

# TJCA Impact on Individuals

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# Overview of TCJA Impact on Individuals

- Tax rate and brackets
  - Seven brackets, most two to three points lower, top rate decreased from 39.6% to 37%
  - Top rate now begins at \$600,000 of taxable income for MFJ, \$300,000 for MFS and \$400,000 for Single
- Personal exemptions and standard deductions
  - No more personal exemptions, previously \$4,050
  - Standard deduction now \$24,000 for MFJ, \$18,000 HoH, \$12,000 for Single and MFJ
  - Previously standard deduction was \$12,700 for MFJ, \$9,350 HOH, \$6,350 for Single and MFS
- Exemption for dependents and child tax credit
  - No more dependent exemptions
  - Child tax credit increases to \$2,000 up through age 16, previously \$1,000
  - Children over age 16 and other dependents, new \$500 tax credit

# Overview of TCJA Impact on Individuals

- Passthrough tax break, Section 199A
  - New 20% deduction for qualified business income from sole proprietorships
- SALT Deduction
  - \$10,000 limit for property and income taxes, previously no limit
- Mortgage Interest Deduction
  - \$750,000 loan amount, previously \$1,000,000; existing loans grandfathered
  - No more interest deductions for home equity loans
- Deduction for Charitable Contributions
  - 60% AGI charitable deduction limit for cash contributions to public charities, previously 50% limit

# Overview of TCJA Impact on Individuals

- Repeal of Deduction for Certain Miscellaneous Expenses
  - No more miscellaneous itemized deductions subject to 2% AGI
  - Examples: Unreimbursed job expenses, investment expenses, tax preparation fees, attorney fees
- Repeal of Alimony Deduction
  - Beginning in 2019, also repeals the inclusion of alimony income by recipient
  - Separation agreements entered before 2019 are grandfathered
- AMT
  - Increased exemption by 27%, increased exemption phase out
- Expanded Uses of 529 Plan Distributions
  - \$10,000 distributions per year now for elementary and secondary school tuition
  - Previously distributions could only be used for higher education

# Overview of TCJA Impact on Individuals

- Deduction for Medical Expenses
  - Exceeding 7.5% of AGI in 2017 and 2018. Exceeding 10% of AGI in 2019.
- Repeal of Deduction for Casualty and Theft Losses
  - Exception: presidentially declared disaster areas
  - Enhanced relief for victims in federally declared disaster areas in 2016 and 2017
- Repeal of Individual Healthcare Mandate
  - No more tax penalty on individuals who fail to carry health insurance as part of the Affordable Care Act (ACA)
  - Previously the tax penalty was the greater of \$695 per adult and \$347.50 per child or 2.5% of AGI ; maximum penalty of \$2,085
- Estate and Gift Tax Exclusion
  - Doubles from \$5,490,000 in 2017 to \$11,180,000 in 2018

# Temporary Bonus Depreciation

# Temporary Bonus Depreciation

- The Act allows taxpayers to claim an immediate deduction for 100% of the cost of certain tangible property used in a trade or business
  - Under old law, the cost of the property was generally required to be depreciated over a specified recovery period
  - To qualify for the 100% deduction, the property must be placed in service after Sept. 27, 2017, and before January 1, 2023
  - Thereafter, the percentage of the property's cost that can be immediately expensed is reduced at a rate equal to 20% per year

<b>Tax Year</b>	<b>Percentage</b>
9/28/17 to 12/31/22	100%
2023	80%
2024	60%
2025	40%
2026	20%

# Temporary Bonus Depreciation

- “Qualified property”
  - Generally means tangible personal property with a recovery period of 20 years or less, certain software, and certain qualifying improvements to real property
- The Act eliminates the requirement that the original use of the property commence with the taxpayer
  - Depreciation is now available for used property
- Related-party exceptions

# Section 179 Expense

# Increase in Section 179 Expense

- Without section 179, deductions attributable to “section 179 property” would be required to be capitalized and depreciated over the asset’s recovery period
- The Act increases from \$500,000 to \$1 million the amount a taxpayer may deduct with respect to section 179 property
  - Amounts are adjusted for inflation after January 1, 2019
  - Section 179 property means new or used tangible depreciable property or certain computer software that is acquired for purchase in the active conduct of a taxpayer’s trade or business
- Limitations:
  - If the taxpayer places into service more than \$2.5 million (adjusted for inflation), then the amount available for an immediate deduction is reduced by the amount by which the cost of the property > \$2.5 million (adjusted for inflation)
  - Interplay with bonus depreciation

# Limitations on Business Interest Expense

# Limitations on Business Interest Expense

- The Act enacts a complex new regime which disallows a deduction for business interest expense that exceeds the sum of the borrower's business-related interest income plus 30% of the borrower's "adjusted taxable income"
  - "Adjusted taxable income" is defined in a manner that is similar to EBITDA for taxable years beginning before January 1, 2022 (*i.e.*, for the first four years that the new 30% limitation is in effect), but the definition then changes for subsequent years so that it is more similar to EBIT
- No grandfathering of existing debt
- Nondeductible business interest can be carried forward indefinitely
- Exceptions:
  - Taxpayers with average annual gross receipts of \$25 million or less on a rolling three-year lookback basis
  - Certain real estate businesses that elect out of the provisions

# Excess Business Losses

# Excess Business Losses

- The Act imposes a new limitation on an individual's ability to deduct aggregate net business losses to the extent such net businesses loss exceeds:
  - \$500,000 for taxpayers filing a joint tax return
  - \$250,000 for all other taxpayers
    - Both amounts indexed for inflation and relevant provisions in section 461
- An individual's excess business loss is not deductible against investment income and other non-business income
  - Instead, the excess business loss will be deemed to give rise to an NOL that is carried forward in future years in accordance with the rules applicable to post-2018 NOLs (*e.g.*, 80% of taxable income limit)
  - The individual's excess business loss is determined after applying existing limitations based on an individual's at-risk amount and passive activity loss limitations
- Applies at the partner/shareholder level

# Section 199A Deduction for Qualified Business Income

# Section 199A – Overview

- New Section 199A
  - Applies to individuals, trusts, and estates
- Deduction of 20% for “qualified business income” from certain sole proprietorships, pass-through entities, or a single-member LLC classified as a disregarded entity
  - After December 31, 2017
  - Set to expire after December 31, 2025
  - Not allowed in computing AGI
- Practical effect is to reduce the highest marginal rate on qualified business income from 37% to 29.6%

# Section 199A – Qualified Business Income

- Qualified business income
  - Generally
    - The computation of qualified business income requires several steps and is subject to numerous exceptions and limitations
      - Must be evaluated on a case-by-case basis
  - Includes for any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer
  - Determined for each trade or business
  - If net amount from all qualified business is a loss it is carried forward as a loss

# Section 199A – Qualified Business Income (con't)

- Qualified business income
  - Does not include any amount paid by an S corporation that is treated as reasonable compensation
  - Guaranteed payments for services rendered
  - Stock in a C corporation does not qualify for this new deduction

# Section 199A – Guidance for Rental Real Estate

- Rental real estate
  - Notice 2019-07 (proposed revenue procedure (Rev. Proc. 2019-XX))
  - Provides a safe harbor under which a rental real estate enterprise will be treated as a trade or business for purposes of section 199A
    - Rental real estate enterprise includes interests in real property held for the production of rents and includes interests in multiple properties
    - Must hold interest in a real estate enterprise directly or through a DRE
  - Must maintain separate books and records to reflect income and expenses for each rental real estate enterprise
  - Must spend a minimum number of hours performing rental services
    - Taxable years beginning prior to 1/1/2023, 250 or more hours
    - Taxable years beginning after 12/31/2022, 250 or more hours in any three of the five consecutive taxable years that end with the taxable year
    - Taxpayer maintains contemporaneous records, including time reports, logs, or similar documents regarding hours, date, description and person performing services

# Section 199A – Exclusions

- Exclusions
  - The qualified business income must be U.S. source income (generally, including Puerto Rico)
  - A qualified trade or business does not include specified service-oriented businesses for owners above certain taxable income thresholds

# Section 199A – Limitations

- Deduction limitation:
  - Based on wages paid **or**
  - Wages paid plus a capital component
- The deduction limitation equals the greater of:
  - 50% of the wages paid with respect to the qualified trade or business **or**
  - The sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis of all qualified property

# Section 199A – Limitations (con't)

- 20% deduction limitation thresholds:
  - \$315,000 or less if married persons
  - \$157,500 for all other individuals
- 20% deduction phase-out:
  - Next \$100,000 of taxable income or \$415,000 for married person
  - Next the \$50,000 of taxable income or \$207,500 for all other individuals

# Section 199A – Information Reporting

- You will need information from each pass-through entity to make these calculations
  - Expect information on Schedules K-1 reporting such information (either on Line 20 or a statement to the K-1)
  - Expect the IRS to issue regulations imposing these requirements sooner rather than later

# Basic Examples of Section 199A For Individuals

# Business Income Deduction – No Limitation

- Harold is married to Wilma and they have two dependent children. For 2018, Harold earns \$52,000 of net commission income while Wilma earns a salary of \$75,000. They have itemized deductions totaling \$18,000, which are comprised of state and local taxes, mortgage interest, and charitable contributions.

# Business Income Deduction

Pre- December 20, 2017		Post- December 20, 2017	
Wages	\$75,000	Wages	\$75,000
Net Income	\$52,000	Net Income	\$52,000
Personal exemptions (4 x \$4,150)	(\$16,600)	Business income deduction (20%)	(\$10,400)
Itemized deductions	(\$18,000)	Standard deduction	(\$24,000)
Taxable income	\$92,400	Taxable income	\$92,600
Tax	\$14,408	Tax	\$12,251
Tax credit for children (2 X \$1,000)	(\$1,400)	Tax credit for children (2X\$2,000)	(\$4,000)
Net tax after credits	\$13,008	Net tax after credits	\$8,251

## Business Income Deduction – Wage and Capital Limitation Example

- Harold and Wilma are married with no dependents. Harold is a widget developer and Wilma is a homemaker. Harold is the sole owner of HW Enterprises, an S-Corp that earned net income of \$360,000, after paying Harold a salary of \$87,000 and his administrative assistant a salary of \$52,000.
- In addition, HW Enterprises has the following assets: office building worth \$320,000, and other depreciable assets with a basis of \$65,000. Harold and Wilma have itemized deductions total \$31,000.

# Business Income Deduction – Individual Setting

- Harold and Wilma's AGI is \$447,000 determined without regard to the deduction for qualified business income.
  - Exceeds the qualified business income threshold of \$315,000 and the phase-out of \$415,000
  - Not eligible for the 20% business income deduction; subject to the limitations on wages and capital

# Business Income Deduction – Individual Setting

- The deductible amount for Harold's business income deduction is determined by the greater of:
  - (1) 50% of the W-2 wages paid by the business, or
  - (2) the total of 25% of the W-2 wages paid by the business plus 2.5% of the cost basis of the tangible depreciable property of the business at the end of the year.

# Business Income Deduction – Individual Setting

- 50% of Harold's total wages paid:

$$\$87,000 + \$52,000 = \$139,000 \times .50 = \$69,500$$

OR

- 25% of Harold's total wages paid + 2.5% of the cost of tangible depreciable property:

$$\begin{array}{r} \$139,000 \times .25 = \$34,750 \\ \$385,000 \times .025 = \$9,625 \\ \hline \$44,375 \end{array}$$

# Business Income Deduction – Individual Setting

- The greater of the two limitations is \$69,500
- If Harold and Wilma did not exceed the income limitations, the business deduction would have been \$72,000 ( $\$360,000 \times .20$ )

# Business Income Deduction – Individual Setting

Pre- December 20, 2017		Post- December 20, 2017	
Wages	\$87,000	Wages	\$87,000
Net pass-through Income	\$360,000	Net pass-through Income	\$360,000
Personal Exemption (phased-out)	\$ -	Business Income deduction	(\$69,500)
Itemized deductions (limited by 3%)	(\$27,190)	Itemized deductions (No phase-out)	(\$31,000)
Taxable Income	\$419,810	Taxable Income	\$346,500
Tax	\$113,263	Tax	\$74,259