# NON-CORPORATE TAXATION: INDIVIDUALS & PARTNERSHIPS FACE HIGHS & LOWS UNDER THE T.C.J.A.

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The Tax Cuts and Jobs Act ("T.C.J.A.") brought many changes for non-corporate taxation, changing tax rates and repealing many popular deductions. Several changes in the partnership provisions corrected what lawmakers considered to be loopholes.

## INDIVIDUAL TAX REFORM

### Individual Rate Reform

The individual tax brackets have been reduced and modified up to the year 2025. The personal exemption has been temporarily suspended, and the standard deduction has been temporarily increased to $24,000 for married individuals filing jointly, $18,000 for heads of households, and $12,000 for all other individuals. The standard deduction is not available to nonresident aliens.

Here is a comparison of the old and new individual income tax rates:

**Single Taxpayers**

| Prior Law | | T.C.J.A. | |
|---|---|---|---|
| Income Bracket | Tax Liability | Income Bracket | Tax Liability |
| $0 - $9,325 | 10% | $0 - $9,525 | 10% |
| $9,325 - $37,950 | $932.50 + 15% over $9,325 but not over $37,950 | $9,525 - $38,700 | $952.50 + 12% over $9,525 but not over $38,700 |
| $37,950 - $91,900 | $5,226.25 + 25% over $37,950 but not over $91,900 | $38,700 - $82,500 | $4,453.5 + 22% over $38,700 but not over $82,500 |
| $91,900 - $191,650 | $18,713.75 + 28% over $91,900 but not over $191,650 | $82,500 - $157,500 | $14,089.5 + 24% over $82,500 but not over $157,500 |
| $191,650 - $416,700 | $46,643.75 + 33% over $191,650 but not over $416,700 | $157,500 - $200,000 | $32,089.5 + 32% over $157,500 but not over $200,000 |
| $416,700 - $418,400 | $120,910.25 + 35% over $416,700 but not over $418,400 | $200,000 - $500,000 | $45,689.5 + 35% over $200,000 but not over $500,000 |
| Above $418,400 | $121,505.25 + 39.6% over $418,400 | Above $500,000 | $150,689.5 + 37% over $500,000 |

### Married Individuals Filing Jointly

| Prior Law | | T.C.J.A. | |
|---|---|---|---|
| Income Bracket | Tax Liability | Income Bracket | Tax Liability |
| $0 - $18,650 | 10% | $0 - $19,050 | 10% |
| $18,650 - $75,900 | $1,865 + 15% over $18,650 but not over $75,900 | $19,050 - $77,400 | $1,905 + 12% over $19,050 but not over $77,400 |
| $75,900 - $153,100 | $10,452.5 + 25% over $75,900 but not over $153,100 | $77,400 - $165,000 | $8,907 + 22% over $77,400 but not over $165,000 |
| $153,100 - $233,350 | $29,752.5 + 28% over $153,100 but not over $233,350 | $165,000 - $315,000 | $28,179 + 24% over $165,000 but not over $315,000 |
| $233,350 - $416,700 | $52,222.5 + 33% over $233,350 but not over $416,700 | $315,000 - $400,000 | $64,179 + 32% over $315,000 but not over $400,000 |
| $416,700 - $470,700 | $112,728 + 35% over $416,700 but not over $470,700 | $400,000 - $600,000 | $91,379 + 35% over $400,000 but not over $600,000 |
| Above $470,700 | $131,628 + 39.6% over $470,700 | Above $600,000 | $161,379 + 37% over $600,000 |

***"The individual tax brackets have been reduced and modified up to the year 2025."***

### Married Individuals Filing Separate Returns

| Prior Law | | T.C.J.A. | |
|---|---|---|---|
| Income Bracket | Tax Liability | Income Bracket | Tax Liability |
| $0 - $9,325 | 10% | $0 - $9,525 | 10% |
| $9,325 - $37,950 | $932.50 + 15% over $9,325 but not over $37,950 | $9,525 - $38,700 | $952.50 + 12% over $9,525 but not over $38,700 |
| $37,950 - $76,750 | $5,226.25 + 25% over $37,950 but not over $76,750 | $38,700 - $82,500 | $4,453.5 + 22% over $38,700 but not over $82,500 |
| $76,750 - $116,675 | $14,876.25 + 28% over $76,750 but not over $116,675 | $82,500 - $157,500 | $14,089.5 + 24% over $82,500 but not over $157,500 |
| $116,675 - $208,350 | $26,111.25 + 33% over $116,675 but not over $208,350 | $157,500 - $200,000 | $32,089.5 + 32% over $157,500 but not over $200,000 |
| $208,350 - $235,350 | $56,364 + 35% over $208,350 but not over $235,350 | $200,000 - $300,000 | $45,689.5 + 35% over $200,000 but not over $300,000 |
| Above $235,350 | $65,814 + 39.6% over $235,350 | Above $300,000 | $80,689.5 + 37% over $300,000 |

## Foreign Income Tax Deduction

*Prior Law*

Previously, individuals were allowed deductions for certain taxes paid or accrued, even if they were not incurred in the individual's trade or business. This included state, local, and foreign property, income, war profits, and excess profits tax.

*T.C.J.A.*

Now, state, local, and foreign property taxes and state and local sales taxes are only deductible when paid or accrued in carrying on a trade or business or in association with an investment expense under Code §212.

Foreign income taxes paid may only be deducted under Code §164(b)(6)(B) as part of an aggregate deduction for (i) state and local real property taxes, (ii) state and local personal property taxes, and (iii) state, local, and foreign income taxes, which is limited to $10,000 unless the taxes were paid or accrued in carrying on a trade or business or a Code §212 expense. Note that taxpayers generally chose to claim a foreign tax credit in lieu of a deduction, so this change as it relates to foreign income taxes may have little impact.

**Limitation on Deduction of Foreign Taxes**[1]

| Foreign Income Taxes | | Foreign Real Property Taxes | |
|---|---|---|---|
| **Prior Law** | **T.C.J.A.** | **Prior Law** | **T.C.J.A.** |
| • No limitation on the deduction of foreign income taxes. | • Business expenses are deductible without limitation, *i.e.*, when income is reported on Schedule C, E, or F.<br>• Any other foreign income tax is limited to $10,000, *e.g.*, income tax paid on interest earned from foreign investments, reported on Schedule B. | • No limitation on the deduction of foreign income taxes. | • GR: Not deductible<br>• **Exception:** Deductible without any limitation if incurred in carrying on a trade or business |

## Alimony Deduction

*Prior Law*

Alimony and separate maintenance payments were deductible by the payor and includible in income by the recipient.

*T.C.J.A.*

Alimony and separate maintenance payments are no longer deductible by the payor spouse nor included in income by the recipient. The provision will become effective for any divorce or separation instrument executed or modified after 2018.

[1] Applicable until tax year 2025. Code §164(b)(6) as amended by §11042 of the T.C.J.A.

## Estate and Gift Tax

Under current and prior law, gift tax is imposed on lifetime gifts, while estate tax is imposed on transfers made at death. Gifts and bequests are generally excluded from the recipients' gross income.

A unified credit is available to taxable gifts and bequests.[2] The amount of the exemption used to offset lifetime gifts reduces the amount available at time of death. The top marginal tax rate of 40% is imposed on gifts and estates for transfers in excess of $1 million after the exemption has been utilized. A 40% generation-skipping transfer tax may also be imposed on transfers exceeding the exemption to a recipient more than one generation younger than that of the transferor.

### *Prior Law*

The amount exempted from tax was set at $5 million and increased for inflation to $5.49 million for 2017.

### *T.C.J.A.*

The T.C.J.A. roughly doubles the estate and gift tax exemption for tax years after 2017 and before 2026. The amount for 2018 is $11.18 million. The Secretary shall prescribe regulations with respect to differences between the exclusion amount at the time of decedent's death and any gifts made before that date.

# PARTNERSHIPS

## Prior Law

### *Technical Termination*

A partnership was considered technically terminated if, within a 12-month period, there was a sale or exchange of 50% or more of the total partnership interests. There was a deemed contribution of all of the partnership's assets and liabilities to a new partnership in exchange for an interest and a deemed distribution of the interests to the new and remaining partners.[3] A technical termination generally terminated the partnership's election and restarted depreciation but did not end its existence.

### *Substantial Built-In Loss*

The transfer of a partnership interest did not result in an adjustment of basis unless a Code §754 election was made or there was substantial built-in loss with respect to the interest transferred. A substantial built-in loss was created if the partnership's adjusted basis in the partnership property exceeded the fair market value of the property by more than $250,000.

### *Carried Interest Rule*

A profits interest, also known as a carried interest, in a partnership is a right to receive profits in exchange for services. Under a safe harbor rule, the receipt of

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[2] Code §2010.

[3] Treas. Reg. §1.708-1(b)(4).

such interest was not a taxable event to the taxpayer if the carried interest entitled the holder only to a share in the gains and profits after the date of issuance.[4] If the interest related to a substantially certain and predictable stream of income from partnership assets, the partner disposed of the interest within two years of receipt, or the interest was a limited partnership interest in a publicly traded partnership, the safe harbor would not apply. Capital gains from asset sales at the partnership level passed through to all partners, including those receiving a carried interest, generally resulting in taxation to the partners at more favorable rates.

**T.C.J.A.**

*Technical Termination*

Under the new law, the Code §708(b)(1)(B) technical termination is repealed. This means a partnership only terminates if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

*Substantial Built-In Loss*

Substantial built-in loss requiring the adjustment of partnership bases has been expanded under the T.C.J.A. to include either (i) the partnership's adjusted basis in the partnership exceeding the fair market value of the property by $250,000 or (ii) a loss allocation of more than $250,000 to the transferee if the partnership assets were sold at fair market value for cash immediately after the loss.[5]

*Carried Interest Rule*

The T.C.J.A. provides a three-year holding period for long-term capital gain with respect to "applicable partnership interests."[6] The three-year holding period is required for both the taxpayer's interest in the partnership and the partnership's interest in asset(s) sold.

An applicable partnership interest is any interest that is transferred to or held by the taxpayer for the taxpayer or a related party's performance of substantial services in any applicable trade or business.[7] This does not include a partnership interest held by a corporation or a capital interest with the right to share in the partnership capital for the amount contributed.[8] Partnerships covered under the new rule are essentially investment partnerships and real estate partnerships, with some exceptions.

## LIKE-KIND EXCHANGES

Like-kind exchanges are a popular transactions utilized by individulas and partnerships to defer tax on property exchanges. The new law has significantly curtailed this technique.

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[4] Rev. Proc. 93-27 (1993-2 C.B. 343).

[5] Code §743(d)(1).

[6] Code §83.

[7] Code §1061(c)(1).

[8] Code §1061(c)(4).

## Prior Law

An exchange of property is generally considered a taxable event. However, no gain or loss was recognized on property held for productive use in a trade or business or for investment if it was exchanged for property that was "like-kind" and to be held in a similar manner and for a similar purpose.[9] This exception did not apply to stocks considered inventory, partnership interests, trust certificates, or foreign property.[10] Additionally, the nonrecognition rule did not apply to an exchange of one class or kind or property for another and did not recognize losses either.

*"The like-kind exchange nonrecognition rule is limited and now only applies to real property that is not held primarily for sale or exchange for other real property."*

The basis of property received will be equal to the basis of the property transferred and increased by any gain recognized or decreased by any other property received[11] The holding period received includes the holding period transferred on qualifying property.[12]

The property received in the exchange must be received no more than 180 days after the date on which the original property is relinquished. The taxpayer must identify the property to be received within 45 days after the date on which the taxpayer transfers the relinquished property.[13]

## T.C.J.A.

Under the T.C.J.A., the like-kind exchange nonrecognition rule is limited and now only applies to real property that is not held primarily for sale or exchange for other real property. As before, real property cannot be exchanged for another class of property. The different classes are depreciable tangible property, intangible or non-depreciable property, and real property. Improved and unimproved property of the same class is considered like-kind. The rules relating to the transfer of real property, as well as the basis and holding period requirements, remain unchanged. As under prior law, U.S. real property cannot be exchanged for foreign real property, or vice versa.

# CONCLUSION

There are clear winners and losers under the T.C.J.A. Clearly, real estate investors have been afforded the continuing ability to make tax-free like-kind exchanges. The doubling of the lifetime exemption will afford wealthy individuals an even greater ability to transfer wealth to younger generations. Several former loopholes in the partnership area have been closed or the rules tightened. Lastly, the new rules relating to alimony may have real-world impact by making divorce more expensive.

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[9] Code §1031(a)(1).

[10] Code §1031.

[11] Code §1031(d).

[12] Code §1223(1).

[13] Code §1031(a)(3).

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