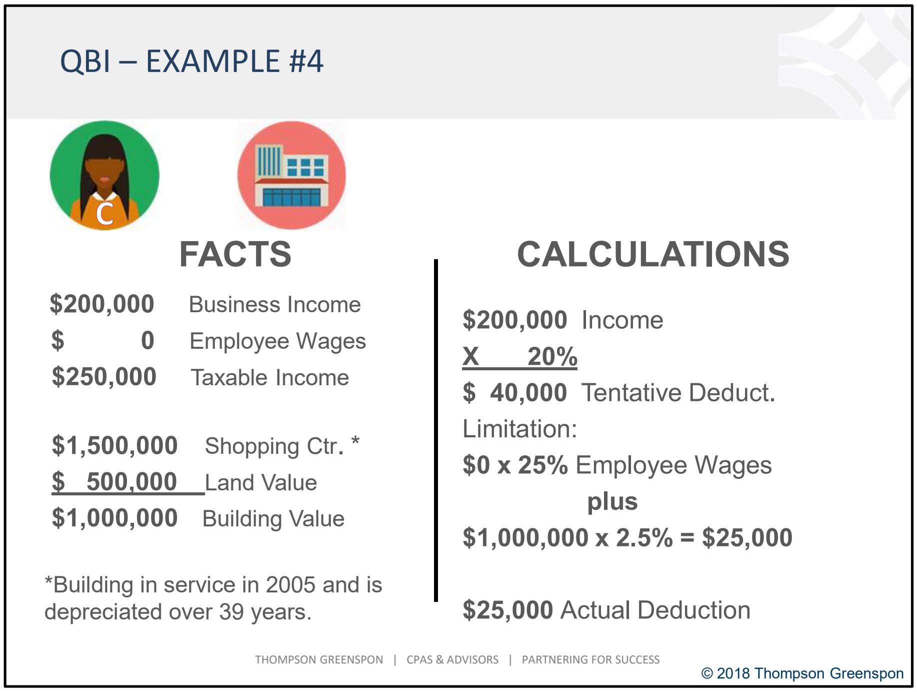
- A is entitled to a QBI deduction of $40,000 for 2018 ($200,000 x 20%)
- Because A and B's taxable income is below the limitation threshold, they are not subject to the W-2 limitations



- Assume the same facts in Example #1, except that B reports W-2 income from his employment of $300,000
- A and B’s taxable income for 2018 is $460,000
- A deducts W-2 wages of $20,000 to an employee who assists her in her business
- A’s QBI tentative QBI deduction is $40,000
- Because A and B’s taxable income exceeds $415,000, the QBI deduction is subject to limitation ($20,000 x 50% = $10,000)
- A’s allowable QBI deduction is $10,000



- Assume the same facts as in Example #2, except that A and B's taxable income is only $375,000
- The total benefit of the income limitation phase-in is $30,000 ($40,000 - $10,000)
- A and B's taxable income consumes 60% of the phase-in [($375,000 - $315,000) / $100,000]
- A's QBI deduction is reduced by $18,000, thus totaling $22,000 [($40,000 – ($30,000 x 60%)]



- C owns a shopping center
- C paid $1,500,000 for the shopping center. $1,000,000 of the purchase price is allocated to the building property
- C placed the building in service in 2005 and is depreciating it over 39 years
- C's QBI from her rental trade or business is $200,000, and her taxable income is $250,000
- C pays no wages in her rental trade or business
- C's tentative QBI deduction is $40,000
- The W-2 limitation on QBI is $25,000 [($0 wages x 25%) + ($1,000,000 unadjusted basis x 2.5%)]
- C's allowable QBI deduction is $25,000

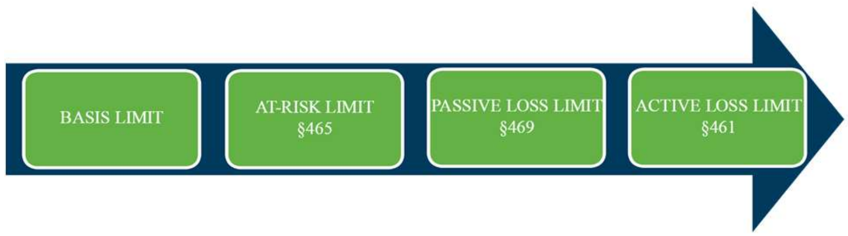
(Note that if the property used in this trade or business was machinery depreciable over 5 years, C would not be entitled to any QBI deduction because 2018 is beyond the 10-year life allowable)

NET OPERATING LOSSES

- Net Operating Losses (NOL) limited to 80% of taxable income
- Cannot be carried back; carried forward indefinitely
- Applies to NOLs arising in the tax years ending after December 31, 2017

LIMITATION ON LOSSES FOR TAXPAYERS OTHER THAN CORPORATIONS

New Fourth tier:



LIMITATION ON BUSINESS LOSSES FOR TAXPAYERS OTHER THAN CORPORATIONS

2017	2018
Unlimited use of trade or business losses after the application of passive loss rules to offset other income.	Amount that can offset other income is limited to $500,000 for married filing jointly ($250,000 for single filers)

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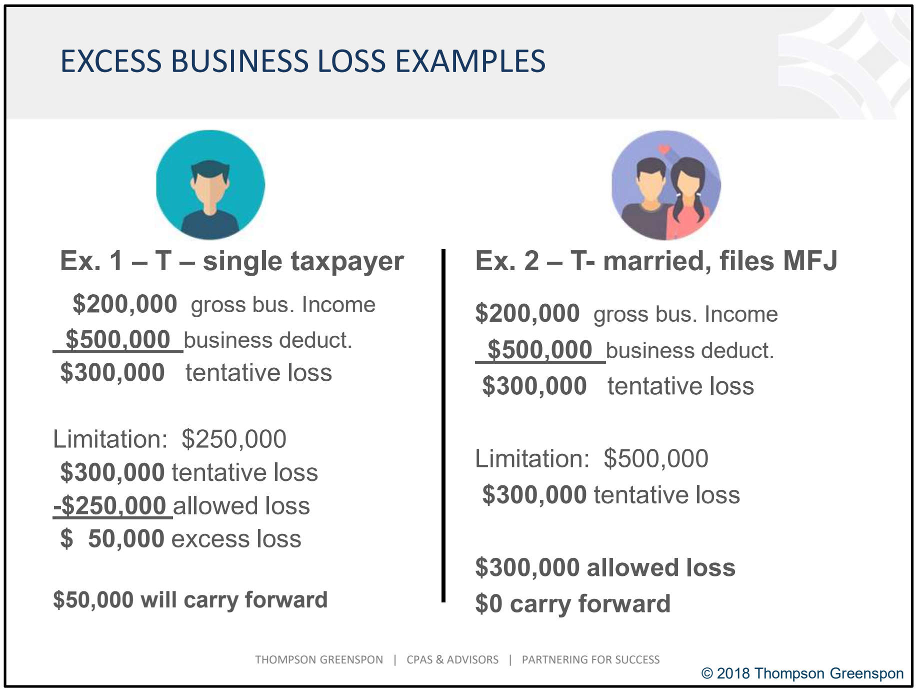
- For taxable years beginning after 12/31/17 and before 1/1/26, excess business losses of a taxpayer, other than a Corporation, are not allowed for the taxable year
- Such losses are carried forward and treated as part of the taxpayer's NOL carryforward in subsequent taxable years for partnerships and S Corporations
- In the case of a partnership or S Corporation, the provision applies at the partner or shareholder level; The limitation rule applies at the partner or shareholder level
- Each partner's distributive share and each S Corporation shareholder's pro rata share of items of income, gain, deduction, or loss of the partnership or S Corporation are taken into account in applying the limitation under the provision for the taxable year of the partner or S Corporation shareholder

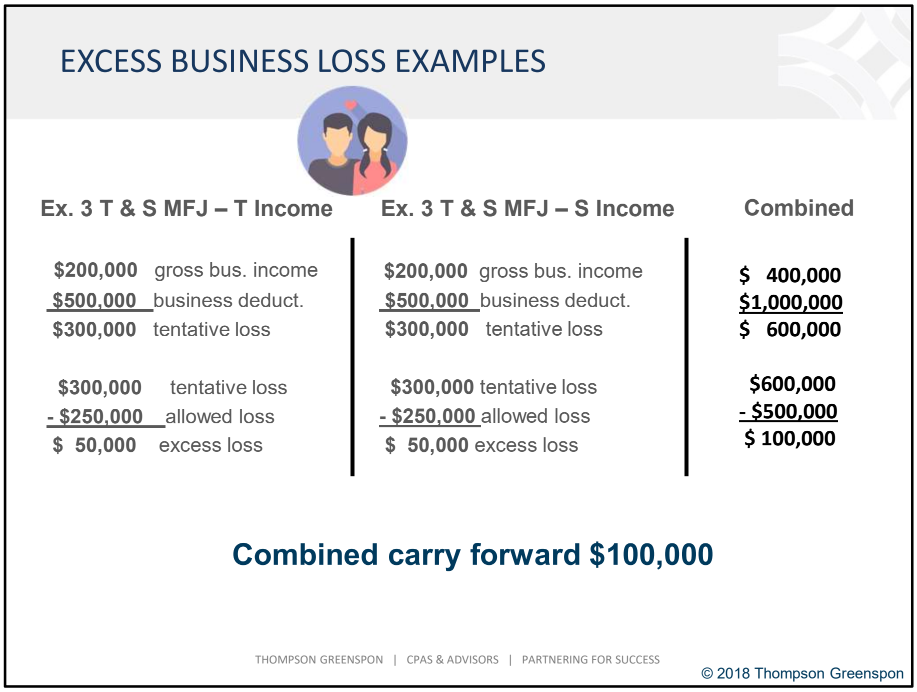
An excess business loss for the taxable year is the excess of aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer (determined without regard to the limitation of the provision), over the sum of aggregate gross income or gain for the tax year which is attributable to those trades or businesses, plus a threshold amount

The threshold amount for a taxable year is $250,000 ($500,000 for MFJ)

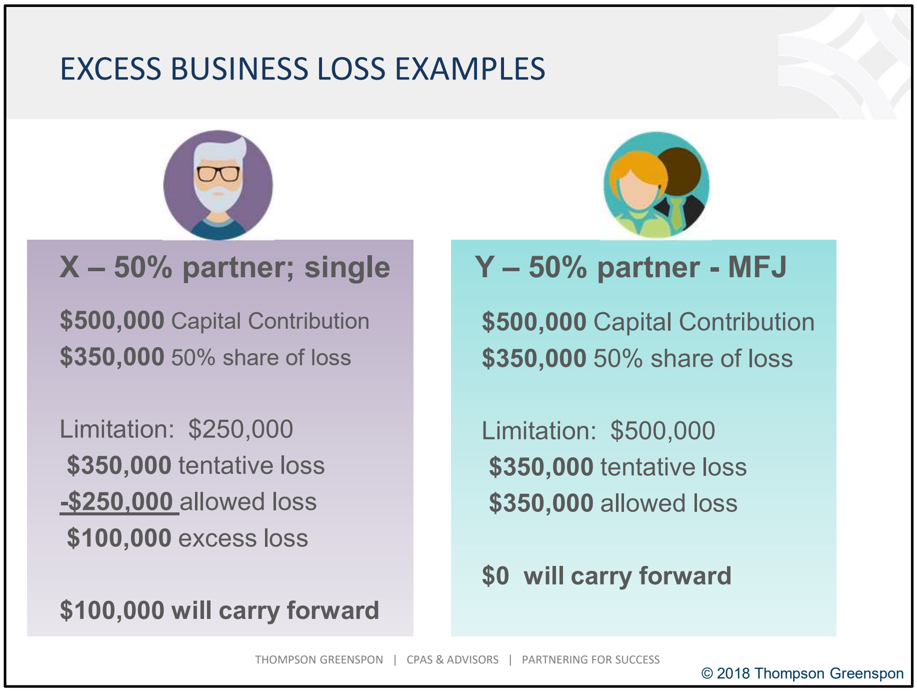
If husband and wife have separate businesses – limitation based on the aggregate activities



1. In 2018, T, a single taxpayer, has deductions of $500,000 from a business. T's gross income from the business is $200,000. T's excess business loss is $50,000 [$500,000 – ($200,000 + $250,000)]. The $50,000 excess business loss is treated as part of the taxpayer's NOL carryforward in later years.
2. Same facts as #1 above, except T is married and files a joint return. T does not have an excess business loss because the aggregate business deductions ($500,000) do not exceed the $200,000 of business income plus the $500,000 threshold for joint filers.



3. Same facts as #2, except that T's spouse (S) also has a business that has deductions of $500,000 and gross income of $200,000. S and T's excess business loss is $100,000 [$1,000,000 – ($400,000 + $500,000)].



4. In 2017, X and Y quit their jobs in order to start a business, as equal partners. X is single and invests $500,000 of capital, and so does Y, who is married. The 2018 partnership tax return reports a net loss of $700,000. X's and Y's allocable share of the partnership's loss is $350,000 each, which they report on Schedule E of their respective 2018 individual returns.

Since the excess loss limitation applies at the partner level, X has an excess business loss of $100,000 ($350,000 less the $250,000 threshold for single), and Y has no excess business loss because his allocable share of $350,000 is less than the $500,000 married threshold.

EXCESS BUSINESS LOSS EXAMPLES

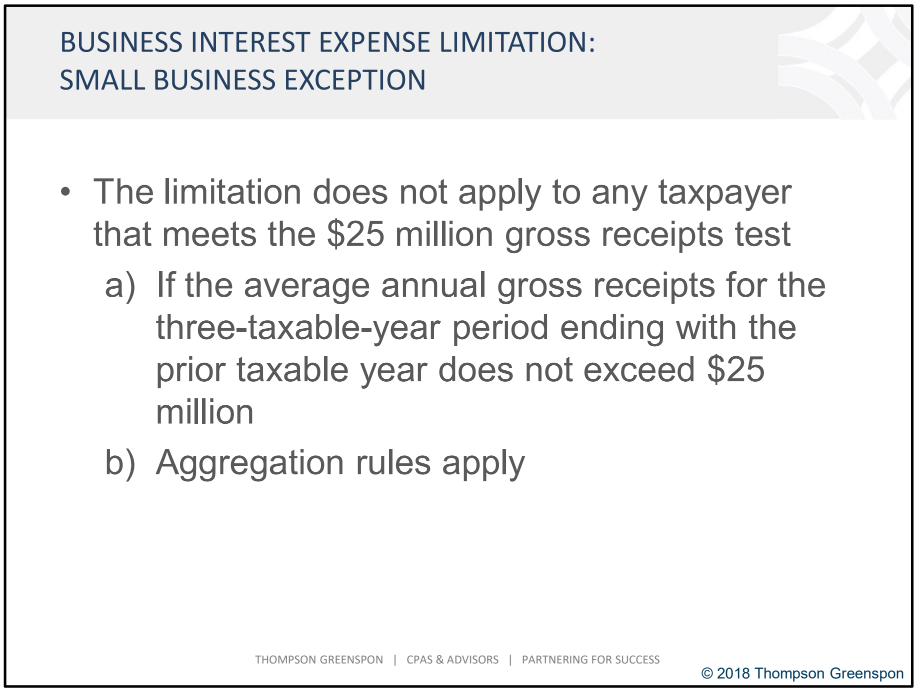
X – 50% partner; single

$300,000 Wages from prior job
$500,000 Capital Contribution
$350,000 50% share of partnership loss

Limitation: $250,000
$350,000 tentative loss
-$250,000 allowed loss
$100,000 excess loss

$100,000 will still carry forward

5. Same facts as #4. In 2018, X received a salary of $300,000 before forming the partnership and had income from other sources of $50,000. Even though X has an excess business loss, X can use $250,000 (up to the threshold amount) of the losses from the partnership to offset X's other income. However, even though X has sufficient income in 2018 to offset the entire loss, X *must* treat the $100,000 excess business loss as an NOL carryforward. If the partnership is not profitable in 2018 and X has no other substantial sources of income, X must continue to carry forward the NOL.



The limitation does not apply to any taxpayer that meets the $25 million gross receipts test

a) If the average annual gross receipts for the three-taxable-year period ending with the prior taxable year does not exceed $25 million

b) Aggregation rules apply

BUSINESS INTEREST EXPENSE LIMITATION

- In the case of any taxpayer for any taxable year, the deduction for business interest is limited to the sum of:
  1) Business interest income;
  2) 30% of the adjusted taxable income of the taxpayer for the taxable year; and
  3) The floor plan financing interest of the taxpayer for the taxable year

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BUSINESS INTEREST EXPENSE LIMITATION

- The amount of any business interest not allowed as a deduction for any taxable year is treated as business interest paid or accrued in the following year and may be carried forward indefinitely.
- In the case of any partnership or S Corporation, the limitation is applied at the entity level
- To prevent double counting, special rules are provided for the determination of the adjusted taxable income of each owner of the entity

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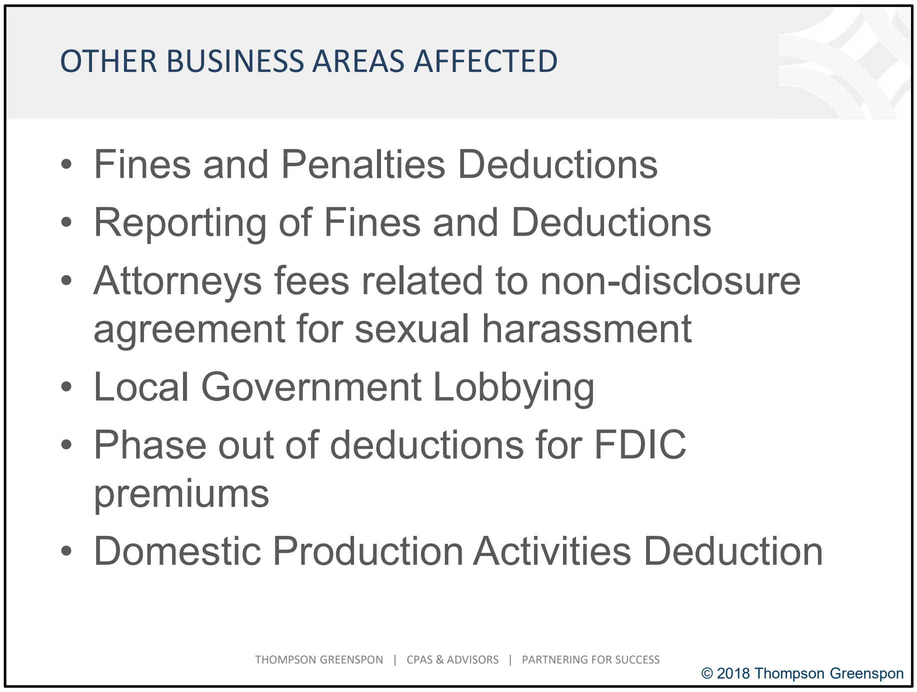

No deduction for fines and penalties paid or incurred on or after 12/22/17 broadened
New reporting requirements mandate government agencies to report amounts received for fines and penalties
No deduction for attorney's fees and settlements of sexual abuse or harassment suits subject to a non-disclosure agreement
No deduction for expenses of lobbying local governments paid or incurred on or after 12/22/17
Domestic Production Activities Deduction - eliminated
Deductions for FDIC premiums phased out for banks with assets between $10-50 billion

OTHER BUSINESS AREAS AFFECTED

- Family and Medical Leave
- Rehabilitation Credits
- Orphan Drug Credit
- Achievement Awards
- Option or RSU Vesting

Credit allowed for paid family and medical leave wages paid after 12/31/17
Qualified rehabilitation credits limited to certain historic structures
Orphan drug credit reduced to 25%
Excludible employee achievement awards cannot include cash, gift certificates, vacations, tickets to theater or sporting events, securities, meals or lodging
Employees can elect to defer income from option or RSU vesting for up to 5 years

TAX-EXEMPT ENTITIES

- New excise tax on certain compensation
- Excise tax on investment income of applicable educational institutions
- Unrelated Business Taxable Income (UBTI) must be determined separately for each unrelated trade or business
- UBTI increased by disallowed fringe benefit expenses

New excise tax on compensation in excess of $1 million paid to covered employees
1.4% excise tax imposed on investment income of applicable educational institutions
Unrelated Business Taxable Income (UBTI) must be determined separately for each unrelated trade or business
UBTI increased by disallowed fringe benefit expenses

Bunching itemized deductions
Donor Advised Funds
For Self-employed – defined benefit plans
Maxing retirement contributions

CONCLUSION

- Sweeping changes
- Anticipating further guidance
- “Simplification”
- Opportunity