Delaware Tax Institute

Individual Tax Planning

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Key Individual Tax Reforms

Individual Rates
- Overall rate decease; 7 brackets retained

Standard Deductions

• Married Filing Joint	$24,000
• Head of Household	$18,000
• Single	$12,000
• Married Filing Separate	$12,000

Personal Exemptions
- Repealed

AMT
- Exemption increased
- Exemption phaseout substantially increased

SALT Deduction
- Limited to $10,000 in property, state and local taxes

Mortgage Interest Deduction
- Limited to interest on up to $750,000 of acquisition indebtedness
- Repeals home equity indebtedness interest deduction

Pease Limitation
- Repealed

Individual provisions sunset December 31, 2025

Tax Cuts and Jobs Act: Conference Report

TITLE I – INDIVIDUAL TAX REFORM

A. Reduction and Simplification of Individual Income Tax Rates (sec. 1001 of the House bill, sec. 11001 of the Senate amendment, and sec. 1 of the Code)

Conference Agreement

The conference agreement temporarily replaces the existing rate structure with a new rate structure.

Federal Individual Income Tax Rates for 2018 Under the Conference Agreement

If taxable income is:	**Single Individuals**
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000	$45,689.50 plus 35% of the excess over $200,000
Over $500,000	$150,689.50 plus 37% of the excess over $500,000

If taxable income is:	**Head of Households**
Not over $13,600	10% of the taxable income
Over $13,600 but not over $51,800	$1,360 plus 12% of the excess over $13,600
Over $51,800 but not over $82,500	$5,944 plus 22% of the excess over $51,800
Over $82,500 but not over $157,500	$12,698 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$30,698 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000	$44,298 plus 35% of the excess over $200,000
Over $500,000	$149,298 plus 37% of the excess over $500,000

If taxable income is:	**Married Individuals Filing Joint Returns and Surviving Spouses**
Not over $19,050	10% of the taxable income
Over $19,050 but not over $77,400	$1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $165,000	$8,907 plus 22% of the excess over $77,400
Over $165,000 but not over $315,000	$28,179 plus 24% of the excess over $165,000
Over $315,000 but not over $400,000	$64,179 plus 32% of the excess over $315,000
Over $400,000 but not over $600,000	$91,379 plus 35% of the excess over $400,000
Over $600,000	$161,379 plus 37% of the excess over $600,000

If taxable income is:	**Married Individuals Filing Separate Returns**
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $300,000	$45,689.50 plus 35% of the excess over $200,000
Over $300,000	$80,689.50 plus 37% of the excess over $300,000

If taxable income is:	**Estates and Trusts**
Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

The provision's rate structure does not apply to taxable years beginning after December 31, 2025.

Effective date: The provision applies to taxable years beginning after December 31, 2017.

Planning Notes:

1. Kiddie Tax Rates

   Simplification of tax on unearned income of children
   The provision simplifies the "kiddie tax" by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. Taxable income attributable to net unearned income is taxed according to the brackets applicable to trusts and estates, with respect to both ordinary income and income taxed at preferential rates. Thus, under the provision, the child's tax is unaffected by the tax situation of the child's parent or the unearned income of any siblings.

2. Corporate rates vs Individual rates

   The maximum tax rates below are the rates paid on the highest income levels. Please note that the definition of income changes frequently, so keep that in mind when comparing rates.

   Until 1936, all companies paid the same rate, regardless of income. The current system is more progressive.

Year Changed	Max Tax Rate	President	Comments
1909	1%	Taft	.
1916	2%	Wilson	
1917	6%		
1918	12%		
1919	10%		WWI began.
1922	12.5%	Harding	Finance WWI.
1925	13%	Coolidge	
1926	13.5%		
1928	12%		
1929	11%	Hoover	Tax cut triggered stock market crash.
1930	12%		Tax hikes to stop speculation worsened depression.
1932	13.8%		
1936	15%	FDR	Hike revived depression.
1938	19%		Hike to finance WWII.
1940	24%		
1941	31%		Pearl Harbor attack triggered more hikes.
1942	40%		
1950	38%	Truman	Cut to fight recession.
1951	50.75%		Hike to fund Korean War.
1952	52%	Eisenhower	No cuts, despite 1953 and 1957 recessions.
1964	50%	LBJ	Implemented JFK's tax cut.
1965	48%		Cut boosted economy.
1968	52.8%		Hikes paid for Great Society and Vietnam War.
1970	49.2%	Nixon	Cut to fight recession.
1971	48%		
1979	46%	Carter	Cut to offset high interest rates.
1987	40%	Reagan	Tax Reform Act.
1988	34%		Cut to fight recession.
1993	35%	Clinton	Omnibus Budget Reconciliation Act.
2018	21%	Trump	Cut goes into effect.

(Sources for Table: "Corporate Tax Rates 1909-2002," IRS. "Corporate Tax Rate and Jobs," ProCon.org.)

3. Marginal income tax brackets and inefficiencies in investment portfolio

   Marginal tax rates are used to evaluate the use of taxable and tax-exempt bonds. The absolute yields of taxable vs municipal bonds are not directly comparable, and planners need to consider the taxable-equivalent yields when constructing the portfolio. The tax-equivalent yield is calculated by dividing the tax-exempt yield by one minus the investor's marginal income tax rate.

   Example: A high-grade 10-year municipal bond may have an average yield of approximately 2.5%, while a high-grade 10-year corporate bond may have an average yield of about 4%. The yield on the federally tax-exempt municipal bond likens to a 4.14% taxable yield for an investor in the 39.6% tax bracket, but the tax-equivalent yield falls to 3.85% for an investor in the 35% tax bracket. As a result, under the lower top income tax bracket, the investor's municipal bond portfolio may no longer be the most tax efficient investment choice.

1. Increase in standard deduction (sec. 1002 of the House bill, sec. 11021 of the Senate amendment, and sec. 63 of the Code)

Senate Amendment

The Senate amendment temporarily increases the basic standard deduction for individuals across all filing statuses. Under the provision, the amount of the standard deduction is temporarily increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other individuals. The amount of the standard deduction is indexed for inflation using the C-CPI-U for taxable years beginning after December 31, 2018.

The additional standard deduction for the elderly and the blind is not changed by the provision.

The increase of the basic standard deduction does not apply to taxable years beginning after December 31, 2025.

Effective date: The provision is effective for taxable years beginning after December 31, 2017.

Conference Agreement

The conference agreement follows the Senate amendment.

Planning Notes:

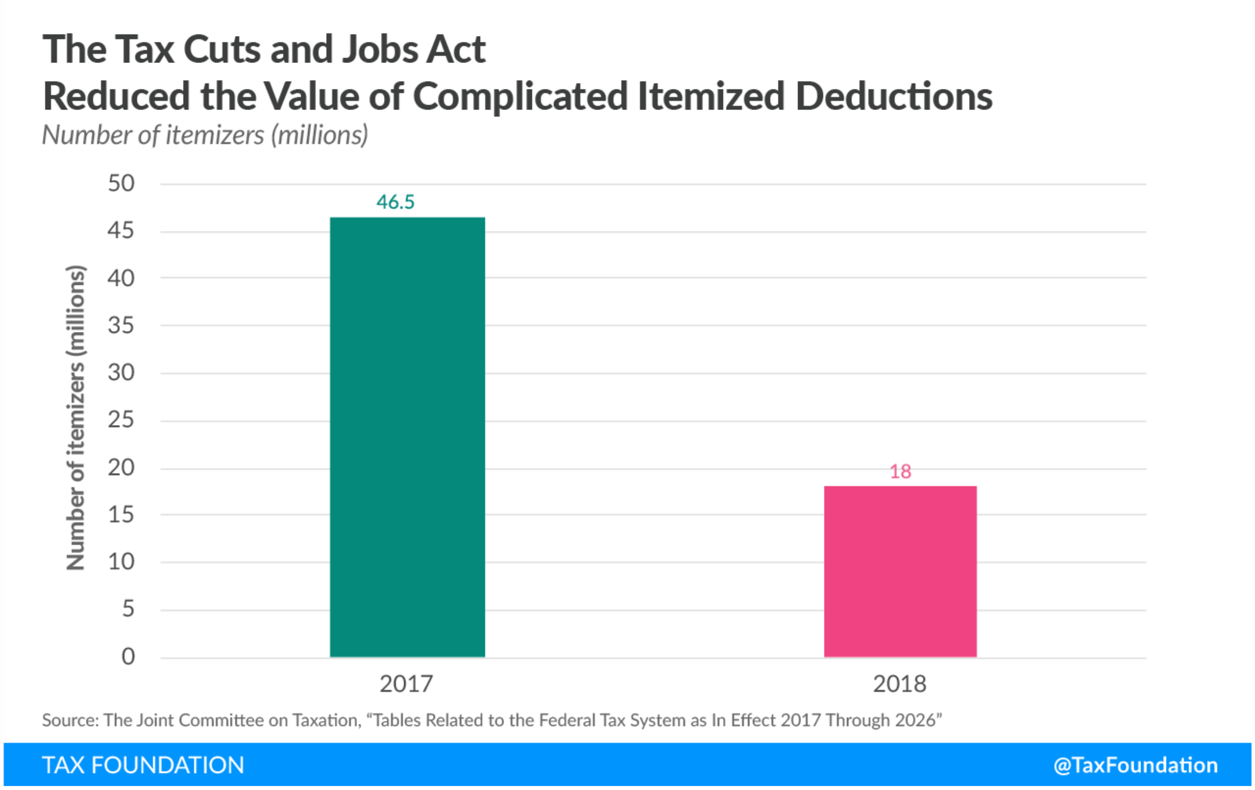
In all, the Joint Committee on Taxation (JCT) estimates that the number of itemized filers will decline from 46.5 million in 2017 to just over 18 million in 2018, implying that nearly 30 million households will now find it more advantageous to take the standard deduction. In total, now 88 percent of filers will use the standard deduction to complete their taxes.

By making the standard deduction larger, the value of itemized deductions is lessened. It is now more advantageous for many filers to take the standard deduction than to itemize their deductions.

Number of Returns (Thousands)			
Income Category	**2017**	**2018**	**Percent Change**
Less than $10,000	178	65	-63.5%
$10,000 to $20,000	517	154	-70.2%
$20,000 to $30,000	933	237	-74.6%
$30,000 to $40,000	1,595	410	-74.3%
$40,000 to $50,000	2,222	635	-71.4%
$50,000 to $75,000	6,683	2,136	-68.0%
$75,000 to $100,000	6,622	2,442	-63.1%
$100,000 to $200,000	17,959	6,513	-63.7%
$200,000 to $500,000	8,207	4,185	-49.0%
$500,000 to $1,000,000	1,089	791	-27.4%
$1,000,000 and over	509	444	-12.8%

Table 1: Number of Returns Utilizing Itemized Deductions

Source: The Joint Committee on Taxation, "Tables Related to the Federal Tax System as In Effect 2017 Through 2026"; authors' calculations



Pease limitation repealed.

The Act repealed the "Pease limit," which specified that the total amount of certain otherwise allowable itemized deductions (including charitable contributions) was limited for certain upper income taxpayers (for 2018, the income threshold above which the otherwise allowable itemized deductions are reduced would have been $266,700 for single filers and $320,000 for joint filers).

Bunching Deductions:

Bunching involves consolidating itemized deductions that would normally be made over multiple years into a single tax year. Charitable deductions can be timed in using this technique. Since charitable contributions are entirely at the client's discretion, they present the best opportunity for 2018 tax planning on Schedule A, Itemized Deductions. What clients should try to avoid is "wasting" the charitable contribution's deductibility in years when the client is taking the standard deduction.

Clients should determine what their anticipated itemized deductions for the year will be to see whether they will exceed their standard deduction.

Those whose current itemized deductions fall far short of the standard deduction may want to postpone deductible expenses until next year; those that are close to the standard deduction amount may want to move planned 2019 spending into 2018 to maximize 2018 itemized deductions.

In the right circumstances, bunching strategies can make a notable difference. Consider, for instance, the following scenario involving a married couple filing jointly, outlined to the right. The hypothetical example underscores how bunching tactics can be applied as well as the considerable longer-term impact these techniques can have on tax deductions.

Potential Itemized Deductions:

State and Local Income and Real Estate Tax	$10,000 (out of $52,000)
Mortgage Interest	$0 (no mortgage)
Medical Expenses	$0 (did not exceed 7.5%of AGI)
Charitable Giving	$20,000
Total	$30,000
Standard Deduction	$24,000 (Married Filing Joint)

2. Repeal of the deduction for personal exemptions (sec. 1003 of the House bill, sec. 11041

Senate Amendment

The Senate amendment suspends the deduction for personal exemptions.

The Senate amendment follows the House bill in modifying the requirements for those who are required to file a tax return.

The provision does not apply to taxable years beginning after December 31, 2025.

Effective date: The provision is effective for taxable years beginning after December 31, 2017.

Conference Agreement

The conference agreement follows the Senate amendment and suspends the deduction for personal exemptions. The suspension does not apply to taxable years beginning after December 31, 2025.

The conference agreement generally follows the House bill in modifying the withholding rules to reflect that taxpayers no longer claim personal exemptions under the conference agreement.

Effective date: The provision is effective for taxable years beginning after December 31, 2017. The conference agreement provides that the Secretary may administer the withholding rules under section 3402 for taxable years beginning before January 1, 2019, without regard to the amendments made under this provision. Thus, at the Secretary's discretion, wage withholding rules may remain the same as under present law for 2018.

Planning Notes:

1. No longer an AMT adjustment:

   The standard deduction and the deduction for personal exemptions are not allowed.

2. Guidance under §§ 36B, 5000A, and 6011 on the suspension of personal exemption deductions

Notice 2018-84

PURPOSE

Section 11041 of the Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054, 2082 (the Act), added § 151(d)(5) to the Internal Revenue Code (Code). Section 151(d)(5) reduces the amount of the personal exemption deduction to zero for taxable years beginning after December 31, 2017, and before January 1, 2026. This notice provides interim guidance clarifying how the reduction of the personal exemption deduction to zero in § 151(d)(5) applies for purposes of certain rules under §§ 36B and 6011 relating to the premium tax credit and under § 5000A relating to the individual shared responsibility provision. This notice also announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to amend the regulations under §§ 36B and 6011 to clarify the application of § 151(d)(5). Until further guidance is issued, the interim guidance described in this notice applies for purposes of the regulations under §§ 36B and 5000A and for purposes of § 1.6011-8(a).

BACKGROUND

Section 151 generally allows a taxpayer to claim a personal exemption deduction for the taxpayer, the taxpayer's spouse, and any dependents, based on the exemption amount defined in § 151(d). For tax years prior to 2018, a taxpayer claimed a personal exemption deduction for an individual by putting the individual's name and taxpayer identification number (TIN) on the taxpayer's income tax return, multiplying the number of allowed exemptions by the exemption amount, and entering that amount on the tax return.

Section 11041 of the Act added § 151(d)(5) to the Code. Section 151(d)(5)(A) provides that, for taxable years beginning after December 31, 2017, and before January 1, 2026, the term "exemption amount" means zero. Section 151(d)(5)(B) provides that the reduction of the exemption amount to zero "shall not be taken into account in determining whether a [personal exemption] deduction is allowed or allowable, or whether a taxpayer is entitled to a deduction under this section." Thus, even though the amount of the personal exemption deduction is reduced to zero, taxpayers are still allowed personal exemption deductions under § 151 for purposes of other provisions of the Code. See H.R. Rep. No. 115-466 at 203 n.16 (Conf. Rep.) (2017) ("The provision [amendments to § 151] also clarifies that, for purposes of taxable years in which the personal exemption is reduced to zero, this should not alter the operation of those provisions of the Code which refer to a taxpayer allowed a deduction (or an individual with respect to whom a taxpayer is allowed a deduction) under section 151.").

Section 36B allows a premium tax credit to eligible individuals who enroll themselves, their spouse, or any dependent (as defined in § 152) in a qualified health plan through an Exchange, and § 6011 provides general rules related to income tax return filing requirements. The regulations under §§ 36B and 6011 include rules that apply based on whether a taxpayer claims or claimed a personal exemption deduction under § 151 for an individual. These rules affect eligibility for the premium tax credit, computation of the premium tax credit, reconciliation of advance payments of the premium tax credit, and income tax return filing requirements related to the premium tax credit. Specifically, references such as "claim a personal exemption deduction," "claims a personal exemption deduction," or "claimed as a personal exemption deduction," are included in §§ 1.36B-1(d); 1.36B-2(c)(4); 1.36B-4(a)(1)(ii)(B)(1), (a)(1)(ii)(B)(2), (a)(1)(ii)(C), and (a)(4); and § 1.6011-8(a). The Treasury Department and the IRS intend to amend the regulations under §§ 36B and 6011 to clarify the meaning of claiming a personal exemption deduction for the taxable years for which the exemption amount is reduced to zero.

Section 5000A provides that if a taxpayer, or dependent of the taxpayer who is an applicable individual for whom the taxpayer is liable, is without minimum essential coverage or a coverage exemption for one or more months in a taxable year, the taxpayer must include an individual shared responsibility payment when filing his or her federal income tax return. The regulations under § 5000A include rules that apply based on whether a taxpayer claims or claimed a personal exemption deduction under § 151 for an individual. Specifically, § 1.5000A-1(d)(4) refers to a taxpayer who "claims a deduction for a personal exemption," and § 1.5000A-3(e)(3)(ii)(B) refers to "an individual for whom a personal exemption deduction … is claimed."

INTERIM GUIDANCE

Because the Act reduces the exemption amount to zero, taxpayers will no longer claim a personal exemption deduction on their individual income tax returns by listing an individual's name and TIN, multiplying the number of allowed exemptions by the exemption amount, and entering that amount on their tax return. Accordingly, taxpayers may have questions about what it means to claim a personal exemption deduction for purposes of the premium tax credit and the individual shared responsibility provision. Until further guidance is issued, the following rules apply for purposes of the regulations under §§ 36B and 5000A and for purposes of § 1.6011-8(a):

> (1) A taxpayer is considered to have claimed a personal exemption deduction for himself or herself for a taxable year if the taxpayer files an income tax return for the year and does not qualify as a dependent of another taxpayer under § 152 for the year;
> (2) A taxpayer is considered to have claimed a personal exemption deduction for an individual other than the taxpayer if the taxpayer is allowed a personal exemption deduction for the individual (taking into account § 151(d)(5)(B)) and lists the individual's name and TIN on the Form 1040, U.S. Individual Income Tax Return, or Form 1040NR, U.S. Nonresident Alien Income Tax Return, the taxpayer files for the year

INFERENCE

No inference should be drawn from any provision of this notice concerning any other provision of the Act or any other section of the Code.

EFFECTIVE/APPLICABILITY DATE

This notice applies to taxable years beginning in 2018.

DRAFTING INFORMATION

The principal author of this notice is Lisa Mojiri-Azad of the Office of Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Ms. Mojiri-Azad or Steve Toomey at 202-317-4718 (not a toll-free number).

D. Simplification and Reform of Deductions and Exclusions

1. Modification of deduction for home mortgage interest (sec. 1302 of the House bill, sec. 11043 of the Senate amendment, and sec. 163(h) of the Code)

Conference Agreement

The conference agreement provides that, in the case of taxable years beginning after December 31, 2017, and beginning before January 1, 2026, a taxpayer may treat no more than $750,000 as acquisition indebtedness ($375,000 in the case of married taxpayers filing separately). In the case of acquisition indebtedness incurred before December 15, 2017(**162)** this limitation is $1,000,000 ($500,000 in the case of married taxpayers filing separately) (**163**). For taxable years beginning after December 31, 2025, a taxpayer may treat up to $1,000,000 ($500,000 in the case of married taxpayers filing separately) of indebtedness as acquisition indebtedness, regardless of when the indebtedness was incurred.

Additionally, the conference agreement suspends the deduction for interest on home equity indebtedness. Thus, for taxable years beginning after December 31, 2017, a taxpayer may not claim a deduction for interest on home equity indebtedness. The suspension ends for taxable years beginning after December 31, 2025.

Effective date: The provision is effective for taxable years beginning after December 31, 2017.

162 The conference agreement provides that a taxpayer who has entered into a binding written contract before December 15, 2017 to close on the purchase of a principal residence before January 1, 2018, and who purchases such residence before April 1, 2018, shall be considered to incurred acquisition indebtedness prior to December 15, 2017 under this provision.

163 Special rules apply in the case of indebtedness from refinancing existing acquisition indebtedness. Specifically, the $1,000,000 ($500,000 in the case of married taxpayers filing separately) limitation continues to apply to any indebtedness incurred on or after December 15, 2017, to refinance qualified residence indebtedness incurred before that date to the extent the amount of the indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness. Thus, the maximum dollar amount that may be treated as principal residence acquisition indebtedness will not decrease by reason of a refinancing.

Interest on Home Equity Loans Often Still Deductible Under New Law

IR-2018-32, Feb. 21, 2018

WASHINGTON — The Internal Revenue Service today advised taxpayers that in many cases they can continue to deduct interest paid on home equity loans.

Responding to many questions received from taxpayers and tax professionals, the IRS said that despite newly-enacted restrictions on home mortgages, taxpayers can often still deduct interest on a home equity loan, home equity line of credit (HELOC) or second mortgage, regardless of how the loan is labelled. The Tax Cuts and Jobs Act of 2017, enacted Dec. 22, suspends from 2018 until 2026 the deduction for interest paid on home equity loans and lines of credit, unless they are used to buy, build or substantially improve the taxpayer's home that secures the loan.

Under the new law, for example, interest on a home equity loan used to build an addition to an existing home is typically deductible, while interest on the same loan used to pay personal living expenses, such as credit card debts, is not. As under prior law, the loan must be secured by the taxpayer's main home or second home (known as a qualified residence), not exceed the cost of the home and meet other requirements.

New dollar limit on total qualified residence loan balance

For anyone considering taking out a mortgage, the new law imposes a lower dollar limit on mortgages qualifying for the home mortgage interest deduction. Beginning in 2018, taxpayers may only deduct interest on $750,000 of qualified residence loans. The limit is $375,000 for a married taxpayer filing a separate return. These are down from the prior limits of $1 million, or $500,000 for a married taxpayer filing a separate return. The limits apply to the combined amount of loans used to buy, build or substantially improve the taxpayer's main home and second home.

The following examples illustrate these points.

Example 1: In January 2018, a taxpayer takes out a $500,000 mortgage to purchase a main home with a fair market value of $800,000. In February 2018, the taxpayer takes out a $250,000 home equity loan to put an addition on the main home. Both loans are secured by the main home and the total does not exceed the cost of the home. Because the total amount of both loans does not exceed $750,000, all of the interest paid on the loans is deductible. However, if the taxpayer used the home equity loan proceeds for personal expenses, such as paying off student loans and credit cards, then the interest on the home equity loan would not be deductible.

Example 2: In January 2018, a taxpayer takes out a $500,000 mortgage to purchase a main home. The loan is secured by the main home. In February 2018, the taxpayer takes out a $250,000 loan to purchase a vacation home. The loan is secured by the vacation home. Because the total amount of both mortgages does not exceed $750,000, all of the interest paid on both mortgages is deductible. However, if the taxpayer took out a $250,000 home equity loan on the main home to purchase the vacation home, then the interest on the home equity loan would not be deductible.

Example 3: In January 2018, a taxpayer takes out a $500,000 mortgage to purchase a main home. The loan is secured by the main home. In February 2018, the taxpayer takes out a $500,000 loan to purchase a vacation home. The loan is secured by the vacation home. Because the total amount of both mortgages exceeds $750,000, not all of the interest paid on the mortgages is deductible. A percentage of the total interest paid is deductible (see Publication 936).

Planning Notes:

1. Home Equity Loan: No longer an AMT adjustment:

   Deductions for interest on home equity loans are not allowed.

2. Interest tracing rules?

   If you can apply them successfully, your interest expense might be deductible

   Election to reallocate home equity debt

   - Under Temp. Regs. Sec. 1.163-10T(o)(5), taxpayers can irrevocably elect to treat debt as not secured by a qualified residence. The effect of this election is that the general tracing rules of Temp. Regs. Sec. 1.163-8T apply to determine the tax treatment of the interest expense. The election does not have to be made in the year the debt is incurred; instead, it can be made in that year or any subsequent year the debt is outstanding. However, once made, the election is binding on all future years (as to that debt) unless the IRS consents to revoke the election. The election is made by attaching a properly completed statement to the return for the year of the election.
   - Example: Taxpayer takes out a home-equity loan for $75,000. She deposits the loan proceeds into an account used by her sole proprietorship, a business in which she actively participates. The money is immediately spent on new equipment for the business. If the taxpayer elects to treat the $75,000 loan as not secured by a qualified residence, using the general tracing rules, the interest will be treated as business interest.

3. Refinancing existing home mortgage

   The $1,000,000 limitation continues to apply to taxpayers who refinance existing mortgage debt that was incurred before Dec. 15, 2017, so long as the debt resulting from the refinancing does not exceed the amount of the refinanced debt.

4. Rent vs Buy analysis

   The loss of formerly available deductions changes the basic equation for many clients as to whether to buy a home, how much home they should own, how much to borrow and even whether they're better off renting their home to someone else. With respect to home tax benefits, much is different.

2. Modification of deduction for taxes not paid or accrued in a trade or business (sec. 1303 of the House bill, sec. 11042 of the Senate amendment, and sec. 164 of the Code)

<u>Conference Agreement</u>

The conference agreement provides that in the case of an individual,**171** as a general matter, State, local, and foreign property taxes and State and local sales taxes are allowed as a deduction only when paid or accrued in carrying on a trade or business, or an activity described in section 212 (relating to expenses for the production of income).**172** Thus, the provision allows only those deductions for State, local, and foreign property taxes, and sales taxes, that are presently deductible in computing income on an individual's Schedule C, Schedule E, or Schedule F on such individual's tax return. Thus, for instance, in the case of property taxes, an individual may deduct such items only if these taxes were imposed on business assets (such as residential rental property).

171 See sec. 641(b) regarding the computation of taxable income of an estate or trust in the same manner as an individual.

172 The proposal does not modify the deductibility of GST tax imposed on certain income distributions. Additionally, taxes imposed at the entity level, such as a business tax imposed on pass-through entities, that are reflected in a partner's or S corporation shareholder's distributive or pro-rata share of income or loss on a Schedule K-1 (or similar form), will continue to reduce such partner's or shareholder's distributive or pro-rata share of income as under present law.

Under the provision, in the case of an individual, State and local income, war profits, and excess profits taxes are not allowable as a deduction.

The provision contains an exception to the above-stated rule. Under the provision a taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for married taxpayer filing a separate return) for the aggregate of (i) State and local property taxes not paid or accrued in carrying on a trade or business, or an activity described in section 212, and (ii) State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the taxable year. Foreign real property taxes may not be deducted under this exception.

Effective date: The above rules apply to taxable years beginning after December 31, 2017, and beginning before January 1, 2026.

The conference agreement also provides that, in the case of an amount paid in a taxable year beginning before January 1, 2018, with respect to a state or local income tax imposed for a taxable year beginning after December 31, 2017, the payment shall be treated as paid on the last day of the taxable year for which such tax is so imposed for purposes of applying the provision limiting the dollar amount of the deduction. Thus, under the provision, an individual may not claim an itemized deduction in 2017 on a pre-payment of income tax for a future taxable year in order to avoid the dollar limitation applicable for taxable years beginning after 2017.

Effective date: The provision is effective for taxable years beginning after December 31, 2016.

Planning notes:

1. AMT Adjustment:

   Itemized deductions for State, local, and foreign real property taxes; State and local personal property taxes; State, local, and foreign income, war profits, and excess profits taxes; and State and local sales taxes are not allowed.

2. Charitable Contributions and state and local tax credits:

   Some states have passed legislation to allow taxpayers to contribute money to funds controlled by state or local governments in exchange for credits against their state or local taxes. These funds are designed to allow taxpayers to get around the $10,000 cap.

IR-2018-172

The U.S. Department of the Treasury and the Internal Revenue Service issued proposed regulations (REG-112176-18) providing rules on the availability of charitable contribution deductions when the taxpayer receives or expects to receive a corresponding state or local tax credit.

Under the proposed regulations, a taxpayer who makes payments or transfers property to an entity eligible to receive tax deductible contributions must reduce their charitable deduction by the amount of any state or local tax credit the taxpayer receives or expects to receive.

For example, if a state grants a 70 percent state tax credit and the taxpayer pays $1,000 to an eligible entity, the taxpayer receives a $700 state tax credit. The taxpayer must reduce the $1,000 contribution by the $700 state tax credit, leaving an allowable contribution deduction of $300 on the taxpayer's federal income tax return. The proposed regulations also apply to payments made by trusts or decedents' estates in determining the amount of their contribution deduction.

The proposed regulations provide exceptions for dollar-for-dollar state tax deductions and for tax credits of no more than 15 percent of the payment amount or of the fair market value of the property transferred. A taxpayer who makes a $1,000 contribution to an eligible entity is not required to reduce the $1,000 deduction on the taxpayer's federal income tax return if the state or local tax credit received or expected to be received is no more than $150.

3. Placing real estate in trust
   Some wealthy property owners may set up special trusts and place income-producing items into the trusts with real estate to allow for deducting $10,000 per trust per year for property taxes.

4. Time to Re-evaluate
   It may be time to re-evaluate your client's situation to determine their after-tax cost of home ownership and what they might do to improve their situation. This may mean renting instead of buying.

5. Modifications to the deduction for charitable contributions (sec. 1306 of the House bill, secs. 11023, 13703, and 13704 of the Senate amendment, and sec. 170 of the Code)

House Bill

The provision makes the following modifications to the present law charitable deduction
rules.

Increased percentage limit for contributions of cash to public charities

The provision increases the income-based percentage limit described in section 170(b)(1)(A) for certain charitable contributions by an individual taxpayer of cash to public charities and certain other organizations from 50 percent to 60 percent.

Denial of charitable deduction for college athletic event seating rights

The provision amends section 170(l) to provide that no charitable deduction shall be allowed for any amount described in paragraph 170(l)(2), generally, a payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event, as described in greater detail above.

Repeal of substantiation exception for certain contributions reported by the done organization

The provision repeals the section 170(f)(8)(D) exception to the contemporaneous written acknowledgment requirement.

Effective date: The provision is effective for contributions made in taxable years beginning after December 31, 2017

Senate Amendment

The Senate amendment includes three of the House bill's four modifications to the present-law charitable contribution rules: (1) the increase in the percentage limit for charitable contributions of cash to public charities; (2) the denial of a charitable deduction for payments made in exchange for college athletic event seating rights; and (3) the repeal of the substantiation exception for certain contributions reported by the donee organization. The Senate amendment does not include the provision from the House bill that allows the charitable standard mileage rate to be adjusted for inflation.

Effective date: The provisions that increase the charitable contribution percentage limit and deny a deduction for stadium seating payments are effective for contributions made in taxable years beginning after December 31, 2017. The provision that repeals the substantiation exception for certain contributions reported by the donee organization is effective for contributions made in taxable years beginning after December 31, 2016.

Conference Agreement

The conference agreement follows the Senate amendment.

6. Repeal of Certain Miscellaneous Itemized Deductions Subject to the Two-Percent Floor (secs. 1307 and 1312 of the House bill, sec. 11045 of the Senate amendment, and secs. 62, 67 and 212 of the Code)

Present Law
Individuals may claim itemized deductions for certain miscellaneous expenses. Certain of these expenses are not deductible unless, in aggregate, they exceed two percent of the taxpayer's adjusted gross income ("AGI"). The deductions described below are subject to the aggregate two-percent floor.

Expenses for the production or collection of income
Individuals may deduct all ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income. Present law and IRS guidance provide examples of items that may be deducted under this provision. This non-exhaustive list includes:

- Appraisal fees for a casualty loss or charitable contribution;
- Casualty and theft losses from property used in performing services as an employee;
- Clerical help and office rent in caring for investments;
- Depreciation on home computers used for investments;
- Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust;
- Fees to collect interest and dividends;
- Hobby expenses, but generally not more than hobby income;
- Indirect miscellaneous deductions from pass-through entities;
- Investment fees and expenses;
- Loss on deposits in an insolvent or bankrupt financial institution;
- Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed;
- Repayments of income;
- Safe deposit box rental fees, except for storing jewelry and other personal effects;
- Service charges on dividend reinvestment plans; and
- Trustee's fees for an IRA, if separately billed and paid.

Tax preparation expenses

For regular income tax purposes, individuals are allowed an itemized deduction for expenses for the production of income. These expenses are defined as ordinary and necessary expenses paid or incurred in a taxable year: (1) for the production or collection of income; (2) for the management, conservation, or maintenance of property held for the production of income; or (3) in connection with the determination, collection, or refund of any tax.

Unreimbursed expenses attributable to the trade or business of being an employee

In general, unreimbursed business expenses incurred by an employee are deductible, but only as an itemized deduction and only to the extent the expenses exceed two percent of adjusted gross income.

Present law and IRS guidance provide examples of items that may be deducted under this provision. This non-exhaustive list includes:
- Business bad debt of an employee;
- Business liability insurance premiums;
- Damages paid to a former employer for breach of an employment contract;
- Depreciation on a computer a taxpayer's employer requires him to use in his work;
- Dues to a chamber of commerce if membership helps the taxpayer perform his job;
- Dues to professional societies;
- Educator expenses;
- Home office or part of a taxpayer's home used regularly and exclusively in the
- taxpayer's work;
- Job search expenses in the taxpayer's present occupation;
- Laboratory breakage fees;
- Legal fees related to the taxpayer's job;
- Licenses and regulatory fees;
- Malpractice insurance premiums;
- Medical examinations required by an employer;
- Occupational taxes;
- Passport fees for a business trip;
- Repayment of an income aid payment received under an employer's plan;
- Research expenses of a college professor;
- Rural mail carriers' vehicle expenses;
- Subscriptions to professional journals and trade magazines related to the taxpayer's
- work;

- Tools and supplies used in the taxpayer's work;
- Purchase of travel, transportation, meals, entertainment, gifts, and local lodging related to the taxpayer's work;
- Union dues and expenses;
- Work clothes and uniforms if required and not suitable for everyday use; and
- Work-related education.

Other miscellaneous itemized deductions subject to the two-percent floor

Other miscellaneous itemized deductions subject to the two-percent floor include:

- Repayments of income received under a claim of right (only subject to the two percent
- floor if less than $3,000);
- Repayments of Social Security benefits; and
- The share of deductible investment expenses from pass-through entities

Senate Amendment

The Senate amendment suspends all miscellaneous itemized deductions that are subject to the two-percent floor under present law. Thus, under the provision, taxpayers may not claim the above-listed items as itemized deductions for the taxable years to which the suspension applies. The provision does not apply for taxable years beginning after December 31, 2025.

Effective date. The provision is effective for taxable years beginning after December 31, 2017.

Conference Agreement

The conference agreement follows the Senate amendment.

Planning Notes:

1. Net Investment Income Tax (NIIT): No changes to NIIT, but

    - Suspension of miscellaneous deductions and SALT limitation of $10,000 reduces the available deductions in computing Net Investment Income.
    - This will increase the amount of investment income subject to the NIIT.

2. Mutual Funds:

   Mutual fund investors effectively may continue to deduct management fees as such fees are netted against the fund's distributable taxable income.

3. Carrying charges vs. itemized deductions:

   Because investment fees and expenses are no longer deductible, some accountants might consider a Section 266 election to capitalize investment management fees as "carrying charges" to deduct them from capital gains and losses. The IRS said taxpayers could not capitalize investment management fees under Section 266 because they are managerial rather than transactional**. See IRC Chief Counsel Memorandum 200721015.**

4. Short-selling expenses:

   The tax act retained "other miscellaneous deductions" not subject to the two-percent floor, including short-selling expenses like stock borrow fees.

5. Hedge Funds and Private Equity Management Fees:

   Individuals, trusts, and estates investing in a private equity fund or hedge fund classified as an "investor" will no longer be allowed to deduct their distributive shares of a fund's management fees and administrative expenses such as brokerage fees, administration fees, legal fees, audit fees, and tax preparation fees.

   However, individuals, trusts, and estates investing in a hedge fund classified as a "trader" will still be allowed a deduction for their distributive shares of the fund's management fees and administrative expenses. This is because the amounts are treated as business expenses rather than portfolio deductions.

G. Alternative Minimum Tax
(sec. 2001 of the House bill, sec. 12001 of the Senate amendment, and secs. 53 and 55-59 of the Code)

Individual alternative minimum tax

House Bill

The House bill repeals the individual and corporate alternative minimum tax.

The provision allows the AMT credit to offset the taxpayer's regular tax liability for any taxable year. In addition, the AMT credit is refundable for any taxable year beginning after 2018 and before 2023 in an amount equal to 50 percent (100 percent in the case of taxable years beginning in 2022) of the excess of the minimum tax credit for the taxable year over the amount of the credit allowable for the year against regular tax liability. Thus, the full amount of the minimum tax credit will be allowed in taxable years beginning before 2023.

Effective date: The provision is effective for taxable years beginning after December 31, 2017.

In determining the alternative minimum taxable income for taxable years beginning before January 1, 2018, the net operating loss deduction carryback from taxable years beginning after December 31, 2017, are determined without regard to any AMT adjustments or preferences.

The repeal of the election to write off certain expenditures over a specified period applies to amounts paid or incurred after December 31, 2017.

Senate Amendment

The Senate amendment temporarily increases both the exemption amount and the exemption amount phaseout thresholds for the individual AMT. Under the provision, for taxable years beginning after December 31, 2017, and beginning before January 1, 2026, the AMT exemption amount is increased to $109,400 for married taxpayers filing a joint return (half this amount for married taxpayers filing a separate return), and $70,300 for all other taxpayers (other than estates and trusts). The phaseout thresholds are increased to $208,400 (half this amount for married taxpayers filing a separate return), and $156,300 for all other taxpayers (other than estates and trusts). These amounts are indexed for inflation.

The provision does not change the corporate alternative minimum tax.

Effective date: The provision is effective for taxable years beginning after December 31, 2017.

Conference Agreement

The conference agreement temporarily increases both the exemption amount and the exemption amount phaseout thresholds for the individual AMT. Under the provision, for taxable years beginning after December 31, 2017, and beginning before January 1, 2026, the AMT exemption amount is increased to $109,400 for married taxpayers filing a joint return (half this amount for married taxpayers filing a separate return), and $70,300 for all other taxpayers (other than estates and trusts). The phaseout thresholds are increased to $1,000,000 for married taxpayers filing a joint return, and $500,000 for all other taxpayers (other than estates and trusts). These amounts are indexed for inflation.

The conference agreement follows the House bill in repealing the corporate alternative minimum tax. In the case of a corporation, the conference agreement allows the AMT credit to offset the regular tax liability for any taxable year. In addition, the AMT credit is refundable for any taxable year beginning after 2017 and before 2022 in an amount equal to 50 percent (100 percent in the case of taxable years beginning in 2021) of the excess of the minimum tax credit for the taxable year over the amount of the credit allowable for the year against regular tax liability. Thus, the full amount of the minimum tax credit will be allowed in taxable years beginning before 2022.

Effective date: The provisions are effective for taxable years beginning after December 31, 2017.

Planning Notes:

1. The increase in the AMT exemption amount and phaseout thresholds along with elimination the following adjustments in computing AMTI will significantly reduce taxpayers subject to AMT.

ALTERNATIVE MINIMUM TAX				
	Single	Married Filing Jointly	Married Filing Separately	Head of Household
Exemption	$70,300	$109,400	$54,700	$70,300
26% on Excess	$0-$191,500	$0-$191,500	$0-$95,750	$0-191,500
28% on Excess	$191,501+	$191,501+	$95,751+	$191,501+
Phase-out Begins	$500,000	$1,000,000	$500,000	$500,000

2. The phase-out effectively increased the 26% and 28% tax rates under the AMT to a marginal rate of 32.5% and 35% for those in income levels that reflected the phase-out.

Alternative Minimum Tax (AMT)

AMT – Married		
	2017	**2018**
Exemption	$84,500	**$109,400**
Phaseout	$160,900 – $498,900	**$100,000,000 – $1,437,600**
AMT – Unmarried		
Exemption	$54,300	**$70,300**
Phaseout	$120,700 – $337,900	**$500,000 – $717,200**

3. AMT defanged:

   The AMT is perhaps the original Stealth Tax. When created in 1969 it was targeted at wealthy individuals who used a lot of tax breaks to avoid paying any income tax. More than five million taxpayers owed the AMT according to the most recent IRS statistics. Under the new tax law, this number is expected to fall to somewhere between 200,000 (Tax Policy Center) and 500,000 (Joint Committee on Taxation).

4. AMT Changes: Adjustments in computing AMTI:
   - Medical expenses:
     - The medical expenses for AMT and regular tax is 7.5% for the 2017 and 2018 year.
   - Large SALT deductions:
     - SALT deductions limited to $10,000.
   - Personal exemptions:
     - The standard deduction has been eliminated.
   - Miscellaneous itemized Deductions:
     - All miscellaneous itemized deductions are suspended that are subject to the two-percent floor under present law.
   - Home Equity Interest:
     - Deductions for interest on home equity loans are not allowed. See exceptions above.
   - Standard Deduction:
     - Disallowed for AMT.
5. Private Activity Bonds:
   - Interest from specified private activity bonds exempt from the regular tax.
   - Reevaluate if not subject to the AMT.
6. AMT Credit:
   - Form 8801, Credit for Prior Year Minimum Tax—Individuals, Estates, and Trusts
7. Trusts and Estates:

   - Congressional Intent

     The Committee Report for the provision amending Section 67 provides:

     "The Senate amendment suspends all miscellaneous itemized deductions *that are subject to the [2%] floor under present law*" (emphasis added). The Conference Agreement followed the Senate amendment. Certain trust and estate administration expenses, such as fiduciary fees related to administration and tax preparation fees for a trust, are not subject to the 2% floor under present law.

No alternative minimum tax add-backs on Schedule I

When calculating alternative minimum tax (AMT) liability, a taxpayer is not allowed certain deductions, including miscellaneous itemized deductions, and must add these deductions back when calculating his alternative minimum taxable income. Schedule I, the AMT form applicable to estates and trusts, has historically only added back miscellaneous itemized deductions that were subject to the 2% floor. This suggests that the IRS may not seem to consider "above-the-line" trust and estate administration expenses to be "miscellaneous itemized deductions." Otherwise, the IRS likely would have included those expenses as an add-back on Schedule I for AMT purposes, instead of limiting the add-back to "miscellaneous itemized deductions *subject to the [2%] floor.*"

Capital gains rates

The conference agreement follows the House bill and generally retains present-law maximum rates on net capital gains and qualified dividends.

In general

In the case of an individual, estate, or trust, any adjusted net capital gain which otherwise would be taxed at the 10- or 15-percent rate is not taxed. Any adjusted net capital gain which otherwise would be taxed at rates over 15-percent and below 39.6 percent is taxed at a 15-percent rate. Any adjusted net capital gain which otherwise would be taxed at a 39.6-percent rate is taxed at a 20-percent rate.

The unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 10- or 15-percent rate is taxed at the otherwise applicable rate.

In addition, a tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income, which includes gains and dividends, or the excess of modified adjusted gross income over the threshold amount. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in the case of any other individual.

Trusts and Estates

Income tax brackets for estates and trusts

Rate	Estate and trusts
10%	Up to $2,550
24%	$2,551–$9,150
35%	$9,151–$12,500
37%	Over $12,500

Long-term capital gains and qualified dividends rates for 2018

The 0% tax rate will apply to net capital gains for trusts and estates with taxable income up to $2,600.

The 15% tax rate will apply to net capital gains for estates and trusts with taxable income over $2,600.

The 20% tax rate will apply to net capital gains when taxable income amounts exceed $12,700.

For tax years after 2018 through 2025, the dollar amounts will be adjusted for inflation.

Standard Deduction

In lieu of the deduction for personal exemptions, an estate is allowed a deduction of $600. A trust is allowed a deduction of $100; $300 if required to distribute all its income currently; and an amount equal to the personal exemption of an individual in the case of a qualified disability trust.

Estate/gift exemptions/exclusions

Estate and gift tax exemptions — For decedents dying in 2018, the basic exclusion amount for determining the unified credit against estate tax is $11,180,000. This exemption will be indexed for inflation and will revert to pre-TCJA levels for years starting Jan. 1, 2026.

The annual gift tax exclusion for 2018 is $15,000.

2019 State Business Tax Climate Index

By Jared Walczak, Scott Drenkard, and Joseph Bishop-Henchman

Tax Foundation

Delaware

Delaware reversed its short-lived and counterproductive experiment with the estate tax, repealing it as of January 1, 2018. First adopted less than a decade ago, the tax generated very little revenue while driving wealthy seniors out of the state. Legislators scrapped the tax this year, and its elimination is the driving force behind the state's improvement from 20th to 9th on the property tax component of the Index, and from 16th to 11th overall.

Overall Rank: #11

Corporate Tax Rank: #50

2016-2019 #50

Individual Income Tax Rank: #41

2016-2018 #40

2019 #41

Sales Tax Rank: #2

2016-2018 #1

2019 #2

Property Tax Rank: #9

2016 #15

2017-2018 #20

2019 #9

Unemployment Insurance Tax Rank: #3

2016-2019 #3

The 10 best states in this year's *Index* are:

1. Wyoming
2. Alaska
3. South Dakota
4. Florida
5. Montana
6. New Hampshire
7. Oregon
8. Utah
9. Nevada
10. Indiana

Delaware Tax Institute
Disclosure

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