

Many states conform to the Internal Revenue Code, and the recent federal tax reform legislation will impact the states. In this article, Seattle University School of Law Adjunct Professor Victoria S. Byerly discusses the legislation by highlighting a number of changes and their implications.

*Tax Policy*

## The 2017 Federal Tax Overhaul Led by Republicans



By **Victoria S. Byerly**

*Victoria S. Byerly is a tax, public finance, and estate planning attorney in Olympia, Washington, who is also an adjunct law professor at Seattle University School of Law.*

Congress and President Trump have passed the most significant overhaul of the federal tax code since 1986. Republicans continue to tout that the changes will simplify tax preparation and simplify the code. The Democrats warn that the changes benefit corporations and the wealthy at the expense of the middle class. Democrats also take issue with the speed taken to change the federal tax code and that the process was done mostly behind closed doors. Regardless of where you are politically (and whether there may be constitutional issues), we now have some new tax laws. For the sake of brevity, here are some highlights.

### *Itemized Deductions*

As of the date of publication of this article, the overall limitation on itemized deductions has been suspended. Prior to the passage of the 2017 federal tax overhaul, the total amount of *most* itemized deductions was limited for certain upper income earners (keep in mind there are separate floors, and then the allowable total amount of itemized deductions is reduced further by 3% of the taxpayer's adjusted gross income that exceeds a threshold amount). In 2017, the threshold limitation was \$261,500 for single taxpayers, \$287,650 for heads of households, \$313,800 for married filing jointly taxpayers, and \$156,900 for married taxpayers filing separately. Under the new law, the old threshold limitations will apply for tax years after December 31, 2025.

### *Home Mortgage Interest Deduction and Home Equity Interest Deduction*

For tax years before January 1, 2026, the maximum amount of acquisition indebtedness for a qualified personal residence is \$750,000. Effective January 1, 2027, the maximum amount of acquisition indebtedness for purposes of the home mortgage interest deduction is \$1,000,000 (this is what it was for 2017). The home equity interest deduction has been suspended until January 1, 2026.

### *Other Deductions Including for State and Local Income or Sales Taxes*

Under the modified §164, deductions for state and local sales tax, property tax, including foreign property tax are permitted for the production of income (or business) only. For an individual, state and local income taxes, war profits, and excess profits taxes are not allowable as a deduction. There is an exception to this rule: a taxpayer may claim an itemized deduction of up to \$10,000 for the aggregate of state and local property taxes not paid in connection for the production of income, and state and local income (or state and local sales tax, but not both), war profits, excess profit taxes paid or accrued in the tax year. Like the others, this modification is temporary.

### *Deduction for Personal Casualty Loss*

The modified §165 temporarily, only permits a casualty loss deduction if the loss was attributable to a disaster declared by the President under §401 of the Robert T. Stafford Federal Disaster Relief and Emergency Assistance Act. The loss must be incurred after December 31, 2017.

### *Deduction for Charitable Contributions*

The limitation for cash contributions is increased to 60% of adjusted gross income and the statutory mileage rate has been replaced by a rate to be determined by the Internal Revenue Service. Additionally, no deduction is permitted for payments made to higher education institutions for the right to purchase tickets or seating at an athletic event.

### *Suspension of Miscellaneous Itemized Deductions*

Effective January 1, 2018, all miscellaneous itemized deductions are suspended until January 1, 2026. These must have exceeded (in the aggregate) 2% of the taxpayer's adjusted gross income under the old law. Examples of expenses that could be a miscellaneous deduction in the past included fee paid for tax preparation and unreimbursed expenses attributable to the employee's trade.

### *Estate and Gift Tax*

Effective January 1, 2018 (but before January 1, 2026), the life time exclusion, under §2010(c) is \$11,200,000. As a result, a couple can give \$22,400,000 together. The annual exclusion is \$15,000 for year 2018. Like all the other changes, this is effective through December 31, 2025.

### *Alternative Minimum Tax*

§53 and §55 through 59 have been modified, temporarily. The alternative minimum tax affects individuals and corporations. It parallels the normal tax and was intended to affect taxpayers with higher incomes, imposing an additional tax. The exemption amounts have increased to \$109,400 for married filing jointly taxpayers, \$70,300 for other taxpayers (excluding trusts and estates). The corporate alternative minimum tax has been repealed temporarily. Additionally, the alternative minimum tax credit is refundable for tax years 2018 through December 31, 2021 in an amount equal to 50% of the excess minimum tax credit for the taxable year over the amount of the credit permissible for the year against regular tax liability.

### *Individual Mandate under Affordable Care Act*

Effective after December 31, 2018, the individual responsibility payment is reduced to \$0.

### *Extension of Time to Contest an IRS Levy*

§6343 and §6532 have been modified to extend the time to contest a levy. Under the old law, any person (except the taxpayer against whom the assessment is made) may bring a civil action for wrongful levy in district court within nine months of the date of the levy. Now, taxpayers may file a civil action within two years from the date of the levy.

### *Business Tax Reform*

§11 has been modified so that the tax rate for corporations is 21%. §168 (increased expensing) has also been modified so that the first year depreciation allowance is increased to 100% from 50% for property placed in service after September 27, 2017. Since this area is complicated (and §179 must also be considered) and modifications are also specific to certain kinds of property, it is highly recommended that you discuss depreciation with your tax professional.

There has also been reform to accounting methods for small businesses. The relevant code sections are §263A, 448, 460, and 471. The two most common accounting methods are the cash method and the accrual method. The cash method is administratively easy and small businesses may use it. Under the accrual method of accounting, the right to receive income is important versus actual receipt. The new tax laws expands the universe of taxpayers who may use the cash method so long as the (\$25 million) gross receipts test is satisfied; tax shelters are still not permitted to use the cash method. There are additional considerations that can't be discussed here so, it's recommended that taxpayers talk to their tax professionals.

§172 regarding net operating losses (NOLs) has been modified, too. Now, NOLs are limited to 80% of net income, generally, effective January 1, 2018. The two year carry back and special provisions are repealed but there's an exception for farming and insurance companies (as defined under §816(a)).

There is also a modification to the ability to deduct business expenses as they relate to local legislation under §162(e). Now, the general rule of disallowance applies to amounts paid or incurred related to lobbying local councils or similar governing bodies, including Tribal Governments.

§199 permitted a deduction for domestic production activities. The deduction is now denied.

§274 has also been modified. The old exception permitting a deduction for entertainment, amusement or social activities that are directly related to the active conduct of the taxpayer's business has been repealed (including the 50% limitation). Businesses may still deduct 50% of food and beverage expenses associated with operating the business.

### *Unrelated Business Income Tax*

§512 has been modified so that unrelated business income includes amounts paid for qualified fringe benefits under §132(f), a parking facility used in connection with qualified parking, or any on premise athletic facility, provides the amounts are not deductible under §274.

### *Denial of Deduction for Settlements Subject to Non-Disclosure Agreements*

The modified §162(q) no longer permits a deduction for ordinary and necessary expenses incurred in the employee's trade or business for settlements subject to non-disclosure agreements for sexual harassment or sexual abuse.

### *Deduction for Qualified Business Income*

§199A is a new section and the general rule permits a deduction in an amount equal to the lesser of, combined qualified business income or, 20% of the excess of taxable income (for the year) over net capital gain (under §1(h)) plus qualified cooperative dividends, plus the lesser of 20% of qualified cooperative dividends or taxable income reduced by net capital gains. But wait, there's more math. The overall deductible amount cannot exceed the taxable income of the taxpayer (minus net capital gain).

There are limits based upon threshold amounts of \$157,500 for individuals and \$315,000 for joint returns. These threshold amounts are intended to deter high income taxpayers from converting wages, personal services or other compensation to income that is qualified for the deduction. Other limitations include situations where there is a specified service business of the taxpayer. Specified service business includes any business involving performance of services such as law, health, consulting, athletics, financial services, brokerage services or any business where the principal asset of the trade or business is the reputation or skill of one of the employees or owners. However, engineering and architecture services are excluded. In the case of a specified service business, the deduction is limited to only the applicable percentage of qualified income, gain, loss, W-2 wages, and the unadjusted basis of qualified property immediately after acquisition. It is noteworthy that this deduction is against taxable income and not adjusted gross income. As a result, the deduction would reduce tax potentially due.

### *Public Finance*

With respect to public finance, advance refundings are no longer permitted. Current refundings are, however. Tax exempt qualified private activity bonds have been preserved. This means that bond financing for airports, docks and wharves, sewage and solid waste facilities, multi-family housing, single family housing, small issue manufacturing bonds, student loan bonds, and qualified 501(c)(3) bonds are still permissible.

Qualified tax credit bonds are no longer permissible and mortgage credit certificates have been retained. The 9% low income housing tax credit and 4% low income housing tax credit and new markets credit have been retained. There are no changes to volume cap limits.

### *Conclusion*

With these new changes (including the tax tables), comes opportunities for planning, and an opportunity for the Internal Revenue Service to issue regulations which will aid with planning and clarification. These laws will remain in effect until December 31, 2025, other laws are enacted, or the courts find them unlawful.

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