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Final Tax Reform Bill Approved by Congress

Published: December 21, 2017

On December 20, the final version of the tax reform bill (formerly known as the "Tax Cuts and Jobs Act") was approved in the House by a vote of 224-201, following passage earlier in the Senate by a vote of 51-48. The final bill, which includes a few changes to employee benefits introduced in earlier versions, is expected to be signed into law by the President in the coming weeks. Most of the provisions in the law take effect for taxable years beginning in 2018.

Some of the key domestic provisions are summarized in the following sections (***you may click on any of the listed sections to go directly to that section***):

I. Individual Tax Provisions

II. Corporate Tax Provisions

III. Executive Compensation Provisions

IV. Compensation Provisions for Tax-Exempt Entities

V. Qualified Retirement Plans

VI. Health, Welfare and Fringe Benefits

Summary of Final Provisions

Tax Feature	Current Law			Final Bill			Observations
I. Individual Tax Provisions							
Individual Tax Rates and Brackets	Income Tax Brackets for 2017			Income Brackets for 2018 *(rate structure applies through 2025, adjusted by inflation)*			This provision does not apply to taxable years after December 31, 2025.
	Rates	Single	Married, Filing Jointly	Rates	Single	Married, Filing Jointly	
	10%	$9,325 or less	$18,650 or less	10%	$9,525 or less	$19,050 or less	
	15%	$9,325 - $37,950	$18,650 - $75,900	12%	$9,525 - $38,700	$19,050 - $77,400	
	25%	$37,950 - $91,900	$75,900 - $153,100	22%	$38,700 - $82,500	$77,400 - $165,000	
	28%	$91,900 - $191,650	$153,100 - $233,350	24%	$82,500 - $157,500	$165,000 - $315,000	
	33%	$191,650 - $416,700	$233,350 - $416,700	32%	$157,500 - $200,000	$315,000 - $400,000	
	35%	$416,700 - $418,400	$416,700 - $470,700	35%	$200,000 - $500,000	$400,000 - $600,000	
	39.6%	Over $418,400	Over $470,700	37%	Over $500,000	Over $600,000	

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Standard Deduction and Personal Exemptions	Individuals can reduce taxable income by a personal exemption deduction ($4,050 for 2017), which is phased out at higher income levels. Also, individuals who do not itemize deductions may reduce income by a standard deduction. For 2017, the standard deduction is $6,350 (single) and $12,700 (married, filing jointly).	For taxable years beginning in 2018, the personal exemption will be suspended, and the standard deduction will significantly increase. For 2018, the standard deduction will be $12,000 (single) and $24,000 (married, filing jointly).	This change will result in fewer individuals itemizing their deductions. This provision does not apply to taxable years after December 31, 2025.
Individual Alternative Minimum Tax	Individual taxpayers are generally required to calculate their taxes twice: first using the standard tax rates, and second using lower tax rates but disregarding certain deductions and adjustments. The second calculation is known as the "alternative minimum tax" (AMT).	The exemption amount and phaseout thresholds to calculate the AMT will increase.	This provision does not apply to taxable years after December 31, 2025.
Pass Through Income	Individuals generally include items of income, gain, loss, deduction and credit from pass through entities such as partnerships on their personal tax returns, which impacts the individuals' tax rates and brackets listed above.	Individuals can deduct up to 20% of their income from pass through entities. There are limitations on the deduction for income from certain specified service businesses, such as law, medicine and financial services. Also, the deduction begins to phase out for higher-income individuals.	This provision does not apply to taxable years after December 31, 2025.
Expanded Child Tax Credit	Individuals may claim a tax credit of $1,000 for qualifying children under age 17, and the credit is phased out at higher income levels.	The child tax credit will increase to $2,000, and there is a non-refundable credit of $500 for qualifying dependents other than qualifying children. The maximum refundable tax credit is $1,400 per qualifying child. The credit will not be available if the child's Social Security Number is not included when the credit is claimed. The current phase-out limitations based on income will also increase.	This provision does not apply to taxable years after December 31, 2025.
Changes to Deductions	**Cap on Deductions.** The total amount of most allowable itemized deductions is limited for certain upper-income individuals.	**Cap on Deductions.** The cap on itemized deductions will be suspended for taxable years from 2018 to 2025.	This provision does not apply to taxable years after December 31, 2025.
	Mortgage Loan Interest. Interest paid on a loan to acquire or construct a home is generally deductible on a loan of up to $1 million. Interest on a home equity loan is generally deductible on a loan of up to $100,000.	**Mortgage Loan Interest.** The mortgage interest deduction to acquire or construct a home will be limited to a maximum loan amount of $750,000 for loans incurred after December 15, 2017. The deduction for home equity loans will be suspended for taxable years from 2018 to 2025.	The limit on the deduction for new loans to acquire a home is generally $750,000 until December 31, 2025. After 2025, the maximum increases to $1,000,000 regardless of when the loan was taken. The suspension of interest for home equity loans does not apply to taxable years after December 31, 2025.

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	Charitable Contributions. Charitable cash contributions are generally limited to 50% of the individual's contribution base. In addition, an individual can deduct amounts for college athletic seating rights, and certain contributions do not require a written acknowledgement from the charity.	**Charitable Contributions** The limit on cash contributions will increase from 50% to 60% of the individual's contribution base. Additionally, no deduction will be allowed for the right to purchase tickets for college athletic events, and all contributions over $250 will require substantiation.	The increase in the charitable contribution percentage limit does not apply to taxable years after December 31, 2025. The repeal of the substantiation exception is effective for contributions made in taxable years beginning in 2017.
	Miscellaneous Deductions. Individuals may claim itemized deductions for certain miscellaneous expenses if they exceed 2% of adjusted gross income in the aggregate.	**Miscellaneous Deductions.** Deductions will be suspended for all miscellaneous itemized deductions subject to the 2% floor. This includes expenses such as investment fees and expenses, tax preparation expenses, and business expenses attributable to being an employee.	This provision does not apply to taxable years after December 31, 2025.
	Medical Expenses. Unreimbursed medical expenses can be deducted if they exceed 10% of adjusted gross income. For taxable years before 2017, the 10% threshold is 7.5% for individuals who are 65 or older.	**Medical Expenses.** For taxable years beginning in 2017 and ending before 2019, the threshold for deducting medical expenses will be 7.5% for all individuals.	This provision is only effective for taxable years 2017 and 2018.
	Alimony. Alimony is deductible by the payor spouse and included in income by the recipient spouse.	**Alimony.** Alimony will not be deductible by the payor spouse and will not be included in income to the recipient spouse.	This provision is effective for divorce or separation instruments executed after December 31, 2018, or those executed earlier if modified after that date and the modification expressly provides for this.
	State and Local Taxes. Individuals can deduct certain taxes paid or incurred, including state and local real property, personal property, and income taxes. An individual can elect to deduct sales taxes instead of income taxes.	**State and Local Taxes.** A taxpayer may claim a deduction for up to $10,000 for state and local property taxes, income taxes, or sales taxes.	This provision does not apply to taxable years after December 31, 2025.
	Personal Casualty Losses. An individual can claim a deduction for losses sustained during the year resulting from fire, storm, shipwreck, or other casualty, or theft.	**Personal Casualty Losses.** An individual will be able to claim a personal casualty loss only if attributable to a federally declared disaster.	This provision does not apply to losses incurred after December 31, 2025.
	Moving Expenses. Individuals can deduct moving expenses paid during the year in connection with work, subject to certain limitations.	**Moving Expenses.** Moving expense deductions will be suspended for taxable years from 2018 to 2025. However, moving expenses for members of the Armed Forces on active duty that move pursuant to a military order can be deducted.	This provision does not apply to taxable years after December 31, 2025.

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Student Loan Indebtedness	Gross income generally includes amounts forgiven for loans, except for certain student loans when the forgiveness depends on the student working for a period of time.	Income from student debt discharge because of death or disability will also be excluded from taxable income.	This provision does not apply to taxable years after December 31, 2025.
Estate and Gift Taxes	Amounts transferred during life are subject to a gift tax, and amounts transferred upon death are subject to an estate tax. A basic exclusion amount of $5 million (indexed) applies to the transfer. In 2017, the indexed basic exclusion amount is approximately $5.5 million.	The basic exclusion amount for the estate and gift tax exemption will double from $5 million to $10 million (indexed). For 2018, the indexed basic exclusion will be approximately $11 million.	This provision does not apply to taxable years after December 31, 2025.
II. Corporate Tax Provisions			
Reduced Corporate Tax Rate	Corporate taxable income is subject to tax of up to 35% based on a graduated scale.	The corporate tax rate will be reduced to a flat rate of 21%.	
Corporate Alternative Minimum Tax	Corporate taxpayers are generally required to calculate their taxes twice: first using the standard tax rules, and second using lower tax rates but disregarding certain deductions and adjustments. The second calculation is known as the AMT.	The corporate AMT is repealed.	
Elimination of Employment-Related Deductions	An employer is generally allowed deductions for ordinary and necessary expenses paid or incurred in carrying on a business.	No deduction will be allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if payments are subject to a nondisclosure agreement.	This provision is in effect for amounts paid or incurred after the date of enactment.
	If the taxpayer establishes that expenses for entertainment, food, or beverages are directly related to a trade or business, up to 50% of the expenses can be deducted.	No deduction will be allowed for an activity considered to be entertainment, amusement or recreation, or for membership dues. Employers may still deduct 50% of business-related food and beverages expenses.	
	The 50% limit does not apply to food or beverages excluded as a de minimis fringe benefit. Business meals provided at an onsite eating facility for the convenience of the employer are fully deductible.	The 50% limit will also apply to expenses associated with providing food and beverages to employees through an onsite eating facility that is a de minimis fringe benefit and for the convenience of the employer.	After December 31, 2025, no deduction will be allowed for an onsite eating facility that is a de minimis fringe benefit and for the convenience of the employer.
	Employers may also deduct the cost of providing qualified transportation fringe benefits to employees.	No deduction will be allowed for providing any qualified transportation fringe benefit to employees.	

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Tax-Exempt Entities and UBTI	Although tax-exempt entities are generally exempt from federal income tax, they are subject to tax on any unrelated business taxable income (UBTI).	The value of transportation fringe benefits, parking facilities, and on-premises athletic facilities, provided by a tax-exempt entity will be treated as UBTI.	
III. Executive Compensation Provisions			
Hard $1M Cap on Deductible Executive Compensation for Public Companies	A public corporation may deduct compensation expenses as ordinary and necessary business expenses, subject to the Section 162(m) maximum limit of $1 million on non-performance-based compensation for the CEO and 3 highest paid executive officers (other than the CFO). Performance-based compensation is not subject to the $1 million cap, and the CFO is not subject to the deduction cap.	The $1M maximum deductible compensation limit will apply to all compensation paid to the CEO, the CFO and the 3 highest paid executive officers, whether or not the compensation is performance-based. Once an employee qualifies as a "covered employee" in one year, the deduction limitation will continue to apply to that individual in all future years and will apply to compensation paid after termination of employment and to payments made to the covered employee's beneficiaries. Under a transition rule, the proposed changes will not apply to compensation provided under a written binding contract in effect on November 2, 2017 and not materially modified after that date.	The lost deductions for public companies will increase the cost of compensating their senior executives, although that impact will be mitigated by lower corporate tax rates. For reasons unrelated to deductibility, corporations are likely to continue to make performance-based compensation a significant component of executive pay, but compensation committees will no longer be constrained by the rigid requirements of the current rules for performance-based compensation under Section 162(m). The scope of the transition rules is potentially very broad. For example, the Conference Report indicates that the rule could cover benefits that accrue entirely after the 2017 taxable year, as long as the accruals are under a binding contract in effect on November 2, 2017. However, the Report indicates that this grandfathering status may not apply if the contract provides that either party may unilaterally modify or terminate the contract. Employers should carefully analyze existing contracts to determine if any future compensation under those contracts is subject to the transition rule. Employers will want to develop a process to track this compensation and limit or avoid future modifications to avoid the loss of transition status.

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Deferral of Taxation for Certain Equity Compensation Arrangements	Employees who receive nonqualified stock options or stock-settled restricted stock units ("RSUs") are generally taxed in the year when the option is exercised or the RSUs are settled or, if later, when the stock received is transferable or no longer subject to a substantial risk of forfeiture.	Qualified employees of a private company will be able to elect to defer inclusion of income from company stock acquired under options or RSUs for up to 5 years. The election will not be available to senior officers, certain highly compensated employees, and 1% owners. To qualify, the company must grant options or RSUs to at least 80% of its full-time U.S. employees. The employees are not required to receive grants for the same number of shares, but they must receive more than a de minimis amount. If an election is made to defer income under an incentive stock option (ISO) or an Employee Stock Purchase Plan (ESPP), the options are treated as nonqualified stock options for FICA purposes.	For a number of reasons, including the exclusion of senior management and the need to comply with federal and state securities laws, we expect that relatively few private companies will establish plans intended to comply with this provision.
IV. Compensation Provisions for Tax-Exempt Entities			
Tax on Executive Compensation Exceeding $1M For Tax-Exempt Entities	No specific restrictions exist on compensation in excess of $1 million paid by tax-exempt entities for executive compensation.	A 21% excise tax will apply to compensation exceeding $1 million paid by a tax-exempt entity to any of its 5 highest paid employees. Compensation is considered paid when it is no longer subject to a substantial risk of forfeiture, and includes "ineligible" deferred compensation taxable under 457(f). Compensation paid to licensed medical or veterinary service professionals is excluded. The tax is imposed on the tax-exempt entity, not the employee. Once an employee qualifies as a "covered employee" in one year, the excise tax will apply in all future years.	This excise tax will impact the cost structure of affected tax-exempt entities and could require additional disclosures to donors.
Tax on Excess Severance Payments to Executives of Tax-Exempt Entities	There are no specific restrictions on severance benefits payable to executives of tax-exempt entities.	A 21% excise tax will apply to any "excess parachute payment" paid by a tax-exempt entity to its 5 highest paid employees, except those employees who do not meet the definition of highly compensated under Section 414(q). A "parachute payment" is a payment contingent on the employee's separation from employment. The tax applies to parachute payments that exceed 3 times the employee's average taxable wages over the preceding 5 years. Amounts that are not deductible under the $1 million limit on deductible compensation are disregarded in calculating parachute payments.	This tax resembles the tax imposed on employees of taxable corporations under Section 280G on excess parachute payments that are conditioned upon a change in control of the corporation, and the Bill incorporates concepts from Section 280G. However, the tax is not related to a change in control and is imposed on the tax-exempt entity, not the employee.

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V. Qualified Retirement Plans			
Rollover of Loan Offset Amounts	If a participant defaults on a plan loan, that loan becomes immediately taxable to the participant. The participant may avoid taxation by making a contribution to an IRA or a qualified employer plan in an amount equal to the defaulted loan. This contribution is treated as a rollover of the loan offset amount, so it must be made within 60 days of the loan default.	The contribution deadline will be extended to the latest date for the participant to file his or her tax return for the year of the loan default.	
Recharacterizing Roth Conversions	An individual who elects to convert a traditional IRA into a Roth IRA may recharacterize that conversion as late as October 15 of the year following the year of conversion.	A conversion from a traditional IRA to a Roth IRA is still allowed, but recharacterizing a traditional IRA that has previously been converted to a Roth IRA will no longer be permitted.	
Special Disaster Relief	Distributions from eligible retirement plans are included in income for the year distributed. In addition, unless an exception applies, a distribution received before age 59½ is subject to a 10% additional tax.	The 10% early withdrawal tax does not apply to qualified distributions received in connection with areas damaged by federally declared 2016 disasters. Such qualified 2016 disaster distributions may be repaid within 3 years and income recognition from such distributions can be spread over 3 years.	Plans may need to be amended to take advantage of some of this relief.
VI. Health, Welfare and Fringe Benefits			
ACA Changes	Individuals must be covered by a health plan that provides at least minimum essential coverage or be subject to a tax (the "ACA Individual Mandate"). The tax is imposed for any month that the individual does not have minimum essential coverage unless an individual qualifies for an exemption.	The ACA Individual Mandate will be eliminated by reducing the tax to zero beginning in 2019.	Although the penalty for individuals who do not purchase health insurance is eliminated beginning in 2019, it does not affect the employer mandate. Therefore, because the employer mandate requirement remains unchanged, to avoid penalties, large employers must still (i) offer affordable, minimum value, minimum essential coverage to full-time employees, and (ii) complete mandatory ACA reporting.
Qualified Moving Expense Reimbursement	Certain moving expenses provided by an employer are excluded from an employee's income.	Moving expenses received by an employee from an employer as payment or reimbursement will be taxable to the recipient, except in the case of a member of the Armed Forces on active duty who moves pursuant to a military order.	This provision does not apply to taxable years after December 31, 2025.

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Employee Achievement Awards	Qualified service awards are excludable from employees' taxable compensation up to certain amounts.	The exclusion for employee achievement awards will be preserved. However, awards of cash, gift cards, and other non-tangible personal property are not excluded from income.	
New Credit for Employer-Paid Family and Medical Leave	An employer cannot claim a deduction or credit for granting paid FMLA leave.	An employer will be able to claim a general business credit of 12.5% of wages paid to qualifying employees during any period in which employees are on paid FMLA if the rate of payment is at least 50% of wages normally paid to employees. The credit increases if the rate of payment is over 50%.	The credit only applies to wages paid in taxable years 2018 and 2019.

Significant Benefits Provisions Removed from Final Version

Several proposed changes to employee benefits were ultimately removed from the final version of the bill, including:

- Overhaul of nonqualified deferred compensation plans;
- Accelerated taxation of restricted stock units, performance share units, stock options and stock appreciation rights;
- Elimination of 457(b) plans;
- Combined aggregate contribution limit for 401(k), 403(b), and 457(b) plans;
- Income-based phase-out of 401(k) catch-up contributions;
- Reduced age for in-service withdrawals from pension plan;
- Simplification of hardship withdrawal rules;
- Relief for frozen pension plans;
- Recharacterization of Roth IRA contributions;
- Elimination of tax exclusion for dependent care flexible spending accounts, adoption assistance programs, tuition reimbursement and education assistance programs, and employer-provided child care; and
- Limitation of the exclusion for employer-provided housing.

Effective Date and "Sunset" Provisions. Unless noted above, the provisions are generally effective for taxable years beginning in 2018. Note that many individual tax provisions are scheduled to expire at the end of 2025.

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Planning for 2018. Employers should consult with their payroll providers and ensure that systems will be programmed to accommodate new withholding allowances. Additionally, employers should communicate relevant changes to employees and meet with compensation committee members to review changes to executive compensation limits.

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