Tax Reform - The Final Edition:

What You Really Need To Know To Help Your Clients In A Labyrinth Filled With Opportunity, Statutory Review & Short-Term/Urgent And Longer-Term Planning

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The Big Six






What the Lawyer Should Know

- Overview of New Decanting and Reformation Opportunities
- Selecting of the Proper Year-End for Trusts and Estates
- Charitable Planning After Tax Reform Including QCDs, CLTs and DAFs
- Tax Reform and the Income Taxation of Trusts and Estates
- Estate, Gift and GST Planning in case the Exemption decreases
- Enhanced Asset Protection with a Larger Exemption
- Advanced Income Tax Planning Using Non-Grantor Trusts
- Estate planning with an $22,400,000 exemption
- Lower Tax Rates for Professional Service Firms
- S-Corp vs. C-Corp Analysis
- Tax Reform for the Old-Fashioned C-Corp
- Individual Tax Changes and Planning Going Forward
- Taxation of Real Estate Ventures After Tax Reform
- Changes to the Taxation of Pass-Through Entities
- Creating trusts to use the $157,500 § 199A Threshold

What the Accountant Should Know

- Analysis of individual tax changes and planning going forward
- Modification of the AMT and how to handle ISOS
- Drawdown planning after tax reform
- Tax reform and the income taxation of trusts and estates
- Advanced income tax planning using trusts
- Estate planning with a $22,360,000 exemption
- Portability planning
- Estate, gift and GST planning in case the exemption decreases
- Overview of new decanting and reformation opportunities
- Taxation of business entities
- Depreciation and expensing methods
- Taxation of real estate ventures after tax reform
- S-Corp vs. C-Corp analysis
- Taxation of professional service firms
- New limitation on the deductibility of interest
- Contributions to defined contribution or defined benefit plans for business owners

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What the Financial Advisor Should Know

- Analysis of individual tax changes and planning going forward
- Drawdown planning after tax reform
- Charitable planning including DAFs, QCDs, CLTs AND CRTs
- Modification of the AMT and how to handle ISOs
- Planning for long-term care after tax reform
- Estate, gift and GST planning in case the exemption decreases
- Overview of taxation of business entities
- Understanding the taxation of real estate ventures after tax reform
- Advanced income tax planning using trusts
- College planning after tax reform
- Roth IRA conversions going forward
- Taxation of inversion dividends

Top Ideas

1. Timing itemized deductions
2. Timing the sale of securities
3. AMT planning
4. Alimony agreements
5. Roth IRA conversions and recharacterizations
6. Estate and gift tax planning
7. Timing business expenses
8. Business taxation
9. S v. C Corporation
10. Non-grantor intentionally defective trusts

Notable Individual Changes

	Senate
Individual Rates	Overall rate decrease; 7 brackets retained
Standard Deduction	$24,000 (MFJ)
Personal Exemptions	Repealed
Child/Family Credit	Increased
AMT	Exemption increased; Exemption phaseout threshold substantially increased
SALT Deduction	Limited to $10,000 in property and state/local income taxes (except for taxes incurred in a trade or business)
Mortgage Interest Deduction	Limited to interest on up to $750,000 of acquisition indebtedness; Repeals deduction for home equity indebtedness
Pease Limitation	Repealed

Individual provisions sunset December 31, 2025

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Critical Changes

- **Estate & GST tax**
  - Doubles the exemption to $11,200,000 in 2018
  - Sunsets December 31, 2025
  - Step-up in basis retained at death
- **Business**
  - Lowers the corporate rate to 21%
  - Lowers tax liability for certain pass-through business income
  - Increased expensing of capital items
  - Business interest deduction limited
  - Active business losses limited
  - NOL deduction modified
  - Like-kind exchanges limited to real property
  - New markets tax credit retained and "opportunity zones" added
  - 20% historic rehabilitation credit now claimed over five-years and 10% pre-1936 building rehabilitation credit is repealed

Modifications Discussed, But Not Included:

- Changes to the exclusion of gain on the sale of a principal residence
- Elimination of the specific indemnification method in favor of a FIFO basis accounting for marketable securities
- Reduction of the capital gain rates or changes to the taxation of interest income
- Elimination of the “step-up” in basis
- The “five-year rule” for inherited IRAs
- “Rothification”

INDIVIDUAL INCOME TAXATION

Individual Income Tax Rates

2017

CURRENT TOP OF EACH BRACKET

	S	MFJ/QW	MFS	HOH	T&E
10.0%	$ 9,325	$ 18,650	$ 9,325	$ 13,350	
15.0%	$ 37,950	$ 75,900	$ 37,950	$ 50,800	$ 2,550
25.0%	$ 91,900	$ 153,100	$ 76,550	$ 131,200	$ 6,000
28.0%	$ 191,650	$ 233,350	$ 116,675	$ 212,500	$ 9,150
33.0%	$ 416,700	$ 416,700	$ 208,350	$ 416,700	$ 12,500
35.0%	$ 418,400	$ 470,700	$ 235,350	$ 444,500	
39.6%					

CAPITAL GAINS	0%	15%	20%

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Individual Income Tax Rates

2018

PROPOSED TOP OF EACH BRACKET

	S	MFJ/QW	MFS	HOH	T&E
10%	$ 9,525	$ 19,050	$ 9,525	$ 13,600	$ 2,550
12%	$ 38,700	$ 77,400	$ 38,700	$ 51,800	-
22%	$ 82,500	$ 165,000	$ 82,500	$ 82,500	-
24%	$ 157,500	$ 315,000	$ 157,500	$ 157,500	$ 9,150
32%	$ 200,000	$ 400,000	$ 200,000	$ 200,000	-
35%	$ 500,000	$ 600,000	$ 300,000	$ 500,000	$ 12,500
37%					

PROPOSED TOP OF EACH CAPITAL GAINS BRACKET

	S	MFJ/QW	MFS	HOH	T&E
0%	$ 45,000	$ 77,200	$ 38,600	$ 51,700	$ 2,600
15%	$ 425,800	$ 479,000	$ 239,500	$ 452,400	$ 12,700
20%					

Also, simplifies the “kiddie tax” by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child

§ 1, §11001

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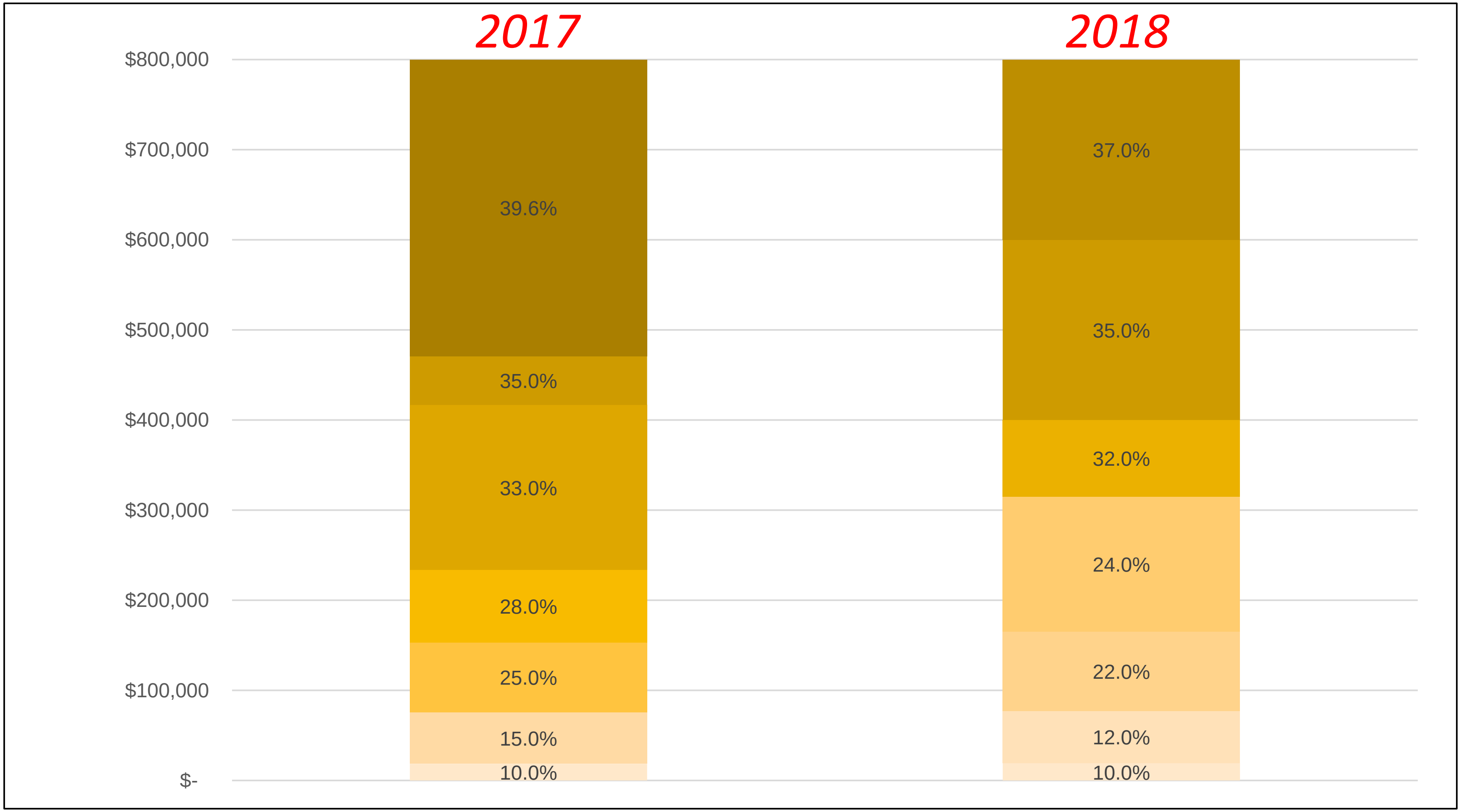
Comparison of MFJ Rates:

Income Range	Scheduled 2018 rate	TCJA
$1 to $19,050	10%	10%
$19,051 to $77,400	15%	12%
$77,401 to $156,150	25%	22%
$156,150 to $165,000	28%	22%
$165,001 to $237,950	28%	24%
$237,951 to $315,000	**33%**	**24%**
$315,001 to $400,000	33%	32%
$400,001 to $424,950	**33%**	**35%**
$424,950 to $480,050	35%	35%
$480,051 to $600,000	39.6%	35%
Over $600,000	39.6%	37%

Individual Income Tax Rates
Comparison



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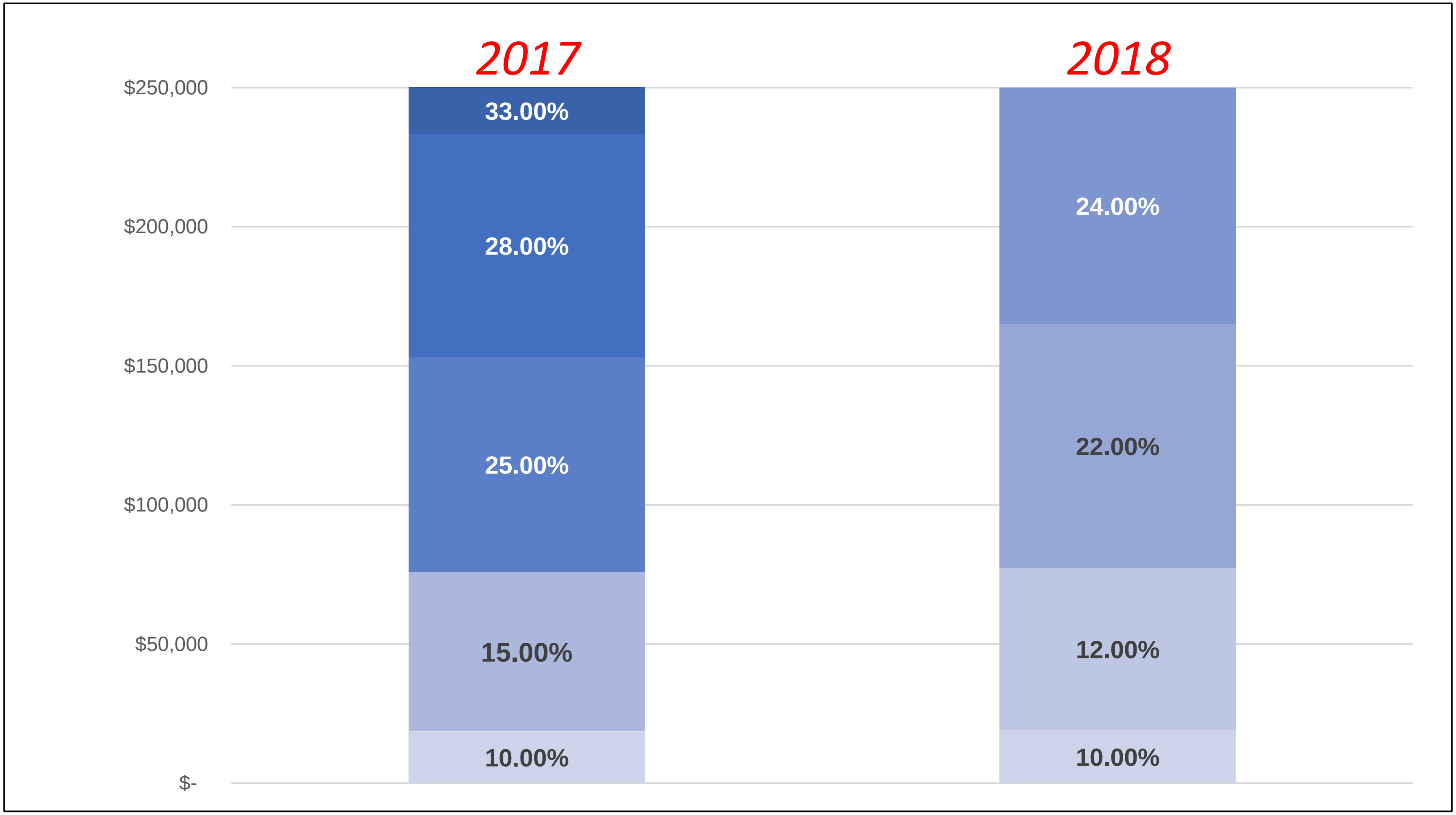
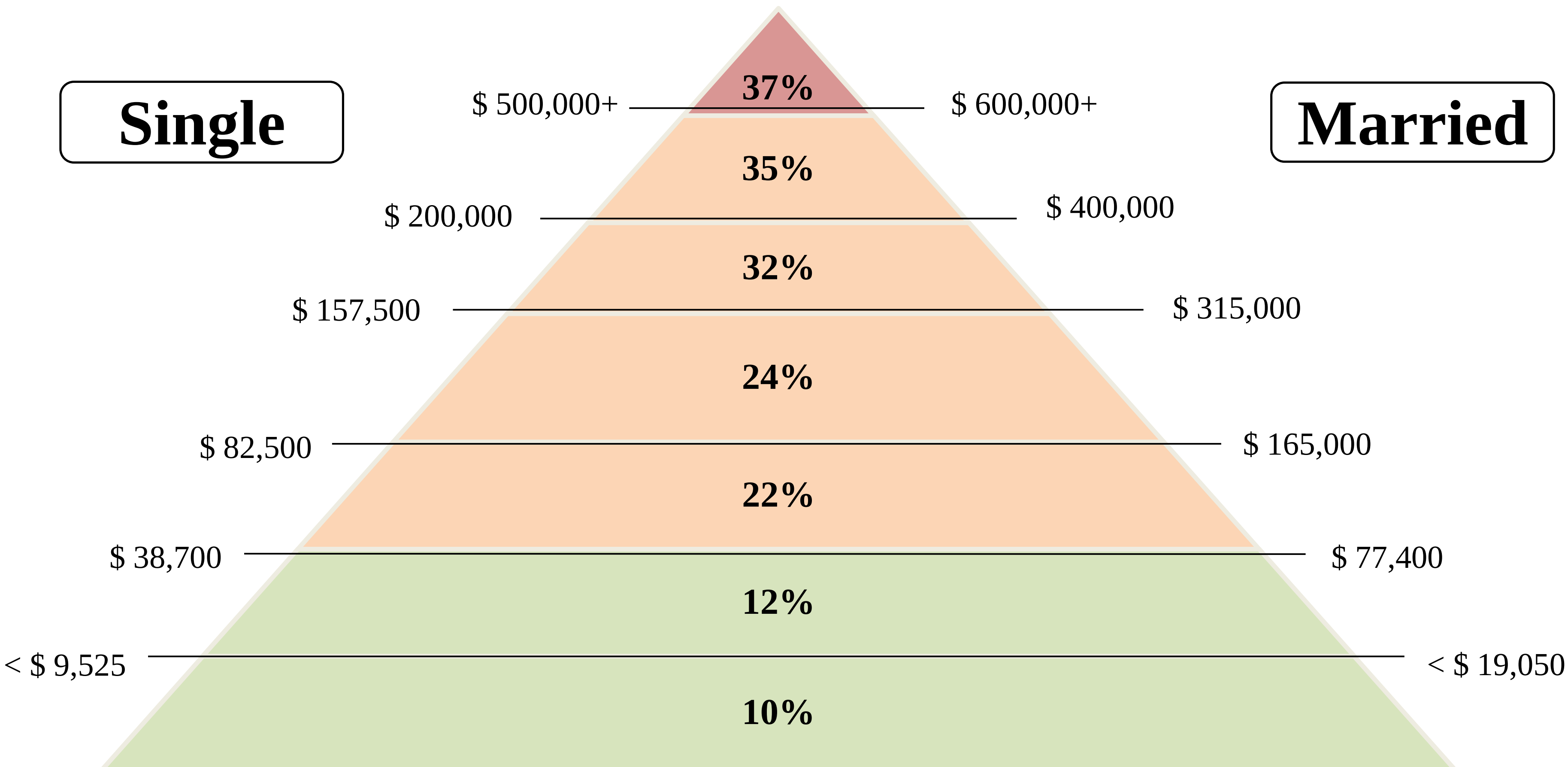
Individual Income Tax Rates

Comparison - $250,000 & Lower

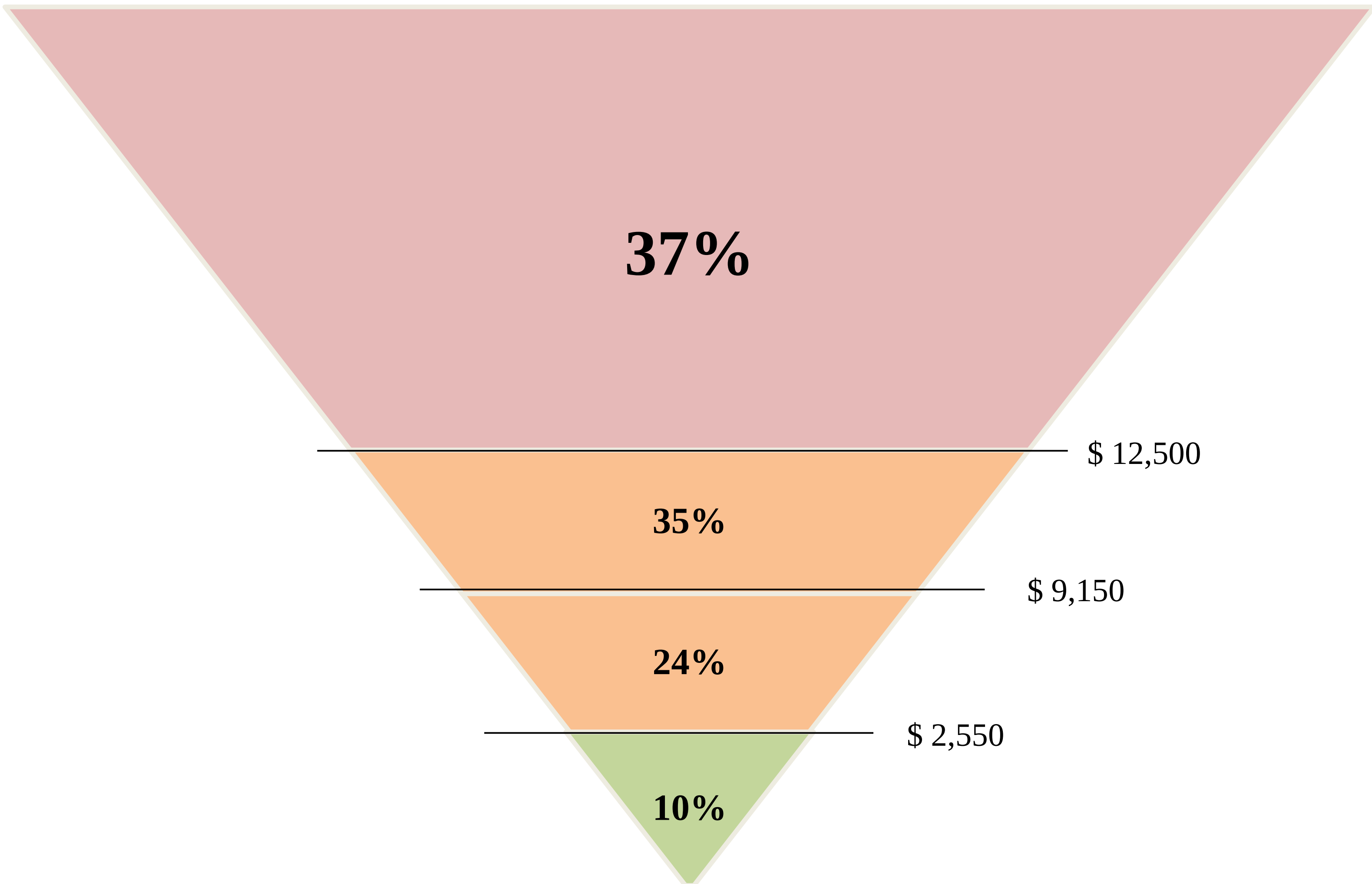




Capital Gains Rates* **0%** **15%** **20%**

*The capital gain & ordinary income brackets no longer align perfectly

Trusts & Estates



Capital Gains Rates **0%** **15%** **20%**

*The capital gain & ordinary income brackets no longer align perfectly

Standard Deduction

2017

CURRENT STANDARD DEDUCTION

S	MFJ/QW	MFS	HOH
$ 6,350	$ 12,700	$ 6,350	$ 9,350

2018

STANDARD DEDUCTION

S	MFJ/QW	MFS	HOH
$ 12,000	$ 24,000	$ 12,000	$ 18,000

§ 63, §11021

Exemptions

- **Exemptions are completely repealed at the end of 2017**
  - Consolidated into the standard deduction
  - Expanded child tax credit and a new family tax credit designed to offset the loss for families

§ 151, §11041

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Child and Family Tax Credits

- Credits after 2017
  - Child tax credit increased from $1,000 to $2,000
  - Compare to the value of an exemption: 12% x $4,150 = $498
  - Additional $500 nonrefundable credit for non-child dependents
- Phase-out increased after 2017
  - Phase-out to increase from $110,000 to $400,000 for joint filers
  - Compare to the value of an exemption: 32% x $4,150 = $1,328

§ 24, §11022

Child and Family Tax Credits

Summary

	2017	2018
Credit for Children	$1,000	$2,000
Credit for other Family Members	$0	$500
Phase-out Begins	$110,000	$400,000
Refundable Amount (credit for children only)	$1,000	$1,400

All figures for MFJ

§ 24, §11022

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Education Provisions

- Section 529 Plans
  - Distributions of <u>up to $10,000</u> may be used for "qualified expenses" for elementary school and high school
- Student loan forgiveness
  - Starting in 2018, forgiveness of student loan debt will not be taxable income to the student on account of the student's death or total disability

§ 529, §11032

§ 108, §11031

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Education Provisions

- Items retained, but modification discussed:
  - Interest expense on education loans
  - Exclusion for employer-provided assistance
  - Exclusion for qualified tuition reduction programs
  - Exclusion for US savings bonds
  - Deduction for qualified tuition and related expenses
  - Lifetime Learning and American Opportunity Tax Credits

ABLE Accounts

- Increases the contribution limit in certain circumstances
- Allows the designated beneficiary of an ABLE account to claim the Saver's Credit for contributions made
- Allows rollovers from 529 accounts to ABLE accounts

§ 529A, §§ 11024-5

Simplification of Deductions

	2018
SALT Deduction (§ 164, § 11042)	Limited to $10,000
Mortgage Interest Deduction (§ 163, § 11043)	Limited to interest on up to $750,000 of acquisition indebtedness; Repeals deduction for home equity indebtedness
Charitable Contributions (§ 170, § 11023)	Percentage Limit increased from 50% to 60% (for cash);
Personal Casualty Losses (§71, § 11044)	Repealed, except for declared disasters
Medical Expenses (§213, § 11027)	Expanded for two years by setting the deduction threshold to 7.5% of AGI for all taxpayers
Job Expenses & Miscellaneous Deductions (§67, § 11045)	All deductions subject to the 2% floor repealed; Many above-the-line deductions retained
Alimony Paid (§71, § 11051)	Repealed for any divorce or separate instrument executed after **12/31/18**
Moving Expenses (§217, § 11049)	Repealed

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Simplification of Deductions

SALT Deduction

- **Pre-payment of state income taxes is specifically barred in the legislation**

- *Example*
  - Doug knows he will owe about $50,000 of state income taxes in 2018
  - State law allows him pre-pay this liability in December 2017
  - However, the legislation specifically bars Doug from deducting this pre-payment on his 2017 federal return

§ 164, § 11042

Simplification of Deductions

SALT Deduction

- **JTC's Summary of the Conference Agreement:**

The conference agreement also provides that, in the case of an amount paid in a taxable year beginning before January 1, 2018, with respect to a State or local income tax imposed for a taxable year beginning after December 31, 2017, the payment shall be treated as paid on the last day of the taxable year for which such tax is so imposed for purposes of applying the provision limiting the dollar amount of the deduction. Thus, under the provision, an individual may not claim an itemized deduction in 2017 on a pre-payment of income tax for a future taxable year in order to avoid the dollar limitation applicable for taxable years beginning after 2017.

§ 164, § 11042

Simplification of Deductions

SALT Deduction

- **Statutory Language:**

For purposes of subparagraph (B), an amount paid in a taxable year beginning before January 1, 2018, with respect to a State or local income tax imposed for a taxable year beginning after December 31, 2017, shall be treated as paid on the last day of the taxable year for which such tax is so imposed.

§ 164, §11042

Simplification of Deductions

SALT Deduction

- **IMPORTANT**

State, local, and foreign property taxes
and State and local sales taxes
are allowed as a deduction
when paid or accrued in carrying on
a trade or business,
or an activity described in section 212
(relating to expenses for the production of income).

§ 164, § 11042

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Simplification of Deductions

SALT Deduction

- **IR-2017-210**

Real property taxes assessed before 2018
And paid in 2017
Are deductible in 2017

Real property taxes paid in 2017
But not assessed before 2018
Are not deductible 2017

§ 164, § 11042

Simplification of Deductions

- Other changes
  - Wagering losses and expenses limited to wagering winnings after 2017
  - “Pease limitation” eliminated

§ 68, § 11046

§ 165, § 11050

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Retirement Plans

- **Roth Recharacterization**
  - Cannot be used to unwind a Roth conversion after 2017
    - The experts are debating whether 9100 relief may be available to those who miss the deadline
  - Can still be used to change a Roth contribution to a contribution to a traditional IRA
- Extended rollover period for plan loan offset amounts after 2017
  - Currently plan loans must be repaid within 60-days of separating from the employer
  - The proposal moves the deadline to the due date of the employee’s income tax return

§ 408A, § 13611

§ 402, § 13613

AMT

- **AMT exemption increased**

	2017	2018
Single or Head of Household	$54,300	$70,300
Married Filing Jointly	$84,500	$109,400
Begin of Phaseout, Single or HoH	$120,700	$500,000
Begin of Phaseout, MFJ	$160,900	$1,000,000

§ 55, § 12003

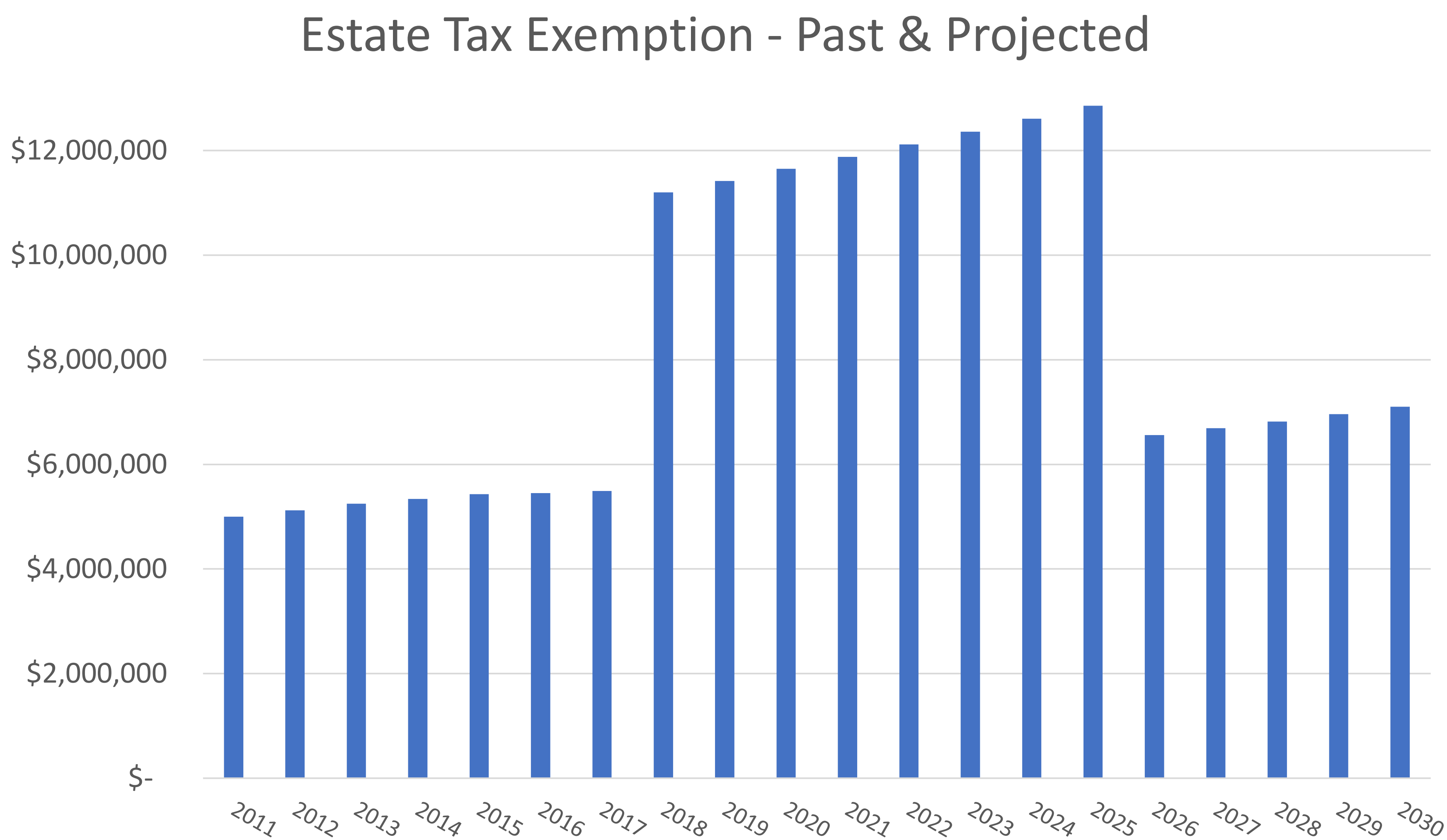
ESTATE PLANNING

Estate & GST Taxes

- Doubles the Basic Exclusion Amount and GST exemption in 2018 ($10,000,000 in 2011 dollars)
- Higher exemption sunsets December 31, 2025
- Retains the § 1014(a) basis adjustment ("step-up")

§ 2010, §11061

Estate & GST Taxes



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Estate & GST Taxes

Planning for a Future Congressional Reduction in the Exemption

- Tax-free gifts (to Dynasty Trusts) to use the higher exemption in anticipation of change
- IDGT sales
- Transfers taking advantage of valuation discounts.
- GST planning
- Shifting growth
- Four to eight-year GRATs for those “in the middle”
  - Force inclusion & obtain a “step-up” sunset in case of death
- GST grandfathered trusts/GST exempt trusts
- Portability elections
- “Springing” SLATs (i.e. SLAT with contingent GPOA provision)
- Increased ease of income shifting
- **Note, it will be difficult to decrease the exemption without creating inequitable results**

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Estate & GST Taxes

Using a GRAT Hedge

- Using a GRAT can "hedge" the risk that a client dies early by protecting the basis step-up.
- Clients must live a significant period of time to shift post-gift appreciation out of their taxable estate for estate tax cost to exceed the income tax cost of preserving basis.
- A GRAT can hedge against the risk of early death because it forces inclusion, thereby achieving a basis increase for appreciated assets.

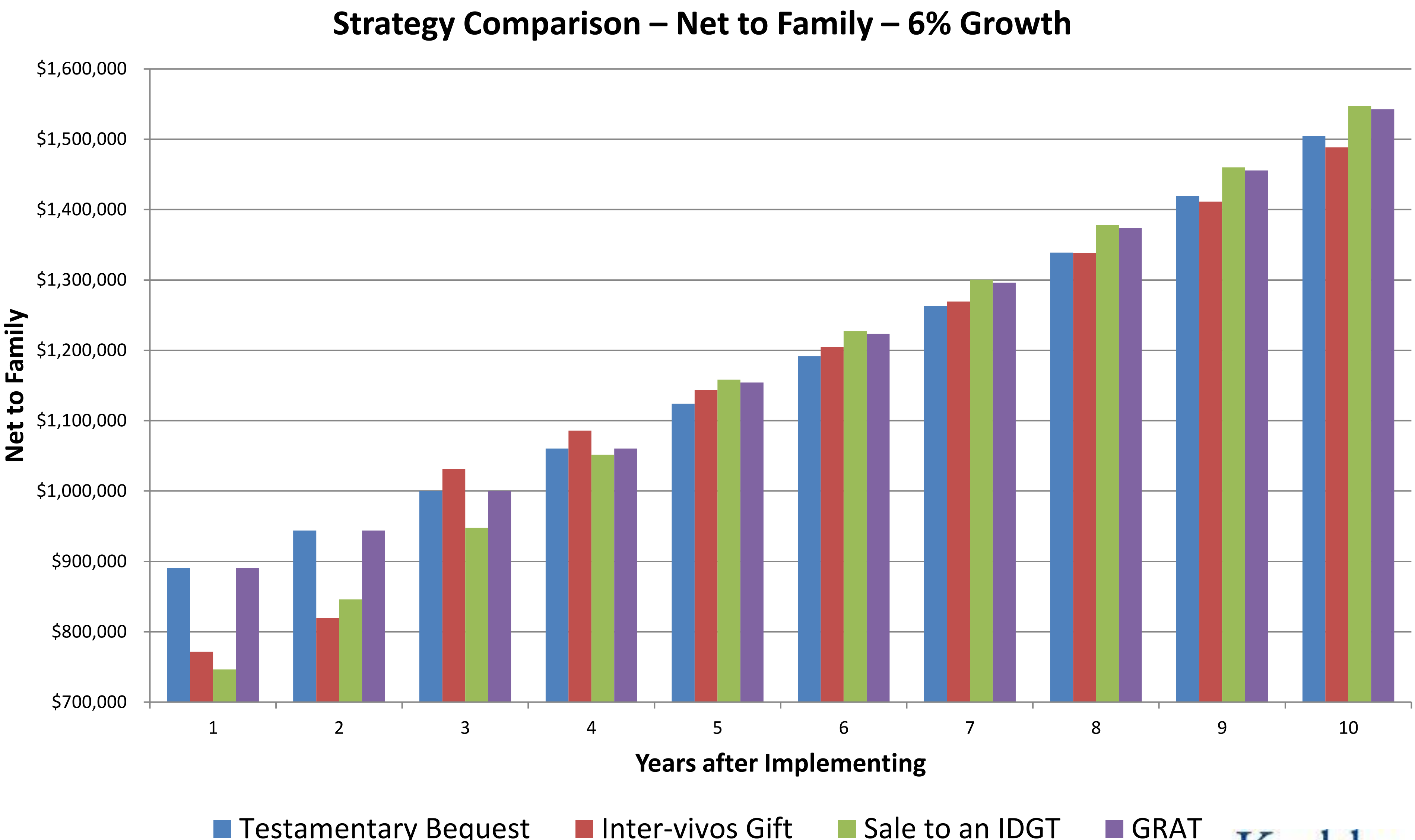
Estate & GST Taxes

Using a GRAT Hedge

- Example:
  - Client owns stock in a closely held business worth $1,000,000; basis is $200,000; rate of return is 6%.
  - The client also has $400,000 of cash available to pay gift tax.
  - The client already exhausted their lifetime exemption by funding a dynasty trust.
  - How should the client plan to transfer the stock to the next generation?
  - You consider the following options:
    - Testamentary bequest
    - Inter vivos gift
    - IDGT Sale to the existing well-funded dynasty trust, with the note fully amortized over five years
    - **Five-year GRAT**

Estate & GST Taxes

Using a GRAT Hedge



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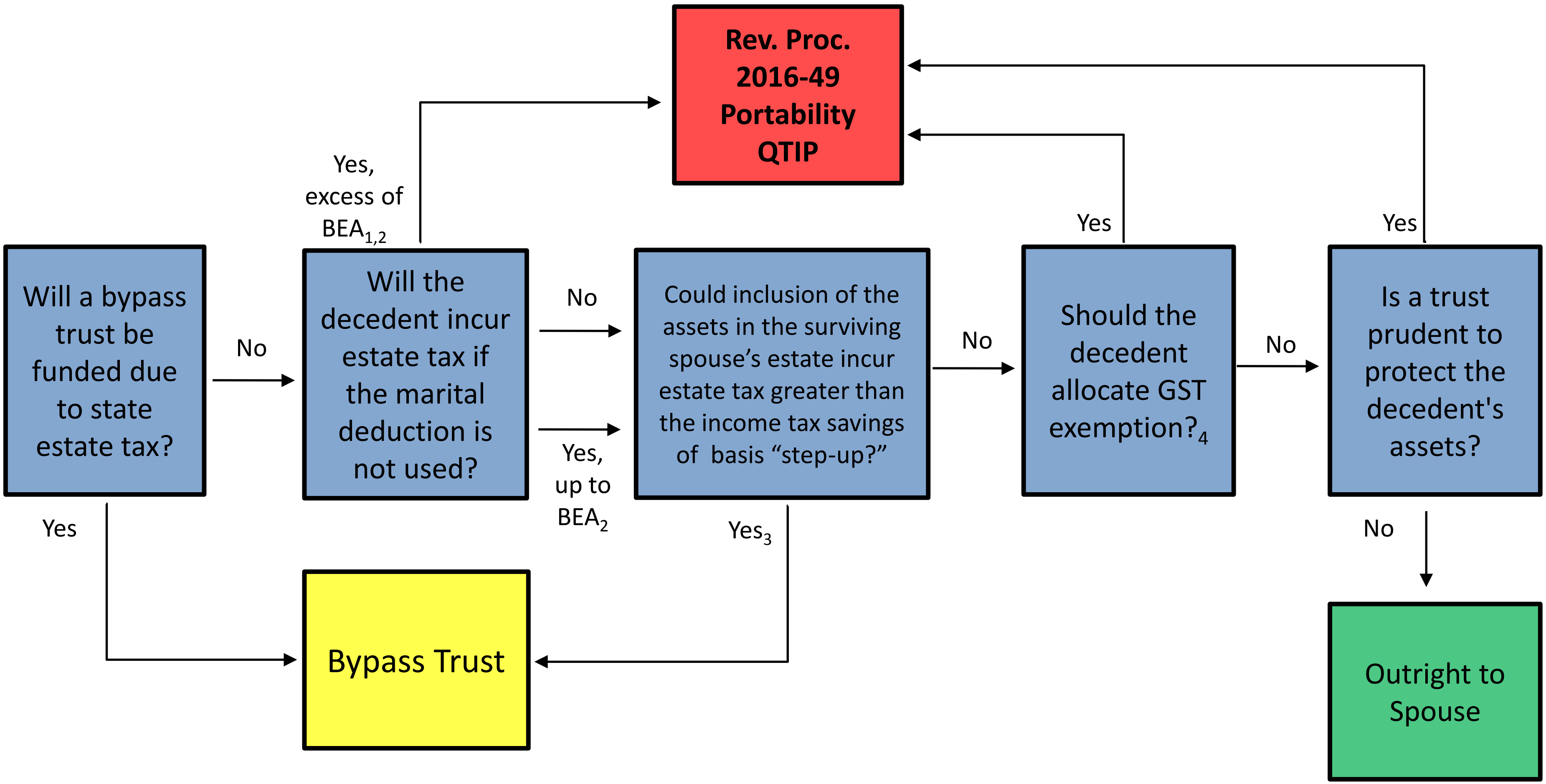
Current Testamentary Planning



1. Basic Exclusion Amount (BEA)
2. Assumes asset protection is desirable.
3. May be prudent to elect portability, give assets to the surviving spouse and then fund the trust in order to allow for a grantor trust.
4. Note that the GST exemption cannot "port" to the surviving spouse, however a "reverse-QTIP" election is available.

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Tax Brackets for Trusts & Estates

2017:

Taxable income over	But not over	Is taxed at
$0	$2,550	15%
$2,550	$6,000	25%
$6,000	$9,150	28%
$9,150	$12,500	33%
$12,500		39.6%

2018:

Taxable income over	But not over	Tax Bill
$0	$2,550	10%
$2,550	$9,150	24%
$9,150	$12,500	35%
$12,500		37%

Income Taxation

- State income taxes are no longer be deductible and trustees should focus on state tax reduction.
- NINGs will be more popular because state income taxes would no longer be deductible.
- Treasury bills, notes and bond interest are generally not subject to state income taxes and should be reviewed.
- It appears that some deductions for professional fees were limited in Conference.
- The selection of the proper year-end for a 645 estate/trust is an important issue this year.

Year-End Planning

- Picking a year-end for estates – In general
  - The date of death is the end of the individual taxpayer's last tax year
  - However, the estate may choose it's first reporting period provided it is twelve months or less and ends on the last day of the month

Year-End Planning

- Picking a year-end for estates –In general
  - The § 645 election allows a QRT to be taxed as if it's part of the estate thereby avoiding that the trust have a 12/31 year-end
  - The end of the reporting period determines the applicable law

Year-End Planning

- Picking a Year-end for Estates – Current Considerations:
  - Rates
  - Effective business income tax rate
  - Charitable contribution timing
  - Date of death

Year-End Planning

- Picking a Year-end for Estates – *Example:*
  - Joe died 4/25/2017
  - His final reporting period is 1/1/2017 – 4/25/2017
  - The start of Joe's estate's tax year is 4/25/2017
  - The estate can choose it's first tax year to end between 4/30/2017 and 3/31/2018
  - Joe's executor will decide whether a 645 election is prudent
  - Joe's executor will intentionally choose a year end so the more favorable tax laws apply to the estate (and QRT)

Year-End Planning

- Bracket Management
- Reducing Income Taxation with Trust Distributions
- Limit on Miscellaneous Deductions (the 2% floor)
- Reducing State Income Taxation with Trust Situs

Shifting Income with Trust Distributions

General Tax Rules

- Income taxed to either the trust or the beneficiary
  - If income is accumulated, then the income is taxed to the trust
  - If income is distributed, then the trust receives an income tax deduction and beneficiaries report taxable income

WARNING

A lawyer or CPA should assist the executor or trustee with annual planning.

Decanting Overview

- Definition: modifying the terms of a trust by distributing its assets to another trust

- The second trust (receiving trust) can be either new or pre-existing

- Decanting can be authorized by the terms of the original trust, state law, or perhaps even by common law.

Decanting

Planning Idea

- Decant to a trust that gives a beneficiary a general power of appointment.
- Trust would be included in beneficiary's taxable estate. IRC Sec. 2041
- Goal: Obtain step-up in basis for trust assets at death of beneficiary

Decanting

Value of the Step-Up - Example

- H dies in 2005 owning XYZ real estate with a value of $400,000. Pursuant to H's estate planning documents, the real estate goes to a credit shelter trust for the benefit of H's wife, W.

- The new basis of the real estate held in the trust is $400,000 (i.e. the value at H's death).

- Assume W dies in 2018 when the real estate has appreciated to $1,000,000. The real estate held in the family trust would still have a basis of $400,000. If the real estate is sold following W's death, the gain would be $600,000 ($1,000,000-$400,000).

- If the trust is decanted into a new trust giving W a GPOA, the trust will be included in W's estate. The real estate would then receive a step-up in basis to $1,000,000 at W's death.

- Decanting the trust property into a trust over which W has a GPOA could save $120,000 of income tax ($600,000 x 20% capital gain tax).

Uses of Decanting

Caveats

- Whether decanting can be used for the applications listed on the previous slides may depend on the applicable state's decanting statute

- Some state decanting statutes are much more favorable than others

- Some of the applications may result in unfavorable tax consequences depending on how the tax issues are resolved by the IRS and the courts

4th Annual Trust Decanting State Rankings Chart

Rank	State	Has Decanting Statute? (60% weight)	Can Decant Trust with Ascert. Standard? (7.5% weight)	Notice to Beneficiaries Required? (7.5% weight)	Can Decant Trust with Ascertainable Standard into Discretionary Trust? (7.5% weight)	Can Remove Mandatory Income Interest? (2.5% weight)	Allow Power of Appointment in Second Trust to Bene fbo Non-Bene? (2.5% weight)	Can Accelerate Remainder Bene's Interest? (2.5% weight)	Dynasty Trust State Ranking (7.5% weight)	Domestic Asset Protection Trust State Ranking (2.5% weight)	Total Score
1	SD	§55.2.15-21	Yes	No	Yes	Yes	Yes	Yes	Ranked #1	Ranked #2	99.5
2	NV	§163.556; SB 484, Sec. 57	Yes	No	Yes	Yes	Yes	Yes	Ranked #2	Ranked #1	99
3	TN	§35-15-816(b)(27)	Yes	No	Yes	No	Yes	Silent	Ranked #3	Ranked #3	93
4	NH	§564-B:4-418	Yes	No, except charitable trusts	Yes	No	Yes	Silent	Ranked #7 (tie)	Ranked #10	91
5	DE	12, §3528	Yes	No	No	Yes	Yes	No	Ranked #7 (tie)	Ranked #5 (tie)	87
6	OH	§5808.18	Yes	Yes	No	Yes	Yes	No	Ranked #6	Ranked #4	80
7 (tie)	AK	§13.36.157-159; §13.36.215	Yes	Yes	No, except after first trust would have ended	No	Yes	No	Ranked #4	Ranked #7	77.5
7 (tie)	IL	760 ILCS 5/16.4	Yes	Yes	No	No	Yes	Silent	Ranked #9	Not allowed	77.5
9	IN	§30-4-3-36	Yes	Yes	Yes	No	Silent	Silent	Unranked	Not allowed	75
10 (tie)	MO	§456.4-419	Yes	Yes, only to beneficiaries of second trust	No	Yes	Silent	Yes	Unranked	Ranked #5 (tie)	74.5
10 (tie)	WY	§4-10-816(a)(xxviii)	Yes	No	Yes	Silent	Silent	Silent	Ranked #5	Ranked #8	74.5

http://www.oshins.com

Steve Oshins is a member of the Law Offices of Oshins & Associates, LLC in Las Vegas, Nevada. He is rated AV by the Martindale-Hubbell Law Directory and is listed in The Best Lawyers in America®. He was inducted into the NAEPC Estate Planning Hall of Fame® in 2011 and has been named one of the 24 "Elite Estate Planning Attorneys" by The Trust Advisor and one of the Top 100 Attorneys in Worth. He can be reached at 702-341-6000, ext. 2 or soshins@oshins.com. His law firm's website is www.oshins.com.

10 – MINUTE INTERMISSION

BUSINESS TAXATION

AFTER THE TCJA

Business Taxation

Main Issues

- Corporate rate reduction
  - AET & PHC Tax
- New 199A pass-through deduction
- Accelerated cost recovery
- New interest paid deduction limit
- New loss deduction limits

TAXATION OF BUSINESS ENTITIES INTRODUCTION

- Overview of Topics
  - Partnership and LLC taxation
  - S-Corporation Taxation
  - C-Corporation Taxation
- Transactional Approach

UNDERSTAND THAT THERE ARE TWO TYPES OF CORPORATIONS

- C-Corporation
  - Taxed at corporate level
  - Free transferability of shares
  - Double taxation

- S-Corporation
  - Income taxed at individual level
  - "BIG" tax within five years
  - Avoids "double" taxation
  - Election may be revoked

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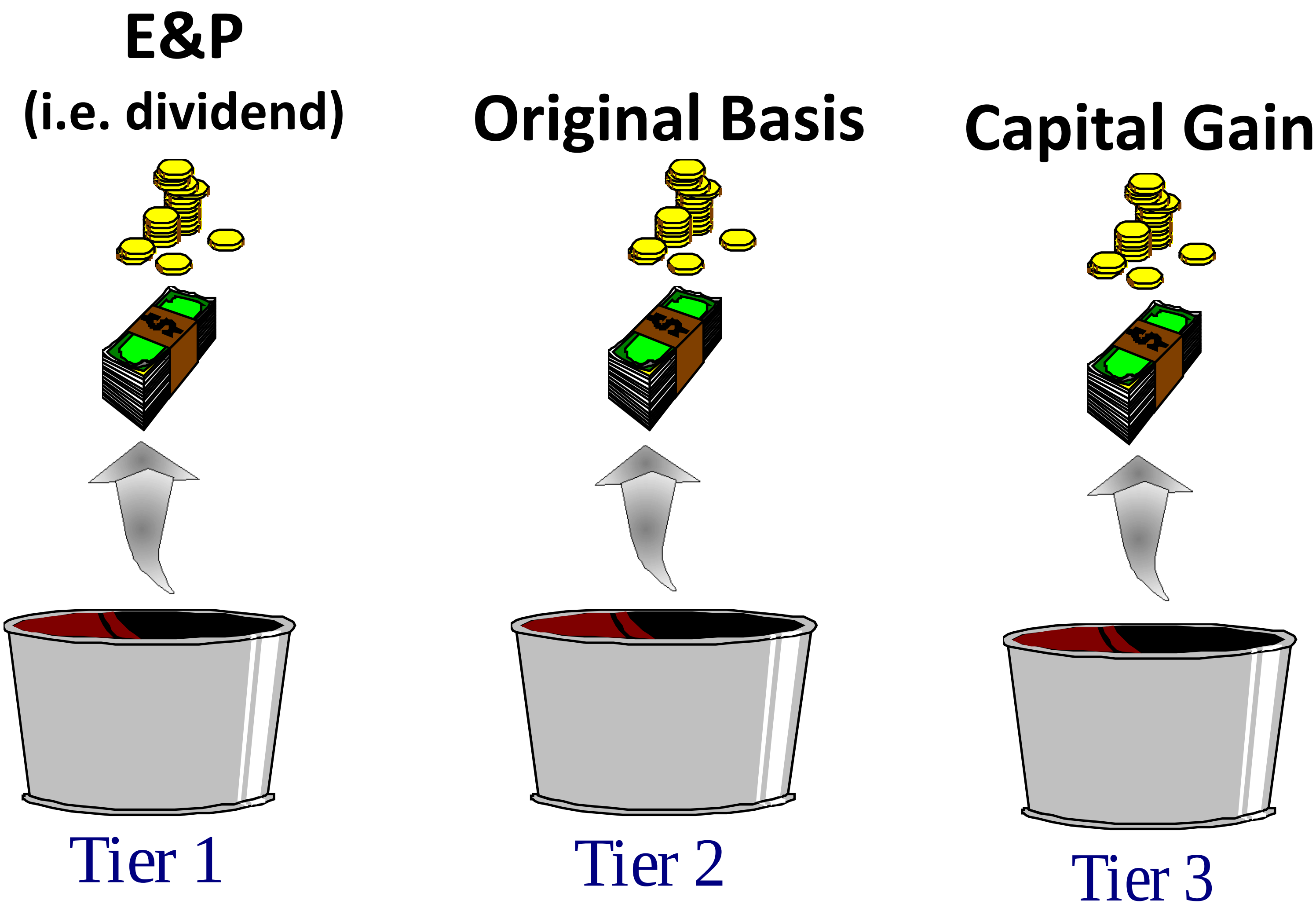
HOW ARE DISTRIBUTIONS AND DIVIDENDS TAXED?

- C-Corporation Distributions
- S-Corporation Distributions
- LLC or Partnership Distributions

C-CORPORATION DISTRIBUTIONS

- Corporation
  - Recognizes gain on the distribution of **appreciated** assets (IRC § 311(b))
    - Example: ABC, Inc. distributes a track of land with a basis of $10,000 and FMV of $100,000. **A gain of $90,000 will be recognized at the corporate level.**

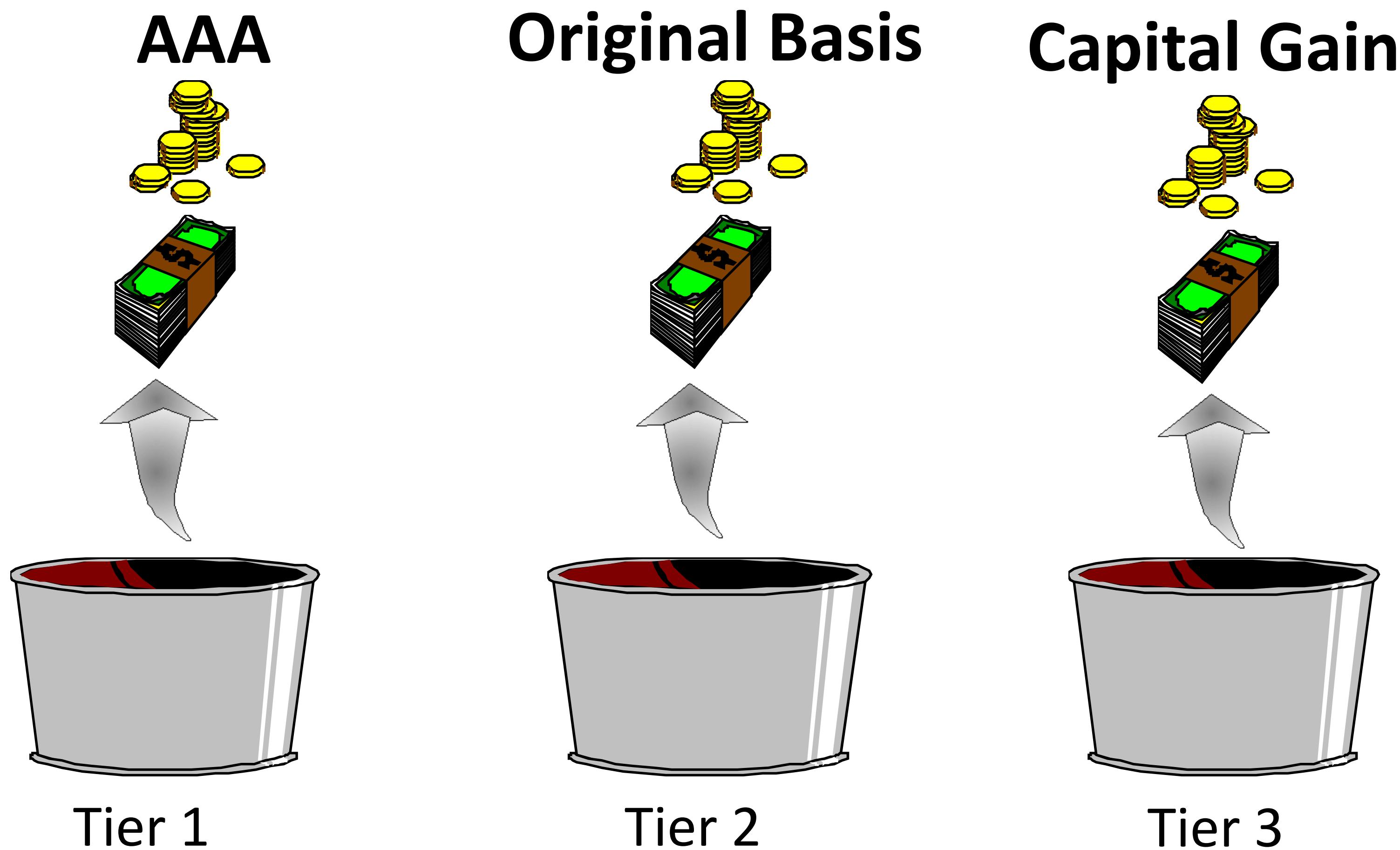
C-CORPORATION DISTRIBUTIONS



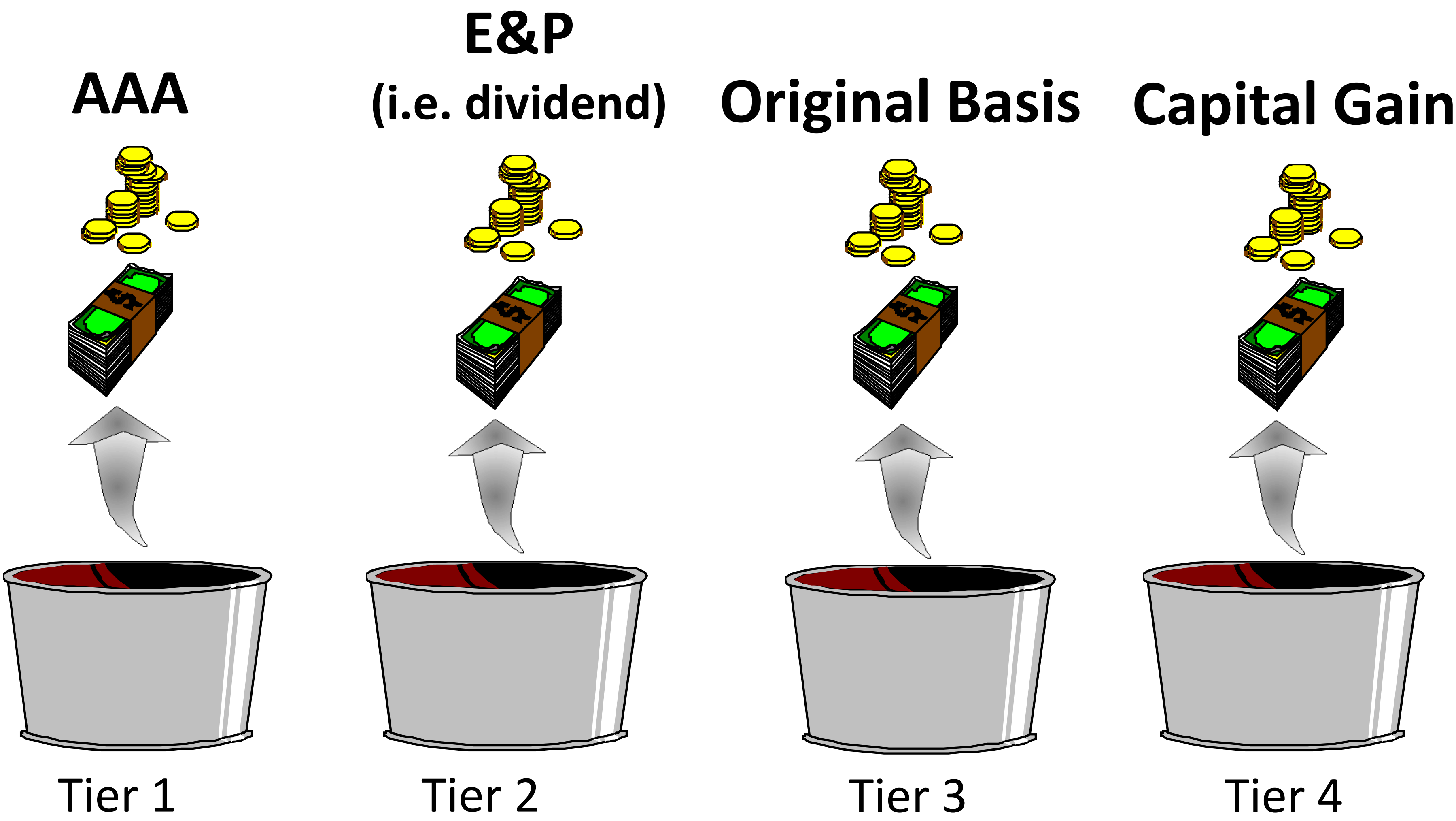
S-CORPORATION DISTRIBUTIONS

- S-Corporation distributions are taxed to the shareholder under a tier system
  - A. Corporation has no E&P
    - Distribution first reduces basis
    - Amounts in excess of basis treated as capital gain from the sale of stock (IRC §1368(b)(2)
  - B. Corporation has E&P
    - Distribution treated the same as for a corporation without E&P up to the amount of AAA (reduction of basis, then capital gain)
    - Remaining portion then treated as a dividend (to the extent of E&P)
    - The amount still left is again treated the same as for a corporation without E&P (IRC §1368(c))

S-CORPORATION DISTRIBUTIONS CORPORATION HAS **NO** E&P



S-CORPORATION DISTRIBUTIONS
CORPORATION HAS E&P



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PARTNERSHIP DISTRIBUTIONS

- Partner
  - Generally not taxable except to the extent the amount of the distribution exceeds the partner's basis in his partnership interest (IRC §731(a))
    - Exception for guaranteed payments and distributions of cash
- Partnership
  - Generally no gain recognized
  - Exception for distribution of unrealized receivables or appreciated inventory (IRC §731)

UNDERSTANDING DOUBLE TAXATION

- C-Corporations are in Essence Taxed Twice
- Pure S-Corporations are Only Taxed Once
- S-Corporation that were Former C-Corporations have Special Concerns
- Partnerships are Only Taxed Once
- Partnerships can make a §754 Election

Personal Holding Company (PHC)

- 20% tax imposed on undistributed personal holding company income
- PHC Definition
  - 60% of adjusted ordinary gross income is personal holding company income
  - Greater than 50% of the value of outstanding stock is owned directly or indirectly by, or for, not more than 5 individuals
- Personal holding company income includes:
  - Dividends
  - Rents
  - Royalties
  - Personal service contracts
  - Trust distributions
- §§ 541-547

Accumulated Earnings Tax (AET)

- 20% tax imposed on accumulated E&P beyond the reasonable needs of the business
- Reasonable needs of the business (basically) include
  - The reasonably anticipated needs of the business (subjective test)
    - Expansion, M&A, retire debt, working capital, investments or loans to customers & suppliers
  - The amount needed for a § 303 redemption
- Purposes suggesting unreasonable accumulations
  - Loans to shareholders or relatives
  - Expenditures for the personal benefit of shareholders
  - Investments unrelated to the corporation's business
  - Retention of amounts to protect against unrealistic risks
- Designed to force distributions of amounts not needed to run the business
- Doesn't apply in addition to the PHC Tax
- §§ 531-537

Corporate Tax Rates

Current

Taxable income:	Tax rate:
$0-$50,000	15 percent
$50,001-$75,000	25 percent
$75,001-$10,000,000	34 percent
Over $10,000,000	35 percent

2018

21% flat rate

§ 11, §13001

Business Pass-through Rate

- Traditional Businesses
- Rental Real Estate
- Specified Service Businesses
- Planning
  - Basic Planning
  - Advanced Planning
  - Completed Gift Trusts
  - Incomplete Gift Trusts

Business Pass-through Rate

- Deduction equal to 20% of domestic “qualified business income” (QBI) from a pass-through entity
- Basically, provides an effective top marginal rate of 29.6% [37% x (1 – 20%)]
- Applies to trusts & estates

§ 199A, §11011

Business Pass-through Rate

- Owners of:
  - Sole proprietorships (Schedule C)
  - Sole owners (or TIC owners) of rental real estate (Schedule E)
  - S-Corporation owners (Form 1120S)
  - Partnership owners (Form 1065)

Business Pass-through Rate

Four Business Classifications

	Non-Service	Service
Taxable income less than $315,000 (MFJ)	**20% deduction**	**20% deduction**
Taxable income greater than $315,000 but less than $415,000	Limitation phased-in	Deduction phased-out
Taxable income greater than $415,000	**W-2/Property limit applies**	**No deduction**

THE HEART OF PLANNING IS MANAGING TAXABLE INCOME AND THE WAGE / PROPERTY LIMITATION.

Business Pass-through Rate

TYPES OF TAXPAYERS	THRESHOLD AMOUNT
Single persons	$ 157,500
Married persons	$ 315,000
Estates	$ 157,500
Non-grantor completed gift trusts	$ 157,500
Non-grantor incomplete gift trusts	$ 157,500
Children subject to the “kiddie tax”	$ 157,500

Business Pass-through Rate

- Deduction equal to 20% of domestic "qualified business income" (QBI) from a pass-through entity
- Basically, provides an effective top marginal rate of 29.6%
- Applies to trusts & estates

§ 199A, §11011

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Business Pass-through Rate

- For those with taxable income in excess of $415,000 (MFJ) the deduction is limited to the greater of:
  - 50% of W-2 Wages
  - 25% of W-2 Wages plus 2.5% of unadjusted basis
- Unavailable to Specified Service Business owner's taxable income in excess of $415,000 (MFJ)
- Limitations phased-in from $315,000 - $415,000 (MFJ) of taxable income

§ 199A, §11011

Business Pass-through Rate

- Specified Service Business – defined in § 1202(e)(3)(A):

  "any 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 any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees"

- The final version includes new statutory language to exclude architects and engineers from the Specified Service Business definition

§ 199A, §11011

Business Pass-through Rate

- The deduction also cannot exceed the lesser of
  - The Combined QBI Amount, or
  - 20% x (total taxable income – capital gain)

- Combined QBI amount = deduction for each qualified trade or business ***PLUS*** 20% of REIT dividends and PTP income

§ 199A, §11011

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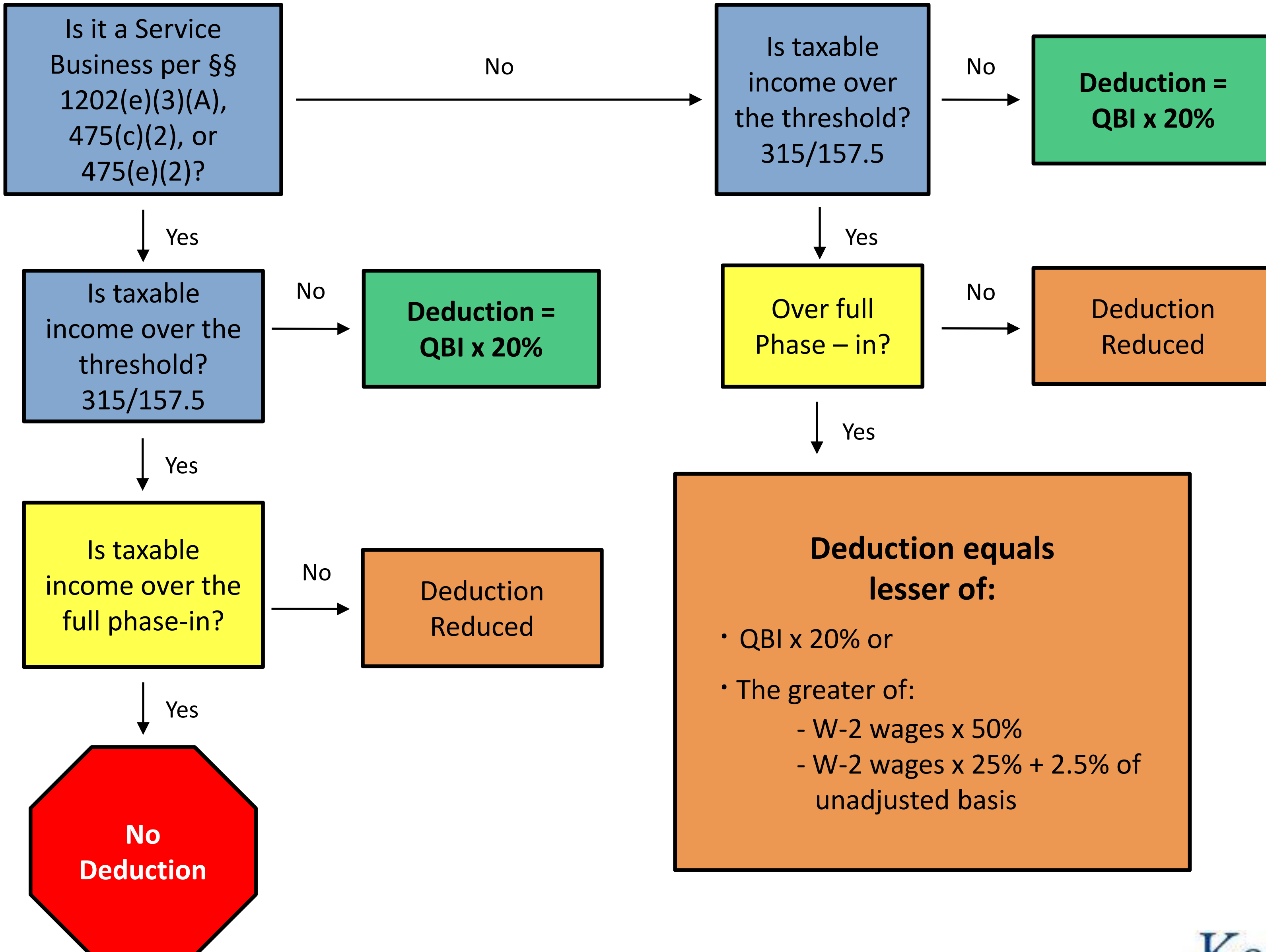
Is it a Service Business per §§ 1202(e)(3)(A), 475(c)(2), or 475(e)(2)?
No
Is taxable income over the threshold? 315/157.5
No
Deduction = QBI x 20%
Yes
Yes
Is taxable income over the threshold? 315/157.5
No
Deduction = QBI x 20%
Over full Phase – in?
No
Deduction Reduced
Yes
Yes
Is taxable income over the full phase-in?
No
Deduction Reduced
Deduction equals lesser of:
• QBI x 20% or
• The greater of:
- W-2 wages x 50%
- W-2 wages x 25% + 2.5% of unadjusted basis
Yes
No Deduction

Service Business (Re)Classification

Marginal Rate Example – Taxable Income of $315,000 (MFJ)

Pass-through

Business Income		$ 100.00
Special Business Deduction	20%	(20.00)
Taxable Income		$ 80.00
Income Tax	24%	$ (19.20)
Business Income		$ 100.00
Less: Income Tax		(19.20)
Net to Business Owner		$ 80.80
Tax Rate		**19.2%**

C-Corp

Corporate Income		$ 100.00
Corporate Income Tax	21%	(21.00)
Net to Corporation		$ 79.00
Dividend		$ 79.00
Shareholder Income Tax	18.8%	(14.85)
Net to Shareholder		**$ 64.15**
Tax Rate		**35.85%**

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Service Business (Re)Classification

Marginal Rate Example –
Taxable Income of $415,000 - $479,000 (MFJ)

Pass-through

Income		$ 100.00
Normal Pass-Through Tax	35%	(35.00)
Net to Business Owner		$ 65.00
Tax Rate		**35.0%**

No Deduction

C-Corp

Corporate Income		$ 100.00
Corporate Income Tax	21%	(21.00)
Net to Corporation		$ 79.00
Dividend		$ 79.00
Shareholder Income Tax	18.8%	(14.85)
Net to Shareholder		**$ 64.15**
Tax Rate		**35.85%**

Service Business (Re)Classification

Marginal Rate Example – Taxable Income of $479,000 – $600,000 (MFJ)

Pass-through

Income		$ 100.00
Normal Pass-Through Tax	35%	(35.00)
Net to Business Owner		$ 65.00
Tax Rate		**35.0%**

No Deduction

C-Corp

Corporate Income		$ 100.00
Corporate Income Tax	21%	(21.00)
Net to Corporation		$ 79.00
Dividend		$ 79.00
Shareholder Income Tax	23.8%	(18.80)
Net to Shareholder		**$ 60.20**
Tax Rate		**39.80%**

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Service Business (Re)Classification

Marginal Rate Example – Taxable Income Over $600,000(MFJ)

Pass-through

Income		$	100
Normal Pass-Through Tax	37%		(37)
Net to Business Owner		$	63
Tax Rate			**37.0%**

No Deduction

C-Corp

Corporate Income		$ 100.00
Corporate Income Tax	21%	(21.00)
Net to Corporation		$ 79.00
Dividend		$ 79.00
Shareholder Income Tax	23.8%	(18.80)
Net to Shareholder		**$ 60.20**
Tax Rate		**39.80%**

Pass-thru Deduction

Example #1

Partner in a Partnership Involved in Rental Real Estate (Income Below Phase-Out Range)

Sara, married and a 25% partner in Blackacre, LLP (a rental real estate partnership), has $250,000 of pass-through net business income in 2018. Sara and her husband have $230,000 of other income and expect to take the standard deduction ($24,000) in 2018.

Based on these facts, below is a summary of Sara's QBI deduction in 2018:

Net business income (a)	$62,500
Other income	230,000
Adjusted gross income	$292,000
Less: Standard deduction	- 24,000
Taxable income (b)	$268,000
QBI deduction*	**$12,500**

** QBI deduction = Lesser of: (a) 20% of net business income ($250,000 x 25% x 20% = $12,500) or (b) 20% of taxable income ($256,000 x 20% = $51,200)*

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Pass-thru Deduction

Example #2

Partner in a Partnership Involved in Rental Real Estate (Income Above Phase-Out Range)

Paul, married and a 50% partner in Greenacre, LP (a rental real estate partnership), has $750,000 of pass-through net business income in 2018. Paul and his wife have $100,000 of other income and will have $50,000 of itemized deductions ($10,000 real estate and state income taxes + $40,000 charitable donations) in 2018. Additionally, Greenacre, LP has $120,000 of W-2 wages and $4,000,000 of assets (unadjusted cost basis).

Based on these facts, below is a summary of Paul's QBI deduction in 2018:

Net business income (a)	$375,000
Other income	100,000
Adjusted gross income	$475,000
Less: Itemized deductions	- 50,000
Taxable income (b)	$425,000
QBI deduction*	**$65,000**

**QBI Deduction = Lesser of: (a) 20% of net business income ($750,000 x 50% x 20% = $75,000), (b) 20% of taxable income ($425,000 x 20% = $85,000) or (c) greater of: (i) 50% of W-2 wages ($120,000 x 50% x 50% = $30,000) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets ([$120,000 x 50% x 25%] + [$4,000,000 x 50% x 2.5%] = $65,000)*

Pass-thru Deduction

Example #3

Partner in a Partnership Involved in Rental Real Estate (Income Above Phase-Out Range)

Jane is married and a 75% partner in Mountain Crest, LLC (a rental real estate partnership started in 1995), which has $60,000 of pass-through net business income in 2018. Jane has $500,000 of other income and will claim the standard deduction 2018. Mountain Crest has no employees, but an unadjusted basis in qualified property of $1,000,000.

Based on these facts, below is a summary of Jane's QBI deduction in 2018:

Net business income (a)	$45,000
Other income	500,000
Adjusted gross income	$545,000
Less: Standard deduction	- 24,000
Taxable income (b)	$521,000
QBI deduction*	**$9,000**

** QBI Deduction = Lesser of: (a) 20% of net business income ($60,000 x 75% x 20% = $9,000), (b) 20% of taxable income ($521,000 x 20% = $104,200) or (c) greater of: (i) 50% of W-2 wages ($0 x 75% x 50% = $60,000) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets ([$0 x 75% x 25%] + [$1,000,000 x 75% x 2.5%] = $18,750)*

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Pass-thru Deduction

Example #4

Individual Involved in Rental Real Estate
(Income Above Phase-Out Range)

Debra is single and rents out a duplex she bought in 1981. The improvements are fully depreciated and the mortgage is paid off. She will have $10,000 of taxable income from it in 2018. Debra has $215,000 of other income and will claim the standard deduction 2018. She has no employees and improvements are not qualified property. She did however, replace the appliances in 2012 for $2,400. Based on these facts, below is a summary of Debra's QBI deduction in 2018:

Net business income (a)	$10,000
Other income	215,000
Adjusted gross income	$225,000
Less: Standard deduction	- 12,000
Taxable income (b)	$213,000
QBI deduction*	**$ 60**

** QBI Deduction = Lesser of: (a) 20% of net business income ($10,000 x 20% = $2,000), (b) 20% of taxable income ($225,000 x 20% = $45,000) or (c) greater of: (i) 50% of W-2 wages ($0 x 50% = $0) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets ([$0 x 25%] + [$2,400 x 2.5%] = $60)*

Pass-thru Deduction

Example #5

Individual Involved in Rental Real Estate
(Income Above Phase-Out Range)

Debra bought a neighboring identical duplex for $170,000 in 2017. She paid cash for it. The land is worth $30,000 and depreciable improvements are worth $140,000. She expects to have $5,000 of taxable income after depreciation. Based on these facts, below is a summary of Debra's QBI deduction in 2018:

Net business income (a)	$ 5,000
Other income	220,000
Adjusted gross income	$225,000
Less: Standard deduction	- 12,000
Taxable income (b)	$213,000
QBI deduction*	**$ 1,000**

** QBI Deduction = Lesser of: (a) 20% of net business income ($5,000 x 20% = $1,000), (b) 20% of taxable income ($225,000 x 20% = $45,000) or (c) greater of: (i) 50% of W-2 wages ($0 x 50% = $0) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets ([$0 x 25%] + [$140,000 x 2.5%] = $3,500)*

Qualified Business Income (QBI) Deduction
Example #6
Partner in a Partnership Involved in Rental Real Estate (Income Above Phase-Out Range)

Paul, married and a 50% partner in Greenacre, LP (a rental real estate partnership), has $750,000 of pass-through net business income in 2018. Paul and his wife have $100,000 of other income and will have $50,000 of itemized deductions ($10,000 real estate and state income taxes + $40,000 charitable donations) in 2018. Additionally, Greenacre, LP has $120,000 of W-2 wages and $4,000,000 of assets (unadjusted cost basis).

Based on these facts, below is a summary of Paul's QBI deduction in 2018:

Net business income (a)	$750,000
Other income	100,000
Adjusted gross income	$850,000
Less: Itemized deductions	- 50,000
Taxable income (b)	$800,000
QBI deduction*	**$ 65,000**

** QBI Deduction = Lesser of: (a) 20% of net business income ($750,000 x 20% = $150,000), (b) 20% of taxable income ($800,000 x 20% = $160,000) or (c) greater of: (i) 50% of W-2 wages ($120,000 x 50% x 50% = $30,000) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets ([$120,000 x 50% x 25%] + [$4,000,000 x 50% x 2.5%] = $65,000)*

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Pass-thru Deduction

Example #7-1

Family Involved in Rental Real Estate (Income Above Phase-Out Range)

Richard and Delores, a married couple, purchased 500 apartment units between 1975 and 1990. These are managed by others and they pay no wages. The Qualified Business Income from this activity is about $1,900,000 and their total taxable income is about $2,200,000. The original basis of the improvements is fully depreciated so they have a minimal amount of qualified property; about $750,000. Based on these facts, below is a summary of their QBI deduction in 2018:

QBI Deduction = Lesser of:

(a) 20% of net business income: $1,900,000 x 20% = **$380,000**

(b) 20% of taxable income: $2,200,000 x 20% = $**440,000**

(c) greater of: (i) 50% of W-2 wages ($0 x 50% = $0) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets: [$0 x 25%] + [$750,000 x 2.5%] = **$18,750**

Pass-thru Deduction

Example #7-2

Family Involved in Rental Real Estate
(Income Above Phase-Out Range)

Richard and Delores, gift interests in the entities which own the properties evenly to 15 trusts set up for each of their four children and 11 grandchildren. The Qualified Business Income and taxable income for each of these trusts is approximately $126,667. This is less than the threshold amount of $157,500 and therefore the limitation does not apply. Based on these facts, below is a summary of their QBI deduction for each trust:

QBI Deduction = Lesser of:

(a) 20% of net business income: $126,667 x 20% = **$25,333**

(b) 20% of taxable income: $ 126,667 x 20% = **$25,333**

Managing the Limitation

- **Excess Income**
  - Amount by which taxable income exceeds the threshold amount
  - Opportunity: Reducing income increases the deduction
- **Excess Limitation**
  - Amount by which the limitation imposed on high-earners exceeds 20% x QBI
  - Opportunities: Decrease wages or unadjusted basis without penalty
- **Unused Deduction**
  - Limitation imposed on high-earners reduces the deduction to less than 20% x QBI
  - Opportunities: Increase leverage without penalty, increase wages or investment to increase deduction

Managing the Limitation

Excess Income Example

- Tom is a married self-employed lawyer
  - His taxable income in 2018 will be $400,000
  - The practice generates $200,000 of QBI
- Without planning, his QBI deduction is $9,000
  - Calculation: $200,000 x 20% (1 - ($400,000−$315,000)/$100,000)
  - QBI Deduction Tax Savings : $6,000 x 32% = **$1,920**
- However, with a $85,000 pension contribution his deduction is **$40,000**
  - Calculation: $200,000 x 20%
  - Additional QBI Deduction Tax savings: $40,000 x 32% = $12,800 - $1,920 = **$10,880**
  - Pension Contribution Tax Savings $85,000 x 32% = **$27,200**

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Managing the Limitation

Example of the Asset Limitation –
Investment Real Estate

Qualified Business Income		$	15,000
General Deduction	20%	$	(3,000)
W-2 Wages		$	-
25% of Wages	25%	$	-
Unadjusted Basis of Assets		$	2,000,000
2.5% of Assets	2.5%	$	50,000

Qualified Business Income		$	15,000
199A Deduction			(3,000)
Taxable Income from the Business		$	12,000
Income Tax	37%	$	4,440

Effective Tax Rate **29.60%**

Note, deleveraging would increase QBI & the 199A Deduction

Managing the Limitation

Example of the Asset Limitation – Investment Real Estate

Qualified Business Income		$	90,000
General Deduction	20%	$	(18,000)
W-2 Wages		$	-
25% of Wages	25%	$	-
Unadjusted Basis of Assets		$	2,000,000
2.5% of Assets	2.5%	$	50,000

Qualified Business Income		$	90,000
199A Deduction			(18,000)
Taxable Income from the Business		$	72,000
Income Tax	37%	$	26,640

Effective Tax Rate **29.60%**

Same example, no leverage

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Mismatch Example

Do Nothing

Apartment Building 1

- Acquired by Green Acre LP in 1995 for $4,200,000
- Similar building & identical partners
- $3,400,000 of depreciable assets
- No debt
- QBI of approximately $480,000
- 199A Deduction = lesser of:
  - 20% x $480,000 = $96,000
  - 2.5% x $3,400,000 = **$85,000**

Apartment Building 2

- Acquired by Black Acre LP in 1995 for $4,200,000
- Similar building & identical partners
- $3,400,000 of depreciable assets
- Debt of **$7,000,000**
- QBI of approximately $200,000
- 199A Deduction = lesser of:
  - 20% x $200,000 = **$40,000**
  - 2.5% x $3,400,000 = $85,000

Total Deduction = $125,000

Mismatch Example

Recapitalize / Merge

Apartment Building 1

- New debt of $3,500,000
- New QBI of approximately $340,000
- 199A Deduction = lesser of:
  - 20% x $340,000 = **$68,000**
  - 2.5% x $3,400,000 = $85,000

Apartment Building 2

- New debt of $3,500,000
- New QBI of approximately $340,000
- 199A Deduction = lesser of:
  - 20% x $340,000 = **$68,000**
  - 2.5% x $3,400,000 = $85,000

Total Deduction = $136,000

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Cost Recovery

- Bonus Depreciation

Period	Applicable Percentage
9/27/2017 - 2022	100%
2023	80%
2024	60%
2025	40%
2026	20%

Expanded to Include Used Property

(formerly only allowed new property)

§ 168, §13201

Cost Recovery

- IRC §179 Expansion
  - Currently, a taxpayer may expense (under IRC § 179) up to $500,000 of property. However, this is phased out if a business places over $2,000,000 of property in service during the tax year
  - The proposal increases the expensing limit to $1,000,000 and the phase-out to $2,500,000

Note, Section 179 applies to new and used property

§ 179, §13101

Cost Recovery

- IRC §179 Expansion (cont.)
  - Expands the definition of qualified tangible personal property and qualified real property eligible to include
    - tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging
    - improvements to nonresidential real property placed in service after the date such property was first placed in service:
      - roofs;
      - heating, ventilation, and air-conditioning;
      - fire protection and alarm systems;
      - and security systems.

§ 179, §13101

Recovery Period for Real Property

- A real property trade or business which elects out of the new limit on the deduction for interest paid must use ADS; which requires the following recovery periods:

	2017	2018
– Qualified improvement property	~~39 years~~	20 years
– Nonresidential real property	40 years	40 years
– Residential real property	~~40 years~~	30 years

§ 168, §13204

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Like-Kind Exchanges

- The bill proposes to limit like-kind exchanges to real property
- However, the bill would allow transactions open at the end of 2017 to be completed tax-free

§ 1031, §13303

Business Interest Deduction

- Businesses with average gross receipts that **do not exceed $25,000,000** are exempt (test on a affiliated basis)
- The proposal would disallow interest expense in excess of 30% of a business's "adjusted taxable income"
- "Adjusted taxable income" is computed without regard to deductions allowable for depreciation, amortization, or depletion
- Any interest disallowed would be **carried forward indefinitely**
- Determined at the tax-filer level (e.g. the **partnership** not the partners would be subject to testing), but it is determined at the consolidated return level for affiliated corporations
- At the taxpayer's election, certain real property and construction businesses and farms are exempt (but must use ADS)

§ 163, §13301

Business Interest Deduction

- Example
  - John and Mary own a number of nursing homes
  - All the facilities are owned by a corporation started by Mary's great grandfather
  - Average gross receipts are about $40,000,000 and "adjusted taxable income" is about $5,000,000
  - The business has enormous capital requirements and pays over $2,000,000 of interest annually
  - The legislation limits the deductible amount to $1,500,000 ($5,000,000 x 30%)
  - The excess can be carried forward

§ 163, §13301

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NOL Deduction

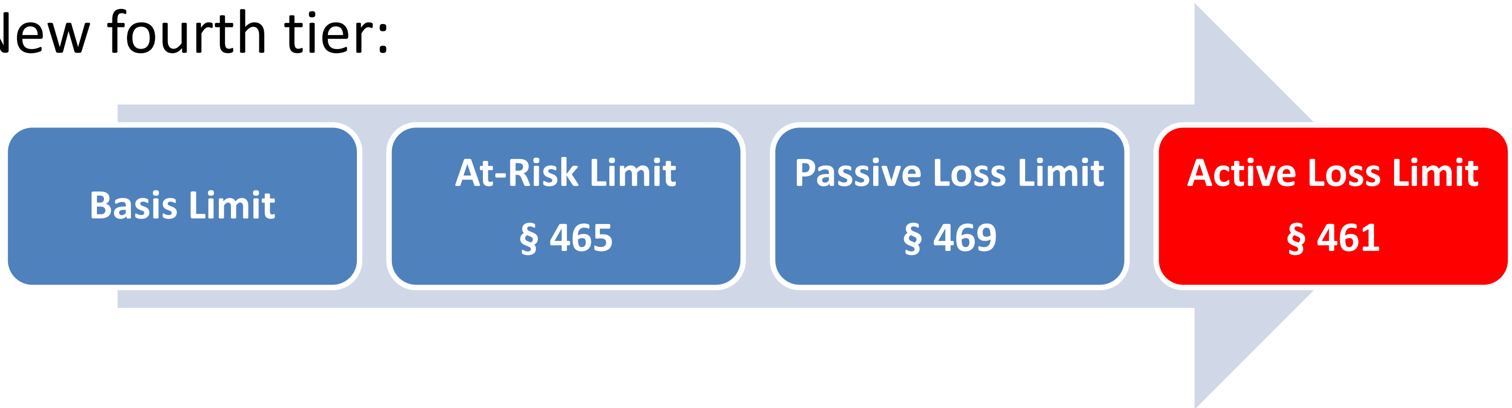
- Under current law, NOLs can generally be carried forward twenty years and back two
- The legislation limits a NOL carryover deduction to offset 80% of taxable income (90% deduction for AMT)
- The legislation would also eliminate carrybacks (generally)
- NOLs to be carried forward indefinitely

§ 172, §13302

Loss Rules

- Amends § 461 to add a new subsection (l)
- Excess business losses disallowed
  - Must be carried-forward
  - Applies to taxpayers with income exceeding $500,000 (MFJ)
  - Applies at the partner or shareholder level

- New fourth tier:



§ 461, §11012

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New Loss Limitation
Example

- Jeff, a married filing jointly taxpayer, owns a single business (in which Jeff "materially participates") which generates a $750,000 loss in 2018.
- Jeff has $2,000,000 of other non-business income

	Current Law	2017 Tax Bill
Other income	$2,000,000	$2,000,000
Business loss	- 750,000	- 500,000
Adjusted Gross Income (AGI)	$1,250,000	$1,500,000

NOTE: The $250,000 loss disallowed under the 2017 tax bill will be carried forward to future tax years

§ 461, §11012

Self-Created Property

- Any patent, invention, secret formula or process, model or design
- Not a capital asset, generally
- Section 1235
  - Override provision allows qualified holder capital asset treatment
  - Individual whose efforts created the patent
  - Other individual who acquired property prior to actual reduction to practice of the invention covered by the patent if not the employer

§§ 1221,1231, §13314

Contributions to Capital

- Currently, capital contributions to a corporation are generally not included in its gross income. This includes contributions which are not made in exchange for stock.
- The proposal would require the inclusion of certain contributions as income which exceed the fair market value of stock exchanged.
  - (1) any contribution in aid of construction or any other contribution as a customer or potential customer
  - (2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such)

§118, §13312

Partnership Technical Terminations

- Currently, a partnership is subject to the technical termination rule when 50% or more of the partnership interest ownership changes within 12 months
- The bill would repeal the technical termination rule and new elections would not be required or permitted

§708, §13504

ESBT Expansion

- Currently, a nonresident alien cannot be the beneficiary of an ESBT because this will cause the corporation's S-election to terminate due to an ineligible shareholder
- However, the Senate proposes to eliminate this issue by amending § 1361(c)(2)(B)(v) by adding: "This clause shall not apply for purposes of subsection (b)(1)(C)"

§1361, §13541

ESBT Charitable Contributions

- Currently, charitable contributions from ESBTs are deducted under the rules of § 642(c):
  - The contribution must be paid out of gross income
  - The contribution made pursuant to the governing instruction
  - Excess contributions cannot be carried forward
- The bill provides the charitable contribution deduction for an ESBT is now determined under the rules applicable to individuals under § 170:
  - Percentage limitations apply
  - Carryforward provisions apply

§641, §13542

Eligible Terminated S-Corporation

- Currently, an S-corporation with AAA which terminates its S-election cannot make distributions from its AAA account until it entirely distributes its E&P account
- The legislation however, proposes to allow an “Eligible Terminated S-Corporation” to treat distributions as made from its AAA and E&P accounts on a pro-rata basis for six years
- “Eligible Terminated S-Corporation:”
  - Is a S-corporation before enactment
  - Revokes its S-election within two years of enactment
  - Has the same owners in the same proportion at enactment and revocation

§481, §13543

Questions