Tax Cuts & Jobs Act

Implications for Individual Taxpayers

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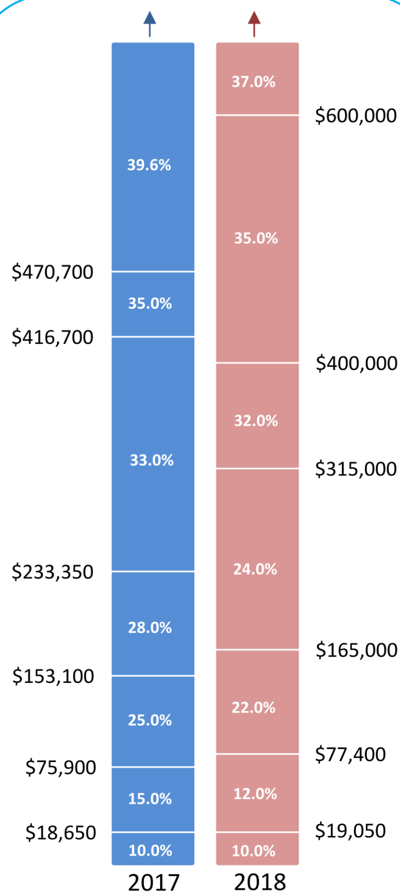
Tax Bracket Comparison (Married Filing Jointly)



Introduction:

The Tax Cuts and Jobs Act was passed by Congress and signed by the President on 12/22/17. The stated objectives of the legislation are to reduce taxes for individuals and businesses while simplifying the tax code. This letter outlines the major changes for individuals beginning in tax year 2018 (or other years where indicated). Many of the provisions expire in 2025. Details about the expiration dates of each provision are beyond the scope of this letter.

List of Changes for Individuals:

Tax brackets/rates shift downward, resulting in lower taxes for most taxpayers.

The **Standard Deduction** increases from $6,500 to $12,000 (single) and $13,000 to $24,000 (married).

Personal and Dependent Exemptions ($4,150 per person) are eliminated.

Deductions for state/local and property taxes are capped at $10,000.

Interest deductions are capped for new mortgages with more than $750,000 in acquisition debt.

Home equity debt deduction is eliminated.

Miscellaneous Itemized Deductions are eliminated. This includes deductions for unreimbursed employee expenses, tax preparation , investment advisory expenses and certain legal fees (among others).

The **medical deduction** income threshold decreases from 10% to 7.5% (for 2017 and 2018 only, then it goes back to 10%).

The **Child Tax Credit** increases from $1,000 to $2,000 per child under 17 years of age.

The refundable portion of the **Child Tax Credit** increases from $1,000 to $1,400.

The income phase-out for the **Child Tax Credit** more than doubles to $200,000 (single) and $400,000 (married).

A new $500 credit is available for non-child dependents (such as elderly parents).

Alimony will no longer be taxable income for the recipient and deductible for the payer (for divorces finalized after 12/31/18).

The **Estate Tax** exemption is doubled to $11 million ($22 million for married couples).

The **Alternative Minimum Tax (AMT)** exemption was increased by about 30%. Fewer taxpayers will pay the AMT.

The **penalty for not having health insurance** is eliminated effective 1/1/19.

Notes for business owners: The details of the changes affecting business owners is beyond the scope of this newsletter. We will, however, briefly outline some major changes affecting business owners as follows:

The top **tax rate for corporations** drops from 35% to 21%.

Other business owners (sole proprietors, s-corporations, and/or partnerships) may be entitled to a **20% deduction** of their share of business income. There are limitations. For example, most service businesses are not allowed the deduction unless their taxable income is less than $157,500 (single) or $315,000 (married).

Businesses will generally be able to **write-off more asset purchases** (including 100% of certain assets that previously had to be expensed over several years).

The **Domestic Production deduction** (for businesses with employees that produce goods in the USA) will be eliminated.

Key Implications:

Most taxpayers will get a break under the new plan. Page 3 of this newsletter quantifies how much some may save (or not). Let's first take a broader look at some of the winners & losers:

Winners:

High income taxpayers benefit from the upper bracket reducing to 37% (from 39.6%). The threshold for the upper bracket was also raised to $500,000 (single) and $600,000 (married).

Middle income taxpayers benefit from raising the upper income limits for both the Child Tax Credit and the AMT.

Low income taxpayers benefit from the increased Standard Deduction and refundable Child Tax Credit.

Taxpayers with low itemized deductions. For example, renters, home owners without a mortgage, residents of low/no tax states will benefit.

Students benefit because none of the education deductions or credits were reduced or eliminated.

Recipients of alimony from a divorce finalized AFTER 12/31/18 benefit because they don't have to pay tax on the income.

Payers of alimony from a divorce finalized BEFORE 1/1/19 benefit because they finalized the divorce before the rules changed and they can deduct the payments.

Large estates benefit from the doubling of the Estate Tax threshold.

Business owners benefit from the lower tax rates (for corporations) and deductions (for sole proprietors, s corporations, and partnerships). They will also be able to write-off greater amounts (and more types) of asset purchases.

Engineering and/or architecture firms benefit because they are exempt from the service business exclusion for the 20% business income deduction.

Taxpayers with VERY high medical bills will likely get a deduction (depending on their income levels) for 2017 /2018.

Taxpayers without health insurance benefit because now they don't have to pay the penalty for not having insurance.

Losers:

Home owners in high property tax areas will lose-out due to the $10,000 cap on state/local/property tax deductions. **Taxpayers in high tax states** will lose-out for the same reason.

Home owners in expensive real estate markets will not be able to deduct all of their interest if they take on greater than $750,000 in mortgage debt.

Taxpayers that donate to charity may no longer benefit (tax wise) due to the increased standard deduction. See page 4 for ideas to help charitable givers.

Service business owners (excluding engineering and architecture firms) with taxable income greater than $157,500 (single) or $315,000 (married) will lose-out on the 20% business income deduction.

Large families will lose out on $4,100 in exemptions for each dependent. The increase in the Standard Deduction will not be enough to make up the difference for families with 3+ dependents.

People with home equity line(s) of credit will lose-out on the interest deduction.

Employees that are not reimbursed for business related expenses will not be able to deduct their out of pocket costs. This includes a variety of qualifying expenses such as; professional union dues, equipment, continuing education, personal vehicle mileage, travel, meals & entertainment. See page 4 for ideas to help employees with unreimbursed expenses.

Employers that make goods here in the USA lose-out because the Domestic Production Deduction was eliminated.

Bicycle commuters lose the $20/month pre-tax bicycle expense reimbursement fringe benefit.

Taxpayers WITH health insurance will likely have to pay higher premiums due to healthy people leaving the insurance pool (due to the elimination of the penalty).

Future taxpayers will lose-out because they will have to foot the bill for the $1.5 trillion increase in the federal deficit/debt. Adding insult to injury, many of the tax cuts expire in 2025.

All taxpayers (present & future) that were hoping that the tax code would be simplified to the point where a return could be filed on a postcard. This did not happen. Rather, the tax code was made more complicated due to new rules for individuals and business entities. Tax matters are complicated further by the fact that few of the provisions were made permanent.

Most taxpayers were given a nice break with the new tax laws.

A few groups of taxpayers lost-out due to eliminated or capped exemptions and/or deductions.

The non-partisan Tax Policy Center estimates that 80% of taxpayers will get a tax break, and the average taxpayer will save about $1,600 under the new plan. Let's look at a wide variety of different taxpayers and see how they compare.

The following scenarios are intentionally over-simplified and the reported tax savings are approximated (and rounded to the closest $100). Even if your situation seems similar you will get different results to what is reported here.

Married filing jointly
2 dependents under 17
Income (AGI) = $150,000
California residents
Property taxes = $5,000
Mortgage interest = $12,000
Charitable contributions = $2,500
Approx. Change: save $3,000

Filing status: Married filing jointly
2 dependents under 17
Income (AGI) = $150,000
Texas residents
Property taxes = $5,200
Mortgage interest = $10,000
Charitable contributions = $3,500
Approx. Change: save $3,400

Filing status: Single
No dependents
Income (AGI) = $80,000
Georgia resident
Takes the Standard Deduction
Approx. Change: save $2,100

Filing status: Head of household
1 dependent under 17
Income (AGI) = $100,000
Ohio resident
Takes the Standard Deduction
Approx. Change: save $4,100

Filing status: Head of household
2 dependents under 17
Income (AGI) = $35,000
Florida resident
Takes the Standard Deduction
Approx. Change: save $2,000

Filing status: Single
Sole proprietor/self employed
Income (AGI) = $150,000
California resident
Property taxes = $5,000
Mortgage interest = $12,000
Charitable contributions = $0
Approx. Change: save $8,500

Filing status: Single
Retired, no dependents
Income (AGI) = $40,000
Maine resident
Property taxes = $5,000
No mortgage
Charitable contributions = $5,100
Approx. Change: No change

Filing status: Head of Household
1 dependent age 17+
Income (AGI) = $135,000
Illinois resident
Property taxes = $7,000
Mortgage interest = $11,000
Charitable contributions = $2,000
Unreimbursed employee business expenses = $9,800
Approx. Change: lose $1,900

Filing status: Married filing jointly
3 dependents 17+
Income (AGI) = $135,000
Minnesota resident
Property taxes = $6,500
Mortgage interest = $7,500
Charitable contributions = $5,000
Approx. Change: lose $1,100

Filing status: Single
No dependents
Income (AGI) = $400,000
New York City resident
Property taxes = $5,000
Mortgage interest = $22,500
Charitable contributions = $4,500
Approx. Change: lose $9,300

2017 Tax Planning Tips:

Most taxpayers will benefit by **pushing taxable income into the future** (when the rates are lower). For example, hold-off on doing a Roth IRA conversion in 2017. Wait until 2018 and take advantage of the lower rates (and increased Standard Deduction if your income is very low in 2018).

Pay any anticipated state tax balance in full before the end of the year (if you itemize). Remember though, If you pay more than you owe you will have to pay tax in 2018 on your state refund.

Pay as much of your property taxes as allowed in 2017 (if you itemize).

Consider **giving more to charity** before the end of 2017 (if you itemize). The same goes for paying **medical bills** (if greater than 7.5% of your income).

Business owners should try to channel expenses into 2017 and push income into 2018 and beyond. A great example of this is advertising, because you get a deduction when business tax rates are higher and you realize the growth in years when rates are lower.

2018 Tax Planning Tips:

Let's start by looking at **folks that will not be itemizing** due to the new rules. Given that state/local/property taxes are now capped and other miscellaneous itemized deductions have been eliminated, that leaves only charitable contributions, mortgage interest, and medical to play with. Let's first look at charity because you have more control over it.

A new game plan for charity: Due to the increased Standard Deduction, fewer taxpayers will benefit (tax wise) from their generous giving to 501(c)(3) groups. Here are some moves you can consider:

- If you are greater than age $70^{1/2}$ you can donate up to $100,000 directly to charity from an IRA. This is a win-win because the income is excluded and you still get to keep the increased Standard Deduction.
- Skip a year of giving. Then double-up the next year. If that doesn't work, then skip two years and triple the third.
- Consider giving gifts to loved ones in lieu of charities. Such gifts were never deductible, so you are not missing out on any tax breaks. Plus, the recipient doesn't pay any tax, so it's another win-win.
- Give to GoFundMe and KickStarter campaigns. Once again, you were never able to deduct such gifts (unless they were 501(c)(3) groups) so you aren't missing out on any tax advantages.

For **taxpayers that continue to itemize**, your situation stays the same. However, if you are **close to the Standard Deduction** you may want to consider DECREASING deductions (e.g. by paying down your mortgage) and bank the increased Standard Deduction. On the flip-side you may want to remain above the Standard Deduction by INCREASING your deductions (e.g. by paying major medical bills in 2018 before the deductibility threshold goes back up, buying a more expensive home, or giving more to charity).

Other situations & tips:

Ask your employer to pay for your out-of-pocket business expenses because they are no longer deductible. Tell them you would prefer to be reimbursed as part of an Accountable Plan. If they refuse then look for ways to reduce expenses, such as not upgrading equipment.

Consider property taxes when shopping for a new home. Some low/middle income taxpayers may be able to optimize the $10,000 cap in state/local/property tax (if you itemize).

It won't pay to have another kid if you make more than $200,000 (single) or $400,000 (married). That's because dependent exemptions were eliminated AND you are phased-out (partially or fully) of the increased Child Tax Credit.

Lastly, don't forget:

Home equity lines of credit are no longer deductible so you may want to pay-it-off.

If you have **very high medical bills** there may be a tax advantage from paying them all in 2018.

The penalty for not having health insurance doesn't go away until 2019 so **don't drop your health insurance in 2018** (if the only reason you are dropping is to avoid the penalty).

If you are going to be **paying alimony** then it benefits you to finalize the divorce before the end of 2018.

If you are going to be **receiving alimony** then it benefits you to finalize the divorce after the end of 2018.

If you are **shopping for a home in an expensive real estate market** consider taking on less than $750,000 in mortgage debt. However, don't worry if you go over by a little because you still get to deduct most of the interest.

If you are **very wealthy and on the verge of death** then hang-on until 2018 (hopefully much longer, and with improving health) to get the increased Estate Tax threshold.

On that note, best of health and success to everyone in 2018 & beyond.