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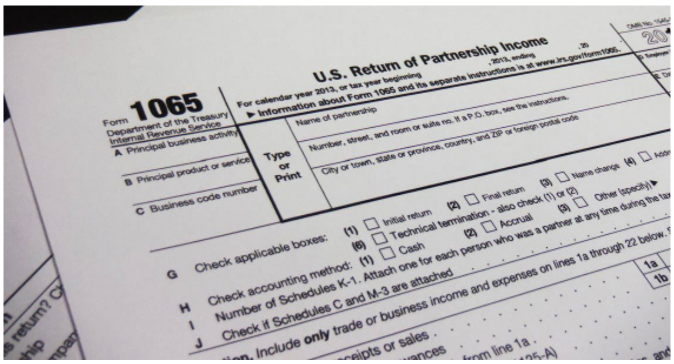
# TAX CUTS AND JOBS ACT PROVIDES SIGNIFICANT TAX CHANGES



On December 22, 2017, President Donald Trump signed into law H.R. 1, commonly known as the "Tax Cuts and Jobs Act." Most provisions affecting individuals are effective for taxable years beginning after December 31, 2017 and expire on December 31, 2025. Most business-related provisions are permanent and are effective for taxable years beginning after December 31, 2017. As described below, this new law, the most significant revision to the U.S. tax code since 1986, includes major changes to the taxation of individuals and businesses.

Tax Brackets and Standard Deduction

Under the new law, the number of tax brackets for individual taxpayers remain the same; however, the rates applicable to the tax brackets are changed to 10%, 12%, 22%, 24%, 32%, 35% and 37% (from 10%, 15%, 25%, 28%, 33%, 35% and 39.6%). The new law also increases the standard deduction to $24,000 for married individuals filing jointly, $18,000 for head-of-household filers, and $12,000 for all other individuals. The standard deduction will be indexed for inflation for taxable years beginning after 2018.

Home Mortgage Interest Deductions

The new law reduces the amount of home mortgage indebtedness on which interest payments are deductible. The acquisition indebtedness for which interest deductions are allowed is reduced to $750,000 (from $1.0 million) for taxable years beginning after December 31, 2017 ($375,000 in the case of married taxpayers filing separately). In the case of acquisition indebtedness incurred before December 15, 2017, the limitation is $1,000,000 ($500,000 in the case of married taxpayers filing separately). Additionally, the deduction for interest on home equity indebtedness is suspended, meaning that for taxable years beginning after 2017 a taxpayer may not claim a deduction for interest on home equity lines of credit. This change, combined with the limit on property tax deductions described below, may indirectly benefit multi-family developers and owners, given the reduced tax benefits of home ownership resulting from these changes.

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Excess Business Losses

The new law disallows "excess business losses" of a taxpayer other than a corporation. "Excess business losses" generally means (i) the excess (if any) of the aggregate deductions attributable to trades or businesses of the taxpayer over (ii) the sum of aggregate gross income or gain attributable to such trades or businesses, plus a threshold amount ($250,000, or twice that amount in the case of a joint return). Such losses are carried forward and treated as part of the taxpayer's net operating loss ("NOL") carryforward in subsequent taxable years as determined under the NOL rules provided in the new law.

Qualified Business Income Deduction

The new law gives non-corporate taxpayers a deduction from gross income equal to 20% of domestic "qualified business income" ("QBI") from a partnership, S-corporation, sole proprietorship, estate, or trust. The deduction is also available for ordinary dividends from a real estate investment trust ("REIT") and qualified income earned through a publicly traded partnership. For income earned from a partnership, S-corporation, sole proprietorship, estate, or trust, the deduction equals 20% of the QBI amounts for each qualified trade or business carried on by the taxpayer. The 20% of QBI deduction is limited to the greater of (i) 50% of the taxpayer's share of W-2 wages paid with respect to the qualified trade or business, or (ii) the sum of 25% of the W-2 wages and 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property. QBI does not include income from certain "specified services" trades or businesses, including health, law, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management, or trading or dealing in securities, partnership interests, or commodities. Architecture and engineering are excluded from "specified services" and, therefore, are eligible for the deduction. The deduction for the taxable year is the lesser of (i) the sum of the deductible amounts for each qualified trade or business carried on by the taxpayer plus 20% of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income, or (ii) 20% of the taxpayer's ordinary income less net capital gain. The foregoing limits and the specified services exclusion do not apply to taxpayers with annual taxable incomes under certain threshold amounts ($315,000 for joint filers and $157,500 for single filers), subject to scale-back as taxable income increases (to $415,000 for joint filers and $207,500 for single filers). This deduction is available regardless of whether the taxpayer takes the standard deduction or itemizes.

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Other Provisions Affecting Individual Taxpayers

In addition, some other provisions of the new law affecting individual taxpayers include:

- Repeal of the overall limitation on high-income taxpayers for otherwise allowable itemized deductions;
- Doubling of the child tax credit from $1,000 to $2,000 per qualifying child, and providing for a $500 nonrefundable credit for qualifying dependents other than qualifying children;
- Limiting the itemized deduction for state and local taxes to up to $10,000 for the aggregate of (i) state and local property taxes and (ii) state and local income taxes (or sales taxes in lieu of income taxes.) The new law also prohibits individuals from prepaying state and local income taxes for taxable years after December 31, 2017, and receiving a deduction for such prepayments in 2017;
- Increasing the limitation on charitable contributions from 50% to 60% of adjusted gross income;
- Repeal of deductions for any expenses that would currently be subject to the "miscellaneous itemized deduction" 2% floor, including deductions for expenses paid or incurred for the production or collection of income and unreimbursed expenses attributable to the trade or business of being an employee;
- Preserving the individual alternative minimum tax ("AMT"), but increasing both the exemption amount and the exemption amount phase-out thresholds; and
- Eliminating the "individual mandate" under the Affordable Care Act for health coverage status for months beginning after December 31, 2018.

Corporate Tax Rate; AMT

The new tax law reduces the general corporate tax rate from a graduated rate of 15%, 25%, 34% or 35% to a flat rate of 21%. The new law also repeals the corporate AMT.

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Cash Method Taxpayers

The new law expands the number of corporations (and partnerships with a corporate partner) that may use the cash method of accounting. Under the new law, the cash method of accounting may be used by corporations (and partnerships with a corporate partner), other than tax shelters, that satisfy the gross receipts test, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. The gross receipts test allows taxpayers with annual average gross receipts that do not exceed $25.0 million for the three prior taxable-year periods (the "$25 million gross receipts test") to use the cash method. The $25.0 million amount is indexed for inflation for taxable years beginning after 2018. The new law retains the exceptions from the required use of accrual method for qualified personal service corporations and taxpayers other than C-corporations. Thus, qualified personal service corporations, partnerships without C-corporation partners, S-corporations, and other pass through entities are allowed to use the cash method without regard to whether they meet the $25 million gross receipts test, so long as the use of such method clearly reflects income.

Inventories

In addition, the new law exempts certain taxpayers from the requirement to keep inventories. Specifically, taxpayers that meet the $25 million gross receipts test are not required to account for inventories under section 471, but rather may use a method of accounting for inventories that either (1) treats inventories as non-incidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.

Construction Contracts

The new law also expands the exception for small construction contracts from the requirement to use the percentage-of-completion method. Under the new law, contracts within this exception are those contracts for the construction or improvement of real property if the contract: (1) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer that (for the taxable year in which the contract was entered into) meets the $25 million gross receipts test.

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Carried Interests

The new law restricts the potential tax benefit of carried interest by limiting the availability of long-term capital gain ("LTCG") rates. Under the new law, a person must use a three-year holding period for partnership assets to determine whether gains from certain partnership interests qualify for LTCG treatment. Amounts that are disqualified are instead treated as short-term capital gain. This restriction applies to partnership interests that are received in connection with performing services for a business that consists in whole or in part of (1) raising or returning capital and either (2) investing in (or disposing of) specified assets (or identifying specified assets for investing or disposition) or (3) developing specified assets. "Specified assets" include securities, commodities, real estate held for rental or investment, cash or cash equivalents, and derivatives that reference any of the foregoing. This restriction does not apply where a partnership interest generates a capital loss, rather than capital gain, for a tax year. It also does not apply to partnership interests held directly or indirectly by a corporation or certain capital interests in partnerships.

Limitations on Business Interest Deductions

The new law restricts business interest expense deductions by providing that no business, regardless of form, may deduct interest expense in excess of 30% of such business's adjusted taxable income (that is, taxable income allocable to the trade or business without regard to the interest deduction, loss carryovers, and certain other items). For taxable years beginning after December 31, 2017, and before January 1, 2022, adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion. Under the new law, interest deductions by businesses that meet the $25 million gross receipts test are exempt from the limitation. This limitation also would not generally apply to real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trades or businesses. These changes are effective beginning in 2018 with no grandfather provision for existing debt.

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Immediate Expensing of Certain Qualified Property

The new law allows taxpayers to fully and immediately expense 100% of the cost of certain qualified property (e.g., certain tangible personal property, certain computer software, water utility property, etc.) acquired after September 27, 2017 and prior to January 1, 2023, with such immediate expensing phased down beginning January 1, 2023. The new law repeals the current requirement that the original use of such qualified property must begin with the taxpayer taking the deduction. Under the new law, a taxpayer is generally eligible for the deduction if it is such taxpayer's first use of such qualified property.

Expansion of Section 179 "Bonus Depreciation"

The maximum amount a taxpayer may expense under Section 179 (so called, "bonus depreciation") is increased under the new law to $1.0 million (from $500,000), and the phase-out threshold amount is increased to $2.5 million (from $2.0 million), both indexed for inflation for taxable years beginning after 2018. In addition, the definition of Section 179 property is expanded to include certain depreciable tangible personal property used predominately to furnish lodging or in connection with furnishing lodging, which should benefit hotels, furnished apartments and student housing. Also, the definition of qualified real property eligible for Section 179 expensing is expanded to include any of the following improvements to non-residential real property placed in service after the date such property was first placed in service: roofs; HVAC property; fire protection and alarm systems; and security systems. In addition, changes under the new law make "qualified improvement property" (defined as any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was first placed in service, not including any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building) eligible for Section 179 expensing.

Modification of Corporate NOL Rules

The new law generally modifies the rules for carrying back NOLs for corporations by eliminating (with limited exceptions) the existing general two-year carryback and permitting an unlimited NOL carryforward period (rather than the 20-year maximum under the prior law). In addition, the unused NOL carryforwards would be adjusted. Under the new law, not more than 80% of the taxpayer's current year's taxable income can be offset by otherwise available NOL carryovers.

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Elimination of Certain Business Deductions

The new law provides that no deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement or recreation, (2) membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, or (3) a facility or portion thereof used in connection with any of the above items.  Thus, the new law repeals the prior-law's exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business.

In addition, the new law disallows a deduction for expenses associated with providing any qualified transportation fringe to employees of the taxpayer, and except as necessary for ensuring the safety of an employee, any expense incurred for providing transportation (or any payment or reimbursement) for commuting between the employee's residence and place of employment.

1031 Exchanges Limited to Real Property

The new law limits like-kind exchange non-recognition treatment to an exchange of real property that is not held primarily for sale.

FMLA Business Credit

The new law allows eligible employers to claim a general business credit equal to 12.5% of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave if the rate of payment under the program is 50% of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%.  The maximum amount of family and medical leave that may be taken into account with respect to any employee for any taxable year is 12 weeks.

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Historic Tax Credits

The new law repeals the 10% credit for qualified rehabilitation expenditures with respect to a qualified rehabilitated building, which generally means a building that was first placed in service before 1936. The new law does retain the 20% credit for qualified rehabilitation expenditures with respect to a certified historic structure, with a modification. Under the new law, the credit allowable for a taxable year during the five-year period beginning in the taxable year in which the qualified rehabilitated building is placed in service is an amount equal to the ratable share. The ratable share for a taxable year during the five-year period is amount equal to 20% of the qualified rehabilitation expenditures for the building, as allocated ratably to each taxable year during the five-year period.

The above summary is only meant to serve as a general summary of some of the more significant provisions that affect individuals and businesses, does not include all provisions included in the law, and should not be relied on as tax advice. This summary does not reflect all of the provisions of the new tax law, and explicitly excludes any discussion related to provisions related to international tax issues or to equity grants, stock options and other equity incentives. Readers are encouraged to consult their tax professional regarding their individual circumstances and the new law's effect on their tax position.

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