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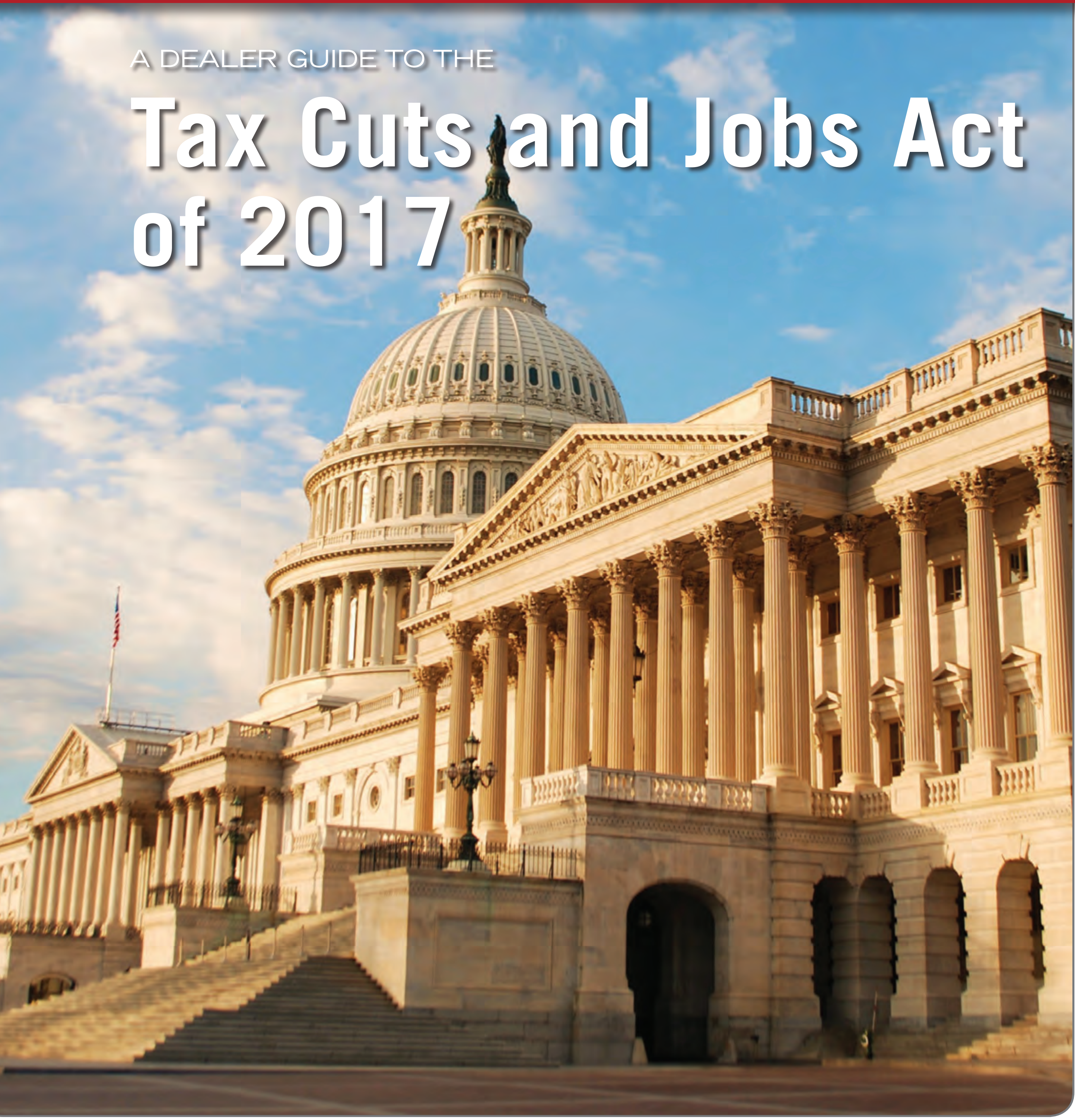

A DEALER GUIDE TO THE

Tax Cuts and Jobs Act of 2017

NADA NATIONAL AUTOMOBILE DEALERS ASSOCIATION

L58

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Foreword

The Tax Cut and Jobs Act of 2017 (TCJA), the most complex and comprehensive tax bill in more than 30 years, contains many technical provisions that will affect members of the National Automobile Dealers Association for years to come. NADA commissioned this guide to assist dealers in working with their tax practitioners to comply with the new provisions and to identify potential tax planning opportunities under the TCJA. On behalf of its members, NADA would like to express appreciation to dealer certified public accountants around the country—and, in particular, to the firms of Boyer & Ritter LLC, Crowe Horwath LLP and Dixon Hughes Goodman LLP—for their professional support and technical analysis during the legislative process. NADA also wishes to thank these three firms for preparing this guide. We look forward to continuing to work together on behalf of NADA's members as the TCJA is implemented.

Following a brief overview of the legislative process that produced the TCJA, the guide is organized in two sections, "Business Tax Considerations" and "Individual Tax Considerations," each containing an alphabetical listing of key provisions that are relevant to franchised automobile and truck dealerships. The guide does not address every provision of the Internal Revenue Code that affects franchised dealers, nor does it provide or intend to provide legal or accounting advice on the subject matter. It is essential that dealers consult with their tax practitioners concerning their specific federal income tax compliance responsibilities.

Overview of the Legislative Process

The day after Donald Trump won the presidential election, the tax reform process began in earnest. House and Senate Republicans, the Trump transition team, and the business community began working toward the enactment of pro-growth tax reform.

Within that environment, NADA promptly engaged to advocate for the nation's franchised automobile and truck dealers. Preliminarily, this involved an internal assessment of the business entities used by NADA's 16,000+ members, which include large public companies operating as C corporations, large private-cap dealer groups using pass through entities, and small and medium-sized dealerships organized as C corporations, pass-throughs, or a combination of entities. Additionally, NADA analyzed key tax attributes of franchised dealerships to quantify how the then-existing provisions of the tax code affected its members. Finally, NADA evaluated the political environment both within Congress and among the various business coalitions that were engaged in the tax reform process. The CPA firms that prepared this guide were among NADA's most active collaborators from the start of the tax reform debate. Through their collective representation of thousands of franchised dealerships, they provided indispensable feedback about the practical effect of potential revisions to the Internal Revenue Code and even participated in NADA conference calls with key members of Congress to discuss the proposed legislation.

The early policy debate focused on the House Blueprint, the general tax reform framework released by the House Ways and Means Committee in 2016. When the elections provided the Republicans with control of the White House and Congress, the Blueprint became the starting point for a pro-growth tax reform bill. At this stage of the debate, NADA asked two threshold questions of policymakers: 1) will tax reform increase consumer demand; and 2) will tax reform enable dealers to retain and attract the working capital necessary to maintain jobs and investments on Main Street?

The first major fight over specific tax provisions involved the border adjustment tax (BAT), which would have undercut consumer demand with price increases in the auto industry and across many other sectors of the economy. Because of the many concerns raised early in the process, the BAT never got traction.

With the demise of the BAT, NADA focused on the provisions most critical to capital retention for franchised automobile and truck dealers. On December 22, 2017, President Trump signed into law the TCJA,* which fulfilled the following NADA advocacy priorities:

- It maintains 100 percent deductibility of floor plan interest, historically one of the largest two expense items for dealers other than personnel;
- It maintains 100 percent deductibility of advertising expenses, the other largest expense item for dealers other than personnel;
- It maintains the Last-In, First-Out (LIFO) method of accounting, which is utilized by many dealers;
- It reduces the burden of the federal estate tax by doubling the exclusion to approximately $22.4 million per couple;
- It provides rate relief for dealerships that use C corporations, reducing the rate from 35 percent to 21 percent; and
- It provides rate relief for pass-through dealerships, through a combination of a 20 percent deduction of pass-through income and a lower top rate on personal returns.

This successful outcome was made possible by the relentless grassroots engagement of NADA directors, countless individual dealers, and state and metro Automotive Trade Association Executives (ATAEs), who communicated directly and effectively with representatives and senators.

** The final version of the tax reform legislation signed by President Trump, Public Law 115-97 (currently available at congress.gov/bill/115th-congress/house-bill/1/text), is identified as H.R. 1. For ease of reference, this guide refers to the law as the "Tax Cuts and Jobs Act" (TCJA), which is the title that appeared in H.R. 1 when originally introduced and which also appears in the Department of the Treasury's 2017-2018 Priority Guidance Plan issued on February 7, 2018.*

Business Tax Considerations

Alternative Minimum Tax—Corporations

The alternative minimum tax was originally enacted to ensure that highly profitable corporations would pay at least a minimum amount of federal income tax. The AMT was 20 percent of alternative minimum taxable income (AMTI), which was calculated using a separate set of rules. The corporation tax for the year was the greater of the regular tax liability or the AMT.

AMT paid in a prior year may have qualified as a minimum tax credit against regular tax in a future year. A minimum tax credit could only offset regular tax, and only by the amount that the regular tax exceeded the tentative minimum tax for the tax year. Any unused minimum tax credit carried over to the following tax year.

The TCJA repeals AMT for tax years beginning after December 31, 2017. A blended AMT rate applies to fiscal year-end taxpayers as follows:

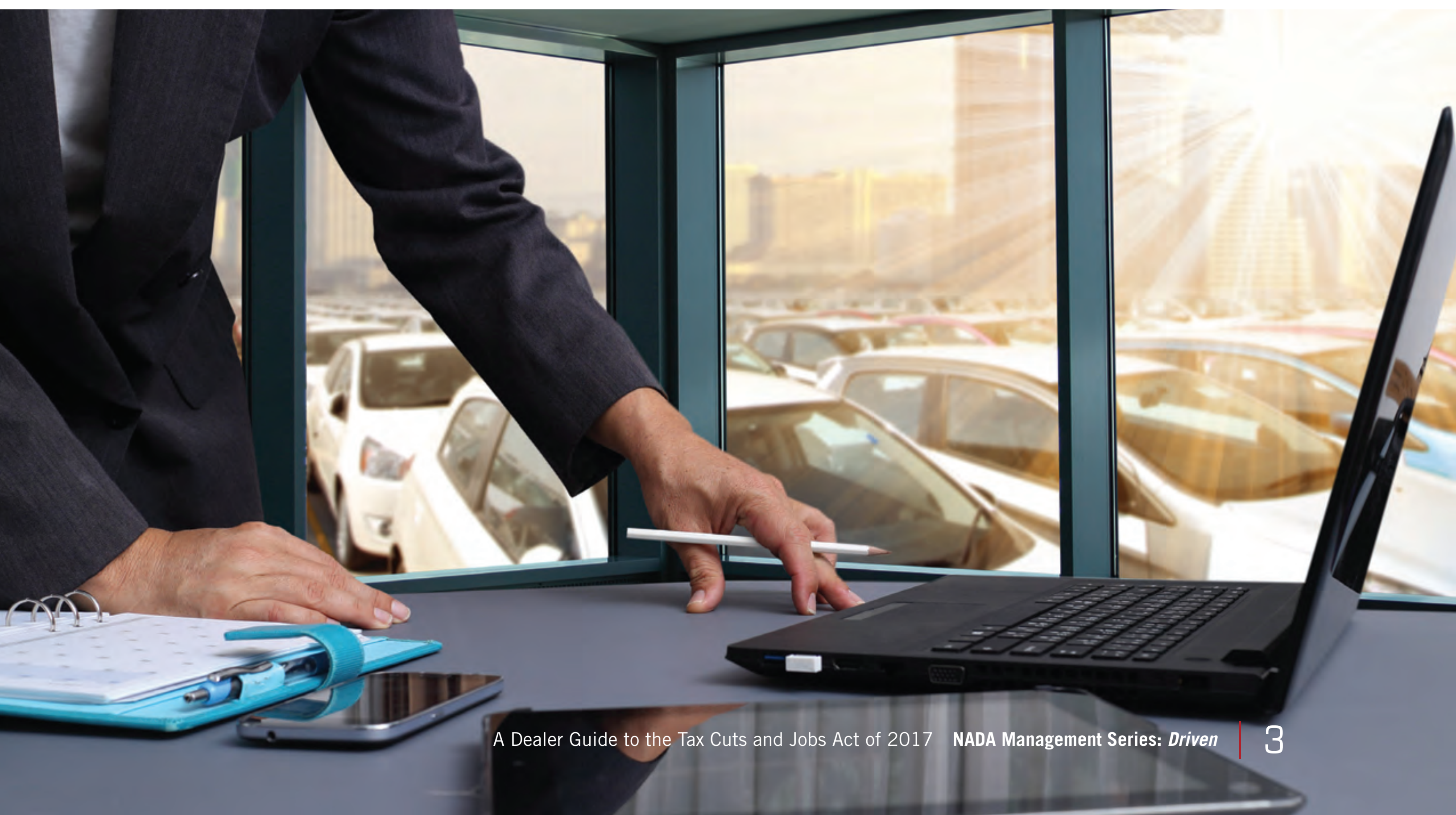
Fiscal Year Ending	1/31/18	2/28/18	3/31/18	4/30/18	5/31/18	6/30/18	7/31/18	8/31/18	9/30/18	10/31/18	11/30/18
AMT Rate	18.33%	16.67%	15.00%	13.33%	11.67%	10.00%	8.33%	6.67%	5.00%	3.33%	1.67%

The TCJA continues to allow unused minimum tax credits to offset regular tax liability for tax years starting in 2018 through 2021. The excess minimum tax credits over the regular tax liability are 50 percent refundable in 2018, 2019, and 2020, with the remaining balance 100 percent refundable in 2021.

Corporate dealers regularly subject to AMT and/or dealers with unused minimum tax credits should consider the new AMT rules in calculating estimated tax payments for tax years ending after December 31, 2017.

Bonus Depreciation—Temporary 100 Percent Expensing for Certain Business Assets

Under prior law, taxpayers could elect to deduct additional first-year depreciation in the amount of 50 percent of the cost of qualifying property placed in service during 2017; 40 percent in 2018; and 30 percent in 2019. Under the TCJA, a taxpayer is



able generally to elect to deduct additional first-year depreciation in the amount of 100 percent of the cost of qualifying property acquired *and* placed in service after September 27, 2017. The TCJA provides for a phase-down of the bonus depreciation percentage beginning with 80 percent in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026. Longer production period property and certain aircraft will receive an additional year to be placed in service at each percentage.

The TCJA also includes a provision whereby the acquisition date for property acquired pursuant to a written binding contract is the date of the contract. This means that for qualifying property acquired and placed in service before September 28, 2017, or for qualifying property acquired or subject to a binding contract before September 28, 2017, but placed in service after September 27, 2017, the old bonus depreciation percentages continue to apply. Property deemed to have been acquired before September 28, 2017 continues to be subject to the 50 percent bonus depreciation percentage if placed in service during 2017 for calendar year taxpayers; 40 percent if placed in service during 2018; and 30 percent if placed in service during 2019.

The TCJA expands the definition of qualified property for bonus depreciation purposes to include used property. Used property acquired by the taxpayer is eligible for bonus depreciation if it has not been previously used by the taxpayer and is not acquired from a related party.

Taxpayers have the option to elect to use 50 percent bonus depreciation in place of 100 percent bonus depreciation for the first tax year ending after September 27, 2017.

Important: Under the new limitation on business interest expense deduction (see the next topic), property used in a trade or business with floor plan financing indebtedness is not eligible for bonus depreciation starting with the taxpayer's first tax year beginning after December 31, 2017. In addition, real estate businesses electing to utilize the alternative depreciation system (ADS) are also not able to take advantage of bonus depreciation on assets depreciated under ADS.

Business Interest Expense Deduction

Under prior law, interest paid or accrued by a business was deductible subject to certain limitations in the calculation of taxable income. The TCJA imposes an additional limitation on the deduction for business interest expense. Under this limitation, the deduction allowed for interest expense is limited to the sum of the following:

1. The taxpayer's business interest income for the year;
2. 30 percent of the taxpayer's adjusted taxable income for the year; and
3. The amount of floor plan financing interest for the year.

So what does this mean? Foremost, dealerships have no limitation on the deduction for their floor plan interest expense. That is, it remains fully deductible. Consequently, dealerships will generally be affected by items 1 and 2 above. Any limitation will be largely dependent on a dealership's income.

EXAMPLE

Dealership X has $1,000,000 of adjusted taxable income, $325,000 of floor plan interest expense, $250,000 of other business interest expense, and $7,000 of business interest income. Dealership X's business interest limitation is $307,000 as determined by 30 percent of $1,000,000 adjusted taxable income plus business interest income of $7,000. Since the limitation of $307,000 is higher than the business interest incurred of $250,000, Dealership X will be able to deduct the entire $250,000 plus the entire $325,000 amount of floor plan interest, which is not subject to limitation.

What happens if a taxpayer is not able to deduct all of the business interest expense because of the limitation? Any such interest limited is available for carryforward and is treated as paid or incurred in the following year and again subject to the limitation. The carryover is indefinite.

The term *adjusted taxable income* for purposes of the limitation has a specific meaning. It is the taxpayer's taxable income computed *without* regard to the following items:

1. Any item of income, gain, deduction, or loss not attributable to a trade or business (e.g., investment income or expense).

2. Any business interest expense or business interest income.
3. The amount of any net operating loss deduction.
4. The amount of the section 199A deduction (i.e., the new 20 percent deduction for qualified business income).
5. The deduction allowable for depreciation, amortization, or depletion. This is in place for tax years beginning before January 1, 2022.

The term *business interest income* means interest income includible in the taxpayer's gross income that is allocable to a trade or business. As applied to automobile and truck dealers, it is interest income earned within the dealership's business activity. It would generally not include interest earned from investment activities. Additionally, it would not include floor plan assistance paid by manufacturers to dealers; that should be treated as a trade discount reducing the cost of the associated inventory for tax purposes.

The term *business interest expense* means interest expense that is paid or accrued on indebtedness that is allocable to a trade or business (e.g., interest expense on indebtedness used in the operation of a dealership). This type of interest is subject to the limitation but there is an exception for floor plan financing interest.

Floor plan financing interest that is exempt from the limitation is defined as interest paid or accrued on floor plan financing indebtedness, which is indebtedness used to finance acquisition of motor vehicles held for sale or lease and secured by such inventory. Applicable motor vehicles include (1) any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road; (2) a boat; and (3) farm machinery or equipment. The definition does not include construction machinery and equipment.

Some smaller dealerships are not subject to the limitation. The law provides an exemption for taxpayers that have average gross receipts (sales and other) that do not exceed $25,000,000 per year for the prior three years. Certain real property trades or businesses may elect to be exempt but must use the alternative depreciation system with respect to properties that require longer depreciable lives.

For partnerships and S corporations, even though the interest expense limitation will be applied at the entity level, partners and shareholders may be able to use any excess of the unused taxable income limitation from one or more entities to deduct additional business interest expense. There are also additional rules for partnerships and partners that allow disallowed interest to be carried forward. These rules and computations are generally maintained at the partner level. Due to the complexity of these rules, dealers should consult with their tax advisors for further details.

As indicated above, taxpayers in a trade or business that deduct floor plan financing indebtedness are excluded from using 100 percent bonus depreciation. This was the trade-off for full deductibility of floor plan interest expense. Additionally, taxpayers with floor plan financing indebtedness remain eligible to claim the expanded section 179 expensing described below.

These rules are effective for tax years beginning after December 31, 2017.

Cash Method of Accounting

The Internal Revenue Code generally allows a taxpayer to elect the method of accounting used to compute taxable income. Two commonly used methods are the accrual method and the cash method of accounting. The method used must clearly reflect the taxpayer's income.

The accrual method of accounting requires that revenues are recorded when earned and expenses as incurred. The accrual method is generally used by larger businesses and businesses with inventories. Alternatively, taxpayers using the cash method of accounting recognize income when cash is received and expenses are paid.

There are several limitations on using the cash method of accounting. For example, taxpayers that maintain inventories generally are required to use the accrual method of accounting rather than the cash method of accounting. Use of the cash method is dependent on the taxpayer's average gross receipts.

The TCJA expands the use of the cash method of accounting. Under prior law, the cash method of accounting had varying levels of average gross receipts tests. The specific test a taxpayer had to meet was based upon the taxpayer's trade or business, entity type, or even the type of owners of the business. Under the TCJA, the average gross receipts limitation is increased to $25,000,000 for all taxpayers (other than tax shelters). For tax years beginning after December 31, 2018, the limitation will be adjusted for inflation.

Important: Changing from the accrual method of accounting to the cash method of accounting requires IRS approval. A taxpayer now qualifying for the cash method of accounting may change the method by filing Form 3115, "Application for Change in Accounting Method," generally using the automatic accounting method change provisions.

Corporate Tax Rate

The federal corporate tax rate for tax years ending in 2017 was imposed at graduated rates with a top overall tax rate of 35 percent.

The TCJA reduces the corporate tax rate to a flat tax rate of 21 percent for tax years beginning after December 31, 2017. A blended rate applies to fiscal year-end taxpayers as follows:

Fiscal Year Ending	1/31/18	2/28/18	3/31/18	4/30/18	5/31/18	6/30/18	7/31/18	8/31/18	9/30/18	10/31/18	11/30/18
Regular Top Tax Rate	33.83%	32.67%	31.50%	30.33%	29.17%	28.00%	26.83%	25.67%	24.50%	23.33%	22.17%

The lowering of the tax rate from 35 percent to 21 percent represents a 40 percent rate cut. Corporate dealers should maximize deductions and minimize income where available for the 2017 tax year. There may still be an opportunity to take advantage of this rate differential (through the extended due date of the tax return) by filing Form(s) 3115 for automatic change in accounting method(s) to defer income recognition (e.g., for trade discounts such as interest assistance) or accelerate deductions (e.g., for regional advertising expenses and certain prepaid expenses).

Non-corporate dealers should give careful consideration to their current entity structure(s) and evaluate the pros and cons of converting to a C corporation. Details of additional considerations are discussed in other sections.

Fringe Benefits

Under prior law, entertainment expenses directly related to actively conducting a trade or business were generally deductible up to 50 percent of the cost of such entertainment expense. Meals while in travel status, including food and beverages, were deductible up to 50 percent of the expense. The cost of holiday parties and certain meals provided on or near the premises of the employer, for example Saturday meals, were 100 percent deductible. Club dues were not deductible.

The TCJA completely disallows any deduction for amounts paid or incurred after December 31, 2017 for entertainment and recreational expenses, and entertainment facilities. Additionally, the TCJA disallows deductions for *de minimis* fringe benefits provided to employees that are primarily personal in nature, including qualified parking and transportation fringe benefits, on-premises athletic facilities, and contributions made for university athletic seating rights that previously received an 80 percent deduction. The 50 percent deduction for trade or business meals and beverages is generally retained until 2026. However, the 50 percent limitation now also applies to meals provided to employees through a qualifying eating facility. Amounts paid and incurred after December 31, 2025 for these meals are not deductible. Holiday parties remain 100 percent deductible.

Dealers might consider setting up separate accounts for entertainment expenses, meals, and holiday parties to easily track the nondeductible, partially deductible, and fully deductible portion of these expenses.

Like-Kind Exchange

Under prior law, the like-kind exchange (LKE) provisions allowed taxpayers to defer gain on business or investment property sold and replaced with like-kind property. The gain on the property reduced the tax basis of property acquired to replace the old property and the gain on the old property was deferred until the replacement property was sold. There were specific requirements to qualify for the favorable gain deferral. Additional provisions and requirements applied to exchanges involving multiple parties when the sale and purchase of like-kind properties occurred at different times, referred to as either forward or reverse exchanges.

The TCJA repeals the LKE provisions on exchanges completed after December 31, 2017 with the exception of real property held for productive use in a trade or business or for investment. However, deferred exchanges (forward or reverse) in progress as of December 31, 2017 continue to qualify for the gain deferral available under prior law.

Under prior law, there were opportunities for dealers to consider planning for the benefit of LKEs especially in sales of dealerships involving certain intangibles (e.g., Blue Sky) other than goodwill (i.e., franchise rights and other supplier-based intangibles). Dealers would also facilitate LKEs through intermediaries for sales that involved large capital property transactions. Planning for these exchanges offered the opportunity to defer substantial gain recognition. These favorable LKE opportunities are no longer available except for transactions involving real property held for productive use in a trade or business or for investment.

Luxury-Vehicle Depreciation Limitation and Listed Property

Annual dollar limitations apply to the depreciation deduction that can be claimed in connection with luxury vehicles under section 280F of the Internal Revenue Code. Under prior law, the limits for passenger automobiles placed in service in 2017 were $3,160 in the first year, $5,100 in the second year, $3,050 in the third year, and $1,875 in all subsequent years, while trucks and vans had a slightly higher limit. The TCJA increases these limits to $10,000 in the first year, $16,000 in the second year, $9,600 in the third year, and $5,760 in all subsequent years. These new limits are effective for passenger automobiles placed in service after December 31, 2017.

In addition to the increased limits, the TCJA removes computers and peripheral equipment from the list of items considered "listed property." This change means that if business use falls below 50 percent on one of these items, a taxpayer is no longer required to depreciate the item using the straight-line method and the item is not subject to possible immediate depreciation recapture.

Net Operating Losses

A net operating loss (NOL) occurs when business deductions exceed business income. Under prior law, NOLs generally could be carried back two years and forward 20 years. With an election, a taxpayer could forego the carryback period and only carry the NOL forward.

Under the TCJA, the NOLs from years beginning after December 31, 2017 generally may not be carried back and the deduction in carryover years may not exceed 80 percent of taxable income computed before the NOL deduction. NOLs from years beginning before December 31, 2017 may continue to be carried back and then forward and offset 100 percent of taxable income in 2018 and going forward. All NOLs generated in tax years beginning prior to January 1, 2018 and carried forward to tax years beginning after December 31, 2017 retain their original 20-year carryforward. NOLs generated in tax years beginning after December 31, 2017 may be carried forward indefinitely.

Dealers should ask their tax advisors to project existing NOLs to future years using the new rules when making taxable income projections and estimated tax calculations. Since the pass-through deduction is calculated after NOLs are taken into consideration, future NOL deductions could limit the pass-through deduction. Additionally, pass-through entity losses are limited as explained in the "Pass-Through Deduction" section.

Nonresidential Real Property—Depreciation Deduction

In general, taxpayers are allowed to recover the cost of certain property through an annual allowance for depreciation intended to account for the wear and tear or obsolescence of the property.

The allowable annual depreciation amount depends on the type of property, the depreciation method selected, its recovery period, and certain applicable conventions. The cost recovery period for most nonresidential real property is 39 years and the amount is computed on a straight-line basis.

Under prior law, the cost recovery period for qualified improvement property was also 39 years. *Qualified improvement property* is any improvement, placed in service after the date the building was first placed in service, to an interior portion of a building that is nonresidential real property—except for any improvement connected with the enlargement of a building, any escalator or elevator, or the internal structural framework of the building.

Also provided under prior law were separate categories for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property, which were depreciated over 15 years under the straight-line method.

The TCJA shortens the recovery period of qualified improvement property to 15 years. (The separate definitions for qualified leasehold improvements, qualified restaurant improvements, and qualified retail improvement property are eliminated but these improvements may be included in the definition of qualified improvement property and qualify for a 15-year recovery period.) These provisions are effective for property placed in service after December 31, 2017. While the intent was to provide for the 15-year recovery period, the proper wording was inadvertently omitted from the final bill. There likely will be steps taken to remedy the oversight.

Paid Family and Medical Leave Employer Credit

The TCJA includes a new business credit for eligible employers who pay wages to qualifying employees while they are on family and medical leave. The payments must be voluntary and not mandated by state or local governments. The credit is 12.5 percent of the wages paid for the leave if the wage payments are at least 50 percent of normal wages. The credit may increase up to a maximum of 25 percent if the wage payments exceed the 50 percent level.

Eligible employers must have a written policy providing that full-time employees receive benefits for at least two weeks annually and part-time employees for a prorated time. Employees only qualify if they

worked for the employer for at least one year and did not receive compensation in the prior year of over $72,000 (2018 amount).

Family or medical leave includes leave for childbirth, to care for seriously ill family members, and similar situations. The credit does not apply to any portion of the payments for vacation, personal, or certain other leave. Wages used to calculate this credit may not be used for any other credit. The credit is available for wages paid in tax years beginning after December 31, 2017 and before January 1, 2020.

Dealers who want to claim this credit should have their tax advisors review their current policies for any changes necessary to satisfy the requirements for the credit. Also, the payroll department or service provider should be advised to track qualifying payments.

Partner Losses—Basis Limitation

Under prior law, partners were allowed to deduct their distributive shares of partnership losses to the extent of their tax basis in their partnership interest. This basis limitation was applied without regard to the partner's distributive share of foreign taxes paid or accrued and charitable contributions.

The TCJA requires that a partner's distributive share of foreign taxes paid or accrued and charitable contributions reduce a partner's basis, which then limits a partner's losses for tax years beginning after December 31, 2017. If a partnership makes a charitable contribution of appreciated property, the new provision does not apply to the excess of fair market value over tax basis. The loss limitation is adjusted by the partner's distributive share of the partnership's tax basis in the appreciated property.

Dealers with partnership interests will need to include their distributive shares of foreign taxes paid or accrued and charitable contributions in the basis adjustment when analyzing the capacity to deduct their distributive share of partnership losses.

Partnerships—Technical Termination

Under prior law, a technical termination of a partnership occurred if, during any consecutive 12-month period, there was a sale or exchange of 50 percent or more of the capital and profit interests of the partnership. When a technical termination occurred, the partnership was considered to have contributed all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership, which was then considered to be distributed to the remaining partners and the purchasing partner. A technical termination of a partnership caused the tax year to close, which often resulted in a requirement to file a short-period tax return. Also, partnership-level elections terminated and new recovery periods for depreciation purposes began. Previous basis adjustments from the sale or exchange of partnership interests remained in effect whether a technical termination occurred or not. Basis in the partnership remained unaffected by a technical termination.

The TCJA repeals technical terminations for partnership tax years starting after December 31, 2017.

Dealers no longer have to worry about technical terminations when there is a sale or exchange of 50 percent or more of the capital and profit interest of the partnership. This results in less paperwork as taxpayers are no longer required to file short-period returns. Additionally, taxpayers no longer have to calculate the tax basis on assets and reset the tax depreciation recovery period. Depreciation continues under the original lives, methods, and conventions, resulting in shorter recovery periods than with a technical termination. There are some disadvantages to the new provisions in that a technical termination could have been used as an opportunity to change accounting methods without the need to file Form 3115 or to change elections that were irrevocable.

Pass-Through Deduction

The TCJA includes a new 20 percent pass-through deduction against a taxpayer's qualified business income from a sole proprietorship, partnership, limited liability company (LLC), or S corporation. The deduction is available to taxpayers for tax years beginning after December 31, 2017 and before January 1, 2026. This deduction is not allowed to a C corporation. The 20 percent deduction is limited by the higher of two wage-based limitations. The first wage-based limitation is 50 percent of the W-2 wages paid by the business. The second limitation is 25 percent of the W-2 wages paid by the business plus 2.5 percent of the initial tax basis, not reduced by depreciation, of qualified property. Wages for the purpose of these tests include compensation paid to both non-owner employees and, in the case of S corporations, employee-owners. In general, the application of these tests should be favorable for dealerships, because historically personnel costs are among the top three expense items.

Entity-Based Limitations

	LLC/S-Corp A (Dealership #1)	LLC/S-Corp B (Dealership #2)	LLC/S-Corp C (Real Estate Entity)
Gross Income	$60,000,000	$60,000,000	$2,000,000
Wages Paid	($1,000,000)	($5,000,000)	$0
Other Deductions	($54,000,000)	($50,000,000)	($1,500,000)
Taxable Income	$5,000,000	$5,000,000	$500,000
Initial Tax Basis of Qualifying Tangible Property	$800,000	$2,000,000	$3,000,000
20% of Taxable Income	$1,000,000	$1,000,000	$100,000
50% of Wages Paid	$500,000	$2,500,000	$0
25% of Wages plus 2.5% of Tangible Property	$270,000	$1,300,000	$75,000
Pass-Through Deduction Allowed	$500,000	$1,000,000	$75,000

Another limitation applicable to all taxpayers is that the 20 percent deduction is the lesser of the amount initially calculated or 20 percent of taxable income in excess of capital gain income. Included in this category is the capital gain or loss portion from the sale of capital assets resulting in section 1231 gain.

The 20 percent deduction does not apply to capital gains, dividends, portfolio interest, or foreign income. The pass-through entity deduction and any limitations are calculated for each trade or business. Complexities exist for tiered entity structures and additional guidance is needed for these situations.

Taxpayer-Based Limitations

	Individual A	Individual B	Individual C
K-1 #1	$500,000	$500,000	$500,000
K-1 #2	$400,000	$400,000	($400,000)
W-2 Income	$0	$150,000	$150,000
Adjusted Gross Income	$900,000	$1,050,000	$250,000
Itemized/Standard Deductions	($50,000)	($50,000)	($50,000)
Taxable Income Before Pass-Through Deduction	$850,000	$1,000,000	$200,000
Pass-Through Deduction—K-1 #1	($100,000)	($100,000)	($100,000)
Pass-Through Deduction—K-1 #2	($80,000)	($80,000)	$0
Pass-Through Deduction Cap— 20% of Taxable Income	($170,000)	($200,000)	($40,000)
Pass-Through Deduction	($170,000)	($180,000)	($40,000)
Taxable Income	$680,000	$820,000	$160,000

For purposes of the 2.5 percent calculation, qualified property consists of personal and real property eligible for depreciation but not land. Qualified property must be used to produce qualified business income, be held at the end of the tax year, and not have reached the end of its depreciable period prior to tax year-end.

The new effective tax rate for business income is 29.6 percent when using the full 20 percent business income deduction and a top rate of 37 percent. This is a ten-point reduction compared to prior law. Most dealerships should qualify for the deduction based on the 50 percent of W-2 wages qualification and real

estate entities might qualify under the 25 percent W-2 wages plus 2.5 percent qualified property. Management companies might qualify or they could be ineligible for the deduction as a specified service business. Each business has its own limit calculations and businesses are currently not allowed to be grouped.

Dealers should discuss the application of these rules with their tax advisors and plan their financial structure accordingly.

Reinsurance Companies

The TCJA includes numerous items related to insurance companies, reinsurance companies, and their shareholders. Some of the complex provisions could affect an automobile dealership, its shareholders, and reinsurance companies affiliated with the dealership's sale of finance and insurance (F&I) products such as vehicle service contracts. Given the complexity of the many changes and the scope of this document, this discussion will be limited and dealers should consult with their tax advisors regarding the dealership's specific facts.

Under the TCJA, domestic F&I reinsurance companies are taxed at the 21 percent rate. This includes both small companies with an election to be taxed only on investment income and Controlled Foreign Corporations (CFCs) that have elected to be taxed as U.S. taxpayers.

The TCJA's more significant changes involve reinsurance companies organized as Non-Controlled Foreign Corporations (NCFCs). The TCJA expands the definition of a U.S. shareholder. It now considers the owner's percentage of value in addition to voting rights in the NCFC. However, the game-changer here pertains to Passive Foreign Investment Company (PFIC) status. The deferral of taxable income that has been available for NCFC owners in the past requires that the NCFC qualify for an exemption to PFIC status. The exemption qualification has changed and an F&I NCFC may be classified as a PFIC going forward. The tax consequences of such a classification may be very significant.

The changes are effective for tax years of the foreign corporation beginning after December 31, 2017.

S Corporation to C Corporation Conversion

S corporations can change to become C corporations. This change can have several consequences. First, as a C corporation, less favorable accounting methods may be required and, when making the change, there may be some methods that will have to be changed. This could result in a significant income pick-up that, under prior law, could be spread over a four-year period. Second, after the change, the corporation could continue to make tax-free distributions, up to a certain amount during, at most, the next year depending on the situation.

The TCJA makes favorable changes to both of these rules but only when the change to a C corporation is made during a two-year window beginning on December 22, 2017, and the company has the same owners on the conversion date. The first change allows for the income pick-up to be spread over a six-year period rather than the four-year period. The second change allows for a portion of the distributions, made after the previous one-year period, to be tax-free in many cases.

Dealers (not only S corporations but also partnerships and single member LLCs) may be attracted to the 21 percent corporation tax rate and the favorable transition rules. However, careful consideration should be given to all possible implications including intention to distribute profits and double taxation; state tax implications; deductibility of state taxes by a C corporation; the need to change accounting methods; interaction with other business interests; future tax law changes and political climate; potential future sale of business; and succession planning.

Dealers should consult with their tax advisors in evaluating the relative benefits of a C corporation versus an S corporation and the timing to make the change.

Section 179 Expensing

Taxpayers that qualify can elect to expense qualifying property used in their trade or business up to a certain dollar limit each year. This limit is reduced dollar-for-dollar if the taxpayer places in service qualifying property over a certain threshold. Under prior law, the limit the taxpayer could elect to expense was generally $500,000, while the threshold whereby the limit would begin to be reduced was $2,000,000. The TCJA increases the annual amount the taxpayer can elect to be expensed to $1,000,000 and increases the placed-in-service threshold to $2,500,000. Taxpayers that incur floor plan indebtedness may still claim the benefits of section 179.

In addition to the increased limits, the TCJA expands the definition of qualifying property at the taxpayer's election to include roofs, HVAC property, fire protection and alarm systems, and security systems, if such property are improvements made to nonresidential real property that is placed in service after the day the original real property was first placed in service.

This provision is effective for property placed in service in tax years beginning after December 31, 2017.

Small Life Insurance Companies

Under prior law, life insurance companies with assets of less than $500 million were allowed a small life insurance deduction. The deduction was 60 percent of the tentative life insurance company taxable income (LICTI), limited to $3 million of LICTI.

The deduction was originally intended as a transition rule effectively providing a tax reduction in connection with the 1984 changes to rules related to small life insurance companies. It is likely that Congress reasoned that the reduction in corporate tax rates provided by the TCJA provides enough tax relief so the deduction is no longer needed.

The TCJA repeals the small life insurance company deduction for tax years beginning after December 31, 2017.

Substantial Built-In Loss

A partnership has a substantial built in loss when the adjusted basis of partnership property exceeds the fair market value of the property by more than $250,000. If there is a transfer of an interest in a partnership in this situation, the partnership is required to adjust the basis of a partnership interest.

The TCJA adds an additional situation when the partnership is required to adjust the basis of a partnership interest. The additional situation occurs when a partnership interest is transferred and, under a hypothetical sale immediately after the partnership interest transfer, the transferee partner would be allocated a loss of more than $250,000. In this case, a downward adjustment is required to the basis of partnership property relative to the transferee partner.

Dealers need to be aware of these situations in order to consider the potential tax implications as well as additional compliance requirements involving transfers of certain partnership interests.

Taxpayers Other than Corporations—Limitation on Losses

Under prior law, the only overall loss limitation for the trades or businesses of an individual applied to losses from farming.

The TCJA extends the loss limitations to all of the trades and businesses of a taxpayer other than a corporation, including pass-through entities, for tax years beginning after December 31, 2017 and before January 1, 2026. The limitation is $500,000 for joint returns and $250,000 for all others and applies on an

aggregate rather than an entity basis. The loss limitation is applied after the effect of any at-risk and passive loss limitation rules. Disallowed losses are carried forward and treated as net operating losses (NOLs).

Dealers are now limited in the amount of business losses they are allowed to deduct to offset other taxable income. Losses that are carried forward and converted to NOLs are subject to the new NOL limitations where NOL deductions cannot exceed 80 percent of taxable income. For example, if a married dealer has an overall business loss in 2018 of $700,000, the dealer can use $500,000 of that loss against other taxable income. The remaining $200,000 loss is converted to an NOL carryforward. In 2019, assuming the taxpayer has $500,000 of business income, the $200,000 loss carryforward would be fully deductible. However, assuming in 2019 that the same taxpayer has an $800,000 business loss, only $500,000 of the $800,000 business loss is deductible against other taxable income and the $200,000 NOL carryforward from 2018 can be used to offset other income. The $300,000 loss limitation from 2019 business losses is an NOL carryforward to 2020. The end result might be only a one-year deferral of the loss in this type of situation.

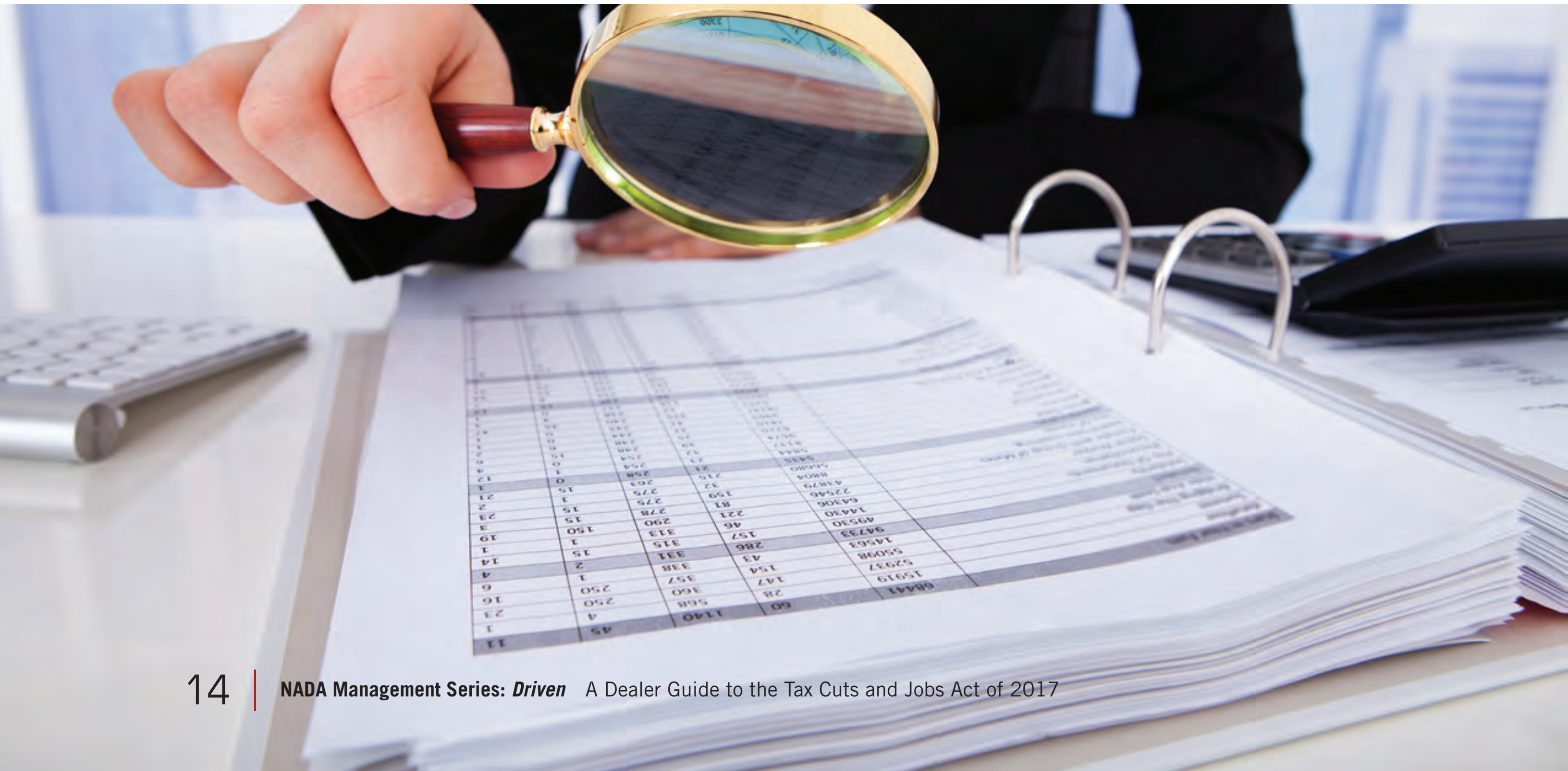
Uniform Inventory Capitalization (UNICAP)

Under the TCJA, the gross receipts exemption from the UNICAP rules increases from $10,000,000 to $25,000,000. That is, dealerships with gross receipts (sales and other receipts) of $25,000,000 or less are now exempt from the UNICAP rules. The TCJA also expands the exemption to include producers. Previously, only resellers such as retailers and wholesalers were included.

The UNICAP rules are complex and generally require the capitalization of certain inventory-related expenses. Consequently, these expenses may not be deducted currently as may other expenses and thus lead to higher taxable income. Dealerships subject to the UNICAP rules may be required to capitalize certain purchasing costs, handling costs, storage costs, and related general and administrative (G&A) expenses. Generally, favorable treatment with respect to the application of UNICAP to dealerships can be found by utilization of the Simplified Resale Method in Regulations section 1.263A-3, the Retail Sales Facility Safe Harbor Method (Revenue Procedure 2010-44), and the Reseller Without Production Activities Safe Harbor Method (Revenue Procedure 2010-44). These methodologies are unaffected by the TCJA.

To qualify for the new $25,000,000 exemption in the current year, the taxpayer's average gross receipts for the previous three years must not exceed $25,000,000 per year. Any taxpayer that previously was not exempt but now meets the new exemption must change its method of accounting by filing a Form 3115, generally under applicable automatic accounting method change provisions.

This is effective for tax years beginning after December 31, 2017.



Affordable Care Act Individual Mandate

Under prior law, a nonexempt individual taxpayer was subject to a tax (also referred to as a penalty) for each month he or she failed to maintain a health plan that provided "minimum essential coverage" for the taxpayer and his or her dependents. This penalty was referred to as a "shared responsibility payment," and the requirement to maintain the coverage was known as the "individual mandate."

Effective for all months beginning after December 31, 2018, the TCJA eliminates the shared responsibility payment for individuals failing to maintain minimum essential health care coverage by reducing the penalty to $0.

Alimony Payments

Under prior law, alimony and separate maintenance payments were deductible by the payor spouse and includible in income by the recipient spouse.

The TCJA repeals the deduction for alimony payments and the recipient's corresponding inclusion of those payments in gross income. This is a permanent provision that is effective for any divorce or separation instrument executed after December 31, 2018, or for any divorce or separation instrument executed on or before December 31, 2018 and modified after that date, if the modification expressly provides that the amendments made by this section apply to such modification.

Alternative Minimum Tax—Individuals

The alternative minimum tax is a parallel tax to the regular income tax and is imposed if the individual's tentative alternative minimum tax exceeds the individual's regular income tax. The alternative minimum taxable income (AMTI) is calculated based on the individual's taxable income increased for AMT preference items and adjusted for certain items related to the timing of deductions. The common preference items and adjustment for dealers were state and local income and real and personal property tax deductions, miscellaneous itemized deductions, and the depreciation adjustment due to different depreciable methods for regular tax and AMT. The AMT rates are 26 percent and 28 percent depending on the amount the AMTI exceeds the exemption amount.

The exemption amounts for the 2017 tax year varied by filing status and were $84,500 for married filing jointly; $54,300 for single or head of household; $42,250 for married filing separately; and $24,100 for estates and trusts. The exemption amounts phased out 25 percent for each dollar of AMTI that exceeded a threshold amount. The threshold amounts for the 2017 tax year were $160,900 for married filing jointly; $120,700 for single or head of household; $80,450 for married filing separately.

The TCJA increases the exemption amount and the exemption amount phase-out for tax years 2018 through 2025. For this eight-year period, the exemption amounts are increased to $109,400 for married filing jointly; $70,300 for other unmarried individuals; and $54,700 for married filing separately. The phase-out thresholds increased to $1,000,000 for married filing jointly; $500,000 for other unmarried individuals; and $500,000 for married filing separately. The exemption amounts and phase out thresholds are indexed for inflation.

With the increase of the exemption amount and the phase out threshold, along with the decrease in deductibility of preference items (such as state and local taxes and miscellaneous itemized deductions), for regular tax purposes, fewer taxpayers should pay AMT.

On the next page we've provided an example of a taxpayer filing married filing jointly with $500,000 of adjusted gross income (AGI), $35,000 of state and local taxes paid, $30,000 of charitable contributions, and $1,000 of miscellaneous itemized deductions after application of the 2 percent threshold on such deductions:

	2017	2018
Adjusted Gross Income	$500,000	$500,000
Itemized Deductions		
State Taxes	($35,000)	($10,000)
Contributions	($30,000)	($30,000)
Miscellaneous	($1,000)	—
Phase-out Add-back	$5,586	—
Taxable Income	$439,586	$460,000
Regular Tax	$120,738	$112,379
Alternative Minimum Tax	$5,083	—
Total Tax	$125,821	$112,379
AMT Calculation		
Income Before Itemized Deductions	$439,586	$460,000
State and Local Taxes	$35,000	$10,000
Miscellaneous Itemized	$1,000	—
Phase-out	($5,586)	—
AMT Income	$470,000	$470,000
Exemption	($84,500)	($109,400)
Phase-out of Exemption	$77,275	-
AMT Taxable Income	$462,775	$360,600
Tentative Minimum Tax	$125,821	$97,212
Regular Income Tax	$120,738	$112,379
AMT	$5,083	

Capital Gains Rates

Capital gains rates apply to the disposition of capital assets, which include any property other than inventory, depreciable, or real property used in the taxpayer's business (with exceptions for gain due to certain depreciation taken); certain literary or artistic property; business accounts and notes receivable; and certain publications. Under prior law, capital gains were taxed at preferential rates from 0 percent to 28 percent, and the capital gains tax rates depended on the taxpayer's tax bracket, the holding period of the asset, and type of capital gain property.

Short-term capital gains (property held one year or less) were taxed at ordinary income tax rates. Collectibles (works of art, antiques, metals such as gold, silver, and platinum bullion, gems, stamps, coins, and certain other tangible property) held more than one year were taxed at the lower of the taxpayer's ordinary income tax rate or 28 percent. Unrecaptured section 1250 depreciation (depreciation on real property) held more than one year was taxed at the lower of the taxpayer's ordinary income tax rate or 25 percent.

Long term capital gains (property held more than one year) were taxed at 0 percent, 15 percent, or 20 percent depending upon the tax bracket of the taxpayer. The 0 percent rate applied to adjusted net capital gains (long-term capital gains less short-term capital gains plus qualified dividends) when taxable income was taxed at the 10-15 percent bracket; the 15 percent rate applied to adjusted net capital gains when taxable income was taxed at brackets between 15 percent and 39.6 percent; and the 20 percent rate applied to adjusted net capital gains when taxable income was taxed at the 39.6 percent bracket. For 2017, the 15 percent tax bracket began at $37,950 (single), $75,900 (married filing jointly), and $50,800 (head of household). For 2017, the 39.6 percent tax bracket began at $418,400 (single), $470,700 (married filing jointly), and $444,550 (head of household).

The TCJA retains the preferential rates for capital gains. For tax years beginning after December 31, 2017, the break points for the different capital gain rates are set at a fixed amount, indexed for inflation. The 0 percent rate applies to net capital gains when taxable income is less than $38,600 (single), $77,200 (married filing jointly), and $51,700 (head of household). The 15 percent rate applies to net capital gains when taxable income is greater than the threshold amounts for the 0 percent rate and less than $425,800 (single), $479,000 (married filing jointly), and $452,400 (head of household). The 20 percent rate applies when taxable income is greater than the threshold amounts for the 15 percent rate.

	2017	**2018**
Short-term capital gains	Taxed at ordinary income rates with highest rate 39.6%	Taxed at ordinary income rates with highest rate 37%
Collectibles held more than 1 year	Lower of ordinary income rates or 28%	Lower of ordinary income rates or 28%
Unrecaptured section 1250 depreciation held more than 1 year	Lower of ordinary income rates or 25%	Lower of ordinary income rates or 25%
Long-term capital gains		
0% rate	Taxpayers in tax rate bracket 15% or less ($75,900 for married filing jointly)	Taxpayers with taxable income of $77,200 or less for married filing jointly
15% rate	Taxpayers in tax rate brackets between 15% and 39.6% ($75,901 through $470,700 for married filing jointly)	Taxpayers with taxable income of $77,201 through $479,000 for married filing jointly
20% rate	Taxpayers in 39.6% tax rate bracket ($470,701+ for married filing jointly)	Taxpayers with taxable income in excess of $479,000 for married filing jointly

Chained Consumer Price Index

Under the TCJA, the Chained Consumer Price Index (C-CPI) is utilized for tax years beginning after December 31, 2017 for inflation-indexed amounts in the tax code. It is calculated in much the same way as the Consumer Price Index, but rather than simply accounting for the impact of inflation on the price of goods, it also accounts for consumers' diminished capacity to achieve the same standard of living due to the increase in the price of consumer goods.

Child Tax Credit and New Family Tax Credit

A taxpayer can claim a tax credit ($1,000 in 2017) for each qualifying child. To qualify, the child must meet the six qualifying tests: age, relationship, support, dependent, citizenship, and residence. The credit is phased out for individuals with a modified adjusted income above threshold amounts. Under prior law, the credit was generally nonrefundable in that it could only offset the taxpayer's tax liability. If the taxpayer's tax liability was less than the allowable credit and certain conditions were met, however, a portion could be refundable (Additional Child Tax Credit). The qualifications for the additional child tax credit were the same as those for the Child Tax Credit, with the exception that the refund was limited to 15 percent of earned income in excess of $3,000.

The TCJA temporarily (until December 31, 2025) increases the current child tax credit (which includes the former additional child tax credit) from $1,000 to $2,000 per qualifying child; up to $1,400 per child is refundable. The TCJA also raises the AGI phase-out thresholds, starting at an AGI of $400,000 for joint filers ($200,000 for all other taxpayers).

The child tax credit is further modified to temporarily provide for a $500 nonrefundable credit (the "family credit') for qualifying dependents other than qualifying children.

Education Savings Rules

Contributions to a qualified tuition program (section 529 plan) are not deductible when contributed to the plan; however, the earnings are not taxed when distributed if used for qualified elementary, secondary, and higher education educational expenses. The earnings portion of any distribution that exceeds qualified expenses is taxable and a 10 percent excise tax also generally applies to such distributions.

The TCJA expands the definition of qualified expenses to include distributions from section 529 plans for secondary or elementary school tuition and certain homeschool expenses, in addition to higher education expenses. The tax-free amount for secondary and elementary school tuition is limited to $10,000 per student-designated beneficiary. Any excess over $10,000 is taxed under the rules discussed above.

Estate and Gift Taxes

The federal transfer tax system includes the gift tax, estate tax, and generation-skipping tax (see next section). The gift tax applies to transfers during the individual's lifetime. The estate tax applies to transfers at death. The generation-skipping tax applies to transfers to beneficiaries at least two generations below the transferor.

The estate tax and gift tax are a unified system in that common tax rates apply and there is one exemption amount and unified credit available for taxable transfers during lifetime and at death. Any taxable transfers during the individual's lifetime reduce the exemption/credit available for transfers at death.

Transfers at death or during lifetime to a spouse or to charity are not taxable. An individual can gift up to $15,000 per year per individual beginning in 2018 and have it excluded from taxable transfers. To qualify for this exclusion, the gift must be of a present interest. Gifts to a trust can qualify as a present interest if the beneficiary has qualifying withdrawal power, which is generally a right to withdraw a certain amount within a certain period of time. The annual gift tax exclusion amount is indexed for inflation.

The recipient's income tax basis in property gifted to the recipient is generally carryover basis (the same basis as the transferor). The recipient's income tax basis in property received as a result of the transferor's death is the fair market value at the date of death, with limited exceptions.

The 2011 Tax Act established the estate and gift tax exemption amount at $5,000,000. The exemption amount was indexed for inflation resulting in an exemption amount of $5,490,000 for 2017. If an individual died in 2017, estate tax would not have to be paid if the taxable transfers at death plus taxable transfers during the individual's lifetime did not exceed $5,490,000. If an individual's entire exemption amount was not utilized, the surviving spouse could make a portability election so that he/she could utilize the unused exemption amount for lifetime transfers or transfers at death.

The TCJA doubles the exemption amounts and retains the annual inflation adjustments. As a result, effective January 1, 2018, the exemption will be approximately $11,200,000 for individuals and $22,400,000 for married couples, compared to the 2017 levels of $5,490,000 and $10,980,000. The 2018 amounts will increase with inflation each year until 2025. On January 1, 2026, unless Congress extends the provision, the exemption amounts will revert to the 2017 levels as adjusted for inflation.

The TCJA did not change the portability rules or income tax basis rules and the top rate remains at 40 percent.

Generation-Skipping Tax (GST)

The GST is a transfer tax in addition to the estate and gift tax. The GST applies to transfers both during lifetime and death. It is designed to prevent individuals from skipping a level of transfer taxes. The normal progression would be that generation 1 property would transfer, by gift or at death, to generation 2 and if taxable, federal transfer tax would be paid on the transfers by generation 1. The property would subsequently be transferred, by gift or death, from generation 2 to generation 3 and if taxable, transfer tax would be paid on the transfers by generation 2. The GST was enacted to prevent generation 1 from transferring property to generation 3 to avoid the imposition of transfer taxes at the generation 2 level. The GST is a highly technical area and the foregoing explanation simply provides the reasoning for the tax.

The exemption amount available for GST transfers is equal to the estate and gift tax exemption rate. With the TCJA increase in the exemption amount for estate and gift tax (see preceding section), the GST exemption also increased and is approximately $11,200,000 for 2018.

Individual Retirement Account (IRA) Contributions

Subject to an aggregate annual limit for contributions to all IRAs, individuals may make tax-deductible or nondeductible contributions to a traditional IRA and nondeductible contributions to a Roth IRA. Participation in an employer retirement plan and AGI limits may prevent an individual from making a tax-deductible traditional IRA contribution or a nondeductible Roth IRA contribution, but a nondeductible contribution may be made to a traditional IRA regardless of AGI or participation in an employer retirement plan.

The traditional IRA and Roth IRA are separate and distinct. The recharacterization rules allow an individual to treat contribution amounts to a traditional IRA as a contribution to a Roth IRA (and vice versa) if changing the character of the contribution amount is done by the due date of the individual's tax return. The recharacterization is done by a trustee-to-trustee transfer of the contribution amount and any income earned on the contribution.

Prior law also allowed a conversion from a traditional IRA to a Roth IRA to be recharacterized and converted back to a traditional IRA. If additional taxes were due from the original conversion to a Roth IRA, a timely recharacterization of the Roth IRA back to a traditional IRA was treated as an unwinding of the original conversion. Thus, additional taxes on the original conversion would either not be due or, if already filed and paid, refunded through an amended return.

The TCJA disallows the recharacterization rules that permitted an individual to unwind a conversion to a Roth IRA back to a traditional IRA. Beginning in 2018, once an amount is converted from a traditional IRA to a Roth IRA, it cannot be undone. Current-year contributions can still be recharacterized.

Individual Tax Rates

The individual tax rates for 2017 ranged from 10 percent to 39.6 percent depending on taxable income. The TCJA modifies the rates with the low end remaining at 10 percent and the maximum rate set at 37 percent. The rate tables effective for 2018 (amounts indexed for inflation for future years) are below.

The change in tax rates is only one item that will affect your tax bill in 2018 and forward. Other changes discussed in this guide will affect your tax bill either positively or negatively.

Itemized Deductions

Charitable Contributions

Charitable contributions of money or property are itemized deductions that are deductible in the year they are contributed to a qualified organization. Under prior law, the deduction was limited to 50 percent, 30 percent, or 20 percent of the taxpayer's AGI and the limitation was determined by what is contributed and to whom the contribution was made.

Effective for tax years beginning after December 31, 2017, the TCJA modifies the increase in the percentage limit for charitable contributions of cash to public charities from 50 percent to 60 percent. Also, the TCJA repeals the current 80 percent deduction for contributions made for university athletic seating rights.

Additionally, the TCJA repeals the substantiation exception for certain contributions reported by the donee organization effective for contributions made in tax years beginning after December 31, 2016. The taxpayer must receive a contemporaneous written acknowledgement for a contribution of $250 or more and cannot utilize as acknowledgement the charitable organization's reporting of the donor and the amount on its federal tax filings.

Tax Rate	Married Filing Jointly and Surviving Spouses	Single	Head of Household	Married Filing Separately	Estates & Trusts
10%	$0-$19,050	$0-$9,525	$0-$13,600	$0-$9,525	$0-$2,550
12%	$19,050-$77,400	$9,525-$38,700	$13,600-$51,800	$9,525-$38,700	N/A
22%	$77,400-$165,000	$38,700-$82,500	$51,800-$82,500	$38,700-$82,500	N/A
24%	$165,000-$315,000	$82,500-$157,500	$82,500-$157,500	$82,500-$157,500	$2,250-$9,150
32%	$315,000-$400,000	$157,500-$200,000	$157,500-$200,000	$157,500-$200,000	N/A
35%	$400,000-$600,000	$200,000-$500,000	$200,000-$500,000	$200,000-$300,000	$9,150-$12,500
37%	Over $600,000	Over $500,000	Over $500,000	Over $300,000	Over $12,500

Charitable contributions that exceed the applicable percentage limit generally may still be carried forward for up to five years.

Medical Expense Deduction
Under prior law, qualified medical expenses were deductible as itemized deductions for taxpayers to the extent these expenses exceeded 10 percent of AGI.

The TCJA retains the medical expense deduction, and lowers the threshold for the deduction to 7.5 percent of AGI for tax years 2017 and 2018.

Miscellaneous 2 Percent Itemized Deductions
Under prior law, itemized deductions subject to the 2 percent limit included expenses for the production or collection of income, investment management and trust fees, unreimbursed employee expenses (including meals and entertainment expenses), tax preparation fees, and other expenses, including the taxpayer's share of deductible investment expenses from pass-through entities.

The TCJA repeals all miscellaneous itemized deductions that are subject to the 2 percent floor. For tax years 2018 through 2025, none of the above expenses are deductible.

Mortgage Interest Deduction
Under prior law, a taxpayer who itemized could deduct interest paid on home acquisition indebtedness up to $1 million. The qualified secured debt loan interest could be a mortgage on your main and/or second home. In addition to the dollar threshold, the deductible amount depended on the date the mortgage was taken out and how the taxpayer used the proceeds from the loan.

Additionally, a taxpayer could deduct interest on home equity debt up to $100,000 regardless of how the taxpayer utilized the loan proceeds.

The TCJA limits the itemized deduction for home mortgage interest and suspends the deduction for home equity interest for tax years 2018 through 2025. The deduction on mortgage acquisition indebtedness is limited to interest on $750,000 ($375,000 in the case of married taxpayers filing separately). The TCJA allows taxpayers to continue to include mortgage interest on second homes, but within these lower dollar caps. For acquisition indebtedness incurred before December 15, 2017, the TCJA allows current homeowners to keep the current limitation of $1 million ($500,000 in the case of married taxpayers filing separately).

State and Local Tax Deduction
State and local taxes paid—part of the taxes paid subcategory on Schedule A—are deductible as itemized deductions. For state and local taxes, the taxpayer can choose between the greater of income taxes or general sales tax paid. Income taxes paid include the withholding reported on the taxpayer's W-2, balance on prior-year state and local returns paid in the tax year, estimated payments paid during the tax year, and extension payments for a prior-year return. The other taxes that are part of the taxes paid subcategory include real estate taxes, personal property taxes, and other applicable taxes, such as income tax paid to a foreign county or U.S. possession.

The TCJA limits annual itemized deductions for all non-business state and local taxes paid, including property taxes, to $10,000 ($5,000 for a married taxpayer filing a separate return). Sales taxes may be included as an alternative to claiming state and local income taxes.

For purposes of applying the dollar limit above, if an individual prepaid before 2018 a state or local income tax imposed for a tax year beginning after 2017, the payment is treated as paid on the last day of the tax year for which the tax is imposed.

Limitation on Itemized Deductions
Under prior law, the "Pease limitation" limited the amount of itemized deductions high-income taxpayers could deduct. The threshold amounts were based on filing status and indexed for inflation. The reduction was calculated as either 3 percent of the amount by which the taxpayer's AGI exceeded the threshold or 80 percent of total itemized deductions, whichever was less.

The TCJA repeals the Pease limitation for tax years 2018 through 2025.

Moving Expenses
The TCJA generally suspends the deduction for moving expenses and exclusion from gross income for reimbursements for tax years beginning after December 31, 2017 and before January 1, 2026 except for active-duty members of the Armed Forces.

Personal Exemption
Under prior law, an individual could reduce AGI by claiming a personal exemption deduction and an exemption deduction for each person he or she claimed as a dependent on his or her return.

The TCJA temporarily repeals the deduction for personal and dependent exemptions for tax years 2018 through 2025.

Relief for 2016 Qualified Disaster Area

Distributions from qualified retirement plans and IRAs generally are taxed in the year of the distribution. If funds are withdrawn before the recipient reaches age 59½, a 10 percent early withdrawal penalty may apply.

The TCJA provides that a qualified 2016 disaster distribution from a qualified plan made in 2016 or 2017 (1) will not be subject to the 10 percent penalty; (2) may be included in income ratably over a three-year period beginning with the year of distribution; and (3) may be recontributed to an eligible retirement plan or IRA within three years.

To qualify, the distribution must be made to an individual whose principal place of abode during 2016 was in a presidentially-declared disaster area and the individual sustained loss because of the disaster. The maximum amount from all qualified plans that can qualify is $100,000. Any amount recontributed to a qualified plan within a three-year period beginning on the date of the distribution will be considered a rollover and not subject to tax. If the individual has previously included all or part of the amount recontributed in income, an amended return can be filed.

Standard Deduction

A taxpayer may choose to itemize applicable deductible expenses or to take the standard deduction, whichever offers greater benefit. The standard deduction amount is the sum of the basic standard deduction plus, if applicable, the additional deduction amounts for aged (at least 65) and/or blind taxpayers. The standard deduction amount depends on a taxpayer's filing status and for 2018 had been set at $13,000 for married filing joint returns, $9,550 for heads of households, and $6,500 for all others.

The TCJA increases the basic standard deduction for tax years 2018 through 2025 and is indexed annually for inflation. All increases are temporary and end after December 31, 2025. This increase again varies by the taxpayer's filing status and is increased to $24,000 for married filing joint returns; $18,000 for heads of households; and $12,000 for all others.

The additional standard deduction for the elderly and the blind ($1,300 each for married taxpayers, $1,600 for single taxpayers) is retained. ■

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