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Key Tax Provisions in the Tax Cut and Jobs Act

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Key Tax Provisions in the Tax Cut and Jobs Act

On December 22, 2017, President Trump signed into law, the Tax Cut and Jobs Act. A majority of the provisions under the Act sunset for tax years beginning after December 31, 2025.

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Key Provisions Related to Individual Income Taxes

- Individual Income Tax Brackets:
  - The number of income tax brackets remain at seven, but the income ranges in several brackets have been changed and each new bracket has lower rates.
  - This has the effect of reducing taxes for most income levels.
  - Sunset provision.
  - A comparison of the current rates and the new rates are, as follows:

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Individual Income Tax Rates

Single Filers (2018)				Married Filing Jointly - MFJ (2018)			
Under Previous Law		**Tax Cuts and Jobs Act**		**Under Previous Law**		**Tax Cuts and Jobs Act**	
Rate	**Income Bracket**	**Rate**	**Income Bracket**	**Rate**	**Income Bracket**	**Rate**	**Income Bracket**
10%	$0-9,525	10%	$0-9,525	10%	$0-19,050	10%	$0-19,050
15%	$9,525-38,700	12%	$9,525-38,700	15%	$19,050-77,400	12%	$19,050-77,400
25%	$38,700-93,700	22%	$38,700-82,500	25%	$77,400-156,150	22%	$77,400-165,000
28%	$93,700-195,450	24%	$82,500-157,500	28%	$156,150-237,950	24%	$165,000-315,000
33%	$195,450-424-950	32%	$157,500-200,000	33%	$237,950-424,950	32%	$315,000-400,000
35%	$424,950-426,700	35%	$200,000-500,000	35%	$424,950-480,050	35%	$400,000-600,000
39.6%	$426,700 and up	37%	$500,000 and up	39.6%	$480,050 and up	37%	$600,000 and up

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Capital Gains and Dividend Rates

- Under the Act, the long-term capital gains and qualified dividends tax rate breakpoints remain about the same as the under present law.
- For tax years beginning in 2018, the rate thresholds are as follows:
- **Married Filing Joint:**
  - 15% Rate Threshold - $77,200 (0% Rate under $77,200).
  - 20% Rate Threshold - $479,000.
- **Single:**
  - 15% Rate Threshold - $38,600 (0% Rate under $38,600).
  - 20% Rate Threshold - $425,800.
- **Head of Household:**
  - 15% Rate Threshold - $51,700 (0% Rate under $51,700).
  - 20% Rate Threshold - $452,400.

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Estates and Trusts Income Tax Rates

Ordinary Taxable Income	Tax Rate
$0 - $2,550	10%
$2,550 - $9,150	24%
$9,150 - $12,500	35%
Over $12,500	37%

Capital Gains and Dividends

- 15% Rate Threshold - $2,600 (0% Rate Under $2,600).
- 20% Rate Threshold - $12,700

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Modifications to the Kiddie Tax

- Act modifies the kiddie tax to effectively apply the estates and trusts ordinary and capital gains rates to the net unearned income of a child.
  - As under pre-Act Law, earned income is taxed according to an unmarried taxpayer's brackets and rates.

- No change in law as to whom the tax applies.
  - Under age 19, by the close of the tax year, or is a full-time student under age 24;
  - Has at least one living parent at the close of the tax year;
  - Has unearned income of more than $2,100 (for 2018); and
  - Doesn't file a joint return.

- Eliminates the need to coordinate filing with the parents return.

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Individual Alternative Minimum Tax (AMT)

- The alternative minimum tax (AMT) is a tax system separate from the regular tax that is intended to prevent a taxpayer with substantial income from avoiding tax liability by using various exclusions, deductions and credits.

- The Act increases the AMT exemption amounts in 2018 for non-corporate taxpayers, as follows:
  - Married Joint - $109,400 *(was $84,500).*
  - Single & HOH - $70,300 *(was $54,300).*
  - Married Filing Separately - $54,700 *(was $42,250).*
  - Estates and Trusts - $22,500 *(was $24,100).*

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Individual Alternative Minimum Tax (AMT)

- Under the Act, the above exemption amounts are reduced (not below zero) to an amount equal to 25 percent of the amount by which the alternative taxable income of the taxpayer exceeds the phase-out amounts, increased, as follows:
  - Married Joint - $1 million *(was $164,000).*
  - All other taxpayers (other than estates and trusts) - $500,000 *(was $123,100).*
  - Estates and Trusts - $75,000 *(was $75,000; i.e., no change).*

- Sunset provision

- **NOTE:** With the repeal of dependent exemptions, the $10,000 limitation on SALT deductions, the disallowance of miscellaneous itemized deductions and the increase in the AMT exemption amounts and thresholds, many taxpayers that were in AMT in prior years will not be going forward.

Changes to Itemized Deductions, the Standard Deduction, Dependent Exemptions and the Child Tax Credit

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State, Local, Sales and Property Tax Deduction

- The deduction for state and local income tax, sales tax and property taxes ("SALT deduction") is capped at $10,000.
  - This will have more impact on taxpayers with more expensive property, generally those who live in higher-income areas, or people in states with higher state tax rates.

- This provision alone, combined with the increased standard deduction will reduce the number of people that will itemize in 2018 and forward.

- Many taxpayers that had large SALT deductions were subject to AMT.
  - With revised AMT rules (discussed previously) the negative impact should be less than anticipated.

- Prepayment in 2017 issues.

- Sunset provision.

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Mortgage Interest Deduction

- Mortgage interest deduction for principal residence and one second home is lowered from total loan balances of $1 million under current law to $750,000.
  - Applies to debt incurred after 12/15/17.
  - The $1million limitation remains for older debt (grandfathered).

- Interest from home equity loans (aka second mortgages) is no longer deductible unless used for acquisition purposes. <u>No grandfather provision.</u>

- Acquisition indebtedness is indebtedness that is incurred in acquiring, constructing or substantially improving a qualified residence of the taxpayer and which secures the residence.

- Sunset provision.

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Charitable Contribution Deduction Limitation Increased

- For contributions made in tax years beginning after December 31, 2017 and before January 1, 2026, the 50 percent AGI limitation under Code Section 170(b) for cash contributions to public charities and certain private foundations is increased to 60 percent.

- Sunset provision.

Healthcare Deductions

- Beginning in 2019 (not 2018), the Affordable Care Act Shared Responsibility Penalty is **permanently** reduced to zero (no sunset provision).

- The Act leaves intact the 3.8% Net Investment Income Tax and the .9% additional Medicare tax enacted by the Affordable Care Act.

- The Act expands amount of out-of-pocket medical expenses that may be deducted by lowering threshold from 10% of AGI to 7.5% of AGI, but only for 2017 (retroactively) and 2018.
  - For 2019 and later years, the threshold will increase to 10%.

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Gambling Losses

- Beginning in 2018, the limitation on gambling losses is modified to provide that all deductions for expenses incurred in carrying out wagering transactions (i.e., traveling to and from the casino), and not just the gambling losses, are limited to the extent of gambling winnings.
- Sunset provision.
- The 2011 Tax Court decision in *Mayo* provided that nonwagering expenses (i.e., expenses incurred in traveling to and from the casino) were deductible business expenses and not part of the gambling losses which would be limited to gambling winnings. The decision only applied to those who were in the trade or business of gambling.

Miscellaneous Itemized Deductions

- Beginning in 2018, the Act suspends all miscellaneous itemized deductions that are subject to the 2% floor under present law.

- Examples include: employee business expenses, tax preparation fees, job search expenses, union dues, dues to professional societies, investment expenses, etc.

- Biggest impact will be on sales people who incur significant business expenses in their line of work and are not reimbursed under an ***accountable plan.***

- Sunset provision.

- **Planning Point:** *Approach employer to establish an accountable plan for expense reimbursements. Lower salary/commission, plus non-taxable reimbursements can provide greater benefit.*

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Pease Limitation on Itemized Deductions Eliminated

- Under Pre-Act law, higher-income taxpayers who itemized their deductions were subject to a limitation on these deductions (commonly known as the "Pease" limitation).
- Beginning in 2018, the "Pease" limitation on itemized deductions is eliminated.
- Sunset provision.

Standard Deduction and Personal Exemption

- The Act nearly doubles the standard deduction,
  - Married Joint Filers - From $12,700 to $24,000
  - Single – From $6,350 to $12,000.
  - Head of Household – From $9,350 to $18,000.

- Previously, about 70 percent of families choose the standard deduction rather than itemized deductions; this could now rise to over 84 percent.

- The bill eliminates the personal exemption, which is a deduction of $4,050 (2017) per taxpayer and dependent.
- Sunset provision.

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Child Tax Credit

- Beginning in 2018, the Act doubles the child tax credit (for children under age 17) <u>from $1,000 to $2,000</u>, $1,400 of which will be refundable.
  - It also provides a $500 credit for other dependents, versus zero under current law.

- The credit begins to phase-out for taxpayers with AGI in excess of $400,000 (married joint) and $200,000 (for all other taxpayers).
  - These phase-out thresholds are not indexed for inflation.
  - Prior phase-outs were at $110,000 (MFJ), $75,000 (single) and $55,000 (MFS).

- New credit will be available to more taxpayers.

- Sunset provision.

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Impact of Changes

Change in Tax on $200,000 AGI, Use of Standard Deduction, No Children

Filing Status MFJ		2017		2018		Change
Taxable Income	$	179,200	$	176,000	$	(3,200)
Income Tax		37,061		30,819		(6,242)

Filing Status Single		2017		2018		Change
Taxable Income	$	189,600	$	188,000	$	(1,600)
Income Tax		46,070		41,850		(4,220)

Change in Tax on $200,000 AGI, Use of Standard Deduction, 2 Children < 17

Filing Status MFJ		2017		2018*		Change
Taxable Income	$	171,100	$	176,000	$	4,900
Income Tax		34,793		26,819		(7,974)

**Note: 2018 tax reduced by $4,000 child tax credit.*

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Impact of Changes

Change in Tax on $200,000 AGI, $28,000 Id's (taxes $18K, Mtg $6K, Cont $4K), No Children

Filing Status MFJ	2017	2018	Change
Taxable Income	$ 163,900	$ 176,000	$ 12,100
Income Tax	32,777	30,819	(1,958)

Filing Status Single	2017	2018	Change
Taxable Income	$ 167,950	$ 180,000	$ 12,050
Income Tax	40,008	39,290	(718)

Change in Tax on $200,000 AGI, $28,000 Id's (taxes $18K, Mtg $6K, Cont $4K), 2 Children < 17

Filing Status MFJ	2017	2018*	Change
Taxable Income	$ 155,800	$ 176,000	$ 20,200
Income Tax	30,509	26,819	(3,690)

**Note: 2018 tax reduced by $4,000 child tax credit.*

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Impact of Changes

Change in Tax on $300,000 AGI, $52,000 Id's (taxes $35K, Mtg $10K, Cont $7K), No Children

Filing Status MFJ	2017	2018	Change
Taxable Income	$ 239,900	$ 273,000	$ 33,100
Income Tax	54,834	54,549	(285)
AMT	5,987	-	(5,987)
Total Tax	$ 60,821	$ 54,549	$ (6,272)

Filing Status Single	2017	2018	Change
Taxable Income	$ 246,401	$ 273,000	$ 26,599
Income Tax	65,612	71,240	5,628
AMT	6,929	-	(6,929)
Total Tax	$ 72,541	$ 71,240	$ (1,301)

Change in Tax on $300,000 AGI, $52,000 Id's (taxes $35K, Mtg $10K, Cont $7K), 2 Children < 17

Filing Status MFJ	2017	2018*	Change
Taxable Income	$ 231,800	$ 273,000	$ 41,200
Income Tax	52,239	50,549	(1,690)
AMT	8,582	-	(8,582)
Total Tax	$ 60,821	$ 50,549	$ (10,272)

**Note: 2018 tax reduced by $4,000 child tax credit.*

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Other Notable Changes

- On the following slides we will review some of the other notable changes impacting contained in the Act impacting individual income taxes beginning in 2018.

Education Deductions and Credits

- No changes are made to major education deductions and credits.
  - The teacher deduction for unreimbursed classroom expenses remains at $250.

- The Act does modify the Section 529 Plan rules:
  - For distributions 2017, “qualified higher education expenses” include tuition at an elementary or secondary public, private or religious school, and various expenses associated with home school.
  - The amount of cash distributions from all 529 plans with respect to a beneficiary during any tax year can't, in the aggregate, include more than $10,000 in above-described expenses (i.e., elementary school and secondary school tuition) incurred during the tax year.

Alimony Deduction

- Alimony paid to an ex-spouse will no longer be deductible by the payor.
    - In addition, alimony payments will no longer be included in the recipient's gross income.

- This effectively shifts the tax burden of alimony from the recipient to the payor.

- This provision is effective for divorce and separation agreements <u>signed or modified after December 31, 2018.</u>

Recharacterizations of Roth Conversions Eliminated

- The Act provides that the special rule that allows a contribution to one type of IRA to be recharacterized as a contribution to the other type of IRA <u>does not apply to a conversion contribution to a Roth IRA</u>.
  - Thus, recharacterization cannot be used to unwind a Roth conversion.
- However, recharacterization is still permitted with respect to other contributions.
- These changes are effective for plan years beginning after Dec. 31, 2017.
- **Note:** The IRS has clarified in a FAQ posted to its website that reconversions back into a traditional IRA will be permitted through 10/15/18.
  - A Roth IRA conversion after 1/1/18 cannot be recharacterized.

Exclusion for Moving Expense Reimbursements Suspended & Moving Expenses Deduction Suspended

- Beginning in 2018, the exclusion for qualified moving expense reimbursements is suspended, along with the deduction for moving expenses.

- Sunset provision.

- ***Exception:*** Does not apply to members of the Armed Forces on active duty (and their spouses and dependents) who move pursuant to a military order and incident to a permanent change of station.

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Treatment of Carried Interest

- Under Pre-Act Law, an owner of a partnership interest who receives payments in connection with the performance of services (i.e., a fund manager) is entitled to long-term gain treatment upon the sale of partnership interests held for greater than one year.
    - This is typically known as a “carried interest.”
- For tax years beginning after Dec. 31, 2017, the Act imposes a three-year holding period requirement in order for certain partnership interests received in connection with the performance of services to be taxed as long-term capital gain rather than ordinary income.

New Limitations on “Excess Business Loss”

- Beginning in 2018, the Act provides that a <u>non-corporate</u> taxpayer's “*excess business loss*” is disallowed.

- Excess business loss (IRC Section 461(l)(3)):
  - Means the excess (if any) of:
    - The aggregate deductions of the taxpayer for the taxable year which are attributable to trades or businesses of such taxpayer, over
  - The sum of-
    - The aggregate gross income or gain of such taxpayer for the taxable year which is attributable to such trades or businesses, plus
    - $250,000 (*200 percent of such amount in the case of a joint return).*

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New Limitations on "Excess Business Loss"

- Excess business losses are not allowed for the tax year, but are instead carried forward and treated as part of the taxpayer's net operating loss (NOL) carryforward in subsequent tax years.

- This limitation applies after the application of the passive loss rules described.

- The threshold amount for a tax year is $500,000 for married individuals filing jointly, and $250,000 for other individuals, with both amounts indexed for inflation.

- In the case of a partnership or S corporation, the provision applies at the partner or shareholder level.

- Sunset provision.

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No Deduction for Amounts Paid for College Athletic Seating Rights

- Beginning in 2018, no charitable deduction is allowed for any payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event.

- Under Pre-Act law, special rules applied to certain payments to institutions of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event.
  - The payor could treat 80% of such payment as a charitable contribution.

Casualty Losses/Disaster Relief

- Beginning in 2018, personal casualty and theft losses of an individual are deductible only to the extent they are attributable to a Federally declared disaster ("Federal disaster losses").

- Sunset provision.

Student Loan Discharged on Death or Disability

- For discharges of indebtedness after December 31, 2017, certain student loans that are discharged on account of death or total and permanent disability of the student are also excluded from gross income.

- Sunset provision.

Certain Self-Created Property Not Treated as Capital Asset

- Effective for dispositions after December 31, 2017, Code Section 1221(a)(3), was amended to exclude of patents, inventions, models or designs (whether or not patented) and secret formulas or processes, which are held either by the taxpayer who created the property or by a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created), from the definition of a "capital asset."

- Accordingly, sale of such assets will now result in an ordinary gain as opposed to a capital gain.

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Deduction for Living Expenses of Members of Congress Eliminated

- For tax years beginning after 12/22/17, members of Congress cannot deduct living expenses when they are away from home.

- Under Pre-Act law, the deductible amount was limited to $3,000 per year.

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Due Diligence Requirements for Claiming Head of Household

- Effective for tax years beginning after December 31, 2017, the Act expands the due diligence requirements for paid preparers to cover determining eligibility for a taxpayer to file as head-of-household.

- A penalty of $500 (adjusted for inflation) is imposed for each failure to meet these requirements.

Key Provisions Related to Estate and Gift Tax

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Estate and Gift Tax Changes

- For estates of decedents dying and gifts made after December 31, 2017, the Act doubles the base estate and gift tax exemption amount from $5 million to $10 million.

- The $10 million amount is indexed for inflation occurring after 2011, and is expected to be approximately $11.2 million in 2018 ($22.4 million per married couple).

- Sunset provision: The increased basic exclusion will not apply to estates of decedents dying and gifts made after December 31, 2025.

- The language in the Act does not mention generation-skipping transfers, but because the GST exemption amount is based on the basic exclusion amount, generation-skipping transfers will also see an increased exclusion amount

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Planning Note - Additional Gifting

- While the increased basic exclusion amount under the Act is scheduled to sunset on December 31, 2025, Congress could change the Act prior to its sunset.

- Consider making any appropriate lifetime gifts and allocations of GST exemption sooner rather than later in case there is a change reducing the exclusion amounts prior to the scheduled sunset.

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Planning Note - GST Exemption

- The increased GST exemption may be an opportunity to address existing irrevocable trusts.

- For clients who have created any irrevocable trusts that have inclusion ratios greater than zero and where assets may ultimately pass to skip persons (either by design or due to changed facts), consider making a late allocation of GST exemption where appropriate, to cause such trusts to have inclusion ratios of **zero.**

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