Tax Reform Bill Workshop
Litchfield Area Chamber of Commerce
May 11th, 2018

Agenda

- Federal individual tax reform items – Dave Corneil
- Minnesota tax changes – Lindsay Kranz
- Federal business tax reform items – Jim Rudnick
- 199A Qualified Business Income deduction – Joel Gratz
- Questions

Tax Cuts and Jobs Act

On December 22, President Trump signed into law H.R. 1, the "Tax Cuts and Jobs Act". The bill is a $1.4 trillion tax cut where the majority of the corporate tax changes are permanent and the individual tax changes are temporary and will expire on 12/31/25.

- The most significant update to the U.S. tax code in more than 30 years
  - Major Elements
    - Reduces tax rates for businesses and individuals
    - Increases the standard deduction and family tax credits
    - Eliminates personal exemptions
    - Adds new 20% deduction for pass-through income

CDS
CONWAY, DEUTH & SCHMIESING

Chart the Tax Rates

	2018
Max income tax rate	37%
Min income tax rate	10%
LT Capital Gain max	20%
LT Capital Gain min	0%
Qualified Dividends	0-20%
Self Employment	15.3%
Medicare Surtax	
Passive Income	3.8%
Earned Income	0.9%

* Apart from the max. income tax rate, these rates remain unchanged.

CDS
CONWAY, DEUTH & SCHMIESING

Federal Tax Brackets

2017 Individual Income Tax Rates		
Rate	Single	Joint
10%	$0-$9,325	$0-$18,650
15%	$9,326-$37,950	$18,651-$75,900
25%	$37,951-$91,900	$75,901-$153,100
28%	$91,901-$191,650	$153,101-$233,350
33%	$191,651-$416,700	$233,351-$416,700
35%	$416,701-$418,400	$416,701-$470,700
39.6%	$418,401 and up	$470,701 and up

2018 Individual Income Tax Rates		
Rate	Single	Joint
10%	$0-$9,525	$0-$19,050
12%	$9,526-$38,700	$19,051-$77,400
22%	$38,701-$82,500	$77,401-$165,000
24%	$82,501-$157,500	$165,001-$315,000
32%	$157,501-$200,000	$315,001-$400,000
35%	$200,001-$500,000	$400,001-600,000
37%	$500,001 and up	$600,001 and up

Capital Gains and Qualified Dividend Rates

2017 Capital Gain and Dividend Rates		
Capital Gain Rate	Single	Joint
0%	$0-$37,950	$0-$75,900
15%	$37,951-$418,400	$75,901-$470,700
20%	$418,401 and up	$470,701 and up

2018 Capital Gain and Dividend Rates		
Capital Gain Rate	Single	Joint
0%	$0-$38,600	$0-$77,200
15%	$38,601-$425,800	$77,201-$479,000
20%	$425,801 and up	$479,001 and up

Long-Term capital gains and qualified dividend tax rates are unchanged

CDS
CONWAY, DEUTH & SCHMIESING

AGI Deductions - 2018

	Under 50	Over 50
IRA (ROTH and Traditional)	$5,500	$6,500
Maximum Employer Plans		
401(k) and others	$18,500	$24,500
SIMPLE	$12,500	$15,500
	Under 55	Over 55
HSA deduction (Single/Family)	$3,450/$6,900	$4,450/$7,900

CONWAY, DEUTH & SCHMIESING

AMT Exemption and Phase-outs

2017-Individual AMT			2018-Individual AMT		
	Single	Joint		Single	Joint
Exemption	$54,300	$84,500	**Exemption**	$70,300	$109,400
Phase-out begins at	$112,500	$150,000	**Phase-out begins at**	$500,000	$1,000,000

Increase to AMT exemption and phase-out amounts

CDS
CONWAY, DEUTH & SCHMIESING

Summary of Individual Items

	Old Law	New Law
Personal standard deduction	Married filing jointly: $12,700 Head of Household: $9,350 Single: $6,350	Married filing jointly: $24,000 Head of Household: $18,000 Single: $12,000
Personal exemption	$4,050	Repealed—no exemption
Child tax credit	$1,000 per child Phase-out at MAGI of $110,000 MFJ, $75,000 single	$2,000 per child (up to $1,400 refundable per child); $500 for non-child dependents Phase-out increased to MAGI of $400,000 MFJ, $200,000 single

CDS
CONWAY, DEUTH & SCHMIESING

Summary of Individual Items

	Old Law	New Law
Personal state income, property tax and sales tax	Allowed as an itemized deduction	Combined deduction for property tax and either income or sales tax limited to $10,000
Mortgage interest	Deductible on up to $1.1 million of debt; interest on second home deductible	Deductible on up to $750,000 of debt (including second home); allowed only for home-related costs
Medical expenses	Deductible to the extent they exceed 10% of AGI	Deductible to the extent they exceed 10% of AGI (7.5% for 2017 and 2018)

CDS
CONWAY, DEUTH & SCHMIESING

Summary of Individual Items

	Old Law	New Law
Miscellaneous itemized deductions	Deductible for portion in excess of 2% of AGI floor	Deduction suspended for employee business expenses, uniforms, tax prep fees, professional dues, hobby loss, employee home office, tools and supplies
Personal casualty loss	Itemized deduction allowed for personal casualty losses	Deduction for personal casualty loss eliminated (except federally declared disasters), theft loss remains
Limit on itemized deductions	Overall limitation based on AGI	Repeals overall limitation

CDS
CONWAY, DEUTH & SCHMIESING

Summary of Individual Items

	Old Law	New Law
Moving expenses	Deduction allowed, qualified moving expense reimbursements excluded from income.	Both moving expenses and ability to exclude reimbursements from income are repealed.
Alimony	Deductible to payor and taxable to recipient	Not deductible to payor, not taxable to recipient for decrees executed or modified after 2018

CDS
CONWAY, DEUTH & SCHMIESING

Summary of Individual Items

	Old Law	New Law
Individual health insurance mandate	Individuals subject to penalty for failure to have minimum essential health insurance coverage	Penalty repealed starting in 2019
Exclusion of gain on sale of principal residence	Exclusion up to $250,000 ($500,000) for MFJ if 2 out of previous 5 year test met	No change
Excess business loss	No provision	Net business losses over $500,000 MFJ ($250,000 single) are not deductible; convert to NOL and carried over

CDS
CONWAY, DEUTH & SCHMIESING

Summary of Individual Items

	Old Law	New Law
Student loan discharged on death or disability	Included in gross income	Excluded from gross income
ABLE/529 accounts	No change on existing provisions	New provisions: -Allows distributions up to $10,000 annually for elementary and high school tuition costs -Allows amounts from qualified tuition programs (529 plan) to be rolled to an ABLE account without penalty -Increased contribution to ABLE accounts
Estate and gift	$5,490,000 gift or estate exemption per individual and $5,490,000 GST exemption.	Lifetime gift and estate tax exemption and the GST tax exemption will be doubled to $11.2 million in 2018. The estate and GST taxes will not be repealed. Planning will be focused on retaining the basis step-up.

CDS
CONWAY, DEUTH & SCHMIESING

Minnesota Tax Update

- Beginning Farmer Incentive & Management Credits
- Social Security Benefit Subtraction
- Child and Dependent Care Credit
- Teacher's Masters degree credit
- Student Loan Credit
- Section 529 credit/subtraction
- First-time homebuyer savings account

Minnesota Tax Brackets

Rate	Head of household		Single	
	More than	*But not more than*	*More than*	*But not more than*
5.35%	$0	$31,880	$0	$25,890
7.0%	$31,881	$128,090	$25,891	$85,060
7.8%	$128,091	$213,360	$85,061	$160,020
9.85%	$213,360		$160,020	

Rate	Married joint		Married Separate	
	More Than	*But not more than*	*More than*	*But not more than*
5.35%	$0	$37,850	$0	$18,930
7.05%	$37,851	$150,380	$18,931	$75,190
7.85%	$150,381	$266,700	$75,191	$133,350
9.85%	$266,700		$133,350	

Beginning Farmer Incentive Credit

Owners of agricultural assets who sell or rent their assets to beginning farmers in Minnesota may be eligible for a nonrefundable credit. Unused portions of this credit can be carried over for 15 years.

- Available beginning in tax year 2018
- Amount will depend on the type of sale or rental agreement and the price or fair market value of the assets, as shown in the table below
- May be claimed only after approval and certification by the Rural Finance Authority

Beginning Farmer Incentive Credit

If you	Then you may qualify for a credit of	Your maximum credit is
Sold assets to a beginning farmer	5% of the lesser of the sale price or the fair market value of the asset	$32,000
Rented assets to a beginning farmer	10% of the gross rental income	$7,000 per year in the first, second, and third years
Rented assets to a beginning farmer in farmer in a share rent agreement	15% of the cash equivalent of the gross rental income	$10,000 per year in the first, second, and third years

CHRISTIANSON
CPAs & Consultants

Beginning Farmer Management Credit

Beginning farmers in Minnesota may be eligible for a nonrefundable credit equal to 100% of the amount paid for participating in a financial management program approved by the Rural Finance Authority

- Up to $1,500
- Unused portions of this credit can be carried over for 3 years
- Available beginning in tax year 2018

Social Security Benefit Subtraction

Minnesota taxpayers who receive Social Security or Railroad Retirement benefits may qualify for a subtraction from income on their state return.

- Available for tax year 2017 and later
- Available to individuals whose taxable Minnesota income includes Social Security or Railroad Retirement benefits. The subtraction is subject to income limits

How much is the subtraction?

- The subtraction amount depends on your filing status and provisional income (federal adjusted gross income (FAGI) plus any tax-exempt interest and one-half of your Social Security and tier 1 Railroad Retirement benefits)

Social Security Benefit Subtraction

If your filing status is	And your provisional income is	Your maximum subtraction is
Married filing joint or qualifying widow(er)	Less than $77,000	$4,500
	$77,000-$99,500	$4,500 minus 20% of your provisional income over $77,000
	More than $99,500	$0 (You are not eligible)
Single or head of household	Less than $60,200	$3,500
	$60,200-$77,700	$3,500 minus 20% of your provisional income over $60,200
	More than $77,700	$0 (You are not eligible)
Married filing separate	Less than $38,500	$2,250
	$38,500-$49,750	$2,250 minus 20% of your provisional income over $38,500
	More than $49,750	$0 (You are not eligible)

CHRISTIANSON
CPAs & Consultants

Child and Dependent Care Credit Changes

- Modified by recent legislation
- Federal Adjusted Gross Income (FAGI) up to $74,000
- FAGI less than $50,000, the credit will be equal to the Federal credit
- Credit begins to phase out for individuals with a FAGI over $50,000

CHRISTIANSON
CPAs & Consultants

Credit for Attaining Master’s Degree in Teacher’s Licensure Field

Minnesota teachers enrolling in an eligible master’s degree program in their licensure field after may be eligible for a nonrefundable credit up to $2,500

- Eligible for credit in the year they complete the program
- 2017 tax returns and beyond
- The master’s degree program must meet the following requirements:
  - Start after June 30, 2017
  - Be for a program in reading, English or language arts, mathematics, science, foreign languages, civics and government, economics, arts, history, or geography
  - Completed the program in the year the credit is claimed
  - Does not include a pedagogy component

Student Loan Credit

Minnesotans who make payments on their postsecondary education loans may qualify for a nonrefundable credit up to $500. For married couples, each spouse may qualify for this credit.

- Available for tax year 2017 and later
- Available to full-year and part-year Minnesota residents who make payments on qualifying education loans during the tax year
- Credit amount depends on your income, loan payments, and original loan amount. The maximum credit is $500 each year (or $1,000 for married couples who file a joint return if both spouses made payments on qualified loans).
- Taxpayers with an AGI greater than $25,000 will get phased out

Section 529 Plan Credit/Subtraction

Minnesota residents that contribute to a Section 529 College Savings Plan may be eligible for a nonrefundable credit up to $500. Individuals who contribute to a Section 529 College Savings Plan may be eligible for a subtraction from income up to $1,500 ($3,000 for married couples filing joint returns).

- Available beginning tax year 2017
- Maximum of $500 or 50% of contributions made during the year
- Credit phases out for taxpayers with an Adjusted Gross Income over $75,000
- Up to $1,500 subtraction for single, HOH, MFS. Up to $3,000 subtraction for MFJ
- No income phase-out for subtraction

First-time Homebuyer Savings Account Subtraction

Individuals may subtract interest earned on the first-time homebuyer savings account from their Minnesota taxable income.

- Available beginning tax year 2017
- Limited to the interest earned on an individual's first-time homebuyer savings account
- Contribution limit $14,000 ($28,000 for married filing joint) per year. $50,000 ($100,000 for married filing joint) total in all years. Each account is limited to a maximum of $150,000

Minnesota Proposed Tax Changes (BOTH Bills)

- Use federal AGI as a starting point for calculating MN taxable income (currently federal taxable income)
- Includes personal exemptions per person of $4,150 (eliminated for federal)
- Includes election to itemize deductions for MN even if taxpayer uses standard deduction for federal
- Reduces the corporate income tax rate from 9.8% to 9.1% by 2020
- Conforms to the increased section 179 and bonus depreciation federal expensing amounts. 80% is still required as an addback in the year of purchase with the 80% claimed as a deduction over the subsequent 5 years.

*Note: Because both bills use AGI as a starting point, the section 199A deduction is “not allowed” for Minnesota.

Minnesota Proposed Tax Changes (House Bill)

- Reduces the 7.05% individual income tax rate to 6.75% by 2020
- State standard deductions of:
  - Single or married filing separately $7,000
  - Married filing jointly $14,000
  - Head of household $10,300
- The additional standard deduction for people who have reached age 65 (or who are blind) is $1,300.
- If itemizing for MN, a $30,000 limit applies to real estate and personal property taxes (federal limit is $10,000 including state income tax)

Minnesota Proposed Tax Changes (Senate Bill)

- Reduces the bottom income tax rate from 5.5% to 5.1%
- Increases the estate tax exemption level to $5 million
- Adds a $60 per person tax credit
- Includes automatic corporate and income tax reductions when the state's economic surplus projects a surplus
- If electing itemized deductions for state, no limit for real estate or personal property taxes (Limit is $10,000 at the federal level)
- State standard deductions of:
  - Single or married filing separately: $6,300
  - Married filing jointly: $12,600
  - Head of household: $9,300
- The additional standard deduction for people who have reached age 65 (or who are blind) is $1,250 for married taxpayers or $1,550 for unmarried taxpayers.

Summary of Business Items

	Old Law	New Law
Maximum Corporate Tax Rate	35%	21% (AMT Repealed)
Net Operating Losses (NOL)	In general, 2 year carryback, 20 year carryforward	Carryback repealed, except 2 years for farms, with indefinite carryover deduction limited to 80% of income before NOL
Real Property Improvements	Multiple criteria to meet to qualify for 15 year life	Changed to allow 15 year depreciation for all qualified improvement property
Fringe Benefits Limited	Entertainment and recreation expenses not deductible unless a direct relationship to active conduct of business	No deduction will be allowed for entertainment, amusement, or recreational activity expenses
Interest Expense Limitation	Interest paid or accrued by a business is generally deductible.	Disallowance for interest in excess of 30% of adjusted taxable income. Exemption for businesses with average gross receipts less than 25 million

CDS
CONWAY, DEUTH & SCHMIESING

Bonus Depreciation and Section 179 Summary

	2017	2018
Sec 179 Expense Max	$510,000	$1,000,000
Sec 179 Phase Out	$2,030,000	$2,500,000
Bonus Depreciation	50% on new property only on or before 9.27.17. 100% on new or used property after 9.27.17 Can elect either 50% or 100% after 9.27.17 to 12.31.17	100% on new or used property

CDS
CONWAY, DEUTH & SCHMIESING

Section 179

- Tax bill provided for annual Section 179 limit of $1 million
- Asset phase-out threshold starts at $2.5 million
- Expanded to include roofs, HVAC and fire alarm and security systems
- Effective for tax years beginning after 2017, indexed for inflation
- MN allows $25,000 of Section 179 depreciation
- Can amend to add/remove Section 179 (bonus can’t)

CDS
CONWAY, DEUTH & SCHMIESING

Bonus Depreciation

- 100% depreciation through 12/31/2022

	Phase Out %
2023	80%
2024	60%
2025	40%
2026	20%

- Expanded to include used property
- Excludes property acquired from related parties, a decedent, and property acquired in carryover basis transactions
- Bonus depreciation cap on first year passenger automobiles is $16,400

CDS
CONWAY, DEUTH & SCHMIESING

Farming Assets

- 5 year cost recovery period for any machinery or equipment, (other than grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which commences with the taxpayer
- Can elect to use the 200% DB method, 150% DB method is no longer required. The 150% DB method still applies to any 15 or 20-year property to which straight-line doesn't apply

CDS
CONWAY, DEUTH & SCHMIESING

Like-Kind Exchange Treatment

> New tax law only allows gain deferral on real property
> Like-kind exchange of tangible personal property is now taxable in year of exchange
> However, this gain taxability creates tax basis which would then be eligible for Section 179 first year expensing or bonus depreciation
> Can create taxable income for state purposes due to MN tax law differences

CDS
CONWAY, DEUTH & SCHMIESING

Interest Expense Limitation

> Deduction for interest expense is limited to 30% of the business's adjusted taxable income determined at tax filer level (entity level for passthroughs)

> Disallowed interest is treated as paid or accrued in succeeding taxable year with indefinite carryforward

> Floor plan interest fully deductible

> Exempt from this rule of 3 previous years gross receipts average less than $25 million

> Real property trades and businesses can elect out of provision if they use ADS to depreciate real property used in trade or business

> Farming businesses can elect out if they use ADS to depreciate any property with a recovery period of 10 years or more

CDS
CONWAY, DEUTH & SCHMIESING

Section 199A Qualified Business Income Deduction

- Subtracts 20% of sole proprietorship, partnership or S-corporation qualified business income (QBI) against overall taxable income (TI)
- The deduction calculated separately for each business
- QBI does not include any guaranteed payments paid to a partner, nor wages paid to an S corporation shareholder
- Deduction limits are phased in over certain TI amounts

Calculating the 199A QBI Deduction

Step 1: Determine QBI deduction per business. This is the lesser of:

- 20% of the taxpayer's QBI with respect to the qualified trade or business,

or

- The greater of the following limitations:
- 50% of the taxpayer's share of allocable wages of the qualified business; or
- 25% of the taxpayer's share of allocable wages of the qualified business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property

Plus: 20% of the aggregate amount of the qualified REIT dividends and qualified publicly traded partnership income of the taxpayer for the taxable year

Calculating the 199A QBI Deduction

Step 2:

The deduction is calculated as the sum of:

- The lesser of:
  - The combined qualified business income amount (from step 1 above) or
  - 20% of the excess, if any, of taxable income over the sum of the net capital gain and the aggregate amount of the qualified cooperative dividends of the taxpayer;
- Plus the lesser of
  - 20% of the aggregate amount of qualified cooperative dividends, or
  - Taxable income, reduced by net capital gain

Calculating the 199A QBI Deduction

- Limitations do not apply until TI exceeds $315,000 MFJ or $157,500 sgl
- Limitations phase in at $315,000 to $415,000 MFJ
- Limitations phase in at $157,500 to $207,500 single
- QBI for sole proprietors = Schedule C net income
- QBI for farmers = Schedule F net income less QBI from coops
- QBI for partnerships or S-corps = owner's share of ordinary income
- Deduction and limitations are applied at the individual level

Business Type Limitations for 199A

- The 199A QBI deduction is <u>not</u> allowed for businesses that perform services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees – except for architects and engineers.
- Regular corporations are not eligible for the 199A QBI deduction
- Cooperatives are not eligible for the 199A QBI deduction, kept old DPAD
- Rental activities, Schedule E and Real Estate LLCs can be eligible

Other Considerations 199A

- The deduction is allowed against AMT
- The deduction does not lower self-employment tax
- 199A is available for estates and trusts
- 199A reduces TI not AGI
- Phase-outs based on AGI not affected by 199A
- 199A deduction is not aggregated, business by business

Other Considerations 199A

- MFJ taxpayers may find it beneficial to file separately
- Unused deduction does not carry over to future tax years
- QBI losses carryforward and offset future QBI

Planning Considerations for 199A

- Review wages to S-corp owners/spouses
- Review guaranteed payments to partners
- Prepare system to report attributes to owners
- Scrub depreciation schedules for asset limitation
- Better TI planning, level it out as much as possible
- Review investments/business structures for 199A

Questions?

THANK YOU!

From:

Dave Corneil, Partner, CDS - dcorneil@cdscpa.com

Lindsay Kranz, Supervisor, Christianson – lkranz@christiansoncpa.com

Jim Rudnick, Partner, CDS - jrudnick@cdscpa.com

Joel Gratz, Partner, Christianson – joel@christiansoncpa.com