

U.S. Tax Legislation – Individual and Passthroughs Provisions

On December 20, 2017, Congress enacted comprehensive tax legislation (the “New Law”), and this memorandum highlights some of the important provisions relating to individual taxpayers and passthrough entities and provides a comparison with the law that was in effect prior to the New Law. Unless otherwise noted the provisions of the New Law will generally be effective for tax years beginning after December 31, 2017 and before January 1, 2026, and will expire January 1, 2026.

Note that the language of the New Law is subject to change through technical correction and is subject to interpretation through agency guidance. Any tax planning currently should take into consideration the possibility of future changes to, and interpretations of, the language of the New Law.

For information on the Corporate and International Provisions of the New Law, see our alert [U.S. Tax Legislation – Corporate and International Provisions](#) dated January 5, 2018.

Individual Provisions

Topic	Old Law	New Law
Individual Income Tax Rates	<p>Individual tax rates ranged up to a maximum of 39.6 percent. The maximum rate was applicable to taxable income in excess of the following thresholds:</p> <p>Married Filing Jointly - \$470,700 Surviving Spouses - \$470,700 Married Filing Separately - \$235,350 Head of Household - \$444,550 Single - \$418,400</p>	<p>Individual tax rates range up to a maximum of 37 percent. The maximum rate is applicable to taxable income in excess of the following thresholds:</p> <p>Married Filing Jointly - \$600,000 Surviving Spouses - \$600,000 Married Filing Separately - \$300,000 Head of Household - \$500,000 Single - \$500,000</p> <p>The income breakpoints applicable to the zero percent, 15 percent, and 20 percent long-term capital gain tax rates are unchanged but will now be indexed for inflation.</p> <p>The income breakpoints for determining the applicable tax rates will be indexed for inflation beginning January 1, 2019. This indexing will not expire.</p>

Individual Provisions

Topic	Old Law	New Law
Standard Deduction	<p>The basic standard deduction (indexed for inflation) was as follows:</p> <p>Married Filing Jointly - \$12,700 Surviving Spouse - \$12,700 Married Filing Separately - \$6,350 Head of Household - \$9,350 Single - \$6,350</p>	<p>The basic standard deduction (to be indexed for inflation) was increased to the following:</p> <p>Married Filing Jointly - \$24,000 Surviving Spouse - \$24,000 Married Filing Separately - \$12,000 Head of Household - \$18,000 Single - \$12,000</p>
Personal Exemption	<p>The personal exemption deduction amount (indexed for inflation) was \$4,050 per person subject to reduction to the extent the taxpayer's income exceeded certain thresholds.</p>	<p>The personal exemption deduction is eliminated from 2018 to 2025.</p>
Miscellaneous Itemized Deductions Subject to the Two Percent Floor	<p>Certain expenses were deductible as miscellaneous itemized deductions to the extent the total of such deductions exceeded two percent of the taxpayer's adjusted gross income (AGI).</p>	<p>Miscellaneous itemized deductions that are subject to the two percent floor are eliminated from 2018 to 2025. These include unreimbursed expenses attributable to the trade or business of being an employee; fees for tax return preparation; and union and professional dues and expenses.</p>
Pease Limitation on Itemized Deductions	<p>Total itemized deductions otherwise allowable were generally reduced by three percent of the amount by which the taxpayer's income exceeds a threshold amount that is determined according to filing status.</p>	<p>The overall limitation on itemized deductions is eliminated from 2018 to 2025.</p>
Mortgage Interest Deduction	<p>Taxpayers who itemized could deduct the interest paid on up to \$1,000,000 in acquisition indebtedness (for acquiring, constructing, or substantially improving a residence) with respect to a principal residence and one other residence, and up to \$100,000 in home</p>	<p>The mortgage interest deduction is limited to the interest paid on up to \$750,000 of acquisition indebtedness on a single residence with respect to debt incurred after December 15, 2017.</p>

Individual Provisions

Topic	Old Law	New Law
	equity indebtedness.	The mortgage interest deduction for interest on home equity indebtedness is eliminated from 2018 to 2025. The \$1,000,000 limitation with respect to acquisition indebtedness on a principal residence continues for older debt, including a refinancing of that older debt. The limitation with respect to all acquisition indebtedness reverts to \$1,000,000 for tax years beginning after December 31, 2025, regardless of when the debt was incurred.
State and Local Tax Deduction	Individuals could claim itemized deductions for property taxes paid and either state and local income or sales taxes paid without any limitation.	Individuals are limited to a total deduction of \$10,000 with respect to state and local sales, income, and property taxes. Individuals are not subject to the limitation with respect to property taxes and sales taxes incurred with respect to investment property or property used in a trade or business.
Charitable Contributions	The limitation on the charitable deduction for cash contributions was generally 50 percent of AGI. A taxpayer was not required to substantiate a charitable contribution with a contemporaneous written acknowledgement from the charity if the recipient organization filed a return reporting the required information regarding the donation.	The limitation on the charitable deduction for cash contributions is increased to 60 percent of AGI. The exception to the contemporaneous written acknowledgement requirement for contributions of \$250 or more is repealed with respect to contributions that were made beginning January 1, 2017.

Individual Provisions

Topic	Old Law	New Law
Deduction for Amounts Paid for College Athletic Seating Rights	A charitable deduction was allowed for 80 percent of contributions made by a taxpayer who received the right to purchase tickets to college athletic events in exchange for the contribution to the college.	The 80 percent deduction for contributions made for college athletic seating rights is eliminated from 2018 to 2025.
Alimony Deduction	Alimony payments generally were allowed as above-the-line deductions for the payor, and were included in the income of the recipient.	Alimony payments are no longer deductible to the payor or income to the recipient. This provision is effective for divorce decrees, separation agreements, and modifications executed after December 31, 2018.
Individual Alternative Minimum Tax (AMT)	AMT is imposed to the extent the tax liability calculated with respect to a taxpayer's alternative minimum taxable income (AMTI) exceeds the taxpayer's regular income tax liability for the taxable year. AMTI is generally the taxpayer's regular taxable income adjusted to take account of specified tax preferences and adjustments. The amount of AMTI in excess of a specified exemption amount is subject to the AMT calculation. The total AMT is calculated as the sum of (1) 26 percent of the taxable excess up to \$187,800 (for married filing jointly) and (2) 28 percent of the remainder. To the extent this total is greater than the taxpayer's regular tax liability, the taxpayer would owe AMT. The breakpoints are indexed for inflation.	The AMT exemption amount is increased to \$109,400 for married taxpayers filing a joint return (half this amount for married taxpayers filing a separate return), and \$70,300 for other taxpayers. The phaseout thresholds are increased to \$1,000,000 (from \$160,900) for married taxpayers filing a joint return, and \$500,000 for other taxpayers. These amounts are indexed for inflation.

Individual Provisions

Topic	Old Law	New Law
	<p>The exemption amounts for 2017 were:</p> <p>Married Filing Jointly - \$84,500 Married Filing Separately - \$42,250 Unmarried - \$54,300</p> <p>For taxable years beginning in 2017, the exemption amounts were phased out by an amount equal to 25 percent of the excess of AMTI over:</p> <p>Married Filing Jointly - \$160,900 Married Filing Separately - \$80,450 Unmarried - \$120,700</p>	

Passthroughs Provisions

Topic	Old Law	New Law
Passthrough Treatment	Partnerships and S corporations generally not subject to tax at entity level. Items of income (including tax-exempt income), gain, loss, deduction, and credit of the entity are taken into account by the owners in computing their income tax liability (based on the entity's method of accounting and regardless of whether the income is distributed to the owners). Top individual tax rate of 39.6 percent.	<p>An individual taxpayer generally may deduct 20 percent of qualified business income from a partnership, S corporation, or sole proprietorship.</p> <p>Qualified business income is determined for each qualified trade or business of the taxpayer. A qualified trade or business generally means any trade or business, but does not include the trade or business of being an employee or certain "specified service trade or businesses." Specified service trades or businesses include law, accounting, consulting, performing arts, and financial services, etc., as well as any trade or business in which the principal asset of the trade or business is the reputation or skill of one or more of its employees or owners.</p> <p>Qualified business income includes only items that are effectively connected with a trade or business within the United States, and does not include certain investment-related items, such as long-term capital gains and losses, dividends, interest unrelated to a trade or business, etc.</p> <p>For each qualified trade or business, the deductible amount is the lesser of (1) 20 percent of W-2 wages, or (2)(A) 50 percent of the W-2 wages with respect to the business or (B) the sum of 25 percent of the W-2 wages with respect to the business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property. W-2 wages are the total wages subject to wage withholding, elective deferrals, and deferred compensation paid by the business with respect to employment of its employees.</p>

Passthroughs Provisions

Topic	Old Law	New Law
-------	---------	---------

If the taxpayer's taxable income for the year does not exceed a certain threshold amount (\$315,000 for joint filers), the deduction is not limited by the "specified service trades or businesses" and W-2 wage/basis limitations described above. However, these limitations are phased in over the next \$100,000 of taxable income for joint filers.

Assuming current distributions are made and the highest marginal individual income tax rate, the new effective tax rates are (i) 29.6 percent if business is held in a pass-through entity and the pass-through deduction is available, (ii) 37 percent if business is held in a pass-through entity and the pass-through deduction is not available and (iii) 36.8 percent if business is held in an entity treated as a corporation.

Partnerships that intend to accumulate earnings might consider converting to corporate form to take advantage of the lower corporate tax rate both on a current basis and on the compounding of the earnings. However, if a partnership converts to a corporation, it may not be able to convert back to a pass-through entity without incurring additional corporate level tax.

Individuals who own a business operating in high-tax states might consider the impact of the new state and local tax deduction limitation if such business is operated in a pass-through vehicle as opposed to a corporation which is able to fully deduct state and local taxes.

Passthroughs Provisions

Topic	Old Law	New Law
REIT Dividends and PTP Interests	<p>Dividends from a REIT other than capital gains dividends generally taxable to REIT shareholders at ordinary rates, at a maximum of 39.6 percent. Generally do not qualify as qualified dividends except under limited circumstances.</p> <p>Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes. A publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof). An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income.</p>	<p>Individual taxpayer generally may deduct 20 percent of aggregate qualified REIT dividends and qualified publicly traded partnership income.</p> <p>Qualified REIT dividends are dividends from a REIT other than capital gain dividends or qualified dividends.</p> <p>Qualified publicly traded partnership income means (with respect to any qualified trade or business of the taxpayer), the sum of the (a) net amount of the taxpayer's allocable share of each qualified item of income, gain, deduction, and loss (that are effectively connected with a U.S. trade or business and are included or allowed in determining taxable income for the taxable year and do not constitute excepted enumerated investment-type income, and not including the taxpayer's reasonable compensation, guaranteed payments for services, or (to the extent provided in regulations) section 707(a) payments for services) from a publicly traded partnership not treated as a corporation, and (b) gain recognized by the taxpayer on disposition of its interest in the partnership that is treated as ordinary income.</p> <p>Qualified REIT dividends are eligible for the deduction regardless of W-2 wages/basis or the specified service trade or business rules.</p>
Technical Terminations	<p>A partnership is treated as terminated if within any 12-month period, there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits (a "technical termination").</p>	<p>Repeals technical termination rule.</p> <p>A partnership generally is treated as continuing if within a 12-month period there is a sale or exchange of 50 percent or</p>

Passthroughs Provisions

Topic	Old Law	New Law
	<p>A technical termination is treated as a deemed contribution of all the partnership’s assets and liabilities to a new partnership in exchange for an interest in the new partnership, followed by a deemed distribution of interests in the new partnership to the purchasing partners and the other remaining partners.</p> <p>The effect of a technical termination is to close the partnership’s tax year and restart depreciation periods. Also, it requires the partnership to make new partnership elections (such as a 754 election or 704(c) method), which may differ from the elections in place before the technical termination.</p>	<p>more of the total interest in partnership capital and profits.</p> <p>This provision does not expire.</p>
Carried Interest	<p>The receipt of a partnership profits interest for services generally is not treated as a taxable event for the partnership or the partner, except in specified circumstances.</p> <p>The character of partnership items passes through to the partners, as if the items were realized directly by the partners. For example, long-term capital gain of the partnership is treated as long-term capital gain in the hands of the partners.</p> <p>The sale of a partnership interest generally is treated as the sale of a capital asset, though capital gain is recharacterized as ordinary to the extent of unrealized receivables and inventory items.</p>	<p>With respect to an “applicable partnership interest,” the taxpayer’s long-term capital gain in excess of the amount that would be considered long-term capital gain if a three-year holding period were required will be treated as short-term capital gain taxed at ordinary income rates, notwithstanding section 83 or any election in effect under section 83(b). To the extent provided in regulations, this rule does not apply to income or gain attributable to any asset not held for portfolio investment on behalf of third-party investors.</p> <p>An “applicable partnership interest” generally is any interest in a partnership which, directly or indirectly, is transferred to (or is held by) the taxpayer in connection with the performance of substantial services by the taxpayer, or any other related person, in any applicable trade or business. However, an applicable partnership interest does not include an interest held by a corporation or a capital interest in which</p>

Passthroughs Provisions

Topic	Old Law	New Law
		<p>the taxpayer has a right to share in capital commensurate with the amount of capital contributed or the value subject to tax under section 83.</p> <p>An “applicable trade or business” generally means any activity conducted on a regular, continuous, and substantial basis which consists, in whole or in part, of (1) raising or returning capital, and (2) either (a) investing in (or disposing of) specified assets (or identifying specified assets for such investing or disposition), or (b) developing specified assets.</p> <p>Specified assets generally are securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing, and an interest in a partnership to the extent of the partnership’s proportionate interest in any of the foregoing.</p> <p>If the taxpayer transfers an applicable partnership interest to a related person, the rules above apply plus any long-term capital gain attributable to the sale or exchange of assets held not more than three years attributable to the interest will be treated as short-term capital gain taxed at ordinary rates. Related persons generally include family members and other persons that performed a service in an applicable trade or business in which the taxpayer performed a service.</p> <p>It is unclear how these rules will apply to tiered partnerships. It is unclear whether S corporations can take advantage of</p>

Passthroughs Provisions

Topic	Old Law	New Law
-------	---------	---------

corporate partner exception. It is unclear whether taxpayers employed by affiliates or similar structures will be effective in avoiding these rules.

This provision does not expire.

Sale of Partnership Interests

A recent Tax Court case (inconsistent with a published IRS ruling from 1991) held that gain or loss from the sale of a partnership interest by a non-U.S. partner will not be treated as income “effectively connected with a U.S. trade or business” (“ECI”).

Gain or loss from the sale of a partnership interest by a non-U.S. partner will be treated as ECI to the extent the partner would have been allocated ECI upon a sale of all of the partnership’s assets at fair market value. In addition, the New Law imposes a 10 percent gross withholding tax on the purchaser unless the transferring partner certifies that it is not a foreign person. If a purchaser fails to withhold, the partnership is liable for the withholding tax.

This provision applies to both private partnerships and publicly traded partnerships such as MLPs. The IRS recently announced in Notice 2018-08 that it is delaying the imposition of a withholding obligation on publicly traded partnership units until regulations or other guidance have been issued.

Although not entirely clear, these rules should be interpreted to apply similarly to partnership redemptions.

Funds should consider amending their organizational documents to require foreign partners to allow it to withhold as required and to provide the fund with an indemnity in the event of a failure to withhold by a purchaser.

Passthroughs Provisions

Topic	Old Law	New Law
Substantial Built-in Loss	<p>In general, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless either the partnership has made a one-time election under section 754 to make basis adjustments, or the partnership has a substantial built-in loss immediately after the transfer.</p> <p>Generally, a substantial built-in loss exists if the partnership's adjusted basis in its property exceeds by more than \$250,000 the fair market value of the partnership property.</p>	<p>The rules treating gain or loss from the sale of a partnership interest as ECI apply to sales, exchanges, and dispositions on or after November 27, 2017.</p> <p>This provision does not expire.</p> <p>In addition to the present-law definition, a substantial built-in loss also will be considered to exist if the transferee partner would be allocated a net loss in excess of \$250,000 upon a hypothetical disposition by the partnership of all of the partnership's assets in a fully taxable transaction for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest.</p> <p>This provision does not expire.</p> <p>This means that there can be a substantial built-in loss with respect to a partnership interest even if the partnership has an overall built-in gain in its assets.</p>
Charitable Contributions and Foreign Taxes	<p>A partner takes into account its distributive share of the foreign taxes paid by the partnership and the charitable contributions made by the partnership for the taxable year.</p> <p>The basis limitations on partner losses do not take into account the partner's share of partnership charitable contributions and foreign taxes paid or accrued. While the regulations relating to the loss limitation do not mention the foreign tax credit, a taxpayer may choose the foreign tax credit in lieu of deducting foreign taxes.</p>	<p>The basis limitation on partner losses is modified to take into account a partner's distributive share of partnership charitable contributions and taxes paid or accrued to foreign countries and to possessions of the United States.</p> <p>In the case of a charitable contribution by the partnership, the amount of the basis limitation on partner losses is decreased by the partner's distributive share of the adjusted basis of the contributed property. In the case of a charitable contribution by the partnership of property whose fair market value</p>

Passthroughs Provisions

Topic	Old Law	New Law
-------	---------	---------

exceeds its adjusted basis, a special rule provides that the basis limitation on partner losses does not apply to the extent of the partner's distributive share of the excess.

This provision does not expire.

Unrelated Business Taxable Income Separately Computed for Each Trade or Business Activity

An organization that operates multiple unrelated trades or businesses calculates its unrelated business taxable income by aggregating income from all such activities and subtracting the aggregate of deductions. Accordingly, an organization may use a loss from one unrelated trade or business to offset gain from another, thereby reducing total unrelated business taxable income.

For an organization with more than one unrelated trade or business, the provision requires that unrelated business taxable income be computed separately with respect to each trade or business.

The organization's unrelated business taxable income for a taxable year is the positive sum of the amounts computed for each separate unrelated trade or business. A net operating loss deduction is allowed only with respect to a trade or business from which the loss arose.

The result of the provision is that a loss from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same taxable year.

This provision does not expire. Net operating loss carryforwards from before 2018 are not subject to this rule.