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Tax Cuts and Jobs Act

Highlights of the final bill are listed below and more details are provided in the commentary:

- A top individual tax rate of 37 percent (lowered from 39.5%);

- A top corporate rate of 21 percent;

- Full repeal of the corporate alternative minimum tax (AMT);

- A 20 percent deduction against qualified business income from passthrough business entities and changes to the rules for calculating "qualified business income";

- A provision allowing taxpayers to aggregate (1) state and local property taxes, and (2) state and local income taxes (or sales taxes in lieu of income taxes) toward a maximum $10,000 itemized deduction for state and local taxes;

- A lowered $750,000 limit on the loan amount for which a mortgage interest deduction can be claimed by individuals, with existing loans grandfathered;

- Three changes to the child tax credit: (1) increased to a $2,000 credit, but also an increase in the refundable portion to $1,400, (2) retaining the current maximum age of 16 for eligibility; and (3) increase in the phaseout threshold amounts to $400,000 for joint filers and $200,000 for all others.

- Repeal of the deduction for alimony paid and corresponding inclusion in income by the recipient, effective for tax years beginning in 2019. Alimony paid under separation agreement entered into prior to the effective date is generally grandfathered.

- a repeal of the personal exemption deductions and an increase in the standard deduction amounts to $24,000 for joint filers and surviving spouses, $18,000 for heads of household, and $12,000 for unmarried taxpayers and married filing separately (additional amounts for the elderly and blind are retained);

- a repeal of miscellaneous itemized deductions subject to the 2 percent of adjusted gross income floor;

- a repeal of the personal deduction for casualty and theft losses, except for losses incurred in presidentially declared disaster areas;

- an increase in the alternative minimum tax (AMT) exemption amounts and the adjusted gross income thresholds at which the exemption amount begins to phase out;

- permanent repeal of the individual shared responsibility payment (individual healthcare mandate) enacted as part of the Affordable Care Act (ACA); and

- the expiration of most individual tax provisions after December 31, 2025.

IN-DEPTH COMMENTARY of the Tax Bill

I. Changes Affecting Individuals

Affordable Care Act (ACA) Individual Healthcare Mandate

Under the Tax Bill, the amount of the individual shared responsibility payment (aka, the "individual healthcare mandate") enacted as part of the ACA would be reduced to zero, effective with respect to health coverage status for months beginning after December 31, 2018.

Individual Tax Rates and Brackets

The Tax Bill would replace the current set of seven individual tax rates with a different set of seven individual tax rates. Under the Tax Bill, the highest marginal tax rate is 37%, as compared to the top tax rate of 39.6% under present law. The current tax rates of 10%, 15%, 25%, 28%, 33%, 35%, 39.6% rates would be replaced with tax rates of 10%, 12%, 22%, 24%, 32%, 35%, and 37%.

Observation: The highest tax rate in the Tax Bill (37%) is lower than the top rates in either the House or Senate Bills (39.6% and 38.5%, respectively). The reduction was reportedly intended to offset the effect, for high income taxpayers, of capping the state and local tax deduction at $10,000.

The income tax bracket thresholds are all adjusted for inflation after December 31, 2018, and then rounded to the next lowest multiple of $100 in future years. Unlike present law (which uses a measure of the consumer price index for all-urban consumers), the new inflation adjustment uses the chained consumer price index for all-urban consumers.

Tax rates and brackets are as follows:

	Bracket Beginning Point				
Rate (%)	**Married Filing Jointly/Surviving Spouse** ($)	**Head of Household** ($)	**Single Individuals** ($)	**Married Filing Separately** ($)	**Estates and Trusts** ($)
10	0	0	0	0	0
12	19,050	13,600	9,525	9,525	N/A
22	77,400	51,800	38,700	38,700	N/A
24	165,000	82,500	82,500	82,500	2,550
32	315,000	157,500	157,500	157,500	N/A
35	400,000	200,000	200,000	200,000	9,150
37	600,000	500,000	500,000	300,000	12,500

This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Estate and Trust Tax Rates and Brackets

Under the Tax Bill, the tax rate for estates and trusts would be 10% of taxable income up to $2,550, 24% of the excess over $2,550 but not over $9,150; 35% of the excess over $9,150 but not over $12,500; and 37% of the excess over $12,500.
This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Simplification of Tax on Unearned Income of Children

The Tax Bill simplifies the "kiddie tax" by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. Thus, taxable income attributable to earned income is taxed according to an unmarried taxpayer's brackets and rates. Taxable income attributable to net unearned income is taxed according to the brackets applicable to trusts and estates, with respect to both ordinary income and income taxed at preferential rates. The child's tax is no longer affected by the tax situation of the child's parent or the unearned income of any siblings.
This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Maximum Rates on Capital Gains and Qualified Dividends

The Tax Bill generally retains the present-law maximum rates on net capital gain and qualified dividends. The breakpoints between the zero- and 15-percent rates ("15-percent breakpoint") and the 15- and 20-percent rates ("20-percent breakpoint") are the same amounts as the breakpoints under current law, except the breakpoints are indexed using the Consumer Price Index for all Urban Consumers (C-CPI-U) in taxable years beginning after 2017. Thus, for 2018, the 15-percent breakpoint is $77,200 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), $51,700 for heads of household, $2,600 for estates and trusts, and $38,600 for other unmarried individuals. The 20-percent breakpoint is $479,000 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), $452,400 for heads of household, $12,700 for estates and trusts, and $425,800 for other unmarried individuals.

Observation: Therefore, in the case of an individual (including an estate or trust) with adjusted net capital gain, to the extent the gain would not result in taxable income exceeding the 15-percent breakpoint, such gain is not taxed. Any adjusted net capital gain which would result in taxable income exceeding the 15-percent breakpoint but not exceeding the 20-percent breakpoint is taxed at 15 percent. The remaining adjusted net capital gain is taxed at 20 percent.

As under current law, unrecaptured Code Sec. 1250 gain generally is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent.

This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Increase in Individual AMT Exemption and Phaseout Amounts

The Tax Bill provides for increased AMT exemptions. For 2018, the exemptions would be $109,400 (up from $84,500 in 2017) in the case of a joint return or the return of a surviving spouse; $70,300 (up from $54,300 in 2017) in the case of an individual who is unmarried and not a surviving spouse; $54,700 (up from $39,375 in 2017) in the case of a married individual filing a separate return. Additionally, the Tax Bill would increase the alternative minimum taxable income limit where the exemptions begin to phase out. Under the Tax Bill, the exemption amount of any taxpayer is reduced by an amount equal to 25 percent of the amount by which the alternative minimum taxable income of the taxpayer exceeds $1,000,000 (up from $160,900 in 2017) in the case of a joint returns; and $500,000 for all others (up from amounts ranging from $80,450 to $120,700 in 2017).

Increase in Standard Deduction

The Tax Bill increases the basic standard deduction for individuals across all filing statuses. Under the provision, the amount of the standard deduction is increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household

filers, and $12,000 for all other taxpayers. The amount of the standard deduction is indexed for inflation using the chained consumer price index for all-urban consumers for taxable years beginning after December 31, 2018. The additional standard deduction for the elderly and the blind is not changed by the provision.
This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Repeal of the Deduction for Personal Exemptions

The Tax Bill repeals the deduction for personal exemptions. In addition, the provision modifies the requirements for those who are required to file a tax return. In the case of an individual who is not married, such individual is required to file a tax return if the taxpayer's gross income for the taxable year exceeds the applicable standard deduction. Married individuals are required to file a return if that individual's gross income, when combined with the individual's spouse's gross income for the taxable year, is more than the standard deduction applicable to a joint return. This provision would be effective after December 31, 2017, and expire after December 31, 2025.
Observation: Withholding rules under present law are based partly on the number of personal exemptions claimed by a taxpayer. Form W-4 and withholding tables would need to be changed to reflect the repeal of personal exemptions. The Tax Bill provides that the Secretary may, at his discretion, administer wage withholding in 2018 without regard to the repeal of the deduction for personal exemptions.

Repeal of Deduction for Alimony Paid

The Tax Bill repeals the deduction for alimony paid and the corresponding inclusion of alimony in income by the recipient. The provision is effective for any divorce or separation instrument executed after December 31, 2018, or for any divorce or separation instrument executed on or before December 31, 2018, and modified after that date, if the modification expressly provides that the amendments made by this section apply to such modification. Thus, alimony paid under a separation agreement entered into prior to the effective date is generally grandfathered.

Temporary Reduction in Medical Expense Deduction Floor

The Tax Bill provides special rules for medical expense deductions for years 2013 through 2018. For a tax year beginning after 2012 and ending before 2017, in the case of a taxpayer or a taxpayer's spouse who has attained age 65 before the close of the year, and for a tax year beginning after 2016, and ending before 2019, in the case of any taxpayer, the adjusted-gross-income floor above which a medical expense is deductible is reduced from 10 percent to 7.5 percent.

Limitation on Deduction for State and Local Taxes

The Tax Bill limits the deduction for state and local property, income, war profits, and excess profits taxes to $10,000 ($5,000 in the case of a married individual filing a separate return), unless such taxes are paid or accrued in carrying on a trade or business or an activity described in Code Sec. 212 (relating to expenses for the production of income). The Tax Bill also repeals the deduction for foreign property taxes. As under current law, taxpayers may elect to deduct state and local sales taxes in lieu of state and local income taxes.

Caution: The Tax Bill includes a provision blocking taxpayers from prepaying state and local income tax relating to the 2018 tax year in 2017 in order to circumvent the new limitation on the deduction. Specifically, the bill provides that, in the case of an amount paid in a tax year beginning before January 1, 2018, with respect to a state or local income tax imposed for a tax year beginning after December 31, 2017, the payment will be treated as paid on the last day of the tax year for which such tax is imposed for purposes of applying the provision limiting the dollar amount of the deduction.

This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Limitation on Mortgage Interest Deduction

The Tax Bill provides that a taxpayer may treat no more than $750,000 as acquisition indebtedness ($375,000 in the case of married taxpayers filing separately) for purposes of the mortgage interest deduction. In the case of acquisition indebtedness incurred before December 15, 2017, the limitation is the same as it is under current law: $1,000,000 ($500,000 in the case of married taxpayers filing separately).

Observation:

The Tax Bill repeals the deduction for home equity indebtedness.

This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Modification to Deduction for Charitable Contributions

The Tax Bill -

(1) increases in the income-based percentage limit for certain charitable contributions by an individual taxpayer of cash to public charities and certain other organizations from 50 percent to 60 percent;

(2) denies a charitable deduction for payments made in exchange for college athletic event seating rights; and

(3) repeals the substantiation exception in Code Sec. 170(f)(8)(D) for certain contributions reported by the donee organization.

Partial Repeal of Deduction for Casualty and Theft Losses

The Tax Bill temporarily modifies the deduction for personal casualty and theft losses. Under the provision, a taxpayer may claim a personal casualty loss, subject to the applicable limitations in Code Sec. 165(h), only if such loss was attributable to a disaster declared by the President. The above-described limitation does not apply with respect to losses incurred after December 31, 2025.

Repeal of Miscellaneous Itemized Deductions Subject to the 2-Percent Floor

The Tax Bill repeals all miscellaneous itemized deductions that are subject to the two-percent of adjusted-gross-income floor.
This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Repeal of Overall Limitation on Itemized Deductions

The Tax Bill repeals the overall limitation on itemized deductions.
This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Relief for 2016 and 2017 Disaster Areas - Relaxation of Casualty Loss Deduction Rules

The Tax Bill provides tax relief relating to a "2016 disaster area," which is defined as any area with respect to which a major disaster was declared by the President under Section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act during calendar year 2016 and 2017. In the case of a personal casualty loss which arose after December 31, 2015, and before January 1, 2018, and was attributable to the events giving rise to the Presidential disaster declaration, such losses are deductible without regard to whether aggregate net losses exceed ten percent of a taxpayer's adjusted gross income. Under the provision, in order to be deductible, the losses must exceed $500 per casualty. Additionally, such losses may be claimed in addition to the standard deduction.

Rules for Exclusion of Gain from the Sale of a Principal Residence Unchanged

Both the House and Senate Bills included similar provisions tightening the rules for the exclusion of gain from the sale of a principal residence. Both bills would have made the exclusion available only if the taxpayer had owned and used the residence as a principal residence for at least five of the eight years (as opposed to two out of five years under current law) prior to selling it, and both would have allowed a taxpayer to benefit from the exclusion only once every five years (as opposed to once every two years under current law).
These provisions were not included in the Tax Bill. Thus, the rules for exclusion of gain from the sale of a principal residence under current law will remain in effect.

Repeal of Exclusion for Qualified Moving Expense Reimbursements

The Tax Bill repeals the exclusion from gross income and wages for qualified moving expense reimbursements except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order.

This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Repeal of Deduction for Moving Expenses

The Tax Bill repeals the deduction for moving expenses. However, under the provision, rules providing for exclusions of amounts attributable to in-kind moving and storage expenses (and reimbursements or allowances for these expenses) for members of the Armed Forces of the United States (or their spouse or dependents) are not repealed.
This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Reform of Child Tax Credit

The Tax Bill increases the child tax credit to $2,000 per qualifying child under the age of 17.
Observation: The Tax Bill retains the current law maximum age of 16 (i.e., "under the age of 17").
The credit is further modified to provide for a $500 nonrefundable credit for qualifying dependents other than qualifying children. The provision generally retains the present-law definition of dependent.
Under the Tax Bill, the modified adjusted gross income threshold at which the credit begins to phase out is increased to $400,000 for joint filers and $200,000 for all other taxpayers. These amounts are not indexed for inflation.
The provision lowers the earned income threshold for the refundable child tax credit to $2,500. The maximum amount refundable may not exceed $1,400 per qualifying child (up from $1,000 under present law). In order to receive the refundable portion of the child tax credit, a taxpayer must include a social security number for each qualifying child for whom the credit is claimed on the tax return.
This provision would be effective after December 31, 2017, and expire after December 31, 2025.

Increased Contributions to ABLE Accounts and Allowance of Contributions to be Eligible for Saver's Credit

The Tax Bill increases the contribution limitation to ABLE accounts under certain circumstances. While the general overall limitation on contributions (the per-donee annual gift tax exclusion ($14,000 for 2017)) remains the same, the limitation is increased with respect to contributions made by the designated beneficiary of the ABLE account. Under the provision, after the overall limitation on contributions is reached, an ABLE account's designated beneficiary can contribute an additional amount, up to the lesser of (1) the federal poverty line for a one-person household; or (2) the individual's compensation for the taxable year. Additionally, the provision allows a designated beneficiary of an ABLE account to claim the saver's credit for contributions made to his or her ABLE account.

The provision would be effective for tax years beginning after the date of enactment and would sunset after December 31, 2025.

Rollovers Between 529 Plans and Qualified ABLE Programs

The Tax Bill allows for amounts from qualified tuition programs (also known as Section 529 accounts) to be rolled over to an ABLE account without penalty, provided that the ABLE account is owned by the designated beneficiary of that Section 529 account, or a member of such designated beneficiary's family. Such rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account within a taxable year. Any amount rolled over that is in excess of this limitation will be includible in the gross income of the distributee in a manner provided by Code Sec. 72. The provision would apply to distributions after December 31, 2017, and would sunset after December 31, 2025.

Deduction for Certain Educator Expenses Retained

The Tax Bill adopted neither the House nor Senate Bill and instead keeps the current law $250 deduction.

Deduction for Student Loan Interest and the Exclusion for Graduate Student Tuition Waivers Retained

The Tax Bill retained the current rules for both provisions.

II. Estate and Gift Tax Changes

Increase in Estate and Gift Tax Exemption

The Tax Bill doubles the estate and gift tax exemption amount. This is accomplished by increasing the basic exclusion amount provided in Code Sec. 2010(c)(3) from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011.

The provision would be effective for decedents dying, generation-skipping transfers, and gifts made after December 31, 2017, and would expire for years beginning after December 31, 2025.

III. Retirement Plan-Related Changes

Partial Repeal of Special Rule Permitting Recharacterization of IRA Contributions

The Tax Bill partially repeals the special rule that allows IRA contributions to one type of IRA (either traditional or Roth) to be recharacterized as a contribution to the other type of IRA. Under the provision, the special rule that allows a contribution to one type of IRA to be recharacterized as a contribution to the other type of IRA does not apply to a conversion contribution to a Roth IRA. Thus, recharacterization cannot be used to unwind a Roth conversion. However, recharacterization is still permitted with respect to other contributions. For example, an individual may make a contribution for a year to a Roth IRA and, before the due date for the individual's income tax return for that year, recharacterize it as a contribution to a traditional IRA.

An individual may still make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA, but the provision precludes the individual from later unwinding the conversion through a recharacterization.

The provision is effective for taxable years beginning after December 31, 2017.

Extended Rollover Period for the Rollover of Plan Loan Offset Amounts in Certain Cases

Under the Tax Bill, the period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a rollover contribution is extended from 60 days after the date of the offset to the due date (including extensions) for filing the federal income tax return for the taxable year in which the plan loan offset occurs, that is, the taxable year in which the amount is treated as distributed from the plan. Under the provision, a qualified plan loan offset amount is a plan loan offset amount that is treated as distributed from a qualified retirement plan, a Code Sec. 403(b) plan or a governmental Code Sec. 457(b) plan solely by reason of the termination of the plan or the failure to meet the repayment terms of the loan because of the employee's separation from service, whether due to layoff, cessation of business, termination of employment, or otherwise. As under present law, a loan offset amount under the provision is the amount by which an employee's account balance under the plan is reduced to repay a loan from the plan. The provision applies to taxable years beginning after December 31, 2017.

IV. Deduction for Qualified Business Income of an Individual (Passthrough Break)

Under the Tax Bill, for taxable years beginning after December 31, 2017, and before January 1, 2026, an individual taxpayer generally may deduct an amount equal to the sum of -

(1) the lesser of (a) the combined qualified business income amount for the taxable year; or (b) an amount equal to 20 percent of the excess (if any) of taxpayer's taxable income for the taxable year over the sum of any net capital gain and qualified cooperative dividends.

This sum may not exceed the taxpayer's taxable income for the taxable year (reduced by net capital gain).

Observation: As discussed below, trusts and estates are also eligible for this deduction.

The deductible amount for each qualified trade or business is the lesser of -
(1) 20 percent of the taxpayer's qualified business income with respect to the trade or business; or
(2) the greater of 50 percent of the W-2 wages (defined below) with respect to the trade or business or the sum of 25 percent of the W-2 wages with respect to the trade or business and 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property.
The 20-percent deduction is not allowed in computing adjusted gross income, and instead is allowed as a deduction reducing taxable income. Thus, for example, the provision does not affect limitations based on adjusted gross income.
Observation: This deduction is available to both nonitemizers and itemizers.

Qualified Trade or Business

For purposes of the deduction for qualified business income, the Tax Bill provides that qualified business income is determined for each qualified trade or business of the taxpayer. The term "qualified trade or business" means any trade or business other than -
(1) a specified service trade or business (defined below); or
(2) the trade or business of performing services as an employee.

Specified Service Trade or Business. A specified service trade or business means any trade or business involving the performance of services in the fields of health, law, 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 of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities. For this purpose, a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities (Code Sec. 475(c)(2) and Code Sec. 475(e)(2), respectively).
The rule disqualifying specified service trades or businesses does not apply to taxpayers with taxable income at or below specified threshold amounts and is phased in for taxpayers with taxable income above the thresholds (threshold amounts and phase-in provisions for specified service trades or businesses are discussed below).

Qualified Business Income

Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer. Similarly, qualified business income does not include any guaranteed payment for services rendered with respect to the trade or business, and to the extent provided in regulations, does not include any amount paid or incurred by a partnership to a partner who is acting other than in his or her capacity as a partner for services.

For any taxable year, qualified business income is the net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer. The determination of qualified items of income, gain, deduction, and loss takes into account these items only to the extent included or allowed in the determination of taxable income for the year.

Example: During the taxable year, a qualified business has $100,000 of ordinary income from inventory sales, and makes an expenditure of $25,000 that is required to be capitalized and amortized over five years under applicable tax rules. Qualified business income is $100,000 minus $5,000 (current-year ordinary amortization deduction), or $95,000. The qualified business income is not reduced by the entire amount of the capital expenditure, only by the amount deductible in determining taxable income for the year.

If the net amount of qualified business income from all qualified trades or businesses during the taxable year is a loss, it is carried forward as a loss from a qualified trade or business in the next taxable year. Similar to a qualified trade or business that has a qualified business loss for the current taxable year, any deduction allowed in a subsequent year is reduced (but not below zero) by 20 percent of any carryover qualified business loss.

Example: Sean has qualified business income of $20,000 from qualified business A and a qualified business loss of $50,000 from qualified business B in Year 1. Sean is not permitted a deduction for Year 1 and has a carryover qualified business loss of $30,000 to Year 2. In Year 2, Sean has qualified business income of $20,000 from qualified business A and qualified business income of $50,000 from qualified business B. To determine the deduction for Year 2, Sean reduces the 20 percent deductible amount determined for the qualified business income of $70,000 from qualified businesses A and B by 20 percent of the $30,000 carryover qualified business loss.

Domestic Business Items

Items are treated as qualified items of income, gain, deduction, and loss only to the extent they are effectively connected with the conduct of a trade or business within the United States.

Treatment of Investment Income

Qualified items do not include investment-related income, deductions, or loss. Specifically, qualified items of income, gain, deduction and loss do not include (1) any item taken into account in determining net long-term capital gain or net long-term capital loss, (2) dividends, income equivalent to a dividend, or payments in lieu of dividends, (3) interest income other than that which is properly allocable to a trade or business.

Phase-in of Specified Service Business Limitation

There is an exclusion from the definition of a qualified business for specified service trades or businesses for certain taxpayers. This exclusion phases in for a taxpayer with taxable income in excess of a threshold amount. The threshold amount is $315,000 for joint filers and $157,500 for all other taxpayers (the "threshold amount"). The threshold amount is indexed for inflation. The exclusion from the definition of a qualified business for specified service trades or businesses is fully phased in for a taxpayer with taxable income in excess of the threshold amount plus $50,000 ($100,000 in the case of a joint return). For a taxpayer with taxable income within the phase-in range, the exclusion applies as follows.

W-2 Wage Limitation on Deduction for Qualified Business Income

There is a limitation on the deduction for qualified business income which is based on either W-2 wages paid, or wages paid plus a capital element. The limitation is phased in above a threshold amount of taxable income. Specifically, the limitation is the greater of (1) 50 percent of the W-2 wages paid with respect to the qualified trade or business, or (2) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property.

Reasonable Compensation and Guaranteed Payments

Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer. Similarly, qualified business income does not include any guaranteed payment for services rendered with respect to the trade or business, and to the extent provided in regulations, does not include any amount paid or incurred by a partnership to a partner who is acting other than in his or her capacity as a partner for services.

W-2 Wages

W-2 wages are the total wages subject to wage withholding, elective deferrals, and deferred compensation paid by the qualified trade or business with respect to employment of its employees during the calendar year.

Phase-in of W-2 Wage Limitation

The application of the W-2 wage limitation phases in for a taxpayer with taxable income in excess of the following threshold amounts: $315,000 for joint filers and $157,500 for all other taxpayers, indexed for inflation. For purposes of phasing in the wage limit, taxable income is computed without regard to the 20 percent deduction. The W-2 wage limitation applies fully for a taxpayer with taxable income in excess of the threshold amount plus $50,000 ($100,000 in the case of a joint return). For a taxpayer with taxable income within the phase-in range, the wage limit applies as follows. With respect to any qualified trade or business, the taxpayer compares -

(1) 20 percent of the taxpayer's qualified business income with respect to the qualified trade or business; with

(2) the W-2 wage limitation (see above) with respect to the qualified trade or business.

If the amount determined under (2) is less than the amount determined (1), (that is, if the wage limit is binding), the taxpayer's deductible amount is the amount determined under (1) reduced by the same proportion of the difference between the two amounts as the excess of the taxable income of the taxpayer over the threshold amount bears to $50,000 ($100,000 in the case of a joint return).

Special Rules for Partnerships and S Corporations

The Tax Bill provides that, in the case of a partnership or S corporation, the business income deduction applies at the partner or shareholder level. Each partner takes into account the partner's allocable share of each qualified item of income, gain, deduction, and loss, and is treated as having W-2 wages for the taxable year equal to the partner's allocable share of W-2 wages of the partnership. The partner's allocable share of W-2 wages is required to be determined in the same manner as the partner's share of wage expenses. For example, if a partner is allocated a deductible amount of 10 percent of wages paid by the partnership to employees for the taxable year, the partner is required to be allocated 10 percent of the W-2 wages of the partnership for purposes of calculating the wage limit under this deduction. Similarly, each shareholder of an S corporation takes into account the shareholder's pro rata share of each qualified item of income, gain, deduction, and loss, and is treated as having W-2 wages for the taxable year equal to the shareholder's pro rata share of W-2 wages of the S corporation.