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Year-End Tax Planning in Light of Republican Tax Proposal

Authors: William Fones Jr.
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No one knows which provisions in the House tax bill, released on November 2, 2017, will change before enactment or if any major tax bill will actually be enacted. To offset lower rates and higher standard deductions, many favorable tax provisions are proposed to be eliminated or substantially reduced for transactions occurring after 2017. There may be no final version until sometime in 2018, and if so, no one may know by the end of 2017 whether these favorable tax provisions in present law will survive or not. Persons in a position to benefit from any of these favorable tax provisions should therefore consider taking the maximum possible advantage of those favorable tax provisions before the end of 2017.

Some of the favorable tax provisions proposed to be eliminated or substantially reduced beginning in 2018 include:

- The loss of an itemized deduction for state income taxes and sales taxes paid after 2017 and a limitation on the deduction of real property taxes to $10,000.
- The loss of a deduction for tax preparation expenses, medical expenses, moving expenses and employee business expenses paid after 2017.
- The loss of any charitable deduction for an amount paid with respect to athletic event seating rights.
- The loss of a deduction for alimony payments under divorce decrees granted or separation agreements executed after 2017.
- The lengthening of the holding period for the exclusion of gain on the sale of a principal residence to five out of eight years, the limitation of the exclusion to once in five years and the phase-out of the exclusion on a dollar-for-dollar basis for taxpayers whose adjusted gross income exceeds $500,000. Effective for sales after 2017.
- The elimination of like-kind exchanges for business or investment property other than real estate, such as business vehicles, heavy equipment, etc. unless at least one part of the exchange is completed before 2018.
- The loss of capital gains treatment on the sale of patents and other self-created intellectual property for dispositions after 2017.
- Repeal of the work opportunity tax credit for employees hired after 2017.
- Repeal of the tax exemption for interest paid on private activity bonds issued after 2017.

It is proposed to limit mortgage interest deductions to a principal residence (eliminating the deduction of mortgage interest on a secondary residence) and to reduce the amount of qualifying acquisition indebtedness from $1,000,000 to $500,000, but these rules are proposed to take effect as to any new indebtedness incurred on or after November 2, 2017 unless the taxpayer is already subject to a binding contract. In that instance, it is too late to avoid these rules if they take effect as they currently are proposed.

Beginning in 2018, the business interest deduction of large businesses is proposed to be limited to 30 percent of adjusted taxable income (taxable income computed without regard to business interest income, business interest expense, net operating losses, depreciation, amortization and depletion). A business with average gross receipts of $25 million or less would not be subject to this rule. There is no exception for existing

indebtedness, so large businesses should consider reducing any indebtedness that would generate nondeductible interest.

Because many taxpayers may pay lower taxes in 2018, these taxpayers should maximize any opportunities to accelerate deductions into 2017 (even those that remain in effect in 2018) and to defer income beyond 2017.

This strategy may be particularly effective for C corporations and taxpayers with pass-through business income. It is proposed that C corporations (other than personal service corporations) will be subject to a 20 percent tax rate (reduced from 35 percent) and that business income that flows to noncorporate taxpayers from S corporations, partnerships and LLCs will be subject to a 25 percent maximum tax rate.

Even individuals who cannot benefit from the 25 percent rate can benefit from the deferral of income or the acceleration of deductions in many cases. Because the standard deduction may be substantially increased to $24,000 for joint return filers and $12,000 for single return filers, many taxpayers may no longer itemize. These taxpayers should consider accelerating deductions where possible, even deductions like real property taxes and charitable contributions that will remain largely unaffected.

Similarly, it is proposed that joint return filers who are currently in the 39.6 percent tax bracket (which in 2017 begins at taxable income of $470,700) will benefit in 2018 from not hitting the 39.6 percent tax bracket until their taxable income exceeds $1,000,000. These taxpayers are proposed to have much more taxable income taxed at a 35 percent tax rate in 2018 than in 2017, so they should consider accelerating deductions that would take advantage of the extra 4.6 percent benefit in 2017 or deferring income that would be taxed a rate 4.6 percent less in 2018.

All persons who may be affected by these proposed changes should promptly consult their tax advisors to determine if they could benefit from any year-end tax planning strategies.

If you have any questions regarding the content of this alert, please reach out to William Fones, or any member of Baker Donelson's Tax Group.