DONE DEAL: TAX BILL TAKES EFFECT

Ed Mills, *Washington Policy Analyst, breaks down the major components of the new tax legislation.*

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The tax bill lowering the corporate tax rate and making a number of adjustments to the individual tax code was signed into law on December 22, 2017. The final tax bill sets a corporate tax rate of 21% starting January 1, 2018, and makes a number of changes to individual tax rates (including lowering the top individual to 37%). Key changes on the individual side include doubling the standard deduction ($12,000 for individuals and $24,000 for joint filers) but the bill reduces and/or removes many existing deductions. On the corporate side of the bill, businesses will have the benefit of 100% depreciation of qualified capital expenditures for the next five years, repeal of the corporate AMT, and a shift towards a territorial tax system (from a worldwide tax system). The bill also repeals the individual mandate of the Affordable Care Act (ACA). In this report, we review the changes to the corporate and individual tax code and cover next steps on tax legislation in 2018.

INDIVIDUAL CHANGES

Seven tax brackets are retained, but the bill provides tax relief by changing the income thresholds and tax rate for most taxpayers. The bill also lowers the top rate to 37% (starting at $600,000 for joint filers). The standard deduction is doubled to $12,000 for individuals and $24,000 for joint filers. Personal exemptions are eliminated, and SALT deductions are capped at $10,000. Mortgage interest deductions are capped interest on loans below $750,000, but grandfathers existing loans at $1 million. The individual AMT is retained, but narrowed with a raised phase-out threshold at $1 million.

CORPORATE CHANGES

Lowering the corporate tax rate to 21% and moving to territorial taxation are the key parts of the corporate tax changes. The corporate alternative minimum tax (AMT) is eliminated. Repatriated earnings will be subject to a 15.5% tax on liquid assets and 8% on other earnings and profits with an eight-year repayment window. Net interest deduction is limited to 30% of adjusted taxable income, and net operating loss deductions are capped at 80% of taxable income. Capital expenditures see full depreciation and are 100% deductible for five years. For small businesses, the capital investment deduction limit under Section 179 is increased from $500,000 to $1 million.

NEXT STEPS

Guidance and interpretations are expected from the IRS over the course of the year. House Ways and Means Committee Chairman Kevin Brady (R-TX) anticipates work will continue on tax legislation with corrections to streamline and clarify provisions in the final bill expected this year. Congressional Republicans may attempt to work with Democrats on fixes that require 60 votes to pass the Senate, but have also signaled that the budget reconciliation measure used to pass tax reform with a 51 majority vote may be used again on issues where bipartisan compromise cannot be reached. This will usher in a new round of debates about which provisions could see further revision (including a potential SALT fix).

See below the changes to the corporate and individual tax code in the final tax bill.

	Prior Law	New Law
Corporate Tax Rate	35%	21%, starting in 2018
Worldwide vs. Territorial	Worldwide	Territorial
Repatriation of Foreign	Foreign earnings are taxed at a 35% minus	Built up foreign earnings deemed repatriated.
Anti-Base Erosion Provisions	U.S. companies are allowed to shift profits to	Establishes a 5% base erosion tax calculation
Net Interest Deduction	Business interest is generally allowed as a deduction, subject to certain limitations.	Limit net interest deduction to 30% of adjusted taxable income. Uses EBITDA for four years, then switches to EBIT.
Changes to NOL Deduction	Companies are allowed to deduct taxes based upon a net operating loss with a 2-year look back and a carryforward for 20 years.	Caps NOL to 80% of taxable income, extends carryforward indefinitely. Repeals lookback. Applies to losses starting in 2018.
Like-kind Exchange of Real Property	Allows for the exchange of certain properties without recognizing a gain or loss. The like-kind exchange establishes a new basis.	Only allows like-kind exchanges for real property, preserving much of the current law.
FDIC Premiums	FDIC premiums paid to the Deposit Insurance Fund (DIF) are an eligible deduction.	Phase out of deduction starting at banks greater than $10 billion in assets, eliminated at $50 billion.
Advance Refunding Bonds	Interest received on advance refunding bonds (more than 90 days before the redemption bond) are exempt from federal taxation.	Repeals tax exempt status on interest received from advance refunding bonds issued after 2017.
New Market Tax Credits	Tax credit allowed for in qualified community development entities.	No provision, status quo maintained.
Carried Interest	Taxation of distributions from partnerships at capital gain rate rather than ordinary income.	To be held for three years to qualify for capital gain rate.
Bond Reform	Interest received from government bonds and private activity bonds (PABs) are tax exempt.	No provision, status quo maintained.
Insurance	Variety of unique provisions to the insurance industry.	Repeal or change to a number of provisions.
Section 179 Expensing	Limits small business expensing to $500,000.	Increases limit to $1,000,000.

	Prior Law	New Law
Income Brackets	7 Brackets: 10% - 39.6% (top rate starts at $470,700 for joint filer – for 2017) 10% - <$9,325 (single); <$18,650 (married) 15% - $9,325; $18,650 25% - $37,950; $75,900 28% - $91,900; $153,100 33% - $191,650; $233,350 35% - $416,700; $416,700 39.6% - $418,400; $470,700	7 Brackets: 10% - 37% (top rates starts at $600,000 for joint filer) 10% - <$9,525 (single); <$19,050 (married) 12% - $9,525; $19,050 22% - $38,700; $77,450 24% - $82,500; $165,000 32% - $157,500; $315,000 35% - $200,000; $400,000 37% - $500,000; $600,000
Pass-through Tax Rate	Net income subject to individual marginal rate.	Allows most pass-throughs to deduct 20% of business income. Limits deduction for joint filer above $315,000 for services businesses.
Standard Deduction	$6,350 individual, $9,350 couples.	$12,000 individual, $24,000 couples.
Personal Deductions	$4,050 deduction for each personal exemption.	Repealed.
State and Local Taxes (SALT)	Filers are able to deduct taxes paid to states and local governments (including property taxes).	Caps state, local, property, and sales tax deduction at $10,000.
Mortgage Interest Deduction (MID)	Itemized deduction for mortgage interest paid on principal residence and one other residence up to $1 million. Allows deduction for up to interest paid on $100,000 in come equity indebtedness.	Caps MID to $750,000 from 2018-2025. Retains $1 million for acquisitions made before December 15, 2017. Removes ability to deduct interest on home equity loan.
Phase out of Deductions (Pease Limitation)	Limitations on otherwise allowable deductions based on income. Current threshold is $261,500 for individuals, $313,800 for couples.	Repealed.
Child Tax Credit	$1,000 credit, phase out beginning at $110,000 (joint filers).	$2,000 credit, $1,400 refundable. $500 for qualifying non-children dependents. Phase-out at $400,000 (joint filers).
Alternative Minimum Tax (AMT)	Taxpayers are required to compute tax liability on an alternative tax code; if filer would pay more in the alternative, the filer is subject to the alternative minimum tax. Tax rate is 26% or 28% depending on income.	Retains AMT, but raises exemption amount ($109,400 for joint filers). Raises exemption phase-out threshold to $1 million (joint filers).
Variety of Current Deductions, Including Student Loans, Medical Expenses, Childcare, Alimony	Subject to certain limits, current code provides an above-the-line deduction for a variety of expenses.	Repeals a variety of current deductions, maintains student loan interest and medical expense deductions.
Estate Tax	40% tax on estates above certain threshold, $5 million as base exclusion.	Doubles base exclusion to $11.2 million, indexed for inflation.
Charitable Contributions	Contributions are an allowed itemized deduction.	Increases percentage limit for charitable contributions.
Sale of Principal Residence	Exclusion from gross income up to $500,000 couple, $250,000 individual if residence was principal residence 2 of last 5 years. Can be used once every 2 years.	No provision, status quo maintained.

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880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // TOLL-FREE: 800.248.8863 // RAYMONDJAMES.COM