Overview of Tax Cuts and Jobs Act, Pub. L. 115-97

Arkansas Tax Reform and Relief Legislative Task Force

February 5, 2018

Arkansas Department of Finance and Administration

DFA Arkansas Department of Finance and Administration

Tax Cuts and Jobs Act

- Pres. Trump signed on December 22, 2017.
- Passed through Budget Reconciliation Process under 1974 Congressional Budget Act.
- “Byrd Rule” Limits Senate Provisions not germane to the budget.
- Concurrent Resolution limits deficit increase to $1.5 Trillion in the 10 Year Budget Window.
- Public Law 115-97

Arkansas Non-Delegation of Taxing Authority

- Changes to Federal tax laws do not apply to Arkansas tax laws.
- General Assembly must specifically adopt Federal provisions as of a date certain.
- Article 2, § 23 prohibits delegating the power to tax or fix the rate of tax, except to political subdivisions of Arkansas.
- Unless otherwise noted, these changes will not directly affect Arkansas tax revenue or Arkansas tax returns.

Inflation Adjustments

- The Tax Cuts and Jobs Act changes the method of calculating Inflation Adjustments in the Internal Revenue Code.
- Previously, CPI, or Consumer Price Index, was used to determine inflation. CPI is calculated by comparing the price of a specific bundle of goods purchased year to year to calculate inflation.
- Under the new law, **Chained CPI** is used instead. Chained CPI assumes that consumers will purchase less expensive versions of the bundled goods first and therefore limits the amount of inflation calculated.
- Chained CPI is used for all components listed as indexed for inflation.

Individual Income Tax Changes

Individual Income Tax Changes will sunset in 10 years

Individual Income - Rate & Bracket Changes

- Previous Income Tax rates and brackets.

	Married (Jointly)	Married (Separately)	Head of Household	Single
10%	$18,650	$9,325	$13,350	$9,325
15%	$75,900	$37,950	$50,800	$37,950
25%	$153,100	$76,550	$131,200	$91,900
28%	$233,350	$116,675	$212,500	$191,650
33%	$416,700	$208,350	$416,700	$416,700
35%	$470,700	$235,350	$444,500	$418,400
39.6%	$470,700+	$235,350+	$444,500+	$418,400+

Individual Income - Rate & Bracket Changes

- Tax Cuts and Jobs Act rates and brackets.

	Married (Jointly)	Married (Separately)	Head of Household	Single
10%	$19,050	$9,525	$13,600	$9,525
12%	$77,400	$38,700	$51,800	$38,700
22%	$165,000	$82,500	$82,500	$82,500
24%	$315,000	$157,500	$157,500	$157,500
32%	$400,000	$200,000	$200,000	$200,000
35%	$600,000	$300,000	$500,000	$500,000
37%	$600,000+	$300,000+	$500,000+	$500,000+

Individual Income – Standard Deduction & Personal Exemptions

- Previous law provided a standard deduction of approximately $6,500; $9,500; and $12,000 for single, head of household, and married filers.
- The Tax Cuts and Jobs Act approximately doubles those amounts to $12,000; $18,000; and $24,000 respectively.
- Previous law provided a personal exemption of approximately $4,000 per person that was deducted from taxable income in addition to the standard deduction.
- The Tax Cuts and Jobs Act eliminates personal exemptions.

Individual Income – Standard Deduction & Personal Exemptions Cont.

Single Filer	**Previous Tax Code**			**Tax Cuts & Jobs Act**		
Gross Income	$20,000	$50,000	$150,000	$20,000	$50,000	$150,000
Standard Deduction	$6,500	$6,500	$6,500	$12,000	$12,000	$12,000
Personal Exemption	$4,000	$4,000	$4,000	$0	$0	$0
Taxable AGI	$9,500	$39,500	$139,500	$8,000	$38,000	$138,000

Married Joint, No Children	**Previous Tax Code**			**Tax Cuts & Jobs Act**		
Gross Income	$20,000	$50,000	$150,000	$20,000	$50,000	$150,000
Standard Deduction	$12,000	$12,000	$12,000	$24,000	$24,000	$24,000
Personal Exemption	$8,000	$8,000	$8,000	$0	$0	$0
Taxable AGI	$0	$30,000	$130,000	($4,000)	$26,000	$126,000

Married, Joint, 1 Child	**Previous Tax Code**			**Tax Cuts & Jobs Act**		
Gross Income	$20,000	$50,000	$150,000	$20,000	$50,000	$150,000
Standard Deduction	$12,000	$12,000	$12,000	$24,000	$24,000	$24,000
Personal Exemption	$12,000	$12,000	$12,000	$0	$0	$0
Taxable AGI	($4,000)	$26,000	$126,000	($4,000)	$26,000	$126,000

Individual Income – Standard Deduction & Personal Exemptions, cont.

Married, Joint, 2 Children	Previous Tax Code			Tax Cuts & Jobs Act		
Gross Income	$20,000	$50,000	$150,000	$20,000	$50,000	$150,000
Standard Deduction	$12,000	$12,000	$12,000	$24,000	$24,000	$24,000
Personal Exemption	$16,000	$16,000	$16,000	$0	$0	$0
Taxable AGI	($8,000)	$22,000	$122,000	($4,000)	$26,000	$126,000

Head of Household, 2 Children	Previous Tax Code			Tax Cuts & Jobs Act		
Gross Income	$20,000	$50,000	$150,000	$20,000	$50,000	$150,000
Standard Deduction	$9,500	$9,500	$9,500	$18,000	$18,000	$18,000
Personal Exemption	$12,000	$12,000	$12,000	$0	$0	$0
Taxable AGI	($1,500)	$28,500	$128,500	$2,000	$32,000	$132,000

Individual Income – Child Tax Credit & Family Tax Credit

- Previously provided for a $1,000 Child Tax Credit that began phasing out at $110,000 for joint filers.
- The Tax Cuts and Jobs Act increased the amount of the Child Tax Credit to $2,000, with $1,400 refundable.
- The phase out for receiving the tax credit begins at $400,000 for joint filers and is not indexed for inflation.

Individual Income – Alternative Minimum Tax

- The Alternative Minimum Tax, or AMT, is a second tax calculation that is applicable to higher income filers without the benefit of numerous exemptions or deductions to create a minimum tax paid.
- Previous law exempted single filers who made less than $54,300 and Joint Filers making less than $84,500 from the AMT calculations.
- The Tax Cuts and Jobs Act raises the exemption to $70,300 for single filers and $109,400 for joint filers and begins the phase out at $1,000,000 for joint filers.

Individual Income – Mortgage Interest Deduction

- Previous law allowed a deduction for interest on the mortgage of a qualified residence or home equity indebtedness for residences up to $1,000,000.
- Tax Cuts and Jobs Act limits the deduction of mortgage interest to new purchases of primary residences that cost $750,000 or less purchased on or after December 15, 2017.
- Tax Cuts and Jobs Act also removes the deduction for home equity indebtedness interest.

Individual Income – State & Local Tax Deduction (SALT)

- Previous law allowed a filer to deduct state and local property taxes AND either income or sales tax with no limitation.
- The Tax Cuts and Jobs Act limits the SALT deduction to $10,000 of state property, income, or sales tax for federal purposes.
- All payments made before January 1, 2018, are treated as paid on the last day of the tax year for the purposes of this deduction limiting prepayment of SALT for deduction purposes.
- This limitation does not apply to businesses SALT payments that are classified as a business expense.

Individual Income – SALT Examples

- Individual Income SALT Example Arkansan Filer Difference
- 45,180 taxpayers averaging $236,217 AGI exceed the $10,000 limitation.
- Average deduction for state and local income, property, and sales taxes (SALT)

Average SALT

AGI	SALT
$25,000	$1,530
$50,000	$3,092
$150,000	$10,058
$300,000	$20,895

Individual Income – Charitable Deductions

- Previously, a filer could deduct up to 50% of the "contribution base", which is generally the filer's adjusted gross income, and carry forward any remaining deduction. **IRC 170(b)**
- The Tax Cuts and Jobs Act increases that to 60% of the contribution base and are prioritized to occur before other contributions.

Individual Income – Charitable Deductions to College Athletics

- The Tax Cuts and Jobs Act repealed a special provision allowing for a deduction of 80% of the payments to an institution of higher education for the right to purchase seats or tickets to an athletic event. **IRC 170**
- For contributions made in tax years beginning after Dec 31, 2017, no charitable deduction is allowed for any payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event.
- The Razorback Foundation received $39,184,292 in contributions and grants during fiscal year 2015. Generally, a donation of $50 or more allows priority tickets/seating at athletic events.

Individual Income – Personal Casualty & Theft Loss

- For tax years beginning after Dec 31, 2017 and before Jan 1, 2026, the personal casualty and theft loss deduction is suspended, except for personal casualty losses incurred in a federally-declared disaster. **IRC 165(h)**

Individual Income – Miscellaneous Provisions

- Returns the 7.5% standard for unreimbursed medical expenses for two years. **IRC 213**
- Removes the inclusion of alimony in a recipient's income & deduction of alimony from the payor's income for separation or divorce after 2018.
- Suspends the deduction for Moving Expenses. **IRC 217**
- Suspends Miscellaneous Itemized Deductions. **IRC 67(g)**

Pass Through Entity Treatment

Pass Through Entity Treatment is complex and involves individual and corporate income considerations.

Pass Through Entity – Context

- Pass Through Entities are entities like “S” Corporations or Limited Liability Companies, L.L.C.s.
- These entities “pass” the profits of the business through to the owners instead of filing as an entity themselves.
- The owners report the income and pay tax on their individual returns rather than a business or corporate return.

Pass Through Entity – Rates & Brackets

- Previous Tax rate for Pass Through Income is the same as individual income tax rates & brackets.

	Married (Jointly)	Married (Separately)	Head of Household	Single
10%	$18,650	$9,325	$13,350	$9,325
15%	$75,900	$37,950	$50,800	$37,950
25%	$153,100	$76,550	$131,200	$91,900
28%	$233,350	$116,675	$212,500	$191,650
33%	$416,700	$208,350	$416,700	$416,700
35%	$470,700	$235,350	$444,500	$418,400
39.6%	$470,700+	$235,350+	$444,500+	$418,400+

Pass Through Entity – Rates & Brackets, cont.

- The Tax Cuts and Jobs Acts provides for a 20% deduction on the individual income tax return for qualified business income from a pass through entity.
- Qualified Business Income is the net amount of income, gain, loss, and deduction from a qualified or eligible trade or business excluding short or long term capital gains or losses.
- Generally, this Deduction is limited to 20% of the filer’s taxable income.

Pass Through Entity - Limitations

- Specific service industry pass-through entities are not included in the applicability of the 20% Deduction.
  - Pass Through Entities providing services in law, health, performing arts, athletics, financial services, accounting and similar fields.
  - Pass Through Entities with the primary business asset as the reputation or skill of one or more of the employees or owners of the entity.
  - Pass Through Entities providing investment management, trading in securities or commodities, or investing.
- Deduction available for the above if taxable income does not exceed \$157,500 for single filers or \$315,000 for joint filers.

Pass Through Entity – Limitations, cont.

- Additional limitations are placed on filers seeking to claim deduction beginning at $157,700 for individual filers and $315,000 for joint filers and fully phased in at $207,500 and $415,000 respectively.
- The Pass Through deduction for these filers cannot exceed 50% of the W-2 Wages from the business, or 25% of the W-2 Wages + 2.5% of the unadjusted basis of all qualified property.
  - For this purpose, W-2 Wages means the wages or deferred compensation paid that is qualified business income -OR- for partnerships and S Corporations, an amount equal to the partner or shareholders allocable share of the entities paid W-2 wages.

Corporate Income Tax Changes

Corporate Income Tax changes are permanent

Corporate Tax – Rates & Brackets

- Previous Corporate Tax Rates & Brackets

Taxable Income	Tax Rate
Up to $50,000	15%
$50,001-$75,000	25%
$75,001 - $100,000	34%
$100,000 - $335,000	39%
$355,000-$10,000,000	34%
$10,000,000 -$15,000,000	35%
$15,000,000-$18,333,333	38%
$18,333,333+	35%

Corporate Tax – Rates & Brackets, cont.

- Tax Cuts & Jobs Act Rates & Brackets

Taxable Income	Tax Rate
$1+	21%

Corporate Income – Bonus Depreciation

- For qualifying assets, previous law provided for a 50% “bonus” depreciation to be applied for corporate income tax purposes.
- The Tax Cuts & Jobs Act provides for 100% depreciation of qualifying assets so that they may be written off completely in the year of purchase.
- The bonus depreciation is phased out 20% per year beginning in 2023 to maintain the required deficit within the budget window.
- Arkansas does not provide for bonus depreciation.

Corporate Income – Bonus Expensing

- Previous law provided up to $500,000 of IRC 179 deductions that began phasing out at $2M. Bonus depreciation for 50% of the cost of most other depreciable assets was allowed.
- The Tax Cuts and Jobs Acts allows for $1M of IRC 179 depreciation for qualified asset purchases with a phaseout beginning at $2.5M. Bonus expensing of other depreciable assets for 100% of the cost for purchases made after September 27, 2017 through December 31, 2022.
- The Bonus Expensing is phased out from 2023 through 2028 to maintain the required deficit numbers within the budget window.
- Arkansas provides for Section 179 deductions of assets up to $25,000 with a phase out beginning at $200,000 with no bonus depreciation.

Corporate Income – Net Operating Losses

- Previously, Federal law provided for Net Operating Losses (NOL) to have a two-year carry back and twenty year carry forward provision.
- The Tax Cuts and Jobs Act eliminates the carryback provision, but allows indefinite carrying forward of NOLs.
- NOL's may only be used to offset 80% of taxable income.
- Few states match Federal treatment of NOLs – Arkansas provides no carryback and a five year carry forward provision.

Corporate Income – Accounting Methods

- This change will result in an approximate loss of $10M for Arkansas.
- The Tax Cuts and Jobs Acts liberalizes the requirements to use a Cash Accounting Methodology versus Accrual Accounting.
- Tax Cuts and Jobs Act raises the gross receipts maximum of a cash accounting business from $5M to $25M annually.
- The Tax Cuts and Jobs Act allows a broader range of businesses to use Cash Accounting.
- Arkansas requires that the same accounting methodology be used for both Arkansas and Federal returns, Ark. Code Ann. 26-51-401.

Corporate Income – Accounting Methods, Cont.

- Cash Accounting means recognizing items of income when payment is received and recognizing expenses as deductions when payments are made.
- Accrual Accounting means recognizing items of income and deduction when they become payable rather than when the payment is either received or paid.
- Previously, Cash Accounting was not available for businesses with over $5M in annual gross receipts.
- Results in losses being realized sooner and reducing corporate income tax liability for cash accounting businesses versus accrual accounting businesses.

Corporate Income – Miscellaneous Changes

- Denies deductions for entertainment, amusement or recreation except for the active conduct of the taxpayer's trade or business and denies deductions for transportation fringe benefits except to ensure employee safety, for club or athletic facility memberships or personal amenities except when such compensation is taxable to the employee for expenses paid or incurred after 2017.
- Disallows deductions for FDIC Premiums for financial institutions with assets exceeding $10 billion for tax years beginning after 2017.
- Disallows a deduction for settlements, payouts or attorney fees related to sexual harassment or sexual abuse if the payments are subject to a non-disclosure agreement for amounts paid or incurred after enactment.

Corporate Income – Miscellaneous Changes, cont.

- Allows governors to nominate "Qualified Opportunity Zones" that if approved would provide temporary deferral of capital gains that are reinvested in a Qualified Opportunity Zone for transactions occurring after enactment. The deferral of gain would be until the investment in a QO zone or Dec. 31, 2026, whichever comes first.
- Continues to allow exempt status for private activity bonds and sports facility construction bonds, but repeals exemption for advance refunding bonds and tax-credit bonds.