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2018 Tax Reform

1. Individual
2. Estate and Gift
3. Corporate and Business
4. Pass-thru Entities

Individual Income Tax Rates

- Lower tax rates for individuals
- Applies to 2018 to 2025 (8 years)
  - 22% rate for taxable income over $77,400
  - 24% rate for taxable income over $165,000
  - 32% rate for taxable income over $315,000
  - 35% rate for taxable income over $400,000
  - 37% rate for taxable income over $600,000

What Taxes haven't changed:

FICA tax on salary and wages of employee	15.4% on wages up to $128,400 of compensation (split between employee and employer) 2.9% on compensation in excess of $128,400 0.9% Add'l Medicare tax on compensation above $200,000
Self-employment tax on sole proprietors, independent contractors and partners	15.4% on self-employment income to $128,400 2.9% on self employment income in excess of $128,400 0.9% Add'l Medicare tax on SE income above $200,000
Net investment income tax	3.8% on NII for taxpayers with AGI over $250,000 (joint)
Capital Gains tax	15% rate for AGI between $77.2K – $479K; 20% rate for AGI of $479K and higher (joint)

Increased Standard Deduction, But No Personal Exemptions

- **Starting in 2018, $24,000 standard deduction (joint) $12,000 (single)**
  - **Increased from $12,700 (joint) in 2017**
- **Personal exemptions suspended through 2025**
  - **$4,050 per dependent in 2017**
  - **But new $500 dependent tax credit starting 2018**

Itemized Deductions – What's changed?

- $10,000 ($5,000 MFS) cap on state and local income and property taxes; exception for property taxes incurred in a trade or business or activity for profit
- Home Mortgage Interest Deduction
  - Interest on mortgage debt to buy, construct or improve qualified residence ("acquisition debt")
  - New mortgages (after 12/15/17) interest deduction on debt of $750,000 is new limitation (2018 – 2025)
  - Existing home mortgage (on or before 12/15/17) interest deduction on debt of $1,000,000 still deductible
  - No interest deduction on home equity loan whether or not incurred prior to 2018
  - Refinanced acquisition debt follows same rules for original acquisition debt within original term of acquisition loan.
- Miscellaneous itemized deductions suspended e.g. unreimbursed employee business expenses.

Alternative Minimum Tax (AMT)

- AMT is alternative tax computation that often applies to individuals due to itemizing deductions for State and Local taxes (because they are not deducible for AMT purposes).

- AMT Exemption amount raised to $109,400 (joint) ($54,700 MFS)

- Phase out of exemption amount raised to $1,000,000 (joint) ($500,000 MFS)

- The $10K cap on deduction for state and local taxes in many cases may be roughly offset by increase in AMT exemption

Child Tax Credit

- Child Tax Credit raised to $2,000 per child
  - Qualifying child under age 17
- $500 credit for other dependents
  - Child under age 19
  - Full time student under age 24
  - Other requirements for dependents
- Phase-out begins at AGI of $400,000 (Joint) ($200,000 MFS)

Alimony payment deduction

- Starting in 2019, no deduction for payor spouse
- Applies to divorce decree, separation agreements and certain modifications to existing agreements entered into after 2018.
- Receipt of alimony is not income to recipient spouse starting in 2019

Estate & Gift Tax

- **Increase in estate, gift and GST exclusion amounts to $11.2 Million per person for decedent's dying and gifts made in 2018 through 2025.**
- **After 2025, exclusion amount reverts to $5.6 Million**
- **Amounts are indexed for inflation**
- **Estates and gifts exceeding exemption amount are subject to 40% estate/gift/GST tax.**

Estate Planning

- Spouses
  - Combined exclusion amount is $22.4 million for 2018 through 2025
  - Portability remains in law
  - QTIP (“Marital Trust”) planning on 1st spouse’s death to obtain tax basis step up on 2nd spouse’s death for appreciated assets
- Everyone
  - Planning for basis step-up for appreciated assets
  - Capital Gain Tax Rate currently about 28.8% [20% + 3.8% (NII) + 5% (Ohio)]
  - High Net Worth clients consider gifting strategies to minimize exposure to 40% estate tax.

Recharacterization of IRA and Roth IRA

- Election to recharacterize conversion of traditional IRA to a Roth IRA is repeal starting for in 2018 plan years. Conversions cannot be unwound. For 2017 conversions, owner has until October 15, 2018 to elect to recharacterize back to traditional IRA.
- Election to recharacterize contributions to either traditional or Roth IRA is still permitted.

Corporate Tax Rate

- 21% Flat rate on C corporation income
  - Applies to fiscal years commencing after 12/31/17
  - Blended rate for fiscal years that begin prior to, but end after, 12/31/17
  - Former rate was 34% on income up to $10 Million, and 35% for income in excess of $10 Million
- 21% on Personal Service Corporations
- Corporate AMT repealed

Accounting Methods – Small Business

- For tax years beginning after 12/31/17
- Applies to taxpayers with average gross receipts of $25 Million or less for prior 3 tax years.
  - Cash method of accounting now permitted for C Corporations that do not exceed gross receipts test.
  - Exempt from requirement to account for inventories and UNICAP rules.
  - Exempt from requirement to use percentage of completion method for long-term construction contracts to be completed within two years.
  - Exempt from annual limit on interest deduction

Bonus Depreciation & §179 Expensing

- 100% expensing for property placed in service after 9/27/17 through 12/31/22; after 12/31/22 reduced expensing percentages

- Qualified Property – New or Used
  - Tangible personal property with recovery period of 20 years or less under MACRS
  - Qualified improvement property (improvements to the interior portions of non-residential property)
  - No limit on amount

- §179 Expensing of tangible personal property (new or used) purchased for use in trade or business
  - Limited to $1,000,000 annually – does not sunset.
  - Phase-out begins at $2.5 Million of qualifying purchases
  - Taxable income limitation on deduction, with carryover for excess

Interest Deduction Limitation

- Applies to tax years beginning after 12/31/17
- Annual cap of 30% of “adjusted taxable income” (Similar to EBITDA)
- Excess interest deduction is carried forward
- Does not apply to:
  - Taxpayers with average annual gross receipts of $25 Million or less are exempt from limit.
  - Electing real property trade or business

New Loss Limitations

- NOL deduction carryover limit to 80% of taxable income
  - No carryback permitted
- Annual Limit on individual business losses.
  - Annual losses and NOL carryover may fully offset current net business income plus $250,000 (500,000 (joint))
  - Effectively $250,000 limitation on business losses annually from being deducted against non-business income.
  - Excess loss is NOL carryover to following year

Other Business Changes

- **Deduction for Domestic Production Activities repealed**
- **Like kind exchanges limited to exchanges of real property not held primarily for sale – exchanges of personal property cannot qualify**
- **Entertainment expenses – repealed 50% deduction.**
  - **No deduction for entertainment, amusement, recreation**
- **Deduction of 50% of cost of business meals is retained**

Entertainment Expense (not-deductible) vs. Business Meals (50% deductible)

- **What is "entertainment"?**
  - **Examples: entertaining at night clubs, cocktail lounges, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation, and similar trips.**
  - **If it generally considered to be entertainment, then it is and no deduction.**
  - **Entertainment facilities – any property owned or rented for use in entertainment.**
  - **Club membership dues have been nondeductible since 1993.**
- **What are business "meals"?**
  - **Example: food and beverage costs incurred in entertaining customers or prospective customers at taxpayer's place of business or a restaurant, lounge, bar, business convention, business meeting, etc.**
  - **Record keeping requirement**

Qualified Equity Grants

- Starting in 2018, for qualified stock plans, an employee may elect up to 5 years of tax deferral on exercise of stock option or vesting of stock grant.
- Limited to non-pubic corporations
- Under normal tax rules, stock options are taxable as compensation to employee at exercise, and stock grants are taxable upon vesting.
- If option or stock has appreciated substantially in value, the exercise or vesting triggers taxable income and tax payment obligation. The 5 year deferral relieves this burden temporarily.
- Plan coverage requirement – at least 80% of employees (excluding 1% owners and 4 highest compensated officers) must be granted stock options or stock awards for the year with same rights.

Carried Interests
Held in Connection with Financial Services

- 3 year holding period for portfolio investments held by partnership with respect to Taxpayer holding a "profits interest" in such partnership that is issued to Taxpayer in exchange for substantial services performed by the Taxpayer consisting of raising or returning capital and either investing in or developing securities, commodities, rental or investment real estate, cash, options or derivatives or an interest in a fund holding such investments.

- 3 year holding period for long term capital gain to pass through to holder of profits interest

- Applies to existing profits interests and pass through gains starting in 2018

Pass-Through Qualified Business Income Deduction

- Applies to tax years beginning after 12/31/17 through 12/31/25
- 20% deduction for business income
- Legislative goal is to reduce tax rates on business income for non-corporate businesses similar to the tax rate reduction for C corporations.
- Applies to "combined qualified business income" of S corporations, partnerships and sole proprietorships
- Qualified Business Income
  - Excludes investment income (dividends, investment interest, capital gains etc.)
  - Excludes foreign sourced income
  - Excludes specified service businesses

20% QBI Deduction

- Determined at the sole proprietor, partner or shareholder level
- Reported on Form 1040 but not an itemized deduction
- Deduction is 20% of combined qualified business income of individual, trust or estate

20% QBI Deduction

Do you have a qualified trade or business?

Any trade or business other than:

(A) Specified service business; or

(B) Employee

What is a specified service trade or business?

- Performance of services in the fields of
  - Health, law, accounting, actuarial science, performing arts, 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 or 1 or more of its employees or owners, or
  - Investing and investment management, trading, or dealing in securities

Exception for lower income service businesses

- **20% QIB deduction allowed for Specified Service business if taxpayer's taxable income is less than $315,000 (joint) $157,500 (Single)**

- **Phase-out for taxable income between $315,000 and $415,000 (joint)**

- **Applied at partner or shareholder level;**
  - **each partner/shareholder takes into account allocable share of business income, gain, deduction and loss;**
  - **W-2 wages (allocated same as wage expense)**
  - **Unadjusted basis of property (allocated same as depreciation)**

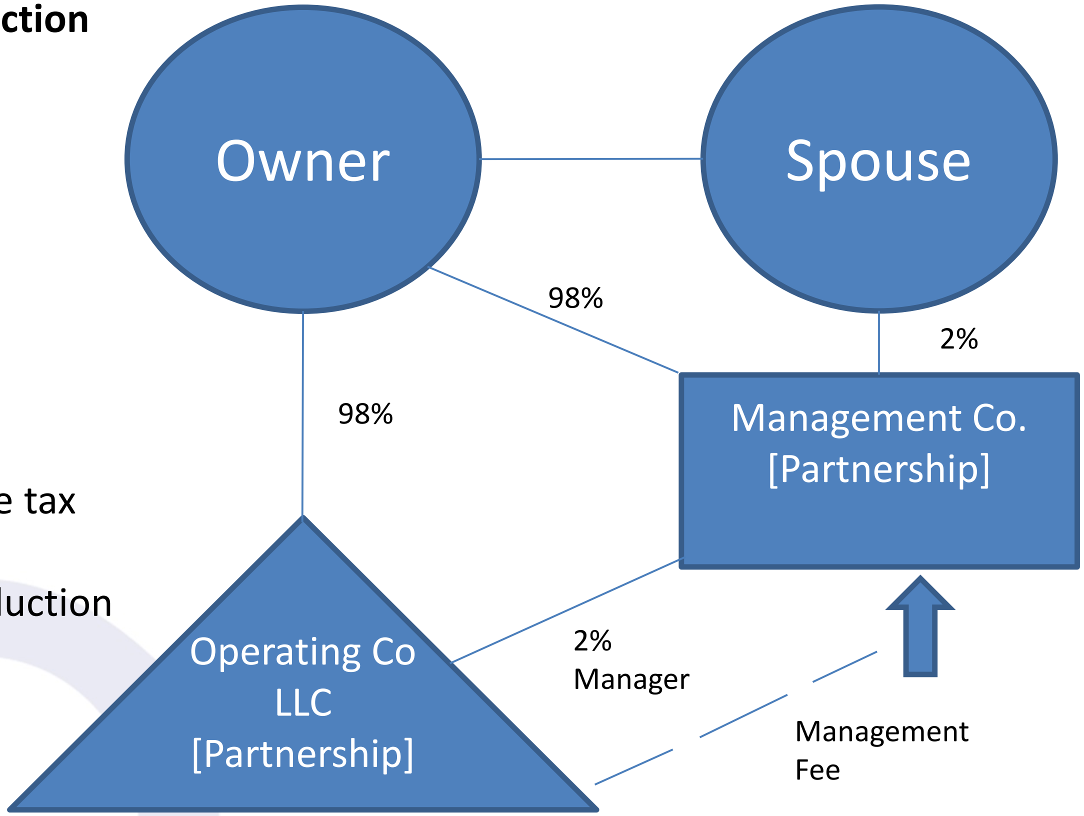
Combined QB Income

- Sum of qualified business income for each trade or business of the Taxpayer
- For each trade or business, 20% of QB Income but not in excess of
  - 50% of W-2 wages for such business
  - 25% of W-2 wages, plus 2.5% of the unadjusted tax basis of qualified property of the business
- W-2 wage limitations do not apply to individual whose taxable income is less than threshold amounts, subject to phase-out

QB Income Deduction

- "Qualified Property"
  - Subject to depreciation and used in trade or business
  - Can include asset in computation until depreciation period for the asset expires

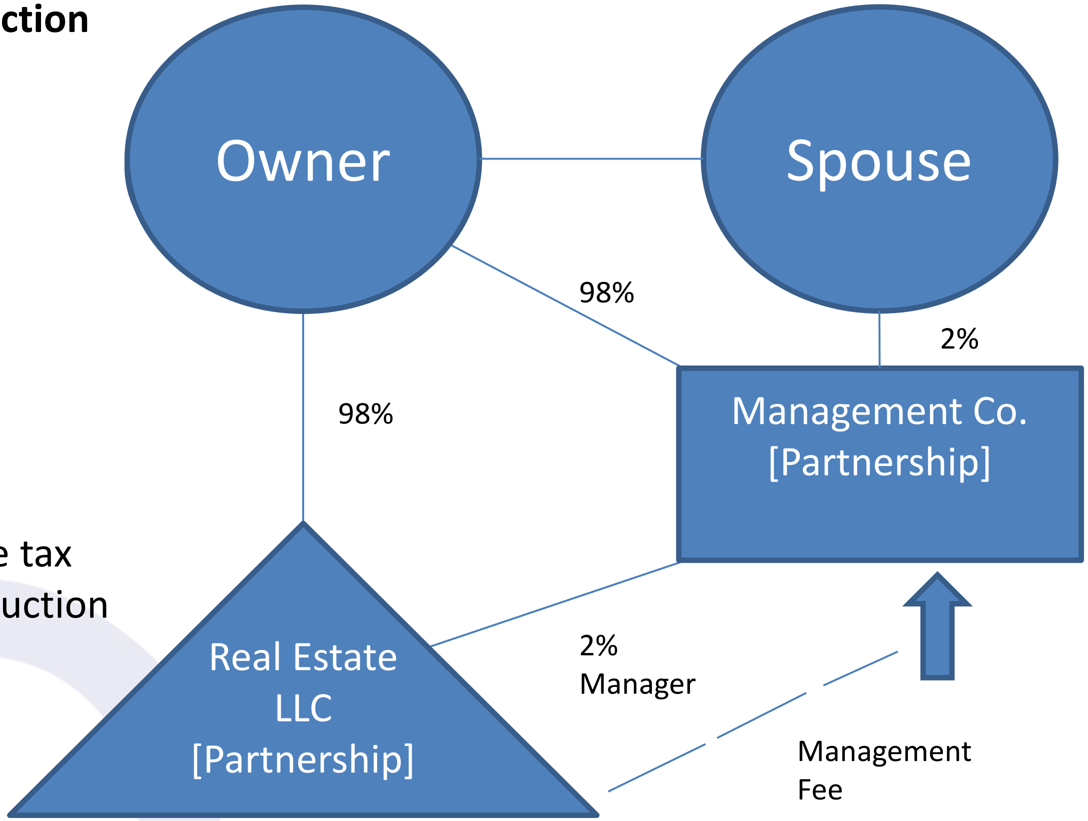
Example of 20% QBI deduction



20% QBI deduction
No Net Investment Income tax
No Self-employment tax
Ohio Business Income deduction

Assumptions:
1. $1 Million net income of LLC
2. W-2 wages of LLC at least 400,000
3. LLC's business is not Specified Service Business
4. QBI deduction is $200,000

Example of 20% QBI deduction
Apartment Building



20% QBI deduction
No Self-employment tax
No Net Investment Income tax
Ohio Business Income deduction

1. LLC has net income of $1,000,000
2. LLC owns apartment building @ original cost of $10 million
3. LLC has no employees
4. QBI deduction limit is $250,000 (2.5% times $10 million)
5. QBI deduction is $200,000 (20% of $1 million net income)

Operating Cash Flow Distributions

	C Corp	Pass-Through
Corporate Tax	21.0%	--
Dividend Tax	15.8%[1]	--
Individual Tax on Income	--	37.0%
QBI deduction	--	(7.4%)[2]
Net Investment Income Tax	3.0%[4]	--[3]
Ohio income tax	4.0%[5]	3.0%[6]
Total	43.8%	32.6% [7]

1. .79 x 20% = 15.8%
2. .37 x 20% = 7.4%
3. If pass-through owner is active no NII tax
4. .79 x 3.8% = 3.0%
5. .79 x 5.0% = 4.0%
6. Ohio Business Income Deduction
7. If owner is passive or subject to self-employment tax, the tax rate increases to 36.4%

Reinvest Cash Flow or Pay Down Debt

	C Corp	Flow-Through
Corporate Tax	21%	--
Dividend Tax	--	--
Individual Tax on Income	--	37.0%
QBI deduction	--	(7.4%)[1]
Net investment income tax	--	--[2]
Ohio income tax	--	3%[3]
Total	21%	32.6% [4]

1. .37 x 20%
2. If pass-through owner is active, no Net Investment Income tax
3. Ohio Business Income deduction
4. If owner is passive or subject to self-employed tax, rate increases to 36.4%

Non-Specified Service Business Example

	C Corp	Flow-Through
Corporate Tax	--	--
Dividend Tax	--	--
Individual Tax on Income	37.0%[1]	37.0%
QBI deduction	--	(7.4%)[2]
FICA & Medicare Tax/Self-Employment Tax	3.8%[3]	3.8%[4]
Ohio income tax	5.0%	3.0%
Total	45.8%	36.4%

1. Assume all cash flow paid to owners as compensation
2. .37 x 20%
3. FICA taxes, including Medicare, applies to wages
4. Assumes all income is subject to self employment tax

Specified Service Business Example

	C Corp	Flow-Through
Corporate Tax	--	--
Dividend Tax	--	--
Individual Tax on Income	37.0%[1]	37.0%
QBI deduction	--	--[2]
FICA & Medicare Tax/Self-Employment Tax	3.8%[3]	3.8%[4]
Ohio income tax	5.0%	3.0%
Total	45.8%	43.8%

1. Assume all cash flow paid to owners as compensation
2. Specified service business excluded from QBI deduction, except if below income thresholds.
3. FICA taxes, including Medicare, applies to wages
4. Assumes all income is subject to self employment tax

Business Sale Proceeds

	C Corp	Flow-Through
Corporate Tax	21.0%	--
Dividend Tax	15.8%[1]	--
Individual Tax on Sale Gain	--	20%/25%/37%[2]
QBI deduction	--	--
Net Investment Income Tax	3.0%[3]	--[4]
Ohio income tax	4.0%[5]	3%[6]
Total	43.8%	23%/28%/40%

1. .79 x 20%
2. 20% capital gains / 25% deprecation recapture real estate/ 37% depreciation recapture personal property
3. .79 x 3.8%
4. If owner is active, no Net Investment Income tax
5. .79 x 5%
6. Ohio Business Income Deduction rate

Effective Marginal Rates by Entity

	C Corp	Flow-Through
Operating Cash Flow: Non Service	43.8%	32.6%/36.4%
Reinvest Cash/Pay-down debt	21.0%	32.6%/36.4%
Non-Specified Service Business	45.8%	36.4%
Specified Service Business	45.8%	43.8%
Business Sale Proceeds	43.8%	23%/28%/40%

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Some Additional Thoughts

- Getting Cash to owners
  - Dividend / distribution
  - Compensation
- Dividends from C corp subject to double tax (43.8%)
- Compensation not eligible for QBI deduction
  - C corp or S corp required to pay owner reasonable compensation for services rendered
- S corporation, partnership and sole proprietor net income eligible for QBI deduction
  - Partnership and sole proprietorship cannot treat owner as employee
- C corporation used to reinvest cash flow and to pay down debt
  - 21% effective rate on "phantom income"
  - Make S election once business can make regular, substantial profit distributions to owner
- When is a contractor really an employee?
  - Eligibility for 20% QBI deduction
  - Loss of unreimbursed expense deductions
  - Exposure for "employer" for unpaid withholding and payroll taxes

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Experience and Background

- Specializes in S-corporation, partnership and real estate taxation
- Represents a wide variety of corporate clients, family-owned businesses, and entrepreneurs.
- Typically engaged for company and joint venture formations, sales and purchases of businesses, mergers, business succession planning, private equity investment and estate planning.
- IRS examinations, appeals and litigation
- Certified Specialist in Federal Taxation law by the Ohio State Bar Association
- Ohio Super Lawyer for 2008, 2009, 2010, 2011, 2012 and 2013
- Former IRS Chief Counsel Attorney
- **Memberships & Associations**
- American Bar and Ohio State Bar Associations
- Geauga Growth Partnership, Mentor and Western Lake County Chambers of Commerce.
- Northern Ohio Italian Association