OVERVIEW: How the Tax Cuts and Jobs Act Affects You and Your Law Practice

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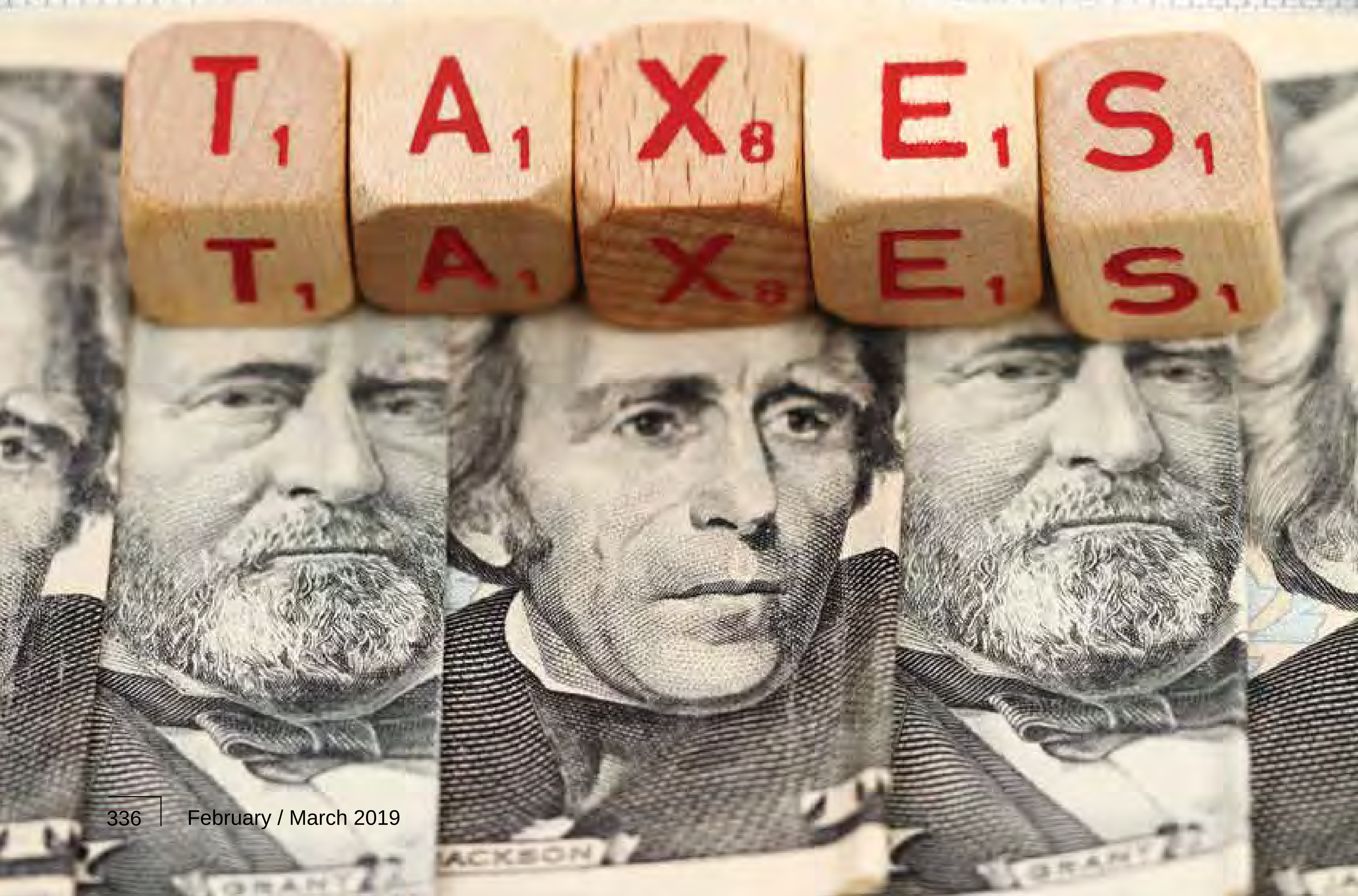

The Tax Cuts and Jobs Act (TCJA or Tax Act) is a sweeping tax package that certainly impacts your federal personal income tax obligation beginning in 2018. Here is a look at some of the more important elements of the new law that will have an impact on you as an individual and as a Louisiana attorney.[1]

Important Changes to Your Individual Federal Income Tax Return

Beginning after Dec. 31, 2017, seven tax rates now apply for individuals — 10 percent, 12 percent, 22 percent, 24 percent, 32 percent, 35 percent and 37 percent. The standard deduction is also increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other taxpayers, adjusted for inflation in tax years beginning after 2018. No changes are made to the additional standard deductions for the elderly and blind. The deduction for personal exemptions is effectively suspended by reducing the exemption amount to zero.

Here are some highlights to relevant changes which will impact your personal income tax return.

Casualty Losses

The new Tax Act suspends the personal casualty and theft loss deduction, except for personal casualty losses incurred in federally declared disaster areas.

Gambling Activities

Under the new Tax Act, the limitation of wagering losses is modified to provide that all deductions for expenses incurred in carrying out wagering transactions, and not just gambling losses, are limited to the extent of gambling winnings.

Child and Family Tax Credit

The child tax credit is increased to $2,000, and the phaseout limits are increased to $400,000 for married taxpayers filing jointly and $200,000 for all other taxpayers. The amount of the tax credit that is refundable is increased to $1,400 per qualifying child, and this amount is indexed for inflation.

State and Local Taxes

Under the new Tax Act, a taxpayer may claim an itemized deduction up to $10,000, $5,000 for married taxpayers filing separately, for the aggregate of (i) state and local property taxes not paid or accrued in carrying a trade or business or an activity undertaken for profit, and (ii) state and local income taxes, or sales taxes in lieu of income, paid or accrued in the year. Foreign real property taxes may not be deducted.

Mortgage Interest

The deduction for interest on home equity indebtedness is suspended, and the deduction for mortgage interest is limited to underlying indebtedness of up to $750,000 ($375,000 for married taxpayers filing separately). After Dec. 31, 2025, the former rules are reinstated.

Medical Expenses

For taxable years beginning after Dec. 31, 2016, and before Jan. 1, 2019, the threshold on personal medical expense deduction is reduced to 7.5 percent.

College Sporting Event Tickets

Under prior law, special rules applied to certain payments to institutions of higher education, in exchange for which the payor received the right to purchase tickets or seating at an athletic event. For contributions made in tax years beginning after Dec. 31, 2017, no charitable deduction is allowed for these types of payments.

Alimony

Per any divorce or separation agreement executed after Dec. 31, 2018, or executed before that date, but modified after, alimony and separate maintenance payments are not deductible by the payor spouse and are not included in the income of the payee spouse. Note: This provision is effective after Dec. 31, 2018, and not Dec. 31, 2017.

Overall Limitation on Itemized Deductions

The deduction for miscellaneous itemized deductions that are subject to the 2 percent floor is suspended, meaning the deduction may no longer be claimed. This includes deductions for tax preparation and out-of-pocket employee expenses.

Moving Expenses

The deduction for moving expenses is suspended. There is an exception for members of the armed forces.

Health Care "Individual Mandate"

The new Tax Act repeals the individual mandates of Obamacare by reducing the amount of the individual shared responsibility (penalty) to zero. The new Tax Act leaves intact the 3.8 percent Net Investment Income Tax, and the 0.9 percent additional Medicare Tax, both enacted by Obamacare.

ABLE Accounts

Under the new Tax Act, changes have been made to Internal Revenue Code Section 529A, which provides for "ABLE Accounts." This is a provision that allows individuals with disabilities, and their families, to fund a tax-preferred savings account to pay for "qualified" disability-related expenses. Under prior law, annual limitation on contributions is the amount of the annual gift tax exemption ($15,000 for 2018). Effective for tax years after the enactment date, and before Jan. 1, 2026, the contribution amount is increased, the lesser of (i) the federal poverty line for a oneperson household or (ii) the individual's compensation for the year.

College Savings Plans

Under prior law, funds in a Code Section 529 College Savings Account could only be used for qualified higher education expenses. For distributions after Dec. 31, 2017, "qualified higher education expenses" include tuition at an elementary or secondary public, private or religious school, up to a $10,000 limit per tax year.

Estate and Gift Tax Exemption

Effective for testamentary and *inter vivos* gifts in 2018, the estate and gift tax exemption has been increased to roughly $11.2 million ($22.4 million for married couples).

Alternative Minimum Tax (AMT) Exemption

The AMT has been retained for individuals by the new law but the exemption has been increased to $109,400 for joint filers ($54,700 for married taxpayers filing separately) and $70,300 for unmarried taxpayers. The exemption is phased out for taxpayers with alternative minimum taxable income over $1 million for joint filers and over $500,000 for all others.

Bottom Line

While these changes will lower rates at many income levels, determining the overall impact on any particular individual or family will depend on a variety of other changes made by the Tax Cuts and Jobs Act, including increases in the standard deduction, loss of personal and dependency exemptions, a dollar limit on itemized deductions for state and local taxes, and changes to the child tax credit.

Important Changes to Your Law Practice

New Corporate Income Tax Rate

C corporations were historically subject to graduated tax rates of 15 percent for taxable income up to $50,000, 25 percent (over $50,000 to $75,000), 34 percent (over $75,000 to $10,000,000), and 35 percent (over $10,000,000). Personal service corporations pay tax on their entire taxable income at the rate of 35 percent. Beginning with the 2018 tax year, the new Tax Act makes the corporate tax rate a flat 21 percent, and it also eliminates the corporate alternative minimum tax.

Meal, Entertainment and Fringe Benefit Changes

There are changes to note in this area, all effective for amounts incurred or paid after Dec. 31, 2017:

► Deductions for business-related entertainment expenses are disallowed.

► The 50 percent limit on the deductibility of business meals is retained and expanded to meals provided through an in-house cafeteria or otherwise on the premises of the employer.

► Deductions for employee transportation fringe benefits (*e.g.*, parking and mass transit) are denied, but the exclusion from income for such benefits received by an employee is retained (except in the case of qualified bicycle commuting reimbursements).

► No deduction is allowed for transportation expenses that are the equivalent of commuting for employees (*e.g.*, between the employee's home and the workplace), except as provided for the safety of the employee. However, this bar on deducting transportation expenses does not apply to any qualified bicycle commuting reimbursement, for amounts paid or incurred after Dec. 31, 2017, and before Jan. 1, 2026.

Expensing Rules Liberalized

For property placed in service in tax years beginning after Dec. 31, 2017, the maximum amount a taxpayer may expense is increased to $1 million, and the phaseout threshold amount is increased to $2.5 million.

Net Operating Losses (NOLs)

Under pre-TCJA rules, a net operating loss (NOL) for any tax year was generally carried back two years, and then carried forward 20 years. The new Tax Act repeals the general two-year NOL carryback and also provides that NOLs may be carried forward indefinitely.

New Business Income Deduction

Under the new Tax Act, a new 20 percent income tax deduction for so-called "passthrough business income" is afforded. With the corporate tax rate being reduced under the new tax law to a flat 21 percent, a deduction for "pass through" forms of business was designed by Congress to give a reduction to those businesses approximating the lower corporate tax rate. If applicable, the 20 percent deduction can be claimed by the owners of S corporations, partnerships, sole proprietorships, and even beneficiaries of trusts. These are generally referred to as "pass-through tax entities" that pay no income tax at the entity level. This business income is "passed through" to the owners (or trust beneficiaries) who must report the income on his or her individual income tax return.

It is an understatement to say this 20 percent deduction found in new IRC § 199A is saddled with exclusions, phase-outs, technical issues and uncertainties. Commentators are still attempting to analyze and figure out how this new deduction actually works.

For most pass-through business owners, the deduction is the lesser of (i) the "combined qualified business income" of the taxpayer, or (ii) 20 percent of the excess of taxable income over the sum of any net capital gain. The term "combined qualified business income" is then defined as the lesser of (i) 20 percent of the business owner's qualified business income, called QBI or (ii) the greater of (a) 50 percent of the W2 wages of business allocable to the owner; or (b) 25 percent of the W-2 wages of the business plus 2.5 percent of the unadjusted tax basis in property of the business allocable to the business owner.[2] Qualified business income is generally profit from the active income and expenses from the operation of the pass-through business and does not include passive income, such as interest, dividends or even capital gains.

The starting point for determining "QBI" is difficult, since the starting point is "profit of the business," which is not really defined under the Internal Revenue Code. Profit might be defined as gross revenue less expenses. The 20 percent deduction of this profit amount, subject to a number of limitations, passes through to the owner as a deduction, which can be claimed on his or her individual income tax return to offset other taxable income, such as wages, dividends, interest and other forms of income.

The deduction is 20 percent of your "qualified business income" (QBI) from a partnership, S corporation or sole proprietorship, defined as the net amount of items of income, gain, deduction and loss with respect to your trade or business. The business must be conducted within the United States to qualify, and specified investment-related items are not included, *e.g.*, capital gains or losses, dividends and interest income (unless the interest is properly allocable to the business). The trade or business of being an employee does not qualify. Also, QBI does not include reasonable compensation received from an S corporation or a guaranteed payment received from a partnership for services provided to a partnership's business.

The deduction is taken "below the line," *i.e.*, it reduces your taxable income but not your adjusted gross income, but is available regardless of whether you itemize deductions or take the standard deduction. In general, the deduction cannot exceed 20 percent of the excess of your taxable income over net capital gain. If QBI is less than zero, it is treated as a loss from qualified business income the following year.

There is also a different phase-out for service businesses, which is applicable to those trades or businesses involving the performance of services in the fields of health, law, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners. The exemption amounts and phase-in amounts are different. It is interesting to note that certain personal service providers have been excluded from the personal service rules.

Conclusion

This article only briefly covers some of the most significant changes to you and your law practice. There are additional rules and limitations which may apply and, as with any piece of large legislation, there will be many lingering questions regarding implementation. Should you have any questions regarding the Tax Act, it is recommended that you consult your paid tax professional, particularly since the new Tax Act could result in material changes to your law practice.

FOOTNOTES

1. Unless otherwise noted, the changes are effective for tax years beginning in 2018 through 2025.

2. Exemptions exist for meeting the requirements of the wage limitation, where taxable income for a single filer is $157,500 or less; or for married filing jointly, $315,000 of income or less. Then there is a phase-out amount, and then the wage test becomes applicable.

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