THE TAX CUTS AND JOBS ACT

INDIVIDUALS

The "Tax Cuts and Jobs Act" contains numerous provisions that will have a significant impact on the tax liability reported by individuals and families. Some of the more important provisions are summarized below. There are many additional provisions in this legislation impacting individuals that are not addressed here.

Tax Rate Structure on Ordinary Income

Beginning in 2018, the current rate structure for individuals, which ranges from 10% to 39.6%, will be replaced by the following:

2018 Tax Rates Before Tax Legislation				
Rate	Married - Joint Return	Married - Separate	Head of Household	Single
10%	$0 - $19,050	$0 - $9,525	$0 - $13,600	$0 - $9,525
15%	$19,051 - $77,400	$9,526 - $38,700	$13,601 - $51,850	$9,526 - $38,700
25%	$77,401 - $156,150	$38,701 - $78,075	$51,851 - $133,850	$38,701 - $93,700
28%	$156,151 - $237,950	$78,076 - $118,975	$133,851 - $216,700	$93,701 - $195,450
33%	$237,951 - $424,950	$118,976 - $212,475	$216,701 - $424,950	$195,451 - $424,950
35%	$424,951 - $480,050	$212,476 - $240,025	$424,951 - $453,350	$424,951 - $426,700
39.6%	> $480,050	> $240,025	> $ 453,350	> 426,700

The Tax Cuts and Jobs Act				
Rate	Married - Joint Return	Married - Separate	Head of Household	Single
10%	$0 - $19,050	$0 - $9,525	$0 - $13,600	$0 - $9,525
12%	$19,051 - $77,400	$9,526 - $38,700	$13,601 - $51,800	$9,526 - $38,700
22%	$77,401 - $165,000	$38,701 - $82,500	$51,801 - $82,500	$38,701 - $82,500
24%	$165,001 - $315,000	$82,501 - $157,500	$82,501 - $157,500	$82,501 - $157,500
32%	$315,001 - $400,000	$157,501 - $200,000	$157,501 - $200,000	$157,501 - $200,000
35%	$400,001 - $600,000	$200,001 - $300,000	$200,001 - $500,000	$200,001 to $500,000
37%	> $600,000	> $300,000	> $500,000	> $500,000

The Act creates special rules for the treatment of "passthrough" income attributable to certain types of businesses. The legislation provides a 20% tax deduction for income attributable to a business organized as a sole proprietorship, partnership, limited liability company or an S corporation (as discussed more fully in the "Business Entities" section). It should be noted here that the deduction is limited for certain businesses providing health, law, consulting, athletics, financial, or brokerage services. For income attributable to these businesses, the deduction is only available for taxpayers with incomes up to $315,000 ($157,500 for a single individual), with a phase-out of these limitations over the next $100,000 of taxable income for married individuals filing jointly ($50,000 for individuals). These low threshold amounts are intended to deter high-income

taxpayers from attempting to convert wages or other compensation for personal services to income eligible for the 20% deduction.

Tax Rate Structure on Capital Gains and Dividends

Income from capital gains and dividends will continue to be taxed at the same rates – generally 20% or 15% for net capital gains and qualified dividends. The 3.8% net investment income tax will remain in place.

Standard and Itemized Deductions

Under current law, the standard deduction for a single individual is $6,350 and the standard deduction for joint filers is $12,700. The legislation increases the standard deduction for single individuals to $12,000 and to $24,000 for joint filers. It is estimated that, with the increased standard deduction, as many as 90% of taxpayers will claim the standard deduction in lieu of itemizing. The Act also repeals the "Pease Limitation," which imposes a limitation on itemized deductions. In addition, the legislation eliminates or severely limits the following itemized deductions through 2025:

- State and local taxes, including income taxes, sales taxes and property taxes are limited to an aggregate $10,000 cap unless incurred in a trade or business or for the production of income;
- Personal casualty losses, subject to limited exceptions;
- Medical expenses (7.5% adjusted gross income floor for deducting medical expenses in 2018);
- Alimony payments for divorces or separations after December 31, 2018;
- Moving expenses;
- Wagering losses only allowed to the extent of gains; and
- Qualified moving expense reimbursements.

Personal Exemption

Current law provides that a taxpayer is permitted to claim a personal exemption deduction of $4,050 for himself or herself, his or her spouse and his or her dependents. The legislation eliminates the deduction for personal exemptions until 2026.

Child and Qualifying Dependent Tax Credits

The child tax credit will increase from $1,000 to $2,000 for qualifying children under the age of 17. $1,400 of the child tax credit is refundable and this amount is indexed for inflation.

In addition, there is a $500 nonrefundable credit for qualifying dependents other than qualifying children.

Health Insurance Mandate

The legislation repeals the individual mandate to buy health insurance, effective January 1, 2019.

Exclusion of Gain From Sale of Personal Residence

Current law provides that an individual can exclude up to $250,000 of gain attributable to the sale of his or her residence (this exclusion is $500,000 for joint filers) provided that the residence was owned and used as the individual's primary residence for at least two out of the last five years. The Act changes the qualifying period for a principal residence to five out of the last eight years.

Mortgage Interest Deduction

The Act limits the mortgage interest deduction on a principal residence to debt of $750,000 (down from $1 million). Debt incurred prior to December 15, 2017 is "grandfathered" and not subject to this reduced limitation. The Act eliminates the ability to deduct interest on home equity indebtedness.

State and Local Tax Deductions

As noted above, the Act limits total SALT deductions, including real property taxes, income taxes and sales taxes to $10,000 for joint filers or $5,000 for married taxpayers filing a separate return. This limitation does not apply if the state and local taxes are incurred in a trade or business (including rental property in a trade or business). Foreign real property taxes are not deductible.

Alternative Minimum Tax

The Act increases both the exemption amount and the phaseout thresholds for individual AMT. The AMT exemption amount is increased from $86,200 to $109,400 for joint filers and from $55,400 to $70,300 for individual filers. The phaseout thresholds are increased to $1 million for joint filers and $500,000 for all other taxpayers other than estates and trusts. These amounts are indexed for inflation.

Like-Kind Exchanges

Like-kind exchanges will be limited to real property, excluding tangible or intangible property. As under current law, real property located in the United States will still not be considered like-kind with respect to real property located outside of the United States and like-kind exchange deferral is not available for real property held primarily for sale.

ESTATE AND GIFT TAX

Exemption Thresholds

Effective January 1, 2018, the exemption against estate tax and gift tax is doubled and remains indexed for inflation. This means that for gifts made in 2018 or decedents dying in 2018, the exemption is $11.2 million which is double the exemption which would have been in place without the new law. This also means that married couples, with effective planning, can transfer at least $22.4 million without estate and gift tax. The generation-skipping transfer tax exemption also increases to $11.2 million ($22.4 million per couple) on January 1, 2018, and will continue to be indexed for future inflation.

These increased exemption amounts apply only to gifts made, decedents dying, or generation-skipping transfers occurring during the 2018 to 2025 tax years. On January 1, 2026, absent further legislation, the exemptions revert to current law ($5 million plus inflation since 2011). Depending on inflation between now and then, the exemption in 2026 would be somewhere around $6.5 million per person / $13 million per couple.

529 Plans

529 plans which permit tax-free growth of funds in those plans, as long as the funds were eventually used for college or graduate school expenses, have been expanded. As of January 1, 2018, up to $10,000 per student per year can be used for tuition at public, private or religious elementary or secondary schools. In addition, certain expenses related to homeschooling can be paid from 529 plans.

Items Not Impacted

Items not changed from current law:

The tax rate on gifts, estates or generation skipping transfers above the exemption amount remains a flat 40%. (There is no California estate tax, gift tax or GST tax).

The gift tax, estate tax and GST tax is not repealed currently or at any future date (the House bill would have repealed estate tax and GST tax as of January 1, 2025).

The gift tax "annual exclusion" remains at its prior $10,000, indexed for inflation, which means that for gifts made in 2018, the inflation-adjusted annual gift tax exclusion is $15,000.

For those estates that are still taxable, discount planning remains alive and well as the 2704 proposed regulations were withdrawn and nothing in the Act affects that either.

In short, the estate tax, gift tax and generation-skipping transfer tax are not repealed, and the increased exemptions revert to prior law in 2026. Therefore, proper estate and gift planning remains vital for estates of all sizes.

BUSINESS ENTITIES

Numerous provisions of the Act impact the taxation of corporations, S corporations, partnerships and limited liability companies. Some of the key highlights:

Corporate Rates

In what is undoubtedly its centerpiece, the Act eliminates the current corporate tax rate structure with a maximum rate of 35%, and instead imposes a maximum corporate tax rate of 21%. This rate is made permanent unlike many other provisions in this Act. The dividends received deduction ("DRD") for dividends from 20% owned corporations is lowered from 80% to 65% and the DRD for less than 20% owned corporations is lowered from 70% to 50%.

Passthrough Rates

In addition, there is now a 20% deduction on an individual's domestic qualified business income from a partnership, LLC, S corporation or sole proprietorship. This deduction is generally limited to the greater of: (i) 50% of the entity's W-2 wages with respect to a qualified trade or business; or (ii) 25% of the taxpayer's W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property. This law is not made permanent under the Act. As discussed in more detail in the "Individuals" section, the deduction generally does not apply to income for performance of services in the fields of health, law, engineering, architecture, accounting, financial services, brokerage services, or consulting.

Depreciation

The Act increases bonus depreciation from 50% to 100% for property placed in service after September 23, 2017 but before January 1, 2023. It also provides a phase down of the bonus depreciation, allowing an 80% deduction for property placed in service in 2023, a 60% deduction for property placed in service in 2024, a 40% deduction for property placed into service in 2025, and a 20% deduction for property placed in service in 2026. Qualified property includes property that is used but is acquired after the applicable date so long as the acquiring taxpayer had not previously used the acquired property and so long as the property is not acquired from a related party. In addition, there is now a new category of qualified property that includes qualified film, television, and live theatrical productions, effective for productions placed in service after September 27, 2017 but before January 1, 2027. A production is treated as placed in service on the first date it is made commercially available to the public.

The applicability of this provision to acquired property may impact the way that M&A transactions are structured as it may incentivize buyers to structure the transaction as an actual or deemed asset purchase in order to get the benefit of the 100% expensing in the first tax year. Sellers should quantify this tax benefit and ask for a corresponding increase to the purchase price.

In order to help offset the costs of these provisions, the domestic manufacturing deduction has been repealed and certain R&D costs must now be capitalized beginning in 2022 and amortized

over a five year period (or 15 years if performed outside the U.S.). While the Act generally retains the 50% meals & entertainment deduction, it expands the 50% limitation for meals & entertainment provided to employees for the convenience of the employer on the business premises, or through an employer operated facility.

Net Operating Losses

Use of net operating losses ("NOLs") in a given year are limited to 80% of taxable income for tax years beginning after December 31, 2017 and ending before January 1, 2026. NOL carryforwards do not expire, which may have a significant impact on financial statement reporting because corporations will no longer have to reserve against their NOL deferred tax asset on their balance sheet. NOL carrybacks have generally been eliminated except in limited circumstances.

Capital Contributions

The Act provides that a "contribution to capital" of a corporation does not include: (i) any contribution in aid of construction or any other contribution as a customer or potential customer; and (ii) any contribution by any governmental entity or civic group (other than contribution made by a shareholder as such). This new definition of capital contribution is intended to limit federal tax subsidies for state and local incentives given to corporations in order to entice them to locate operations in the grantor's jurisdiction.

Net Business Interest Expense

The Act disallows a deduction for net business interest expense of any taxpayer in excess of 30% of the business's adjusted taxable income (including a floor for financing interest).

Corporate AMT

The Act repeals the corporate AMT.

Short-term Capital Gain on Applicable Partnership Interests

A part of the long term capital gain on the sale of an applicable partnership interest, generally an interest held in excess of a year, will be recharacterized as short term capital gain unless the interest is held for greater than three years. This section addresses the long-debated tax treatment of carried interests.

Terminated S Corporations

If taxpayers want to convert an existing S corp to a C corp as a result of the more favorable rules governing C corps, the Act contains rules that will make this conversion more tax efficient.

Qualifying Beneficiaries of Electing Small Business Trust

Nonresident alien individuals now may become beneficiaries of an electing small business trust.

NONPROFITS AND CHARITABLE GIVING

Charitable Giving

Provisions elsewhere in the legislation are likely to have the most significant impact on charitable giving. The charitable income tax deduction may only be claimed by donors who itemize their deduction in lieu of taking the standard deduction, which the legislation doubles. The congressional Joint Committee on Taxation estimates that the number of donors who will itemize their deductions (and qualify for income tax savings from charitable gifts) will fall from 40 million under current law to 9 million under the new law. This means than less than one-fourth as many Americans will have an income tax incentive to make a charitable contribution.

The other provision not directly targeted at the charitable sector, but which will likely have a major impact on charitable giving is the doubling of the exemption amounts for the estate and generation-skipping transfer taxes. Because many major gifts (both lifetime and testamentary) are motivated in part by estate tax avoidance, this change could have a major impact on American philanthropy.

Other changes:

- The limitation for deductibility of cash contributions to public charities in increased from 50% to 60% of adjusted gross income;
- The charitable deduction for amounts paid in exchange for college athletic seating rights is eliminated; and
- The authority of the IRS to prescribe a form to be included in the charity's Form 990 as an alternative means of substantiating charitable gifts is repealed.

Colleges and Universities

For the first time, there will be an excise tax of 1.4% on the net investment income of private colleges and universities with at least 500 tuition-paying students and with endowment assets of at least $500,000 per student. Assets and investment income of certain related entities are included in the calculation for the college or university.

Unrelated Business Income

- An organization with more than one business must compute UBTI separately for each business; and

- UBTI includes expenses incurred for certain employee fringe benefits (primarily for transportation, parking and on-premises athletic facilities) which are no longer deductible under the Act for taxable employers.

Executive Compensation

The Act imposes a 21% excise tax on an employer with respect to compensation in excess of $1 million, including non-cash benefits, paid by tax exempt organizations to a covered employee (generally one of the 5 highest paid employees). This new excise tax will apply to all organizations exempt under Code section 501(a) – not just charitable organizations.

Tax-Exempt Bonds

Advance refunding bonds used to refinance previously issued bonds at a lower rate are effectively eliminated by requiring bondholders to include interest on advance refunding bonds in taxable income.

INTERNATIONAL TAX

Shift From a World-Wide Taxing System to a Territorial Taxing System

The US has historically taxed income earned by foreign corporations when the income is paid to its US shareholders, with US shareholders being able to claim a foreign tax credit for certain foreign taxes paid by the foreign corporations. If certain anti-deferral rules (commonly referred to as the Subpart F rules) applied to a foreign corporation, then the Subpart F income would be taxable to the US shareholders even if the income was not distributed to the US shareholders.

Taxation of Income from Foreign Corporations arising after 12/31/2017

Under new Code Section 245A, a US corporate shareholder would be able to claim a 100% DRD for the foreign-source portion of the dividend. As a result, no additional US taxes would be imposed on the income earned by foreign corporations. Note that this DRD is not available for individuals or other non-corporate shareholders. Since the dividend is not subject to US tax, the provisions of Section 901 have been amended so that a foreign tax credit may no longer be claimed for any foreign withholding taxes imposed on that dividend; and no deduction may be taken for the foreign withholding taxes as well; Section 902 which permitted an indirect foreign tax credit to be claimed for foreign taxes paid by the distributing foreign corporate has been eliminated. Furthermore, Section 904 is amended so that the excluded dividends cannot be taken into account

in computing the US shareholder's foreign tax credit limitation. Lastly, Sections 964 and 1248 are be amended to clarify that the amounts included in income by the US shareholder under those sections are to be treated as dividends for purposes of Section 245A.

Taxation of Income from Foreign Corporations accumulated before 1/1/2018

Income accumulated and not distributed before the effective date of new Section 245A will not be eligible for the 100% DRD. Instead, Section 965 is amended to provide that the accumulated post-1986 deferred foreign income shall be included in the Subpart F income of a foreign corporation in its last taxable year beginning before January 1, 2018. As a result, all previously untaxed earnings of the foreign corporation will now become taxable; however, Section 965 allows for the US tax on that undistributed income to be paid over an 8 year period, and for the income to effectively be taxed at either 8% or 15.5%. The determination of the applicable rate will be based on the assets held by the foreign corporation with the 15.5% rate applicable to earnings held in cash or cash equivalents and the 8% rate applicable to all other earnings.

Unlike Section 245A, Section 965 applies to all US shareholders who hold at least a 10% voting interest in the foreign corporation, including individuals and S Corporations. Furthermore, under Section 962, individual shareholders can elect to have corporate tax rates apply so that the tax imposed on the previously undistributed income will be the same for all US shareholders.

Taxation of Global Intangible Low-Taxed Income

Under new Section 951A, a new category of Subpart F income has been created – global intangible low-taxed income ("GILTI"). GILTI is the excess of the US shareholder's net CFC tested income over the shareholder's net deemed tangible income return. Net deemed tangible income return is essentially a 10% return on the qualified business asset investment of each foreign corporation. Net CFC tested income is essentially the taxable income of the CFC that is not otherwise Subpart F income or a dividend from a related person. This results in income of a CFC that exceeds a 10% return on its tangible business assets, and that is not otherwise Subpart F income being classified as GILTI and the excess returns taxed in the US.

Section 960 is amended to provide that in the case of a US corporation which has to include GILTI in income, that corporation can claim a deemed foreign tax credit equal to 80% of the corporations inclusion percentage multiplied by the actual foreign taxes paid by the corporation on that GILTI. This will have the effect of reducing the actual US corporate tax paid by the US corporation on GILTI. It will also have the effect of increasing the number of individual 10% shareholders in foreign corporations making the Section 962 election to pay tax at corporate rates so that they can avail themselves of this beneficial foreign tax credit computation. Section 904 is amended to provide for a separate foreign tax limitation calculation for GILTI income, so that the deemed foreign tax credits cannot be used to offset US tax on other foreign source income.

In addition, new Section 250 allows a US corporation a deduction of 50% of the GILTI it includes in income under Section 951A (and the gross-up under Section 78 for any foreign taxes claimed as a foreign tax credit).

Export Incentives

New Section 250 also allows domestic corporations to deduct 37.5% of its foreign-derived intangible income. Foreign derived intangible income is determined taking into account income from sales of property to non-US persons for a foreign use, and services provided to any person not located in the US. Foreign derived intangible income is income in excess of a 10% return on qualified tangible business assets.

The Act is the most significant structural change to our federal tax system since 1986. There are many more detailed provisions than contained in this brief summary – some of which will be covered in future blog posts and MSK Tax Alerts. In the meantime, feel free to contact any member of the MSK Tax Practice Group if we can be of assistance.

David Wheeler Newman
(310) 312-3171
dwn@msk.com

Allan E. Biblin
(310) 312-3109
aeb@msk.com

Allan B. Cutrow
(310) 312-3744
abc@msk.com

Jeffrey D. Davine
(310) 312-3178
jdd@msk.com

Jeffrey K. Eisen
(310) 312-3144
jke@msk.com

Robin C. Gilden
(310) 312-3169
rcg@msk.com

Charles Kolstad
(310) 312.3738
csk@msk.com

Robert J. Lowe
(310) 312.3180
rlo@msk.com

S. Eva Wolf
(310) 312-3234
sew@msk.com

Daniel Cousineau
(310) 312-3117
dmc@msk.com