TAX CUTS, RETIREMENT PLANNING & IDENTITY THEFT

The Tax Cuts and Jobs Act of 2017 Is Signed Into Law

The Tax Cuts and Jobs Act "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" (H.R. 1), a measure that has been characterized as the first major reform of the Internal Revenue Code in 31 years, received final approval from the House and the Senate on December 20, and was signed into law by President Trump two days later on December 22. The legislation slashes the top corporate tax rate to 21%, lowers the top marginal rate for individual taxpayers to 37%, eliminates or scales back several popular deductions, reduces taxes on business income earned by pass-through businesses, doubles the estate tax exemption, and substantially enhances immediate expensing of capital investments.

The legislation is expected to add around $1.5 trillion to the Federal deficit over 10 years, before accounting for any economic growth. Under the Senate's budget reconciliation rules, the final bill could be approved by a filibuster-proof simple majority only if it added no more than $1.5 trillion to the Federal deficit over a decade.

The main provisions of the Tax Cuts and Jobs Act (TCJA) of 2017 are as follows:

Reduction in the corporate tax rate: While both the Senate and the House bills called for a reduction of the maximum corporate tax rate to 20%, from 35% in 2017, the rate was lowered to 21% in the final version of the bill. The new rate, which goes into effect starting in 2018, is permanent.

Changes in tax brackets and the standard deduction: The law retains the same number of income tax brackets for individuals as under 2017 law, but imposes slightly lower marginal rates on slightly wider brackets. The revised rates are 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The top marginal rate applies to income over $500,000 for single filers and $600,000 for married filing jointly, up from the current threshold amounts of $418,400 and $470,700, respectively. The TCJA nearly doubles the 2017 standard deduction to $24,000 for married filing jointly, $12,000 for single filers, and

$18,000 for heads of household, indexed for inflation based on the chained consumer price index. The law also eliminates the deduction for personal exemptions and the personal exemption phase-out. These reduced rates and changes to the standard deduction and personal exemption go into effect starting in 2018, and expire at the end of 2025.

Changes in the child tax credit: The TCJA increases the child tax credit from $1,000 per qualifying child in 2017 to $2,000 in 2018, of which up to $1,400 is refundable. The law also raises the adjusted gross income (AGI) phase-out thresholds to $400,000 for married filing jointly and to $200,000 for all other filers. In addition, the legislation creates a new non-refundable $500 credit for dependents who are not qualifying children. These changes sunset at the end of 2025.

State and local tax (SALT) deductions capped: Starting in 2018, the legislation limits deductions for all non-business state and local taxes deductions, including property and sales tax deductions, to an exemption of up to $10,000 for most filers, or $5,000 for each married taxpayer filing separately. These deductions are reinstated after 2025, but the law contains a provision that discourages taxpayers from pre-paying their SALT taxes in 2017 by stipulating that SALT taxes assessed for the 2018 tax year are not deductible on 2017 returns.

Mortgage interest deduction reduced: The TCJA limits the mortgage interest deduction for the purchase of a home after December 15, 2017, to loans of $750,000 or less, down from a cap of $1 million in 2017. The law also scales back the mortgage deduction for second homes purchased after this date by limiting the total mortgage interest deduction a taxpayer can take to the $750,000 cap. The home equity interest deduction is repealed. These changes expire at the end of 2025.

Medical expense deduction enhanced: The law enhances the medical expense deduction by lowering the AGI threshold to 7.5% for 2017 and 2018, down from 10% in 2017.

Alternative Minimum Tax (AMT) retained with higher exemption amounts: The legislation retains the AMT for individuals with some modifications through 2025. The exemption amount is increased to $109,400 for joint filers and to $70,300 for other filers, while the phase-out thresholds are raised to $1 million for joint fillers and $500,000 for other filers. The exemption and threshold amounts are indexed to inflation. The corporate AMT is repealed.

New tax breaks for pass-through businesses: Income earned by pass-through entities (e.g., partnerships, S corporations, and sole proprietorships) in 2017 was subject to the individual tax rates of the owners. The TCJA provides a deduction of 20% of qualified income for pass-through entities, with some limitations and qualifications. Certain professional services firms with incomes above specified thresholds are not eligible for these tax breaks. The provisions expire in 2025.

New estate tax provisions: The estate tax in 2017 applied a 40% tax rate to estates worth more than $5.49 million for individuals, or $10.98 million for married couples. The TCJA retains the estate tax, but doubles the current estate, gift tax, and generation-skipping transfer tax (GST) exemption amounts, indexed for inflation, starting in 2018. The lower thresholds are set to return after 2025.

Repeal of the Affordable Care Act (ACA) individual mandate: The TCJA repeals after 2018 the ACA individual shared responsibility requirement, which imposes a penalty payment on individual taxpayers who do not have health insurance.

Enhanced bonus depreciation and Section 179 expensing: The law increases bonus depreciation to 100% (from 50% in 2017) for qualifying property placed in service between September 27, 2017, and January 1, 2023 (with an additional year for certain property with longer production periods), followed by a phase-down period ending in 0% on January 1, 2027. The law also enhances the Section 179 expensing amount for small businesses, raising it to $1 million with a $2.5 million phase-out threshold from current levels of $500,000 and $2 million, respectively.

Interest deductions limited: The TCJA generally caps the deduction for net interest expenses at 30% of earn-ings before interest, taxes, depreciation, and amortization. The law provides for the exemption of small businesses with average gross receipts of $25 million or less.

Retirement Planning for Small Businesses

Small business owners often struggle to find the time and the resources to set up and start contributing to a retirement plan. But no matter how small the business, chances are owners and their employees would benefit from saving in a tax-advantaged retirement plan. Self-employed individuals and business owners who do not yet have a retirement plan, or are thinking about making changes to their current plan, have a number of options to choose from, from Individual Retirement Accounts (IRAs) to 401(k)s to defined benefit plans.

When selecting a retirement plan, there are a number of questions to consider. Is the plan intended to cover just the business owner and the employees, or also the owner's spouse? How many of the firm's employees should be covered? What level of investment is the business willing to make in setting up a plan? Will the contributions to the retirement plan come solely from the business owner, or will employees also be asked to contribute? Is the priority higher contributions or ease of administration? Is the purpose of the plan primarily to attract and retain employees who want to work for a company with retirement benefits, or for the owner or the employees to lower their taxes? Is it important that the plan contributions are deductible as a business expense? What are the owner's personal retirement savings goals?

The Simplified Employee Pension (SEP) IRA is often chosen by small business owners who want a low-cost plan with a minimal administrative burden. Any business owner, including a self-employed individual, can establish a SEP. Owners can contribute up to 25% of their compensation, up to a maximum amount of $54,000 in 2017 and $55,000 in 2018, to their own SEP IRA account, but they are required to contribute the same percentage to the accounts of their employees. Contributions are only made by the employer, not the employees, and are tax-deductible as a business expense.

In a Savings Incentive Match Plan (SIMPLE) IRA, the employee as well as the employer contribute to employee accounts. To be eligible to start a SIMPLE IRA plan, the business must have fewer than 100 employees. Employer contributions are tax-deductible, and employees' contributions can be made pre-tax. Employees are permitted to make salary deferral contributions to their IRA of up to 100% of compensation up to a limit of $12,500 (with a $3,000 catch-up contribution for employees aged 50 and older) in 2017 and 2018. The employer also contributes to the account, either by matching employee contributions dollar-for-dollar up to 3% of compensation, or by contributing 2% of each employee's compensation. The set-up costs and administrative burden associated with SIMPLE IRAs are again minimal, though fees may be charged by financial service providers.

A SIMPLE 401(k) is similar to the SIMPLE IRA in terms of its features and its set-up costs, but also has some characteristics of standard 401(k) plans. Businesses with fewer than 100 employees can start a SIMPLE 401(k) plan. Employees can elect to contribute, but unlike in a traditional 401(k), the employer is required to make a matching contribution up to 3% of each employee's salary, or a non-elective contribution of 2% of each employee's salary. Participants are permitted to borrow against the funds in their 401(k) account and make penalty-free withdrawals due to financial hardship. The employer is required to file a Form 5500 each year, but is not obliged to perform non-discrimination testing, as is the case for a traditional 401(k). Moreover, unlike in a traditional 401(k) plan, in a SIMPLE 401(k) plan contributions made to the account vest immediately.

A Solo or One-Participant 401(k) is a retirement savings plan that is just for a business owner and his or her spouse, and not for employees. Unlike in a SEP plan, business owners with One-Participant 401(k) plans are allowed to maximize their contributions and tax deferrals by making both employee and employer contributions to their own account. Administering this type of plan can be more time-intensive, as the owner is required to file a Form 5500 with the IRS if the plan's assets exceed $250,000. However, the contribution limits are also high: as an employee, the owner can make salary deferrals of up to $18,000 in 2017 and $18,500 in 2018; while as an employer, the owner can contribute up to 25% of compensation, up to a total of $54,000 in 2017 and $55,000 in 2018 (with a catch-up contribution of $6,000 for those aged 50 and older). A spouse employed by the business can contribute the same amounts. The contributions are considered a business expense if the business is incorporated; otherwise, the business owner can deduct the contributions from personal income.

A traditional pension plan can be a highly effective way for business owners to save for retirement on a tax-deferred basis, and for attracting and retaining employees. But the costs of setting up, administering, and funding a defined benefit plan are high, and the employer must be prepared to take on the investment risk associated with providing a fixed benefit to participants. A defined benefit plan is likely to be of greatest interest to high-income business owners who want to make very large contributions to a tax-advantaged plan over a short period of time. Depending on the structure of the plan, a business owner may be able to contribute $215,000 in 2017 and $220,000 in 2018 a year to a defined benefit plan.

IRS and Other Stakeholders to Collaborate on Identity Theft

A new report from the Government Accountability Office (GAO) has recommended that the IRS step up its efforts to collaborate with the tax preparation industry and state tax authorities to combat identity theft and tax fraud.

The report, "Identity Theft: Improved Collaboration Could Increase Success of IRS Initiatives to Prevent Refund Fraud," was published on November 28. In an opening letter to the chairs and ranking members of the Senate Finance Committee and the House Ways and Means Committee, the report's authors observed that identity theft (IDT) tax refund fraud is an evolving and costly problem that causes hardship for taxpayers who are victims of the crime, and demands an increasing share of IRS resources.

According to the report, IDT refund fraud occurs when a refund-seeking fraudster obtains an individual's Social Security number, date of birth, or other personally identifiable information (PII), and uses it to file a fraudulent tax return seeking a refund. The report cited IRS estimates indicating that in tax year 2015, at least $14.5 billion in IDT tax refund fraud was attempted, of which at least $12.3 billion (85%) was prevented, and at least $2.2 billion (15%) was paid.

To tackle these problems more effectively, the IRS has launched for the 2017 filing season an Identity Theft Tax Refund Fraud Information Sharing and Analysis Center (ISAC) pilot program; an outgrowth of its Security Summit initiative that began in March 2015. According to the report, the aim of this pilot program is to allow IRS, states, and tax preparation industry partners to quickly share information on identity theft (IDT) refund fraud. The GAO was asked to examine the IRS's efforts to collaborate with these partners.

The ISAC pilot consists of two components: an online platform run by the IRS to communicate data on suspected fraud; and an ISAC Partnership, a collaborative organization comprised of IRS, states, and industry, which is intended to serve as the governance structure. The report stated that as of November 2017, the ISAC had 48 members: 31 states (including full members and those receiving alerts only),

14 tax preparation companies, and three financial institutions. The report further noted that the IRS is using a Rapid Response Team (RRT) in partnership with states and industry members to coordinate responses to IDT refund fraud incidents that pose a significant threat within 24 to 72 hours of being discovered; and that the IRS deployed the RRT for six incidents in 2016 and once in 2017.

The GAO's analysis showed that the ISAC pilot aligns with key aspects of all five leading practices for effective pilot design that the GAO has previously identified, but with none fully. For example, the report said, the IRS has worked to incorporate stakeholder input, but its message about the ISAC's benefits has not fully reached states. The report recommended the IRS ensure the ISAC better aligns with leading practices for effective pilot design, and that the ISAC Partnership develops an outreach plan to increase membership and improve understanding of the ISAC's benefits among the states and the industry partners.

News & Notes

Outgoing IRS Commissioner Reflects on Tax Reforms and Accomplishments

John Koskinen, whose four-year tenure as IRS Commissioner ended on November 12, warned before leaving his post that he foresaw problems if major tax reform provisions applied to the 2017 tax year, and predicted that the agency would need more funding from Congress to implement the legislation. Fast forward five weeks,

The Tax Cuts and Jobs Act of 2017 "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" (H.R. 1) was approved by the House and Senate on December 20, and was signed into law by President Trump on December 22. The good news is that it was not approved as retroactive and will go into effect starting in 2018.

At a press briefing held shortly before he left office in November, Koskinen reflected on the IRS's accomplishments and challenges over the past four years, and repeated his warning to Congress that the IRS is dangerously underfunded. Specifically, he noted, the IRS is finding it increasingly difficult to make the necessary changes to its information technology systems in response to legislative mandates.

Koskinen said he is delighted with what the agency has been able to accomplish, despite having to manage with no appreciable increase in funding from Congress. Over the past four years, he asserted, the filing seasons have become smoother and more successful; taxpayer identity theft has been greatly reduced; the taxpayer experience has improved, primarily through online solutions; and the IRS has successfully implemented major legislative mandates.

Referring to the upcoming filing season, Koskinen observed that the IRS is prepared for a straight retroactive extension of pending extenders.

Koskinen also cautioned that further reductions in full-time IRS employee numbers will lead to more noncompliance, partly because taxpayers will be unable get the information they need to comply with the tax laws, and partly because the audit rate will drop so low that tax avoidance and fraud will no longer be adequately deterred.

Koskinen was succeeded by David Kautter, who became Acting Commissioner on November 13.

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