Tax Cuts and Jobs Act

Presenters: Timothy M. Tikalsky, CPA

Date: February 6, 2018

RINA accountancy corporation

Tax Cuts and Jobs Act

Tax Cuts and Jobs Act (TCJA) – Name given by House in H.R. 1

Legal name – Public Law no. 115-97, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018.

Senate parliamentarian ruled that the short name violated the "Byrd rule" and required a name change. Apparently this is the best they could come up with.

We will use TCJA.

Will add $1.4T to the budget over the next 10 years.

Nearly all of the individual income tax provisions will expire after 10 years.

Revenue impact and ‘sunrise’ and ‘sunset’ provisions

The Joint Committee on Taxation (JCT) estimates that the legislation will reduce government revenue by $1.456 trillion over the 10-year budget window. This figure is well within the $1.5 trillion allowance provided by the reconciliation instructions, but the reconciliation process also precludes revenue losses outside the budget

window. The conference agreement is made revenue-neutral outside the budget window primarily by “sunsetting” all individual changes in 2026 except for two permanent revenue-raisers:

- Repeal of ACA Individual Mandate
- Slow down of Inflation Adjustments for tax brackets

Final Tax Reform Bill

- Setting a top corporate rate of 21% (up from 20% in both bills) effective for tax years beginning in 2018
- Setting a top individual rate of 37% (lower than the original proposals in either bill)
- Creating a 20% deduction for pass-through income, with provisions enhancing the deduction for capital-intensive and real estate businesses with low-wage expense, lowering the income allowance for professional services but providing an exception for architects and engineers, and allowing trusts and estates to use the deduction
- Removing the worldwide limit on interest deductions
- Increasing the rate on the one-time tax on unrepatriated earnings to 15.5% on cash and cash equivalents and 8% on other assets

Final Tax Reform Bill

- Repealing the corporate AMT
- Limiting net operating loss (NOL) deductions to 80% of taxable income (down from 90% in earlier versions)
- Retaining the individual AMT with higher exemptions and higher phase-out thresholds
- Allowing a deduction of up to $10,000 in state and local income or property taxes
- Removing a provision requiring basis of securities to be determined on a first-in, first-out method

Final Tax Reform Bill

- Retaining the estate tax with a higher exemption amount
- Narrowing a change requiring certain contributions to capital to be included in income
- Retaining the work opportunity tax credit
- Retaining private activity bonds

Married Individuals Filing Joint

Not over $19,050 10% of the taxable income

Over $19,050 but not over $77,400 $1,905 plus 12% of the excess over $19,050

Over $77,400 but not over $165,000 $8,907 plus 22% of the excess over $77,400

Over $165,000 but not over $315,000 $28,179 plus 24% of the excess over $165,000

Over $315,000 but not over $400,000 $64,179 plus 32% of the excess over $315,000

Over $400,000 but not over $600,000 $91,379 plus 35% of the excess over $400,000

Over $600,000 $161,379 plus 37% of the excess over $600,000

Estates and Trusts

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

Itemized deductions

- Charitable deductions (Raised to 60%)
- Mortgage interest (Capped at $750K)
- Gambling loss (allowed against income only)
- Miscellaneous itemized deductions (eliminated)
- Medical expenses (reduced from 10% to 7.5%)
- Sales taxes (Limited to $10K)

Qualified Business Income Deduction

- Deduction is computed as 20% of the lesser of:

  1. The taxpayer's taxable income reduced by net capital gains, or
  2. The qualified business income amount.

- Item number 2 above is the deduction determined on Qualified Business Income or QBI. This is important – we will spend most of our time determining this number. See next slide for definition of item number 2.
- What is QBI? – pretty simple, it is ordinary income less deductions from the activity. I would assume that would be determined under the tax basis method of accounting. QBI does not include investment type income, unless earned in a trade or business. For example – trade or business of lending money would generate interest income, but it would be considered as QBI.
- See Example A of how the above works.

Qualified Business Income Amount

- QBIA:

The LESSER OF:

1. 20% of the taxpayer's "qualified business income“, or

2. THE GREATER OF:
   - 50% of the W-2 wages with respect to the business, or
   - 25% of the W-2 wages with respect to the business, plus 2.5% of the unadjusted basis of all tangible depreciable property used in the trade or business.

3. Limited to 20% of overall taxable income (reduced by capital gains.

Qualified Business Income Deduction

Example A:

- Taxpayer A has $125,000 of QBI. A also has $175,000 of long-term capital gains, $30,000 of wages and $40,000 of itemized deductions. A's taxable income is $290,000. A files MFJ and QBI is not from a specified service activity.

- A's deduction is limited to the lesser of:

    1. 20% of QBI of $125,000 or $25,000, or

    2. ($290,000-$175,000 = $115,000) * 20% = $23,000

- Taxpayer A's deduction is $23,000.

Qualified Business Income Deduction

- New IRC Section 199A is created. Section 199 Domestic Production Deduction is eliminated.
- The deduction is taken from taxable income.
- Computation is made at the individual taxpayer's return.
- Investment type income (interest, dividends, cap gains, etc) is not QBI, unless generated in the course of a QTB.
- QBI does not include reasonable compensation or guaranteed payments paid the taxpayer. Wages paid to the taxpayer are included in W-2 wages – guaranteed payments are not.
- Trusts and estates are eligible for the deduction.
- C Corporations are not eligible for the deduction.

Qualified Business Income Deduction

- QBI is generated from a qualified trade or business (QTB). QTB means any activity effectively connected with the **conduct of a trade or business in the United States other than: (1) specified service trade or business, or (2) trade or business of being an employee.

- ** Your question to me does this apply to rental real estate? My answer for now is yes, unless the real estate activity is a triple net lease.

Qualified Business Income Deduction – Specified Service Business

- What is a specified service business?

- It is determined under IRC Code Section 1202(e)(3)(A) other than engineering or architecture. See rundown below of specified service business:

  - Taxpayers in service related businesses, such as healthcare professionals, law, accounting, actuarial science, performing artists, consulting, athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities, and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

Qualified Business Income Deduction – Phase Out Limitations for Specified Service Activities

- The deduction available for QBI in specified service businesses is phased out if the taxpayer's taxable income exceeds the threshold amount of $157,500 ($315,000 in the case of a joint return).

- The phase out starts when the taxpayer's taxable income hits $315,000 MFJ and is fully phased out when the taxpayer's taxable income hits $415,000. Got it. For example, if the taxpayer's taxable income is $375,000 then the deduction is phase-out out by $60,000/$100,000 or 60%. Once taxable income hits $415,000 MFJ, then no deduction is available for specified service activities.

- For taxpayers, other than MFJ, they get a $50,000 phase–out above $157,500. That means that taxable incomes above $207,500 no deduction.

Qualified Business Income Deduction – Phase-in of Wage Limitation

- The wage limitation (the greater of 50% of wages or 25% of wages + 2.5 assets) phases in when the taxpayer's taxable income exceeds the threshold amount of $157,500 ($315,000 in the case of a joint return).

- If the taxpayer’s taxable income does not exceed $315,000 MFJ then the wage limitation rules do not apply and the taxpayer’s deduction is 20% of QBI subject to the lower of 20% of taxable income. Conversely, if the taxpayer’s taxable income is above $415,000, then the wage limitation is fully phased-in.

- Same rules apply for the phase-in: $100,000 phase-in range for MFJ and $50,000 for all other taxpayers.

- Sounds complex – yes it is. I have examples to help explain how it works.

Qualified Business Income Deduction
Specified Service Business

- **Example 1**:
  - Taxpayer A is a medical professional and files MFJ. His taxable income is $300,000, A's share of his medical profession QBI K-1 income is $200,000, his allocable share of K-1 W-2 wages is $70,000 and assets is $20,000
  - A gets a deduction for $200,000 * 20% = $40,000 No phase-out for A as his taxable income is below $315,000. Also, no wage limitation is applied.
- **Example 2**:
  - Same as example 1, but A's taxable income is $345,000.
  - Step 1: Determine phase-out percentage:
    a) A's phaseout is $345,000-$315,000 = $30,000. $30,000/$100,000 = 30%. Inverse is 70% or the allowable percentage.

Qualified Business Income Deduction
Specified Service Business

- Step 2. Determine Allocable phase-out of QBI, Wages, and Assets

  a) QBI: $200,000 * .70% = $140,000

  b) Wages: $70,000 * .70% = $49,000

  c) Wages + Assets: $49,000 + ($20,000 * 70% = $14,000)

- Step 3. Determine Deductible share of QBI, Wages, and Assets

  a) QBI: $140,000 * 20% = $28,000

  b) Wages: $49,000 * 50% = $24,500

  c) Wages + Assets ($49,000 * 25% = $12,250) + ($14,000 * 2.5% = $350)
     $12,250 + $350 = $12,600

Qualified Business Income Deduction Specified Service Business

- Step 4. Determine Wage Phase in Limitation

  a) QBI: $140,000 * .20% = $28,000

  b) Wages: $49,000 * 50% = $24,500

  c) Difference between $28,000 - $24,500 = $3,500

  d) $3,500 * 30% = $1,050.

  e) $28,000 - $1,050 = $26,950 A"s deduction

Qualified Business Income Deduction
Specified Service Business

- Example from Senate Finance Committee:

- For example, Taxpayer has taxable income of $280,000, of which $200,000 is attributable to an accounting sole proprietorship after paying wages of $100,000 to employees. Taxpayer has an applicable percentage of 40 percent. In determining includible qualified business income, Taxpayer takes into account 40 percent of $200,000, or $80,000. In determining the includible W-2 wages, Taxpayer takes into account 40 percent of $100,000, or $40,000. Taxpayer calculates the deduction by taking the lesser of 23 percent of $80,000 ($18,400) or 50 percent of $40,000 ($20,000).

- Taxpayer takes a deduction for $18,400.

- Why did we not go through Step 4 of the wage limitation computation on Example 2? Because 20% of QBI is lower than 50% of wages. It was not necessary to go through Step 4.

- CAUTION: EXAMPLE ABOVE IS BEFORE THE FINAL CONFERENCE REPORT. THEREFORE, PHASE-OUT AMOUNTS AND %'S ARE DIFFERENT THAN FINAL LAW.

Qualified Business Income Deduction
Specified Service Business

- **Example 3**:
  - Same as example 1, but A's taxable income is $425,000.

- A gets no deduction. A's taxable income is above $415,000 the phase-out cap.

- A gets no deduction because his activity is a specified service activity and his taxable income is above the phase-out cap. Compare that with the following examples of taxpayers with no specified service activity income.

Qualified Business Income Deduction
Not a Specified Service Business

- Example from Senate Finance Committee:

- H and W file a joint return on which they report taxable income of $520,000 (determined without regard to this provision). H is a partner in a qualified trade or business that is not a specified service business (“qualified business A”). W has a sole proprietorship qualified trade or business that is a specified service business (“qualified business B”). H and W also received $10,000 in qualified REIT dividends during the tax year.

- H's allocable share of qualified business income from qualified business A is $300,000, such that 23 percent of the qualified business income with respect to the business is $69,000. H's allocable share of wages paid by qualified business A is $100,000, such that 50 percent of the W-2 wages with respect to the business is $50,000. As H and W's taxable income is above the threshold amount for a joint return, the application of the wage limit for qualified business A is phased in. Accordingly, the $69,000 amount is reduced by 20 percent of the difference between $69,000 and $50,000, or $3,800. H's deductible amount for qualified business A is $65,200.

  - CAUTION: EXAMPLE ABOVE IS BEFORE THE FINAL CONFERENCE REPORT. THEREFORE, PHASE-OUT AMOUNTS AND %'S ARE DIFFERENT THAN FINAL LAW.

Qualified Business Income Deduction
Not a Specified Service Business

- **Example 4**:
  - H and W are married. H and W taxable income for the year is $650,000. H and W each own 100% of separate LLC's that are not specified services business.
  - H's QBI is $200,000, allocable wages are $40,000, unadjusted basis of depreciable assets are $50,000
  - W's QBI is $250,000, $0 allocable wages, and $2.5M of unadjusted basis of depreciable fixed assets

    1. H computes his deduction the lesser as follows:
       a) $200,000 * 20% = $40,000, or the greater of b or C
       b) $40,000 * 50% = 20,000
       c) ($40,000 * 25% = $10,000) + ($50,000 * .2.5% = $1,250) =$11,250

- H gets $20,000 deduction.

Qualified Business Income Deduction
Not a Specified Service Business

- **Example 4 continued**:
  - H and W are married. H and W taxable income for the year is $650,000. H and W each own 100% of separate LLC's that are not specified services business.
  - H's QBI is $200,000, allocable wages are $40,000, unadjusted basis of depreciable assets are $50,000
  - W's QBI is $250,000, $0 allocable wages, and $2.5M in unadjusted basis of depreciable fixed assets

    1. W computes her deduction the lesser as follows:
        a) $250,000 * 20% = $50,000, or the greater of b or C
        b) $0 * 50% = $0
        c) (0 * 25% = $0) + ($2,500,000 * 2.5% = $62,500) =$62,500

- W gets $50,000 deduction.

Qualified Business Income Deduction
Not a Specified Service Business

- **Example 5**:
  - H and W are married. H and W taxable income for the year is $375,000. W owns 100% of an LLC that is not a specified services business.
  - W's QBI is $75,000, $20,000 allocable wages, and $0 of unadjusted basis of depreciable fixed assets.
  - Step 1: Determine wage phase-in percentage

    a) W's phaseout is $375,000-$315,000 = $60,000. $60,000/$100,000 = 60%. Inverse is 40% or the allowable percentage.

Qualified Business Income Deduction
Not a Specified Service Business

- **Example 5 Continued**:
  - H and W are married. H and W taxable income for the year is $375,000. W owns 100% of an LLC that is not a specified services business.
  - W's QBI is $75,000, $20,000 allocable wages, and $0 of unadjusted basis of depreciable fixed assets.

  - Step 2. Determine Deductible share of QBI, Wages, and Assets

    a) QBI: $75,000 * 20% = $15,000

    b) Wages: $20,000 * 50% = $10,000

    c) Wages + Assets ($20,000 * 25% = $5,000) + ($0 * 2.5% = $0)
       $5,000 + $0 = $5,000

Qualified Business Income Deduction
Not a Specified Service Business

- **Example 5 Continued**:
  - H and W are married. H and W taxable income for the year is $375,000. W owns 100% of an LLC that is not a specified services business.
  - W’s QBI is $75,000, $20,000 allocable wages, and $0 of unadjusted basis of depreciable fixed assets.

  - Step 4. Determine Wage Phase in Limitation

    a) QBI: $75,000 * .20% = $15,000

    b) Wages: $20,000 * 50% = $10,000

    c) Difference between $15,000 - $10,000 = $5,000

    d) $5,000 * 60% = $3,000.

    e) $15,000- $3,000 = $12,000 W”s deduction

Qualified Business Income Deduction How Does Carryover Losses Work

Taxpayer has qualified business income of $20,000 from qualified business A and a qualified business loss of $50,000 from qualified business B in Year 1. Taxpayer is not permitted a deduction for Year 1 and has a carryover qualified business loss of $30,000 to Year 2. In Year 2, Taxpayer has qualified business income of $20,000 from qualified business A and qualified business income of $50,000 from qualified business B. To determine the deduction for Year 2, Taxpayer reduces the 20% deductible amount determined for the qualified business income of $70,000 from qualified businesses A and B by 20% of the $30,000 carryover qualified business loss.

Limitation on Excess Business Deductions

- IRC Code Section 461(I) – Limitation on Excess Business Loss of Noncorporate Taxpayers

- Applies to all taxpayers other than C corporations. For partnerships and S corporations the rules apply at the partner and shareholder level, respectively. I would assume applies to trusts and estates also.

- Excess business losses are defined as the:

  - Excess of trade or business deductions over trade or business income, plus $250,000 or $500,000 for married filing jointly

- Any excess business losses are treated as an NOL under Section 172 in next year.
  - Apparently, IRC 461(I) is designed to restrict taxpayers from using current trade or business losses to offset other income in a taxable year.

- These rules apply after the passive loss rules.

- We will have to wait for regulations to define trade or business deductions/income.

Limitation on Excess Business Deductions

- So how's this going to work?

  - Example 1: In year 1, Taxpayer A has a 50% interest in partnerships P and Z. Partnership P generates an allocable loss to A of $625,000. Partnership Z generates allocable income to A of $225,000. A also has investment income of $75,000. Assume Taxpayer A materially participates in partnership P and Z.

  - Taxpayer A has excess business losses of (($625,000) - $225,000) + $250,000 = ($150,000).

  - The $150,000 excess business loss cannot be used to offset the investment income of $75,000 and must be carried forward as an NOL available in year 2.

- Presumably these rules will allow spouses to offset each other's activities.

Qualified Improvement Property

- From 2015 until 2017, certain capitalized improvements to nonresidential real property are grouped into various categories:

  - (1) qualified improvement property,
  - (2) qualified leasehold improvement property,
  - (3) qualified restaurant property, and
  - (4) qualified retail improvement property.

- In general, the above was assigned 15 year MACRS life and is defined as improvements to the interior portion of nonresidential real estate.

- The grouping above (1-4) do not include (1) enlargements of the building, (2) any elevator or escalator, or (3) internal structural framework of the building.

- For tax year 2017, qualified improvement property, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property are all eligible for 50% bonus depreciation and Section 179 expensing election.

Qualified Improvement Property

- Starting in 2018, the following categories were eliminated:

    - (1) qualified leasehold improvement property,
    - (2) qualified restaurant property, and
    - (3) qualified retail improvement property.

- Starting in 2018, only qualified improvement property remains and is eligible for bonus depreciation and Section 179 expensing election.

- No change in definition of qualified improvement property: interior portion of nonresidential real estate, 15 year MACRS life, and no (1) enlargements of the building, (2) any elevator or escalator, or (3) internal structural framework of the building.

Bonus Depreciation

- Bonus depreciation increases from 50% in 2017 to 100% in 2018.
- Effective for property acquired and placed in service after September 27, 2017. Property acquired before September 27, 2017, but placed after September 27, 2017 still retains 50% bonus.
- Bonus depreciation runs at 100% through December 31, 2022. Thereafter, decreases by 20% per year until zero availability in 2027.
- Bonus now is available for assets whose original use did not begin with the taxpayer.
- Adds requirement that property cannot be acquired from related parties, controlled groups, or carryover basis transactions.
- Qualified improvement property is still eligible for bonus (15 year life).
- Public utility property and vehicle dealer property (floor plan financing) are excluded from bonus. Vehicle dealer property can be eligible, if the taxpayer meets the small business gross receipts rules.

Section 179 Expensing Election

- In 2017, taxpayers may expense tangible fixed asset acquisitions up to $510,000 not to exceed total tangible fixed assets acquisitions in the current year of $2,030,000.

- Property eligible for Section 179:
  - New or used tangible personal property depreciated under MACRS
  - Used in the United States in an active conduct of a trade or business
  - Property not used in lodging activities (lodging is defined as multi-family units i.e. apartments only).
  - Property used in motels, hotels, inn (used 30 days or less okay)
  - Not used in a tax-exempt entity.
  - Qualified real property (if an election is made)

Section 179 Expensing Election

- Starting in 2018, taxpayers may expense tangible fixed asset acquisitions up to $1,000,000 not to exceed total tangible fixed asset acquisitions in the current year of $2,500,000.

- Starting in 2018, new types of property eligible for Section 179:
  - property used in lodging activities (lodging is defined as multi-family units i.e. apartments, dormitory, other type of facility where sleeping accommodations are provided),
  - **roofs,
  - **HVAC systems,
  - **fire protection and alarm systems; and
  - **security systems.

- ** Nonresidential real property only. Does not apply to residential property.

Changes to Net Operating Losses

- Prior to 2018, Net Operating Losses (NOL's) could be carried back 2 years and forward 20 years. In addition, NOL's could be used to offset 100% of taxable income.
- Starting in 2018, NOL's cannot be carried back 2 years, except for certain farming and insurance company losses, and NOL's are now carried forward indefinitely.
- For NOL's generated in 2018 and beyond they will be subject to a 80% of taxable income limitation and can be carried forward indefinitely.
- For NOL's generated prior to January 1, 2018, they are not subject to the 80% and have a 20 year carryforward period. Presumably, we will have to keep track of pre and post NOL's.

Changes to Methods of Accounting

- After December 31, 2017, C corporations and partnerships with a C corporation partner can now use the cash basis method of accounting if their average annual gross receipts in the preceding three years do not exceed $25M (IRC 448(c)). Beginning after December 31, 2018, the $25M is indexed for inflation

- After December 31, 2017, taxpayers that meet the $25M test above under IRC 448(c) are not required to maintain inventories under IRC Section 471, but rather may use a method of accounting for inventories that either:
  - treats inventories as non-incidental materials and supplies, or
  - conforms to the taxpayer's method of accounting reflected in an "applicable financial statement" (AFS) or, if the taxpayer does not have an AFS, the taxpayer's books and records prepared in accordance with the taxpayer's accounting procedures.

Changes to Methods of Accounting

- After December 31, 2017, taxpayers who meet the $25M under IRC 448(c) are not required to include additional costs under IRC 263A (the UNICAP rules). This includes the following:

  - both producers and resellers of property.
  - both personal and real property.

- Congress codified Rev Proc 2004-34 the exception for advance payments or deposits to provide goods or services under the accrual method.

- Starting after 2021, R&D expenses will be required to be capitalized and amortized over a five year period.

Net Business Interest Limitations

- In general, trade or business interest expense is fully deductible. Starting on January 1, 2018, the deduction for trade or business interest is limited.

- Applies to all taxable persons, including C corporations.

- The deduction for business interest cannot exceed the sum of:

  - The taxpayer’s business interest income for the year;
  - 30% of the taxpayer’s adjusted taxable income for the year; plus
  - The taxpayer’s floor financing interest for the tax year.

- Effectively, floor financing of motor vehicles, boats, and farming equipment is exempt from the limitation.

- Any interest expense limited under these provisions is carried forward indefinitely.

Net Business Interest Limitations

- Example 1: Corporation X has $20,000 of adjusted taxable income, $1,000 of business interest income, and $9,000 of interest expense

  - Corporation X’s interest expense deduction is limited to ($20,000* 30% = $6,000) + $1,000 = $7,000. The $2,000 limited is carried forward and treated as interest paid or accrued in the next year.

- Adjusted Taxable Income defined as the taxpayer’s taxable income computed without regard to:
  - any item of income, gain, deduction, or loss that isn’t allocable to a trade or business;
  - any business interest or business interest income;
  - net operating losses;
  - Qualified business income deduction;
  - Depreciation, amortization, or depletion (for taxable years before January 1, 2022), and
  - any other adjustment the IRS chooses to throw in.

Net Business Interest Limitations

- Small Business Exception: Business interest limitation does not apply to a taxpayer that meets the $25M gross receipts test of Code Section 448(c)

  - the test is met if the taxpayer's average annual gross receipts for the three-tax-year period ending with the prior tax year do not exceed $25M.

- Well that seems pretty simple. We just look at each entity and if the gross receipts do not exceed $25M, we are good to go. Regrettably, it does not exactly work that way.

- Aggregation rules for testing $25M – taxpayers must group or aggregate all persons as one person under IRC Section 448(c)(2) in order to determine whether the $25M gross receipts test is met or not.

Net Business Interest Limitations

➢ Other exceptions/exclusions from the interest limitation:

- Trade or business of performing services as an employee,
- Electing real property trades or business,
- Electing farming businesses; and
- Certain regulated public utilities.

ADS Election for Real Property Trades or Businesses

- Electing real property trades or businesses who are subject to the new 30% interest limitation can elect to use ADS depreciation as a get out of jail card. Once made, the election is irrevocable.

- A new term of art: "electing real property trade or business".

- Electing real property trade or business is any trade or business that is a real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

- This definition is intended to include real property trades or businesses conducted by a corporation or a real estate investment trust (REIT). It's also intended that operating or managing a lodging facility is a real property operation or management trade or business.

- At the taxpayer's election, the business interest limitation doesn't apply to electing real property trades or businesses.

ADS Election for Real Property Trades or Businesses

- Non-residential real property is depreciated straight-line over 40 years for ADS.
- Residential real property is depreciated straight-line over 30 years for ADS.
- Qualified improvement property is depreciated straight-line over 20 years for ADS
- Bonus depreciation is not available under ADS (unless ADS is an election and not mandatory).
- For purposes of electing real property trades or business it appears that qualified improvement property would not qualify for bonus depreciation. The MACRS life does not exceed 20 years, but ADS is a mandatory method (reg. 1.168-(k)(b)(2)).

Net Business Interest Limitations
Pass-Through Entities

- How does this work with pass-through entities?

- The business interest limitation applies to partnerships at the partnership level. Any deduction for interest is taken into account under box 1 of the K-1.

- Double-counting rule: each partner's adjusted taxable income is determined without the partner's distributive share of partnership K-1 items.

- Double-counting rule Example A:
  - ABC partnership is owned 50-50 by XYZ Corporation and taxpayer A. ABC generates $200 of business gross income and $60 on interest expense.
  - ABC business interest deduction is limited to $200*.30 = $60.
  - XYZ Corporation's K-1, box 1 reports $70 of income.
  - In the absence of the double-counting rule XYZ would be able to deduct an additional $21 of interest ($70*.30 = $21).

Net Business Interest Limitations
Pass-Through Entities

- Each partner's adjusted taxable income is increased by the partner's distributive share of the partnership's excess taxable income.

- This rule allows a partner to increase available taxable income to deduct additional interest expense.

- Same facts as Example A except that ABC has only $40 of interest expense. ABC has a total cap available of $60. ABC's excess taxable income is computed as (($20/$60)*$200 = $66.67)). XYZ distributive share of excess taxable income is ($33.34 *30% = $10) which it can use on its own return.

- IRC Section 163(j)(4)(D) similar rules are to apply to S corporations. Apparently Congress ran out of time to do S corporation examples.

Net Business Interest Limitations
Pass-Through Entities

- Carryforwards: The general carryforward rules mentioned earlier do not apply to pass-through entities.
- Any business interest that is not deductible at the partnership level due to these rules is not treated as a business interest paid or accrued by the partnership in the next year.
- The excess business interest is allocated to each partner in the same manner as nonseparately stated taxable income or loss.
- The excess business interest is treated as business interest paid or accrued by the partner in the next succeeding tax year to be deducted only to the extent of excess taxable income allocated from that partnership. IRC Section 163(j)(4)(B)(ii)(i)
- .

Net Business Interest Limitations
Pass-Through Entities

- The partner's adjusted basis is reduced (but not below zero) by the amount of the excess business interest allocated to the partner even though the partner did not get the benefit of the deduction in the current year.

- The partner's deduction in the succeeding years does not reduce basis.

- Apparently, the above rules (basis adjustment) do not apply to S corporations and their shareholders.

Changes to Meals and Entertainment

- Entertaining, amusement, and recreation is no longer deductible starting in 2018.
- Taking clients out to meals is still deductible, subject to 50% limitation.
- Employee meals while traveling is still deductible, subject to 50% limitation
- Meals provided on premises cafeteria are 50% deductible until 2025 and then no longer deductible
- Office holiday parties – no change
- Meals provided for employees used to be 100% deductible, that is now 50% deductible.

New Employer Credit for Paid Family and Medical Leave

- New 12.5% credit on wages paid to employees due to family and medical leave absences.

- Family and medical leave absences are:

  - Because of the birth of a son or daughter of the employee and to care for that son or daughter.
  - Because of the placement of a son or daughter with the employee for adoption or foster care.
  - To care for the spouse, or a son, daughter, or parent, of the employee, if that spouse, son, daughter, or parent has a serious health condition.
  - Because of a serious health condition that makes the employee unable to perform the functions of the position of that employee.
  - Because of any qualifying exigency (as determined by the Secretary of Labor) arising out of the fact that the spouse, or a son, daughter, or parent of the employee is on covered active duty (or has been notified of an impending call or order to covered active duty) in the Armed Forces.
  - FMLA section 102(a)(3) provides for leave for an eligible employee who is the spouse, son, daughter, parent, or next of kin of a covered veteran or member of the Armed Forces.

New Employer Credit for Paid Family and Medical Leave

- Employee absences under vacation, sick time, or personal time are not counted.

- Business credit under Section 38.
- Reduces AMT.
- Expires for wages paid after tax years December 31, 2019. Credit is eligible for wages paid in calendar year 2018 and 2019.

- Employer must have a written policy of: (1) not less than two weeks of paid family and medical leave (full-time employees) and (2) rate of payment cannot be less than 50% of normal wages. Part-time employees get some weird formula that I am too tired while I typing this to figure out.
- Example 1:
    - Employer pays $10,000 of wages to qualifying employees during a period in which those employees are on family and medical leave. This amount is 50% of the wages normally paid to the employees for services rendered to the employer. Employer can claim a paid family and medical leave credit of 12.5% of $10,000, or $1,250.

Credit for Qualified Rehabilitation Expenditures

- Prior to TCJA – taxpayers would qualify for a credit of either 10% or 20% on QRE on rehabilitation expenditures on buildings/structures that were either placed in service before 1936 (10% credit) or were designated as a Certified Historic Structure (20%) credit.

- Under the TCJA the 10% credit is repealed and the 20% credit is kept in place.

- Under the TCJA the 20% credit must be taken ratably over a five year period.

Like-Kind Exchange Limitations

- Prior to TCJA – a taxpayer did not recognize gain or loss on exchange of like-kind property if both the relinquished and held for use in a trade or business or for investment purposes.

- Prior to TCJA – property eligible for tax-free exchange deferral included real property, personal property, including intangible personal property such as patents and intellectual property. Inventory, stocks, bonds, notes, or other securities were not eligible for like-kind exchange deferral.

- For exchanges completed after December 31, 2017 only exchanges of real property for real property are eligible for Section 1031 non-recognition of gain or loss deferral.

- Example 1 - Corporation A, purchased a F-350 in 2011 and fully depreciated it as of December 31, 2017. On January 10, 2018, A trades in the F-350 for new F-350 worth $60,000. The Ford dealer gives A $7,500 trade-in allowance for the old F-350. Prior to TCJA A would not have recognized a $7,500 gain. A would have rolled the gain into the basis of the new truck. After TCJA – A must recognize the $7,500 gain.

Like-Kind Exchange Limitations

- Example 2 – Partnership P owns multi-family real estate Y. On January 20, 2018, P enters into an exchange agreement with B to exchange Y for multi-family real estate X. The exchange closed in April of 2018.

  - P had a cost segregation study done on Y which found $750,000 of personal property in Y. At the time of the exchange Y's tax basis in the personal property is zero. P reasonably concludes the FMV of the personal property at exchange to be $250,000.

  - P must now recognize a gain of $250,000 on the exchange.

  - Prior to TCJA P could have had a cost segregation study performed on X which would have determined $250,000 FMV of personal property in X to exchange.

  - What are the options open to P to mitigate the taxable gain?

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Questions?

Timothy M. Tikalsky, Stockholder, CPA

RINA accountancy corporation

201 North Civic Dr., Suite 220

Walnut Creek, CA 94596

925-210-2180

www.rina.com