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TAX PLANNING LETTER

DECEMBER 2017, #244

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Highlights of the "Tax Cuts and Jobs Act" (Individual Tax Changes)

On 12/22/17, President Trump signed into law H.R. 1, the "Tax Cuts and Jobs Act," a sweeping tax reform law that will entirely change the tax landscape. The legislation reflects the largest major tax reform in over three decades.

This Tax Planning Letter, which refers to the Act by its commonly used name, "Tax Cuts and Jobs Act" (or simply, the "Act") describes key individual tax changes that are made under the Act. This comprehensive tax overhaul dramatically changes the rules governing the taxation of individual taxpayers for tax years beginning before 2026, providing new income tax rates and brackets, increasing the standard deduction, suspending personal deductions, increasing the child tax credit, limiting the state and local tax deduction, and temporarily reducing the medical expense threshold, among many other changes. The legislation also provides a new deduction for non-corporate taxpayers with qualified business income from pass-throughs.

For comprehensive summaries on other areas of the new law, see:

(#243) Highlights of the "Tax Cuts and Jobs Act"
- Business Tax Changes
(#245) Highlights of the "Tax Cuts and Jobs Act"
- S Corporations, Partnerships and Other Changes

TAX RATES & KEY FIGURES

New Income Tax Rates & Brackets

To determine regular tax liability, an individual uses the appropriate tax rate schedule (or IRS-issued income tax tables for taxable income of less than $100,000). The Code provides four tax rate schedules for individuals based on filing status (i.e., single, married filing jointly/surviving spouse, married filing separately, and head of household) each of which is divided into income ranges which are taxed at progressively higher marginal tax rates as income increases.

Pre-Act law: Individuals were subject to six tax rates: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%.

New law: For tax years beginning after 12/31/17 and before 1/1/26, seven tax rates apply for individuals: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The Act also provides four tax rates for estates and trusts: 10%, 24%, 35%, and 37%.

Standard Deduction Increased

Taxpayers are allowed to reduce their adjusted gross income (AGI) by the standard deduction or the sum of itemized deductions to determine their taxable income.

Pre-Act law: For 2018, the standard deduction amounts, indexed to inflation, were to be: $6,500 for single individuals and married individuals filing separately; $9,550 for heads of household, and $13,000 for married individuals filing jointly (including surviving spouses). Additional standard deductions may be claimed by taxpayers who are elderly or blind.

New law: For tax years beginning after 12/31/17 and before 1/1/26, the standard deduction is 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 current-law additional standard deduction for the elderly and blind.

Personal Exemptions Suspended

Pre-Act law: Taxpayers determined their taxable income by subtracting from their adjusted gross income any personal exemption deductions. Personal exemptions generally were allowed for the taxpayer, the taxpayer's spouse, and any dependents. The amount deductible for each personal exemption was scheduled to be $4,150 for 2018, subject to a phase-out for higher earners.

New law: For tax years beginning after 12/31/17 and before 1/1/26, the deduction for personal exemptions is effectively suspended by reducing the exemption amount to zero. A number of corresponding changes are made throughout the Code where specific provisions contain references to the personal exemption amount.

Withholding rules: The Conference Agreement specifies that IRS may administer the withholding rules under §3402 for tax years beginning before 1/1/19 **without** regard to the above amendments (i.e., wage withholding rules may **remain the same** as present law for 2018).

New Measure of Inflation Provided

Tax bracket amounts, standard deduction amounts, personal exemptions, and various other tax figures are annually adjusted to reflect inflation.

Pre-Act law: The measure of inflation was CPI-U (Consumer Price Index for all urban customers).

New law: For tax years beginning after 12/31/17 (12/31/18 for figures that are newly provided under the Act for 2018 and thus won't be reset until after that year (e.g., the tax brackets set out above)), dollar amounts that were previously indexed using CPI-U will instead be

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indexed using chained CPI-U (C-CPI-U). This change, unlike many provisions in the Act, is permanent.

Observation: In general, chained CPI grows at a slower pace than CPI-U because it takes into account a consumer's ability to substitute between goods in response to changes in relative prices. Proponents for the use of chained CPI say that CPI-U overstates increases in the cost of living because it doesn't take into account the fact that consumers generally adjust their buying patterns when prices go up, rather than simply buying an item at a higher price.

Kiddie Tax Modified

Pre-Act law: Under the "kiddie tax" provisions, the net unearned income of a child was taxed at the parents' tax rates if the parents' tax rates was higher than the tax rates of the child. The remainder of a child's taxable income (i.e., earned income, plus unearned income up to $2,100 (for 2018), less the child's standard deduction) was taxed at the child's rates. The kiddie tax applied to a child if:

- the child had not reached the age of 19 by the close of the tax year, or the child was a full-time student under the age of 24, and either of the child's parents was alive at such time,
- the child's unearned income exceeded $2,100 (for 2018), and
- the child did not file a joint return.

New law: For tax years beginning after 12/31/17, the taxable income of a child attributable to earned income is taxed under the rates for single individuals, and taxable income of a child attributable to net unearned income is taxed **according to the brackets applicable to trusts and estates.** This rule applies to the child's ordinary income and his or her income taxed at preferential rates.

Capital Gains Provisions Conformed

The adjusted net capital gain of a non-corporate taxpayer (e.g., an individual) is taxed at maximum rates of 0%, 15%, or 20%.

Pre-Act law: The 0% capital gain rate applied to adjusted net capital gain that otherwise would be taxed at a regular tax rate below the 25% rate (i.e., at the 10% or 15% ordinary income tax rates); the 15% capital gain rate applied to adjusted net capital gain in excess of the amount taxed at the 0% rate, that otherwise would be taxed at a regular tax rate below the 39.6% (i.e., at the 25%, 28%, 33% or 35% ordinary income tax rates); and the 20% capital gain rate applied to adjusted net capital gain that exceeded the amounts taxed at the 0% and 15% rates.

New law: The Act generally retains present-law maximum rates on net capital gains and qualified dividends. It retains the breakpoints that exist under pre-Act law, but indexes them for inflation using C-CPI-U in tax years after 12/31/17.

For 2018, the 15% breakpoint is: $77,200 for joint returns and surviving spouses (half this amount for married taxpayers filing separately), $51,700 for heads of household, $2,600 for trusts and estates, and $38,600 for other unmarried individuals. The 20% breakpoint is $479,000 for joint returns and surviving spouses (half this amount for married taxpayers filing separately), $452,400 for heads of household, $12,700 for estates and trusts, and $425,800 for other unmarried individuals.

CARRIED INTEREST

New Holding Period Requirement

In general, the receipt of a capital interest for services provided to a partnership results in taxable compensation for the recipient. However, under a safe harbor rule, the receipt of a profits interest in exchange for services provided is not a taxable event to the recipient if the profits interest entitles the holder to share only in gains and profits generated after the date of issuance (and certain other requirements are met).

Typically, hedge fund managers guide the investment strategy and act as general partners to an investment partnership, while outside investors act as limited partners. Fund managers are compensated in two ways. First, to the extent that they invest their own capital in the funds, they share in the appreciation of fund assets. Second, they charge the outside investors two kinds of annual "performance" fees: a percentage of total fund assets, typically 2%, and a percentage of the fund's earnings, typically 20%, respectively. The 20% profits interest is often carried over from year to year until a cash payment is made, usually following the closing out of an investment. This is called a "carried interest."

Pre-Act law: Carried interests were taxed in the hands of the taxpayer (i.e., the fund manager) at favorable capital gain rates instead of as ordinary income.

New law: Effective for tax years beginning after 12/31/17, the Act effectively imposes a 3-year holding period requirement in order for certain partnership interests received in connection with the performance of services to be taxed as long-term capital gain. If the 3-year holding period is not met with respect to an applicable partnership interest held by the taxpayer, the taxpayer's gain will be treated as short-term gain taxed at ordinary income rates.

LOSS PROVISIONS

New Limitations on "Excess Business Loss"

In general, the passive loss rules under §469 limit deductions and credits from passive trade or business activities. The passive loss rules apply to individuals, estates and trusts, and closely held corporations. A passive activity for this purpose is a trade or business activity in which the taxpayer owns an interest but does not materially participate. "Material participation" means that the taxpayer is involved in the operation of the activity on a basis that is regular, continuous, and substantial. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income and are carried forward and treated as deductions and credits from passive activities in the next year.

Pre-Act law: §469 provided a limitation on excess farm losses that applies to taxpayers other than C corporations. If a taxpayer other than a C corporation received an applicable subsidy for the tax year, the amount of the "excess farm loss" was not allowed for the tax year, and was carried forward and treated as a deduction attributable to farming businesses in the next tax year. An excess farm loss for a tax year meant the excess of aggregate deductions that were attributable to farming businesses over the sum of aggregate gross income or gain attributable to farming businesses plus the threshold amount. The threshold amount was the greater of (1) $300,000 ($150,000 for married individuals filing separately), or (2) for the 5-consecutive-year period preceding the tax year, the excess of the aggregate gross income or gain attributable to the taxpayer's farming businesses over the aggregate deductions attributable to the taxpayer's farming businesses.

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New law: For tax years beginning after 12/31/17 and before 1/1/26, the Act provides that the excess farm loss limitation doesn't apply, and instead a non-corporate taxpayer's "excess business loss" is disallowed. Under the new rule, excess business losses are not allowed for the tax year but are instead carried forward and treated as part of the taxpayer's net operating loss (NOL) carryforward in subsequent tax years. This limitation applies after the application of the passive loss rules described above.

An excess business loss for the tax year is the excess of aggregate deductions of the taxpayer attributable to the taxpayer's trades and businesses, over the sum of aggregate gross income or gain of the taxpayer plus a threshold amount. The threshold amount for a tax year is $500,000 for married individuals filing jointly, and $250,000 for other individuals, with both amounts indexed for inflation.

In the case of a partnership or S corporation, the provision applies at the partner or shareholder level. Each partner's or S corporation shareholder's share of items of income, gain, deduction, or loss of the partnership or S corporation is taken into account in applying the above limitation for the tax year of the partner or S corporation shareholder; and regulatory authority is provided to apply the new provision to any other pass-through entity to the extent necessary, as well as to require any additional reporting as IRS determines is appropriate to carry out the purposes of the provision.

Deduction for Personal Casualty & Theft Losses Suspended

Pre-Act law: Individual taxpayers were generally allowed to claim an itemized deduction for uncompensated personal casualty losses, including those arising from fire, storm, shipwreck, or other casualty, or from theft.

New law: For tax years beginning after 12/31/17 and before 1/1/26, the personal casualty and theft loss deduction is **suspended**, except for personal casualty losses incurred in a Federally-declared disaster. However, where a taxpayer has personal casualty gains, the loss suspension doesn't apply to the extent that such loss doesn't exceed the gain.

Gambling Loss Limitation Modified

In general, taxpayers can claim a deduction for wagering losses to the extent of wagering winnings. However, under pre-Act law, other deductions connected to wagering (e.g., transportation, admission fees) could be claimed regardless of wagering winnings.

New law: For tax years beginning after 12/31/17 and before 1/1/26, the limitation on 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.

CHANGES TO TAX CREDITS

Child Tax Credit Increased

Pre-Act law: A taxpayer could claim a child tax credit of up to $1,000 per qualifying child under the age of 17. The aggregate amount of the credit that could be claimed phased out by $50 for each $1,000 of AGI over $75,000 for single filers, $110,000 for married filers, and $55,000 for married individuals filing separately. To the extent that the credit exceeded a taxpayer's liability, a taxpayer was eligible for a refundable credit (i.e., the additional child tax credit) equal to 15% of earned income in excess of $3,000 (the "earned income threshold"). A taxpayer claiming the credit had to include a valid Taxpayer Identification Number (TIN) for each qualifying child on their return. In most cases, the TIN is the child's Social Security Number (SSN), although Individual Taxpayer Identification Numbers (ITINs) were also accepted.

New law: For tax years beginning after 12/31/17 and before 1/1/26, the child tax credit is increased to $2,000, and other changes are made to phase-outs and refundability during this same period, as outlined below.

Phase-out. The income levels at which the credit phases out are increased to $400,000 for married taxpayers filing jointly ($200,000 for all other taxpayers) (not indexed for inflation).

Non-child dependents. In addition, a $500 nonrefundable credit is provided for certain non-child dependents.

Refundability. The amount of the credit that is refundable is increased to $1,400 per qualifying child, and this amount is indexed for inflation, up to the base $2,000 base credit amount. The earned income threshold for the refundable portion of the credit is decreased from $3,000 to $2,500.

SSN required. No credit will be allowed to a taxpayer with respect to any qualifying child unless the taxpayer provides the child's SSN.

MODIFIED DEDUCTIONS & EXCLUSIONS

State and Local Tax Deduction Limited

Pre-Act law: Taxpayers could deduct from their taxable income as an itemized deduction several types of taxes paid at the state and local level, including real and personal property taxes, income taxes, and/or sales taxes.

New law: For tax years beginning after 12/31/17 and before 1/1/26, subject to the exception described below, State, local, and foreign property taxes, and State and local sales taxes, are deductible **only when paid or accrued in carrying on a trade or business** or an activity described in §212 (generally, for the production of income). State and local income, war profits, and excess profits are not allowable as a deduction.

However, a taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the aggregate of:

- State and local property taxes not paid or accrued in carrying on a trade or business or activity described in §212, and
- State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the tax year.

Foreign real property taxes may **not** be deducted.

Prepayment provision. For tax years beginning after 12/31/16, in the case of an amount paid in a tax year beginning before 1/1/18 with respect to a State or local income tax imposed for a tax year beginning after 12/31/17, the payment will be treated as paid on the last day of the tax year for which such tax is so imposed for purposes of applying the above limits. In other words, a taxpayer who, in 2017, pays an income tax that is imposed for a tax year after 2017, can't claim an itemized deduction in 2017 for that prepaid income tax.

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Mortgage & Home Equity Indebtedness Interest Deduction Limited

Pre-Act law: A taxpayer could deduct as an itemized deduction qualified residence interest, which included interest paid on a mortgage secured by a principal residence or a second residence. The underlying mortgage loans could represent acquisition indebtedness of up to $1 million ($500,000 in the case of a married individual filing a separate return), plus home equity indebtedness of up to $100,000.

New law: For tax years beginning after 12/31/17 and before 1/1/26, 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). For tax years after 12/31/25, the prior $1 million/$500,000 limitations are **restored**, and a taxpayer may treat up to these amounts as acquisition indebtedness regardless of when the indebtedness was incurred. The suspension for home equity indebtedness also **ends** for tax years beginning after 12/31/25.

Treatment of indebtedness incurred on or before 12/15/17. The new lower limit doesn't apply to any acquisition indebtedness incurred before 12/15/17.

"Binding contract" exception. A taxpayer who has entered into a binding written contract before 12/15/17 to close on the purchase of a principal residence before 1/1/18, and who purchases such residence before 4/1/18, shall be considered to incur acquisition indebtedness prior to 12/15/17.

Refinancing. The $1 million/$500,000 limitations continue to apply to taxpayers who refinance existing qualified residence indebtedness that was incurred before 12/15/17, so long as the indebtedness resulting from the refinancing doesn't exceed the amount of the refinanced indebtedness.

Medical Expense Deduction Threshold Temporarily Reduced

A deduction is allowed for the expenses paid during the tax year for the medical care of the taxpayer, the taxpayer's spouse, and the taxpayer's dependents to the extent the expenses exceed a threshold amount. To be deductible, the expenses may not be reimbursed by insurance or otherwise. If the medical expenses are reimbursed, then they must be reduced by the reimbursement before the threshold is applied. Under pre-Act law, the threshold was generally 10% of AGI.

Observation: For tax years beginning after 12/31/12, and ending before 1/1/17, a 7.5%-of-AGI floor for medical expenses applied if a taxpayer or the taxpayer's spouse had reached age 65 before the close of the tax year.

And, under pre-Act law, for alternative minimum tax (AMT) purposes, the medical expenses deduction rules were modified such that medical expenses were only deductible to the extent they exceeded 10% of AGI.

New law: For tax years beginning after 12/31/16 and ending before 1/1/19, the threshhold on medical expense deductions is reduced to 7.5% for all taxpayers.

In addition, the rule limiting the medical expense deduction for AMT purposes to 10% of AGI **doesn't apply** to tax years beginning after 12/31/16 and ending before 1/1/19.

Charitable Contribution Deduction Limitation Increased

The deduction for an individual's charitable contribution is limited to prescribed percentages of the taxpayer's "contribution base."

Pre-Act law: The applicable percentages were 50%, 30%, or 20%, and depended on:

- the type of organization to which the contribution was made,
- whether the contribution was made "to" or merely "for the use of" the donee organization, and
- whether the contribution consisted of capital gain property.

The 50% limitation applied to public charities and certain private foundations.

No charitable deduction is allowed for contributions of $250 or more unless the donor substantiates the contribution by a contemporaneous written acknowledgment (CWA) from the donee organization. The IRS is authorized to issue regs that exempt donors from this substantiation requirement if the donee organization files a return that contains the same required information; however, IRS has decided not to issue such donee reporting regs.

New law: For contributions made in tax years beginning after 12/31/17 and before 1/1/26, the 50% limitation for cash contributions to public charities and certain private foundations is increased to 60%. Contributions exceeding the 60% limitation are generally allowed to be carried forward and deducted for up to five years, subject to the later year's ceiling.

And, for contributions made in tax years beginning after 12/31/16, the "donee-reporting exemption from the CWA requirement" provision is repealed.

No Deduction for Amounts Paid for College Athletic Seating Rights

Pre-Act law: Special rules applied to certain payments to institutions of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event. The payor could treat 80% of a payment as a charitable contribution where:

- the amount was paid to or for the benefit of an institution of higher education (i.e., generally, a school with a regular faculty and curriculum and meeting certain other requirements), and
- such amount would be allowable as a charitable deduction but for the fact that the taxpayer receives (directly or indirectly) as a result of the payment the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution.

New law: For contributions made in tax years beginning after 12/31/17, no charitable deduction is allowed for any payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event.

Alimony Deduction by Payor / Inclusion by Payee Suspended

Pre-Act law: Alimony and separate maintenance payments were deductible by the payor spouse and includible in income by the recipient spouse.

New law: For any divorce or separation agreement executed after 12/31/18, or executed before that date but modified after it (if the modification expressly provides that the new amendments apply), alimony and separate maintenance payments are not deductible

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by the payor spouse and are not included in the income of the payee spouse. Rather, income used for alimony is taxed at the rates applicable to the payor spouse.

Miscellaneous Itemized Deductions Suspended

Pre-Act law: Taxpayers were allowed to deduct certain miscellaneous itemized deductions to the extent they exceeded, in the aggregate, 2% of the taxpayer's adjusted gross income.

New law: For tax years beginning after 12/31/17 and before 1/1/26, the deduction for miscellaneous itemized deductions that are subject to the 2% floor is suspended.

Overall Limitation ("Pease" Limitation) on Itemized Deductions Suspended

Pre-Act law: Higher-income taxpayers who itemized their deductions were subject to a limitation on these deductions (commonly known as the "Pease limitation"). For taxpayers who exceed the threshold, the otherwise allowable amount of itemized deductions was reduced by 3% of the amount of the taxpayers' adjusted gross income exceeding the threshold. The total reduction couldn't be greater than 80% of all itemized deductions, and certain itemized deductions were exempt from the Pease limitation.

New law: For tax years beginning after 12/31/17 and before 1/1/26, the "Pease limitation" on itemized deductions is suspended.

Qualified Bicycle Commuting Exclusion Suspended

Pre-Act law: An employee was allowed to exclude up to $20 per month in qualified bicycle commuting reimbursements (i.e., any amount received from an employer during a 15-month period beginning with the first day of the calendar year as payment for reasonable expenses during a calendar year).

New law: For tax years beginning after 12/31/17 and before 1/1/26, the exclusion from gross income and wages for qualified bicycle commuting reimbursements is suspended.

Exclusion for Moving Expense Reimbursements Suspended

Pre-Act law: An employee could exclude qualified moving expense reimbursements from his or her gross income and from his or her wages for employment tax purposes. These were any amount received (directly or indirectly) from an employer as payment for (or reimbursement of) expenses which would be deductible as moving expenses if directly paid or incurred by the employee.

New law: For tax years beginning after 12/31/17 and before 1/1/26, the exclusion for qualified moving expense reimbursements is suspended, except for members of the Armed Forces on active duty (and their spouses and dependents) who move pursuant to a military order and incident to a permanent change of station.

Moving Expenses Deduction Suspended

Pre-Act law: Taxpayers could claim a deduction for moving expenses incurred in connection with starting a new job if the new workplace was at least 50 miles farther from a taxpayer's former residence than the former place of work.

New law: For tax years beginning after 12/31/17 and before 1/1/26, the deduction for moving expenses is suspended, except for members of the Armed Forces on active duty who move pursuant to a military order and incident to a permanent change of station.

Modified Deductions & Exclusions (Outside the Scope of this Tax Planning Letter)

• Deduction for Living Expenses of Members of Congress Eliminated
• Combat Zone Treatment Extended to Egypt's Sinai Peninsula

HEALTHCARE PROVISIONS

Repeal of Obamacare Individual Mandate

Pre-Act law: The Affordable Care Act (also called the ACA or Obamacare) required that individuals who were not covered by a health plan that provided at least minimum essential coverage were required to pay a "shared responsibility payment" (also referred to as a penalty) with their federal tax return. Unless an exception applied, the tax was imposed for any month that an individual did not have minimum essential coverage.

New law: For months beginning after 12/31/18, the amount of the individual shared responsibility payment is reduced to zero. This repeal is permanent.

Observation: According to the Congressional Budget Office (CBO), reducing the penalty to zero would raise approximately $338 billion over the 10-year budgetary window period because, when no longer penalized for not doing so, fewer people would obtain subsidized coverage.

Observation: The Act leaves intact the 3.8% net investment income tax and the 0.9% additional Medicare tax, both enacted by Obamacare.

ALTERNATIVE MINIMUM TAX (AMT)

AMT Retained, with Higher Exemption Amounts

The alternative minimum tax (AMT) is a tax system separate from the regular tax that is intended to prevent a taxpayer with substantial income from avoiding tax liability by using various exclusions, deductions, and credits. Under it, AMT rates are applied to AMT income determined after the taxpayer "gives back" an assortment of tax benefits. If the tax determined under these calculations exceeds the regular tax, the larger amount is owed.

In computing the AMT, only alternative minimum taxable income (AMTI) above an AMT exemption amount is taken into account. The AMT exemption amount is set by statute and adjusted annually for inflation, and the exemption amounts are phased out at higher income levels.

Pre-Act law: For 2018, the exemption amounts were scheduled to be:

• $86,200 for marrieds filing jointly/surviving spouses,

• $55,400 for other unmarried individuals,
• 50% of the marrieds-filing-jointly amount for marrieds filing separately (i.e. $43,100),

and, those exemption amounts were reduced by an amount equal to 25% of the amount by which the individual's AMTI exceeded:

• $164,100 for marrieds filing jointly and surviving spouses (phase-out complete at $508,900),
• $123,100 for unmarried individuals (phase-out complete at $344,700), and
• 50% of the marrieds-filing-jointly amount for marrieds filing separately (i.e. $82,050 (phase-out complete at $254,450)).

Additionally, married persons filing separately must add the lesser of the following to AMTI:

• 25% of the excess of AMTI (determined without regard to this adjustment) over the minimum amount of income at which the exemption will be completely phased out, or
• the exemption amount.

So, for 2018, a married person filing separately would have had to add the lesser of the following to AMTI: (1) 25% of the excess of AMTI over $254,450, or $43,100. This is referred to as the "25% less-of add-back," and it is intended to prevent an incentive for married persons to file separately.

For trusts and estates, for 2018, the exemption amount was scheduled to be $24,600, and the exemption was to be reduced by 25% of the amount by which its AMTI exceeded $82,050 (phase-out complete at $180,450).

New law: For tax years beginning after 12/31/17 and before 1/1/26, the Act increases the AMT exemption amounts for individuals as follows:

• For joint returns and surviving spouses, $109,400
• For single taxpayers, $70,300
• For marrieds filing separately, $54,700

Under the Act, the above exemption amounts are reduced (not below zero) to an amount equal to 25% of the amount by which the AMTI of the taxpayer exceeds the phase-out amounts, increased as follows:

• For joint returns and surviving spouses, $1 million
• For all other taxpayers (other than estates and trusts), $500,000

For trusts and estates, the pre-inflation adjustment exemption amount of $22,500 and phase-out amount of $75,000 remain unchanged. All of these amounts will be adjusted for inflation after 2018 under the new C-CPI-U inflation measure (see above).

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EDUCATION PROVISIONS

ABLE Account Changes

ABLE Accounts under §529A provide individuals with disabilities and their families the ability to fund a tax preferred savings account to pay for “qualified” disability related expenses. Contributions may be made by the person with a disability (the “designated beneficiary”), parents, family members or others.

Pre-Act law: The annual limitation on contributions is the amount of the annual gift-tax exemption ($15,000 in 2018).

New law: Effective for tax years beginning after the enactment date and before 1/1/26, the contribution limitation to ABLE accounts with respect to contributions made by the designated beneficiary is increased, and other changes are in effect as described below. After the overall limitation on contributions is reached (i.e., the annual gift tax exemption amount; for 2018, $15,000), an ABLE account’s designated beneficiary can contribute an additional amount, up to the lesser of:

• the Federal poverty line for a one-person household, or
• the individual’s compensation for the tax year.

Saver’s credit eligible. Additionally, the designated beneficiary of an ABLE account can claim the saver’s credit under §25B for contributions made to his or her ABLE account.

Recordkeeping requirements. The Act also requires that a designated beneficiary (or person acting on the beneficiary’s behalf) maintain adequate records for ensuring compliance with the above limitations.

For distributions after the date of enactment, amounts from qualified tuition programs (QTPs, also known as 529 accounts; see below) are allowed to be rolled over to an ABLE account without penalty, provided that the ABLE account is owned by the designated beneficiary of that 529 account, or a member of such designated beneficiary’s family. Such rolled-over amounts are counted towards the overall limitation on amounts that can be contributed to an ABLE account within a tax year, and any amount rolled over in excess of this limitation is includible in the gross income of the distributee.

Expanded Use of 529 Account Funds

Pre-Act law: Funds in a §529 college savings account could only be used for “qualified higher education expenses”. If funds were withdrawn from the account for other purposes, each withdrawal was treated as containing a pro-rata portion of earnings and principal. The earnings portion of a nonqualified withdrawal was taxable as ordinary income and subject to a 10% additional tax unless an exception applied.

“Qualified higher education expenses” included tuition, fees, books, supplies, and required equipment, as well as reasonable room and board if the student was enrolled at least half-time. Eligible schools included colleges, universities, vocational schools, or other postsecondary schools eligible to participate in a student aid program of the Department of Education. This included nearly all accredited public, nonprofit, and proprietary (for-profit) postsecondary institutions.

New law: For distributions after 12/31/17, “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.

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Student Loan Discharged on Death or Disability

Gross income generally includes the discharge of indebtedness of the taxpayer. Under an exception to this general rule, gross income does not include any amount from the forgiveness (in whole or in part) of certain student loans, if the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers.

New law: For discharges of indebtedness after 12/31/17 and before 1/1/26, certain student loans that are discharged on account of death or total and permanent disability of the student are also excluded from gross income.

DEFERRED COMPENSATION (Outside the Scope of this Tax Planning Letter)

• New Deferral Election for Qualified Equity Grants

DISASTER RELIEF PROVISIONS (Outside the Scope of this Tax Planning Letter)

• 2016 "Net Disaster Loss" Relief Available to Non-Itemizers & Taxpayers Subject to AMT
• Raised Casualty Floor & Modified Threshold for 2016 Disaster Losses
• Relief from Early Withdrawal Tax for "Qualified 2016 Disaster Distributions"

SELF-CREATED PROPERTY

Certain Self-Created Property Not Treated as Capital Asset

Pre-Act law: Property held by a taxpayer (whether or not connected with the taxpayer's trade or business) is generally considered a capital asset under §1221(a). However, certain assets are specifically excluded from the definition of a capital asset, including inventory property, depreciable property, and certain self-created intangibles (e.g., copyrights, musical compositions).

New law: Effective for dispositions after 12/31/17, the Act amends §1221(a)(3), resulting in the **exclusion** of patents, inventions, models or designs (whether or not patented), and secret formulas or processes, which are held either by the taxpayer who created the property or by a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created), from the definition of a "capital asset."

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ESTATE & GIFT TAX

Estate and Gift Tax Retained, with Increased Exemption Amount

A gift tax is imposed on certain lifetime transfers, and an estate tax is imposed on certain transfers at death.

Pre-Act law: The first $5 million (as adjusted for inflation in years after 2011) of transferred property was exempt from estate and gift tax. For estates of decedents dying and gifts made in 2018, this “basic exclusion amount” was $5.6 million ($11.2 million for a married couple).

New law: For estates of decedents dying and gifts made after 12/31/17 and before 1/1/26, the Act doubles the base estate and gift tax exemption amount from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011 and is expected to be approximately $11.2 million in 2018 ($22.4 million per married couple).

Observation: The language in the Act does not mention generation-skipping transfers, but because the generation-skipping transfer tax exemption amount is based on the basic exclusion amount, generation-skipping transfers will also see an increased exclusion amount.

IRS PRACTICE & PROCEDURAL CHANGES

Time to Contest IRS Levy Extended

IRS is authorized to return property that has been wrongfully levied upon.

Pre-Act law: Monetary proceeds from the sale of levied property could generally be returned within nine months of the date of the levy.

New law: For levies made after the date of enactment; and for levies made on or before the date of enactment if the 9-month period has not expired as of the date of enactment, the 9-month period during which IRS may return the monetary proceeds from the sale of property that has been wrongfully levied upon is extended to two years. The period for bringing a civil action for wrongful levy is similarly extended from nine months to two years.

Due Diligence Requirements for Claiming Head of Household

Any person who is a tax return preparer for any return or claim for refund, who fails to comply with certain regulatory due diligence requirements imposed by regs with regard to determining the eligibility for, or the amount of, an earned income credit, a child tax credit, an additional child tax credit, or an American opportunity tax credit, must pay a penalty.

The base amount of the penalty is $500; for 2018, as adjusted for inflation, the penalty is $520.

New law: Effective for tax years beginning after 12/31/17, the Act expands the due diligence requirements for paid preparers to cover determining eligibility for a taxpayer to file as head of household. A penalty of $500 (adjusted for inflation) is imposed for each failure to meet these requirements.

Questions?

For more details on information presented in this Tax Planning Letter or other issues, please feel free to call Roger Rossmeisl, CPA direct at (714) 325-0442 or via e-mail at roger@khopatel.com.

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