Selected Issues of the Tax Cuts & Jobs Act (H.R. 1)

Hampton Roads Estate Planning Council

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Presented by:

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About Jordon . . .

Jordon N. Rosen, CPA, MST, AEP® is a Director and shareholder in the Wilmington, Delaware CPA firm of Belfint, Lyons & Shuman, where he heads the firm's estate and trust practice. Jordon also provides tax consulting and compliance services to the firm's higher net worth clients and business owners. He is the Past President of the National Association of Estate Planners and Councils (NAEPC) and has served as president of the Delaware Estate Planning Council and the Chester County, PA Estate Planning Council. Mr. Rosen is also a member and past chair of the Delaware State Chamber of Commerce tax committee, is a member of the AICPA Trust, Estate and Gift Tax Technical Resource Panel, and is a member of the editorial board of Thomson Reuters Focus publication.

Jordon is a licensed CPA in Delaware and Pennsylvania and is a member of the Pennsylvania Institute of CPAs, Delaware Society of CPAs and the AICPA Tax Section. He also holds the designation of Accredited Estate Planner ® and has been recognized as a 5-Star Wealth Manager by Philadelphia Magazine and Delaware Today.

Mr. Rosen is a frequently sought out speaker both locally and nationally on tax planning and related issues and has published more than 100 articles. He has been a frequent television and radio guest and a past host of Money Talk on 1450-WILM. He received his undergraduate degree in Accounting from Temple University and his Master's degree in Taxation from Widener University.

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Tax Cuts and Jobs Act (H.R. 1)

- Official title- “An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018”
- “AAPRPTZ5CRBFY18” too hard to say, so we use “TCJA”
- Will create a deficit of $1.456 trillion through 2027
- Most Corporate provisions are permanent
- Most individual provisions sunset after 2025

Estate and Trust Provisions

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Tax Rates for Estates and Trusts (2018 - 2025)

2017	2018-2025
15%	10%
25%	24%
28%	35%
33%	37% (T. I. > $12,500)
39.6%	

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For Estates and Trusts

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

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Estate and Gift Taxes (2018 - 2025)

- Doubles the base exemption to $10 million per person
- Indexed for inflation after 2011
- Retains portability rules
- 2018 amount will be roughly $11,180,000
- TCJA silent on GST Tax exemption - but assumed to increase based on basic exclusion rules
- Rate remains at 40%

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Effect of Other Changes on Estates and Trusts

- State and local income tax deduction
- State and local real estate tax deduction
- 2% deductions
- Other deductions – Section 67(e)
  - Tax preparation
  - Attorney fees
  - Fiduciary fees
- Section 691(c) remains deductible (need clarification)
- Can an ESBT utilize the QBI deduction?

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Effect of Other Changes on Estates and Trusts - Cont.

- Excess deductions in year of termination flow through as a miscellaneous I/D subject to 2% floor. New law would eliminate it? Need to plan for year of termination. Can expenses be broken out by category?
- Assume estates and trusts still entitled to “exemption” (personal exemptions suspended)

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Qualified Beneficiaries of an ESBT (after 2017)

- Existing Law - ESBT - Electing Small Business Trust - may be a shareholder in an S Corporation
- New law now allows a nonresident alien individual to be a potential current beneficiary of an ESBT (in addition to resident individuals, estates, and certain charitable organizations)

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Charitable Contribution Deduction for an ESBT (after 2017)

Deduction for charitable contributions will be determined using rules applicable to individuals (not trusts)

- Percentage limitation
- Carry forward provisions

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Business Provisions

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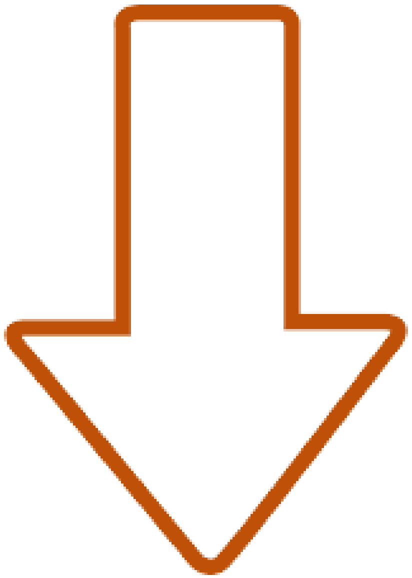
Corporate Tax Rates Reduced (after 2017)

- Prior rates: 15%, 25%, 34%, and 35% (Personal Service Corps. paid at the 35% rate)
- For tax years beginning in 2018: Flat 21% (including Personal Service Corps.)



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Qualified Business Income Deduction: Section 199A

Overview

- Applies to non-corporate taxpayers-
  - Individuals (including children subject to the Kiddie tax)
  - Estates
  - Non-granter trusts
- Applies to tax years beginning 2018 → 2025
- Applies to income from an S Corp., Schedule E real estate rentals, partnerships or sole proprietors
- Applies only to QBI effectively connected with conduct of a trade or business within the U.S.
- QBI includes items of income, gain, deduction and loss
- No distinction between passive and active income

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QBI Does not include

Overview

- Certain investment income
- Reasonable Compensation paid to the taxpayer
- Guaranteed payments paid to the taxpayer

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Section 199A (QBI deduction) Does Not apply to

- Computation of Alternative Minimum Tax
- Computation of Net Investment Income Tax (NIIT)
- Computation of SSA benefits
- Computation of S. E. Tax

The Big Question – currently the QBI deduction computation does not consider certain "adjustment to income", such as the SEP deduction, 50% of S.E. tax deduction and the deduction for S.E. health insurance. Will Congress change this?

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Quick Reference Chart - The QBI Deduction

MFJ :

(Net) Taxable Income	Specified Services	Other Businesses
<$315,000	QBI x 20%	QBI x 20%
$315,000-$415,000	Phase-out of Deduction (W-2/ Asset Limitations Apply)	Phase-in of W-2/Asset Limitation Rule
>$415,000	No Deduction	Full W-2/Asset Limitation Rule APPLIES

Other than MFJ :

<$157,500	QBI x 20%	QBI x 20%
$157,500-$207,500	Phase-out of Deduction (W-2/ Asset Limitations Apply)	Phase-in of W-2/Asset Limitation Rule
>$207,500	No Deduction	Full W-2/Asset Limitation Rule APPLIES

QBI – Wage/Asset Limitation

- Wage Limitation does not apply if taxable income does not exceed $315,000
  - Limitation phases in when taxpayer's taxable income exceeds $315,000 for MFJ ($157,500 for others).
  - Phase-in is over the next $100,000 of taxable income for MFJ ($50,000 for others).
- If taxable income > $415,000 - MFJ ($207,500 for others) - the deduction cannot exceed the greater of:
  - 50% of (allocated share of) W-2 wages of the trade or business, or
  - 25% of (allocated share of) W-2 wages of the trade or business, **PLUS** 2.5% of the unadjusted basis of all qualified property held by and available for use in the T/B at the close of the year

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W-2 Wages

- Paid with respect to employment during the calendar year
- Limited to wages paid attributable to QBI
- Wages do not include any amount which is not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date for such return (including extensions)

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Qualified Property

- With respect to a qualified trade or business
- Tangible property (personal or real), subject to the allowance for depreciation under Section 167
  - Held for use in a qualified t/b at the close of the taxable year,
  - Used at any point during the taxable year in the production of qualified business income, and
  - the depreciation period has not ended before the close of the taxable year.

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Qualified Property Continued

- Depreciable period-
  - Beginning on the date placed in service by the taxpayer
  - Ending on the later of
    - Date which is 10 years after such date, or
    - the last day of full year in the applicable recovery period that would apply to the property under Section 168 (w/o regard to subsection g)

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QBI Deduction for Specified Service Industry

- Generally does not apply
- Exception if taxable income of individual does not exceed $315,000 (MFJ), $157,500 (for others).
- Exception is phased-out over the next $100,000 (MFJ), $50,000 (for others)
- QBI deduction does not apply to the business of performing services as an employee.
- Specified services include any trade or business involving the performance of services in the field of health, law, accounting, actuarial sciences, performing arts, consulting, athletics, financial services, brokerage services, or 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 or owners, or which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interest, or commodities (but not engineers and architects).

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QBI Examples: Example #1

- Basic Rule: Combined QBI deduction cannot exceed taxable income (net of capital gains) x 20%
- John is a married accountant with business income of $150,000
  - QBI Deduction: $150,000 x .20 = $30,000
  - Net Taxable Income: $200,000
  - $200,000 x .20 = $40,000
  - QBI deduction is not limited
- Mary is a married accountant with business income of $250,000
  - QBI Deduction: $250,000 x .20 = $50,000
  - Net Taxable Income: $200,000
  - $200,000 x .20 = $40,000
  - QBI deduction is limited to $40,000

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QBI Examples: Example #2

For Non-Specified Service Businesses:

- When taxable income exceeds $415,000 (MFJ), the QBI deduction is limited to the greater of:
  - 50% of Wages or
  - 25% of Wages **PLUS** 2.5% of unadjusted basis of property
- Bruce is married and has a yard cleaning company and has taxable income of $600,000 and the QBI amount from the company is $100,000. The company pays wages of $50,000 and has nominal assets
- Lesser of:
  - $100,000 x .20 = $20,000
  - Limited to: $50,000 (wages) x .50% = $25,000
  - Bruce's QBI deduction is not limited

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QBI Examples: Example #3

- Bruce also owns a rental property that generates $8,000 of QBI. Assume the property is fully depreciated and there are no employees.
- The QBI deduction is $0

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QBI Examples: Example #4

- Same as EXAMPLE #3 except the building is not fully depreciated and was purchased for $250,000, which includes land cost of $50,000.
  - QBI deduction is $8,000 x .20 = $1,600
  - ($0 wages x .25) **PLUS** $200,000 (net of land) x .025 = $5,000
  - QBI deduction of $1,600 is not limited

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QBI Examples: Example #5

- Jordon is married and has a widget producing business that generates $100,000 of QBI. His taxable income is over $415,000. In addition, he paid wages of $30,000 and has qualified property of $50,000.
    - $100,000 x .20 = $20,000
    - Wage Test 1: $30,000 x .50 = $15,000
    - Wage Test 2: ($30,000 x .25) + ($50,000 x .025) = $8,750
    - QBI deduction is limited to $15,000 (the greater of $15,000 or $8,750)

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QBI Examples: Example #6 (Updated 3/1/2018)

- Valerie is an attorney and has business income of $200,000 after paying wages of $100,000 to employees. She files a joint return which shows taxable wages of $375,000.
- QBI = $\left(1 - \frac{\$375{,}000 - \$315{,}000}{\$100{,}000}\right) \times \$200{,}000 = \$80{,}000$
- Includible wages = 40% x $100,000 = $40,000
- QBI deduction = $80,000 x 20% = $16,000
- Wage limitation = $40,000 x 50% = $20,000
- Deduction of $16,000 is not limited.
- If taxable income were greater than $415,000, the deduction would be **zero**.

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QBI Examples: Example #7

- Same as EXAMPLE #6 except that the trade or business is a widget retailer that paid wages of $50,000 and had no assets.
- The Wage Limitation Test would apply on a phase in basis since taxable income exceeds $315,000, but less than $415,000
- QBI Deduction: $200,000 x .20 = $40,000
- Wage Limit: $50,000 x .50 = $25,000
- Deduction: $25,000 + [50% x ($40,000 - $25,000)] = $32,500

NOTE: If VALERIE'S TAXABLE INCOME WERE GREATER THAN $415,000, THE WAGE TEST LIMIT WOULD BE FULLY PHASED IN AND HER DEDUCTION WOULD BE LIMITED TO $25,000.

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Planning For Trusts

- If income > $157,500-consider separating business interest over multiple non-grantor trusts
- If holding fully depreciated real property that has no basis, consider transferring business interest to a CRT
- Making a Section 645 election may hurt the estate/trust's QBI deduction

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C Corporation Planning

- Generally not as tax favorable
  - Double taxation of profits
  - No QBI deduction (assuming QBI deduction is available to other entity)
- Even if corporation did not pay a current dividend:
  - Accumulated earnings tax potential
  - Personal holding company tax potential

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COMPARISON

C Corporation	LLC/Sole Prop.
1st level tax = 21%	1st level tax = 0
QBI Deduction = 0	QBI Deduction = 20%
2ND Level tax= 15 %	1st level tax = 0
NIIT= 3.8%	NIIT= 0
Net to Owner=64%	Net to Owner=81%
Net Text Rate= 36%	Net Tax Rate=19%

- $1,000 business profit of C corporation would yield $640 to owner, assuming dividend is currently paid
- $1,000 business profit to LLC/Sole Prop. would yield $810 to owner

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Conversion to S Corporation

- Reasonable compensation needs to be paid to owner/employees
- BIG tax
- All shareholders have to be qualified to own S corporation stock
- Cannot have more than one class of stock
- Outstanding loans to business
- Passive investment income exceeding 25% of gross receipts for 3 consecutive years and the S corporation has accumulated E&P will void the S election

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Planning for Specified Service Businesses

- Need to keep taxable income below $315,000/ $157,500
  - D.C. plan
  - D.B./cash balance plan
  - Bonus depreciation/Section 179
  - But, maybe regular depreciation which is taken each year will keep T. I. below threshold EACH YEAR.
  - Breakout assets from operating company/into an LLC and lease back to company (Congress and Treasury are currently silent on issue of attribution)

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Questions

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