



445 Hutchinson Avenue
Suite 550
Columbus, OH 43235

HARDI 2017 Tax Reform Analysis

Business Tax Rates:

- HARDI member businesses classified as C-corporations will have their tax rate reduced from 35% to 21%. Corporate AMT is repealed.
- Pass-through companies (sole proprietorships, partnerships, S-corporations, and limited liability companies) will receive a deduction of 20% from their qualified business income.
 - Pass-through income will still be taxed on the personal income rates, the Senate chose to keep seven brackets:

Tax Rate	Income brackets (Joint filers)		Tax Calculation
10%	\$0	\$19,050	10% of taxable income
12%	\$19,050	\$77,400	\$1,905, plus 12% of the excess over \$19,050
22%	\$77,400	\$165,000	\$8,907, plus 22% of the excess over \$77,400
24%	\$165,000	\$315,000	\$28,179, plus 24% of the excess over \$165,000
32%	\$315,000	\$400,000	\$64,179, plus 32% of the excess over \$315,000
35%	\$400,000	\$600,000	\$91,379, plus 35% of the excess over \$400,000
37%	>\$600,000		\$161,379, plus 37% of the excess over \$600,000

- For S-corporations and partnerships, the 20% deduction is limited to 50% of W-2 wages paid to all employees or the sum of 25% of W-2 wages plus 2.5% of the purchase price of all qualified property (all capital investment that has not been depreciated excluding land).
- The pass-through rates and deductions sunset Dec. 31, 2025, however we expect them to be extended similar to the Bush tax cuts in 2010.
- The profits from any businesses held in trust flow through to the beneficiaries and fiduciaries of the trust.
- Pass-through example:
 - A business doing \$20 million in sales, paying \$500,000 in wages and salaries. The net profit for the business after deducting net interest expense, insurance, advertising, vehicle, and full expensing on purchases is \$1 million, and the business owner was paid \$100,000 in reasonable compensation for a total taxable income of \$1.1 million.

- Business income taxes: $\$1,000,000 - \$200,000$ in pass-through business deduction = $\$800,000 = \$235,379$ (See last line of above chart for tax calculation)
- Personal income taxes (assuming joint filing and standard deduction): $\$100,000 - \$24,000$ standard deduction = $\$76,000$ taxable personal income $\times 37\% = \$28,120$
- Total taxes paid: $\$235,379 + \$28,120 = \$263,499$
- Effective tax rate: $\$263,499/\1.1 million = 24%

Death Tax:

- The unified exclusion for estate and gift taxes is immediately doubled to \$11.2 million per individual and \$22.4 million per couple. The increase in the exemption sunsets Dec. 31, 2025.
 - Full step-up in basis is retained.
 - Example:
 - A business valued at \$30 million would see their estate tax bill reduced by \$2.24 million compared to current law.
 - Current law: $\$30$ million - $\$5.6$ million exemption = $\$24.4$ million $\times 40\% = \$9.76$ million estate tax due = 33% effective tax rate.
 - New law: $\$30$ million - $\$11.2$ million exemption = $\$18.8$ million $\times 40\% = \$7.52$ million estate tax due = 25% effective tax rate.
 - New law with full portability: $\$30$ million - $\$22.4$ million = $\$7.6$ million $\times 40\% = \$3.04$ million = 10.1% effective tax rate.

LIFO:

- The Tax Cut and Jobs Act does not change LIFO accounting rules.

Interest deductibility:

- Pass-through firms with gross receipts of less than \$25 million (averaged over three years) can deduct interest in full. Corporations and large pass through firms are limited to an interest deduction equal to 30% of EBITDA until January 1, 2022 before switching to EBIT, with an indefinite carry forward.

Section 179 small business expensing:

- The small business expensing limitation under section 179 would be increased to \$1 million (from \$500,000) and the phase-out amount would be increased to \$2.5 million. The provision would modify the expensing limitation by indexing both the \$1 million and \$2.5 million limits for inflation after 2018.

HVAC Expensing

- Included in the expansion of Section 179 is a provision allowing commercial building owners to expense the cost of HVAC systems. The provision would modify the definition of Section 179 property to include heating, ventilation, and air-conditioning property, roofs, and security and alarm systems.
 - HARDI led the effort to include HVAC expensing in the tax reform bill through introduction of the HEAT Act, sponsored by Congressmen Patrick Tiberi (R-OH) and Ron Kind (D-WI).
 - Current law requires a building owner to expense HVAC equipment over 39 years.

Expensing:

- The legislation increases Bonus Depreciation to 100% for five years. Any property with a depreciation schedule of less than 20 years qualifies for Bonus Depreciation. After five years, Bonus Depreciation is stepped down 20% per year before reaching zero in 2027.

2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
100%	100%	100%	100%	100%	80%	60%	40%	20%	0%

Section 1031 exchanges:

- Section 1031 exchanges for the purpose of deferral of capital gains will be limited to real property. With the allowance of full expensing on most personal property there is no longer a need to provide preferential treatment to personal property under Section 1031.

Section 179D:

- Section 179D expired at the end of 2016, the Tax Cut and Jobs Act does not extend Section 179D.

Meals:

- Deductions for 50% of the cost of meals, including those consumed while on business travel are still allowed.

Transition from S-corporation to C-corporation:

- The tax bill makes it easier for companies choosing to convert to a C-corporation in the first two years after passage by allowing distributions from the accumulated adjustments account to be charged to the accumulated profits and earnings accounts.

For questions or comments, contact Alex Ayers (aayers@hardinet.org) or Palmer Schoening (pschoening@hardinet.org).