Overview of the Tax Cuts and Jobs Act

What Individuals and Business Owners Need to Know

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Introduction/Agenda

I. Overview of the Tax Cuts and Jobs Act and Future Outlook
II. Individual Estate Tax and Income Tax
III. Business Tax
IV. Employee Benefits and Executive Compensation

The Tax Cuts and Jobs Act (Pub. L. No. 115-97)

- Tax Cuts and Jobs Act: Timeline
  - November 2: Introduced in the House (HR 1)
  - November 6-9: House Ways and Means Committee marks up and reports out HR 1
  - November 13-16: SFC marks up and reports out its tax reform bill
  - November 14: House Rules Committee adopts rule for House consideration of HR 1
  - November 16: House of Representatives passes HR 1
  - November 28: Senate Budget Committee passes SFC tax reform bill
  - December 2: Senate passes HR 1 (with Senate amendment)
  - December 13: House-Senate Conferees meet in public session
  - December 19: House passes Conference Report
  - December 20: Senate passes Conference Report with modifications (51-48, Sen. McCain absent)
  - December 20: House passes modified conference report (224-201, 11 “blue state” Republicans plus Rep. Jones (R-NC) joining 189 Democrats voting against the measure)
  - December 22: Signed into law

- Tax Reform Act of 1986: Timeline
  - First significant W&M Committee vote occurred on October 15, 1985
  - Signed into law on October 22, 1986

Early Implementation Guidance

- IRS
  - IRS Advisory 2017-210: Deductibility of prepayment of state and local property taxes
  - Notice 2018-7: Guidance describing sec. 965 “toll tax” of accumulated foreign earnings
  - Notice 2018-8: Suspension of WH obligations for dispositions of PTP interests
  - Notice 2018-13: Additional guidance describing sec. 965 “toll tax”
  - IR 2018-05 (and Notice 1036): Updated 2018 Withholding Tables

- SEC
  - Staff Accounting Bulletin #118: While companies must reflect the income tax effects in the reporting period in which the Act was enacted if the accounting analysis is <u>complete</u>, companies can report as <u>provisional amounts</u> those effects that can be <u>reasonably estimated</u>. If no reasonable estimate is available, companies would continue to apply current law and provide a reasonable estimate in the first reporting period as determinable (with one year to complete)

- FASB meeting (Jan. 10)
  - SEC SAB #118 can be used by private companies and non-profits
  - Discounting of tax liability for sec. 965 and AMT credits
  - Other accounting issues related to HR 1

- Much more to come…

What To Expect Next?

- Critical need for corrections and guidance
  - Corrections range from typos to very substantive errors
  - Specific issue areas
    - Transition to, and adoption of, international territorial system
    - Global minimum tax and base erosion measures
    - 20% deduction for pass-through businesses
  - Legislative path
    - Technical corrections bill
    - Bi-partisan tax extenders legislation
    - Joint Committee on Taxation's "Blue Book"
    - Other approaches
- IRS/Treasury Implementation Guidance
  - Limited resources
  - Political environment
  - IRS Commissioner

What To Expect Next? (cont'd)

- "Big Picture" Political Hurdles
  - Funding Federal government for remainder of FY 2018 (Sept. 30, 2018)
    - Government funding until February 8
    - Issues include DACA/immigration, border wall, CHIP, natural disasters, and other health care changes
  - Debt Ceiling
    - Congress required to authorize the level of Federal borrowing ("debt ceiling")
    - The debt ceiling expired on December 8
    - Treasury has been using "extraordinary measures" (such as borrowing from government retirement programs) to finance the debt
    - Could run out of cash as early as March 9
  - Looming 2018 Elections
  - Senate Finance Committee Chairmanship
    - ➢ Chairman Hatch announced he is not seeking re-election in 2018
    - ➢ Chairman Grassley has two years remaining
    - ➢ Next in seniority is Chairman Crapo
    - ➢ Next in seniority is Chairman Roberts

Estate/Gift/GST Exemptions

	Federal Estate and Gift Tax Exemption	Federal Generation-Skipping Transfer (GST) Tax Exemption
2011	$5,000,000	$5,000,000
2012	$5,120,000	$5,120,000
2013	$5,250,000	$5,250,000
2014	$5,340,000	$5,340,000
2015	$5,430,000	$5,430,000
2016	$5,450,000	$5,450,000
2017	$5,490,000	$5,490,000
2018	~$11,180,000*	~$11,180,000*

Maryland Exemptions

	Maryland Estate Tax Exemption
2011	$1,000,000
2012	$1,000,000
2013	$1,000,000
2014	$1,000,000
2015	$1,500,000
2016	$2,000,000
2017	$3,000,000
2018	$4,000,000
2019	Match Federal Exemption*

* Footnote: Maryland Delegate James Tarlau is sponsoring a bill to decouple the Maryland estate tax exemption from the federal exemption. The bill will propose limiting the Maryland estate tax exemption to approximately $5 million rather than matching the Federal estate tax exemption in 2019.

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Planning Without Estate Tax

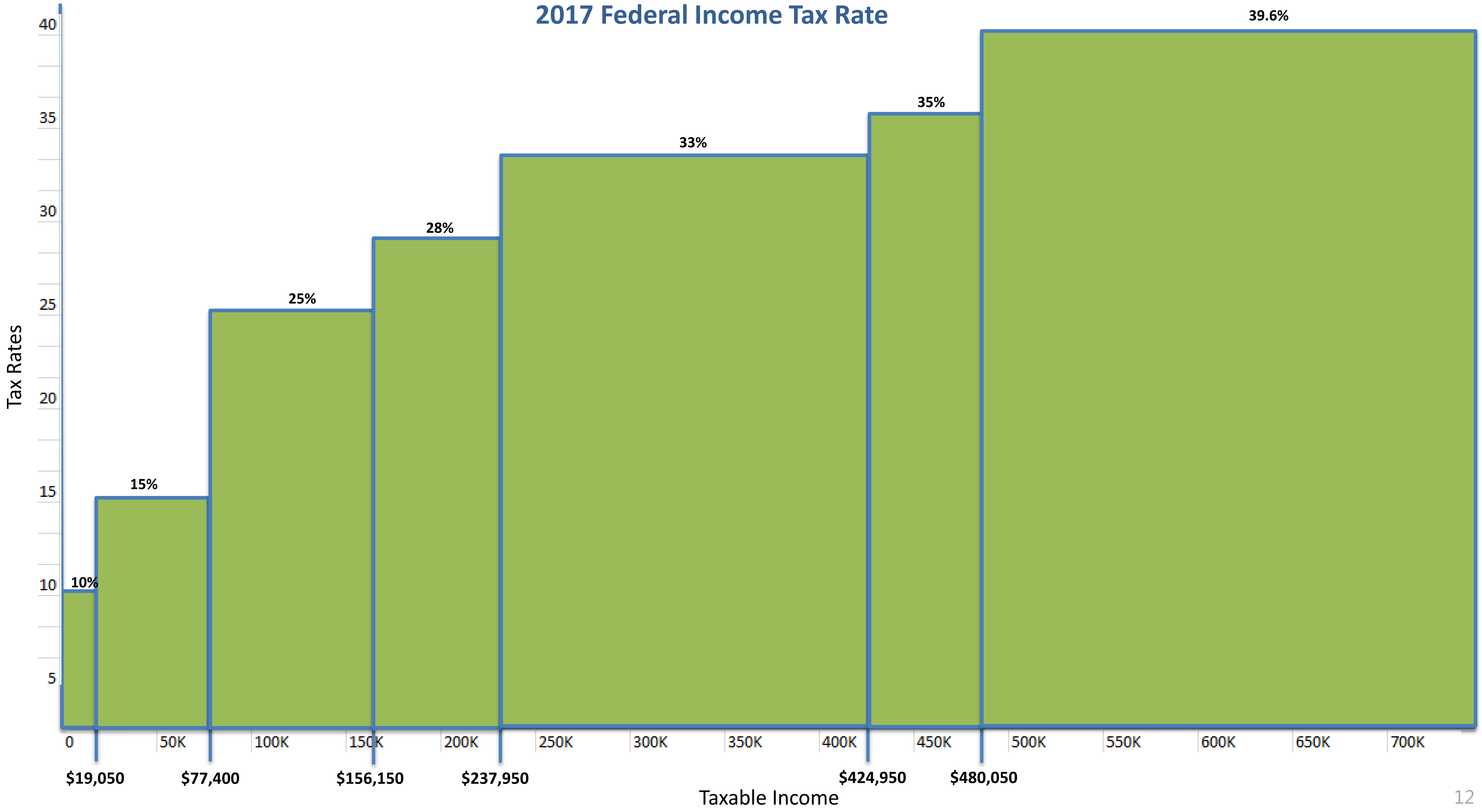
- Step up in basis is central
- Review existing trusts for income tax planning
- Review plan based on exemption (“bucket plan”)

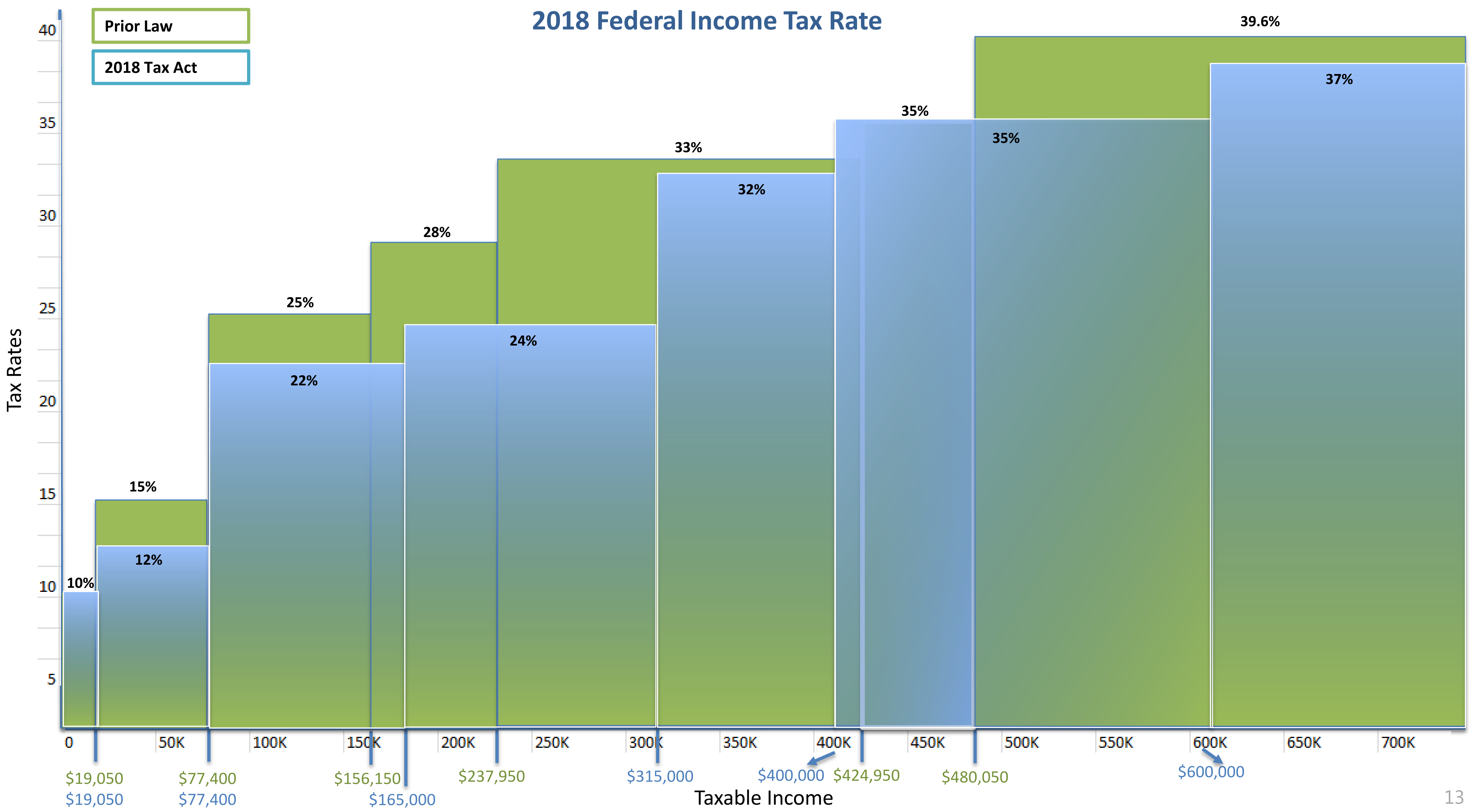
Planning With Potential Estate Tax

- Federal estate tax possible in 2026
- Maryland estate tax possible
- Step up in basis remains relevant
- Consider GRATs

Planning with Estate Tax

- Consider large gifts
- Leverage existing techniques
- Soak up a parent's unused exemptions


2017 Federal Income Tax Rate
Tax Rates
40
35
30
25
20
15
10
5
10%
15%
25%
28%
33%
35%
39.6%
0
50K
100K
150K
200K
250K
300K
350K
400K
450K
500K
550K
600K
650K
700K
$19,050
$77,400
$156,150
$237,950
$424,950
$480,050
Taxable Income



2018 Federal Income Tax Rate
Prior Law
2018 Tax Act
Tax Rates
40
35
30
25
20
15
10
5
10%
15%
12%
25%
22%
28%
24%
33%
32%
35%
35%
39.6%
37%
0
50K
100K
150K
200K
250K
300K
350K
400K
450K
500K
550K
600K
650K
700K
$19,050
$19,050
$77,400
$77,400
$156,150
$165,000
$237,950
$315,000
$400,000
$424,950
$480,050
$600,000
Taxable Income

Good News

- Rate decreases
- Alternative Minimum Tax (AMT) exemption increases
- 529 plans for private school
- Pass through deduction
- Higher standard deduction

Deductions Lost

- State and local tax >$10,000
- Miscellaneous itemized deductions
- Mortgage interest to the extent new indebtedness exceeds $750,000
- Interest on home equity indebtedness

Federal and Effective Maryland State and Local Rates

Examples of Effective Rate Change:	2017 Approx. Combined Federal and Effective Maryland State and Local Rates	2018 Approx. Combined Federal and Maryland State and Local Rates
Married couple filing jointly with taxable income of $155,000	31.15%*	30.20%*
Married couple filing jointly with taxable income of $200,000	34.08%**	32.44%**
Married couple filing jointly with taxable income of $470,000	40.82%***	43.95%***
Married couple filing jointly with taxable income of $500,000	45.01%****	43.95%****
Married couple filing jointly with taxable income of $700,000	45.00%*****	45.95%*****

* Assuming a 2017 Federal income tax rate of 25%; a 2018 Federal income tax rate of 22%; a Maryland income tax rate of 5.00%; and a local city/county income rate of 3.20%

** Assuming a 2017 Federal income tax rate of 28%; a 2018 Federal income tax rate of 24%; a Maryland income tax rate of 5.25%; and a local city/county income rate of 3.20%

*** Assuming a 2017 Federal income tax rate of 35%; a 2018 Federal income tax rate of 35%; a Maryland income tax rate of 5.75%; and a local city/county income rate of 3.20%

**** Assuming a 2017 Federal income tax rate of 39.60%; a 2018 Federal income tax rate of 35%; a Maryland income tax rate of 5.75%; and a local city/county income rate of 3.20%

***** Assuming a 2017 Federal income tax rate of 39.60%; a 2018 Federal income tax rate of 37%; a Maryland income tax rate of 5.75%; and a local city/county income rate of 3.20%

Other Notable Features

- Medical expense deduction retained, expanded for two years
- Surtaxes still apply
- Like kind exchanges for art disallowed
- No Roth IRA recharacterization
- Kiddie tax rate change
- Pease limitation
- Future alimony nondeductible
- ABLE accounts

Charitable Planning Points

- Batch charitable deductions with donor advised fund
- Transfer IRA funds after age 70 ½
- Highlighted changes
  - Limit for deduction on cash donations increased to 60% of adjusted gross income.
  - No 80% deduction on transfers to universities for athletic seating rights

Trust Planning Points

- Consider tax status of beneficiary vs. trust
- Review impact of state tax on trusts
- Grantor or non-grantor preferable?

Corporate Tax Rate

- Corporate income tax rate is permanently lowered to 21% beginning in 2018

Pass-Through Deduction – In General

- New deduction for "qualified business income" from pass-through entities and sole proprietorships
- Maximum deduction is 20% of the taxpayer's qualified business income
- Non-corporate taxpayers (including estates and trusts) are eligible to claim the deduction
- Effectively reduces the rate on pass-through income to eligible taxpayers to 29.6%

Pass-Through Deduction - Qualified Business Income

- Generally, the ordinary income, gain, deduction, and loss of a qualified trade or business
  - What is a "qualified trade or business"?
    - Any business other than a specified service business or the trade or business of performing services as an employee
    - Specified service business - a trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or where the principal asset of the business is the reputation or skill of one or more of its employees, or which involves the performance of services that consist of investing and investment management, trading or dealing in securities, partnership interests or commodities.
- Excluded items: the taxpayer's wages (or reasonable compensation), guaranteed payments, and investment-type income (capital gains, interest, dividends)

Pass-Through Deduction - Calculation

Subject to certain limits and thresholds, the deduction generally is the sum of:

- The lesser of:
  - 20% of the taxpayer's qualified business income; or
  - 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 qualified property
- Plus 20% of REIT dividends and distributions from publicly traded partnerships

Pass-Through Deduction – Limits

Availability and/or calculation of the deduction is subject to limits based on the taxpayer's income and the type of business conducted:

Total Taxable Income	Not Exceeding Threshold (Single - $157,500 / Joint - $315,000)	Threshold Plus Phase In	Over Threshold (Single - $207, 501 / Joint - $415, 001)
Specified Service	Full 20% deduction, no W2/basis limit	20% deduction subject to phase-out, W2/basis limit phased in	No deduction permitted
Non-Specified Service	Full 20% deduction, no W2/basis limit	20% deduction subject to phase-in of W2/basis limit	20% deduction permitted but fully subject to W2/basis limit

Pass Through Deduction - Example

- **Example:** A wholly-owned business purchases an office building for $6M ($3M building, $3M land). The building generates annual rental income of $500,000. The maximum potential allowable pass-through deduction would be $100,000 (20% of $500,000). If the business paid no wages, the business would qualify for a deduction of only $75,000 (2.5% x $3M = $75,000). By contrast, if $4M were allocated to the building, the deduction would not be limited and thus the full $100,000 (2.5% x $4M = $100,000) could be deductible.

Pass-Through Deduction - Open Issues

- "Qualified trade or business" issues
- Aggregation/grouping issues – multiple projects under common ownership
- "Specified service business" issues
  - "principal asset of the business is the reputation or skill of one or more of its employees"
  - "Spinning off" portions of "specified service business" (e.g., HR, IT, IP)
- Real estate management company model
- S corp "reasonable comp" vs. partnership guaranteed payments

Choice of Entity – Effective Rates

As a result of the new lower corporate rate, should taxpayers reconsider their choice of entity?

	C Corporation	Pass-Through
Income Tax Rate	21%	29.6% (effective)
Dividend/Exit Tax Rate	20% + 3.8% = 23.8%	0%
Aggregate Tax Rate	39.8%	29.6%
State/Local Tax Deduction	100%	Property taxes deductible, SALT income taxes not deductible

Choice of Entity – Other Considerations

- Potential for future changes
- Easy to move into C corp status, but difficult to move out
- Limits on ability to defer distributions
- Many disadvantages to C corp status

Choice of Entity - REITs

- REITs do especially well:
  - Only one level of tax
  - Shareholders entitled to a 20% qualified business income deduction for ordinary distributions – with no W2/basis limits

Interest Expense Limitation

- Generally, no deduction for interest expenses that exceed 30% of the taxpayer’s adjusted taxable income
- For pass-through entities, the limit applies at the entity (not the owner) level
- Applies to new and existing debt
- Real estate business can elect out of the limit, but in exchange, depreciation periods extended and no bonus depreciation except for TPP and land improvements

Bonus Depreciation

- 100% bonus depreciation deduction for qualified property, whether new or used, acquired and placed in service after Sept. 27, 2017, and before Jan. 1, 2023
- Phases down beginning in 2023 and sunsets in 2026
- If a real estate business elects out of the interest expense limit, depreciation periods extended and no bonus depreciation except for TPP and land improvements
- In addition, Section 179 deduction increased to $1M and now indexed for inflation

Like-Kind Exchanges

- Like-kind exchanges still are permitted for real estate
- No property other than real estate can be exchanged in a like-kind exchange

Carried Interest

- New 3 year holding period for certain long-term capital gains
- Holding period applies to sale of either underlying asset or partnership interest
- Applies only to businesses that raise capital from third party investors for certain types of investments (e.g., securities, commodities, rental real estate)

NOL Limitations

- No NOL carrybacks, only carryforwards
- Carryforward is indefinite
- Amount of an NOL carryforward that is deductible in any taxable year is limited to 80% of that year's taxable income

Excess Business Loss Limitation

- Taxpayers cannot claim business losses in excess of threshold amounts ($250,000 for single filers / $500,000 for joint filers)
- Previously, concern was generally whether a taxpayer was passive or active with respect to the business activity
- Now even active losses will be limited

Technical Terminations of Partnerships

- Under former Section 708(b)(1)(B), a partnership terminated upon a sale or exchange of 50% or more of a partnership's equity within 12 months
- This provision in now repealed–no restart of depreciation periods, no filing short-year return on termination, and no "clean slate" for elections

Compensation and Employee Benefit Provisions – Fringe Benefits and Retirement Plans

- **Business entertainment, amusement or recreation** – Employer deduction is eliminated
- **Moving expense reimbursements** – Employee tax exclusion repealed (reinstituted in 2025)
- **Transportation fringe benefits** – Parking and transit passes –
  - Can still be provided tax-free to the employee, but employer loses deduction
  - Alternatively, employer can eliminate the pre-tax benefit and take a regular compensation deduction
  - Nonprofit employers must treat as UBTI

Compensation and Employee Benefit Provisions – Fringe Benefits and Retirement Plans (cont'd)

- **Employee achievement awards** – Narrows scope of the deduction for awards of "tangible personal property," by specifically naming gift cards, coupons or certificates, vacations, meals, lodging, and theater or sporting event tickets as nondeductible. (Certain of these items were already nondeductible under earlier proposed regulations.)
- **Meals provided for the convenience of the employer** – Only 50% deductible beginning in 2018; nondeductible beginning in 2026
- **Qualified plan loans** – A participant terminating employment with an outstanding qualified plan loan will now have an extended period (through the tax return due date for the year in which loan is due) within which to contribute the outstanding loan amount to an IRA and avoid default

Compensation and Employee Benefit Provisions – Equity/Executive Compensation

New type of tax-preferred equity awards – "qualified equity grants"

- Intended to facilitate broad-based grants by privately held corporations
- Intended to address problem that tax due upon stock settlement of RSUs or exercise of nonqualified options creates a liquidity issue
- New law allows an election to defer taxation for up to 5 years following RSU settlement or option exercise
- Company must provide grants to at least 80% of its U.S.-based employees for the year
- Grants must be made on similar terms (but not in similar amounts)
- Not available to 1% or greater owner, CEO, CFO or four highest paid officers
- Use of qualified equity grants limits Company's ability to buy back other outstanding stock – at least 25% of the annual buyback must be of qualified equity grant stock
- Timing of election similar to Section 83(b) election – within 30 days after RSU settlement or option exercise
- Effect of election similar to Section 83(b) election – locks in ordinary income amount (though payable on a deferred basis) with subsequent appreciation treated as capital gain

Compensation and Employee Benefit Provisions – Equity/Executive Compensation (cont’d)

“Excessive” Compensation

- Publicly traded companies – loss of “performance-based compensation” deduction under Code Section 162(m)
  - Certain other changes to Code Section 162(m)
- Non-profit employers – excise tax on annual compensation in excess of $1M for key executives, or excessive severance

Compensation and Employee Benefit Provisions

Provisions **Not** Included in the Legislation

- Reduction in pre-tax contribution limits for retirement plans, or a requirement that most deferrals be made as Roth contributions
- Taxation of deferred compensation provided by for-profit employees upon vesting, even before payment
- Sunset of employer-provided dependent care assistance programs
- Allowance of in-service distributions at 59½ for defined benefit plans and governmental 457(b) plans
- Elimination of 6-month deferral suspension upon hardship distribution
- Allowance of hardship distributions from employer contributions and earnings on elective deferrals; elimination of requirement to take available loans before a hardship distribution
- Easing of nondiscrimination rules for frozen defined benefit plans
- Imposition of dollar limit on employer-provided housing exclusion
- Repeal of tax exclusion for employer-provided adoption assistance
- Repeal of qualified tuition reduction provided by educational institutions

Questions

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