Summary of Tax Cuts and Jobs Act Final Conference Agreement

Corporate Rate. Permanently reduces the corporate rate to 21% beginning 1/1/2018.

Top Individual Rate. The top individual rate is lowered to 37% on incomes over $600,000 (married filing jointly) or $500,000 (all others). The lower individual tax rates expire at the end of 2025.

Investment Income. The tax rates for capital gains and dividends are unchanged, as is the 3.8% net investment income tax.

Interest Deduction. Real property trade or business may elect out of the limitation to the interest deduction. Also excluded are businesses with gross receipts of $25 million or less. The final bill otherwise limits the business interest deduction to 30% of EBITDA (EBIT beginning in 2022). The limit is effective beginning 2018 and applies to existing debt. The limit and the real estate election apply at the entity level.

Expensing/Cost Recovery. Real estate businesses that elect out of the interest limitation must depreciate real property over 40 years for nonresidential property, 30 years for residential rental property, and 20 years for qualified improvement property. The election would treat the change in recovery period as a change in use. Land improvements (parking lots, drainage, etc.) and tangible personal property used in a real property trade or business that are placed in service after 9/27/2017 are eligible for 100% expensing (bonus depreciation) for the next 5 years.

For businesses not electing out of the interest deduction limitation (or <$25M gross receipts), qualified improvement property appears to remain eligible for bonus depreciation, as its new 15-year MACRS recovery period meets the general bonus-eligible requirement of having a recovery period of 20 years or less.

The conference agreement also allows used property to qualify for bonus. This could impact corporate M&A activity by allowing an acquiring firm to deduct significant costs of a purchasing another business if structured as an asset purchase, rather than a stock acquisition.

Like-Kind Exchanges are retained for real estate. The conference report clarifies that improved and unimproved real estate are still generally considered to be of like-kind.

Carried Interest. A 3-year holding period is required for assets to qualify for 20% long-term capital gain rate.

Pass-through Relief. The conference agreement provides a 20% deduction for qualified pass-through business income. For married taxpayers with incomes above $315,000 ($157,500 for all others), the 20-percent deduction is limited to the greater of: (a) 50% of the W-2 wages paid by the business or (b) 25% of the W-2 wages paid by the business plus 2.5% of the unadjusted basis (determined immediately after acquisition) of depreciable property, which includes structures but not land. This limit does not apply to REIT dividends and distributions from publicly traded partnerships.

The deduction also phases out for certain service businesses above the $315,000/$157,000 threshold. Those service businesses are: law, accounting, brokerage services, financial services and investment management, consulting, or any trade or business where the principal asset is the reputation or skill of one or more of its owners or employees (excluding engineering and architecture).

Estates and trusts were also made eligible for the pass-through benefit, which will benefit many family-owned businesses. The deduction expires at the end of 2025.

> *Example: A business purchases an office building for $10M ($7M attributable to the structure, $3M attributable to the land). The building generates annual rental income of $500,000. The maximum allowable pass-through deduction would be $100,000 (20% of $500K). Even if the business paid no wages, the business would qualify for the full deduction because 2.5% of $7M is $175,000.*

Limitation of Active Losses. The final agreement includes the Senate provision that prevents a taxpayer from deducting any net losses from active businesses in excess of $250,000 (or $500,000 in the case of a joint return) from their wage or portfolio income. Losses would be carried forward indefinitely as part of the taxpayers net operating loss (NOL). The provision expires at the end of 2025.

Net Operating Losses. The NOL deduction is limited to 80 percent of taxable income for losses arising in taxable years beginning after 12/31/2017. NOLs generated after 12/31/2017 may be carried forward indefinitely, however, they generally can no longer be carried back.

Private Activity Bonds. No change.

New Markets Tax Credit. No change. (Note: NMTC is scheduled to expire 12/31/2019.)

Low-Income Housing Tax Credit. No change.

Historic Preservation and Rehabilitation Credit. The 20% tax credit is preserved but must be claimed ratably over a 5-year period. The bill repeals the 10% credit for the rehabilitation of pre-1936 structures.

Contributions to Capital. The final agreement limits tax-free contributions of capital from state and local governments. The conference report further notes that IRC section 118 only applies to corporations. Thus, any passthrough businesses must recognize a contribution to capital as taxable income.

Technical Terminations. The conference agreement would repeal the "technical termination" rules contained in current IRC section 708(b)(1)(B).

State and Local Tax Deduction. The conference agreement limits itemized deductions for state and local income taxes, property taxes, and sales taxes to $10,000. State and local sales or property taxes paid or accrued in carrying on a trade or business, or in an activity related to the production of income, remain deductible. This provision expires at the end of 2025.

Alternative Minimum Tax (AMT). The corporate AMT is repealed. The phase-out threshold for the individual AMT is raised to $1 million (married filing jointly)/$500,000 (all others). This Individual AMT provision expires at the end of 2025.

Estate Tax. The exemption for the estate, gift, and generation-skipping tax is doubled to $11 million. This provision expires at the end of 2025.

Mortgage Interest & HELOCs. Under the final agreement, a taxpayer may treat no more than $750,000 as debt eligible for the home mortgage interest deduction. Debt used to acquire a second home continues to qualify, and existing mortgages are grandfathered. The conference agreement eliminates the deduction for interest paid on home equity loans (not grandfathered). These provisions expire at the end of 2025.