Tax Cuts and Reform Bill of 2017

Date: December 22, 2017

The impact of the passing of the Tax Cuts and Reform Bill provides some of the most significant tax reform in more than 30 years.

Executive summary

Key provisions of the new bill include: lower individual tax rates; changes in threshold amounts (some higher and some lower); standard deductions that are nearly double current levels; elimination of personal exemptions, and changes to the Alternative Minimum Tax (AMT). Many taxpayers will no longer itemize deductions beginning in 2018 because of the increased standard deduction. Taxpayers need to consider making larger contributions to charity or pre-paying some itemized deductions like property taxes or state income taxes in 2017, rather than wait until 2018 when they may not itemize deductions with the higher standard deduction in effect. In addition, the value of those deductions is greater in 2017 because of the lower tax rates in 2018. Conversely, taxpayers need to also consider deferring income from 2017 to 2018, if possible, taking advantage of the lower tax rates next year. The result is that many Americans will see their tax bills drop in 2018

Another key change as of January 1, 2018, is that the tax rate for Corporations will fall from 35 percent to just 21 percent, the largest one-time rate cut for corporations in U.S. history. In addition, the Corporate AMT is repealed permanently. For small business owners, a 20-percent deduction for qualified business income from a partnership, S corporation, or sole proprietorship will be instituted.

For both individuals and businesses, these are significant changes and may warrant deferring income to 2018 or bunching expenses in 2017

Some of the key provisions of the tax bill investors should keep in mind are outlined below.

Individual tax rates

The bill preserves the current 7 brackets, but lowers the top rate to 37 percent and makes additional modifications to tax rates and income levels for some brackets. Under the bill, the brackets change to 10 percent, 12 percent, 22 percent, 24 percent, 32 percent, 35 percent and 37 percent.

Observation: For those individuals with the ability to defer income into 2018, this may result in a lower tax bill because of the lowered rates, especially at the upper tax brackets. It is important to remember that these rates will revert back to the existing law after 2025.

Standard deduction and personal exemption

Under the bill the standard deduction increases to $12,000 and $24,000 (individual and married couple respectively) almost double the current standard deduction. However, the personal exemption of $4,050 per person is eliminated.

Observation: The repeal of the personal exemption will sunset in 2025 as well as the increased deduction.

Alternative minimum tax

Under the bill, the alternative minimum tax exemption amounts increase to $109,400 for married individuals filing jointly (MFJ), $54,700 for Married Filing Separate (MFS), and $70,300 for individuals. The exemption amounts do not begin to phase out until Alternative Minimum Taxable Income (AMTI) exceeds $1,000,000 for married couples and $500,000.00 for individuals.

Observation: With the increased exemption amounts and phase-out thresholds, far fewer individuals will be affected by AMT. This provision also sunsets after 2025.

For Trusts and Estates the 2018 exemption amount ($24,600) and phase-out thresh hold ($82,050) are unchanged.

Corporate tax rates/corporate alternative minimum tax

Effective January 1, 2018 the corporate tax rate is reduced from 35 percent to 21percent. This is the largest one-time corporate tax cut in U.S. history. In addition, corporations are no longer subject to the corporate Alternative Minimum Tax.

Observation: These are permanent tax cuts. Instead of being the country with the highest corporate tax rate, this change puts the U.S. more in line with other developed economies.

Pass-through tax provisions

The bill also reduces taxes on certain domestic qualified business income (QBI) passed-through from a partnership, S corporation, or sole proprietorship. The final bill allows the owner to deduct 20 percent of their QBI, in effect, making it tax-free. Service businesses such as law firms, doctor's offices and investment offices can take full advantage of the 20 percent deduction only if taxable income is less than $315,000 for married couples filing jointly (MFJ) or $157,500 for individual taxpayers. The 20 percent deduction is phased out over the next $100,000 (MFJ) or $50,000 for individuals of taxable income.

Observation: It is important to keep in mind that this change will expire after 2025.

Itemized deductions, including state, local and property taxes

There are no overall limitations on itemized deductions in the bill. It does, however, repeal the state and local income and sales tax deductions. Individuals will now be able to write off up to $10,000 in property taxes, income or sales tax paid or a combination of property and sales taxes or property and income taxes. Individuals who itemize will no longer be able to deduct an unlimited amount of state and local taxes on their federal tax return. Certain other itemized deductions were also repealed.

Observation: These provisions will sunset after 2025. You will not have the ability to prepay a 2018 income tax liability in 2017 and deduct it for 2017. Note: property taxes do not have that same prohibition. So, if your local assessor allows it, you can pre-pay property taxes before year-end and deduct them in 2017.

Mortgage interest deduction

The bill retains the $1 million / $500,000 (Married Filing Separate - MFS) limitation on mortgage interest deduction for existing mortgages (incurred before December 15, 2017), but limits the popular deduction for interest on mortgage debt up to $750,000 / $375,000 (MFS) for mortgages incurred after Dec 15, 2017. This deduction is available on a first or second home. The bill, however, does eliminate the deduction for interest on home equity loans.

Refinancing: Existing mortgages (those incurred before December 15, 2017) are grandfathered under the Act. Thus the $1million / $500,000 (MFS) limitations continue to apply if an existing grandfathered mortgage is refinanced, as long as the amount refinanced doesn't exceed the amount of refinanced indebtedness.

Observation: This provision sunsets after 2025 and prior limits and deductions, including interest on home equity loans, is reinstated.

Child tax credit

The bill doubles the per child credit to $2,000 for qualifying children under 17. It will also increase the phase out threshold to claim the full credit from $75,000 today to $200,000 for individuals and from $110,000 to $400,000 for MFJ. The bill also makes more of the tax credit refundable – up to $1,400.00.

Observation: This provision expire after 2025.

529 accounts

Under the bill, the use of the 529 account is expanded to cover tuition for students in K-12 private, public, or religious school, up to $10,000 per student, per year. Prior to the bill deductions were only allowed for "qualified higher education expenses" which include: tuition, tuition, fees, books, supplies and required equipment, as well as reasonable room and board if the student is enrolled at least half-time. Eligible schools included: colleges, universities, vocational school or other postsecondary schools eligible to participate in a student aid program of the Department of Education.

Observation: The expansion of the 529 plan allows individuals greater choice in how the funds are used.

Other common personal deductions

The bill keeps in place the student loan interest deduction, the medical expense deduction, the charitable deduction and the graduate student tuition waivers. The bill even makes the medical deduction and the charitable deduction a bit more generous until after 2025.

Medical expenses: For tax years 2017 and 2018, the medical expense deduction may be taken by all taxpayers for expenses over 7.5 percent of adjusted gross income (AGI). After 2018, the medical deduction threshold reverts to 10 percent of AGI.

Charitable contributions: For tax years after 2017, the deductible limit for cash contributions is increased from the current 50 percent of AGI to 60 percent of AGI.

Moving expenses: The new bill repeals the moving expense deduction (except for active duty military personnel). The bill does not include the controversial first in first out, stock sale change which was a concern for investors.

Alimony expense/income: *For divorce or separation agreements executed after December 31, 2018, or prior agreements modified after this date, no deduction is allowed to the payor and the recipient will not include these payments as income.*

Miscellaneous itemized deductions subject to 2 percent AGI threshhold: The new bill repeals these deductions for years after 2017.

Kiddie tax

For tax years beginning after 2017, the earned income of a child is taxed at rates used for individual, and net unearned income is taxed using the rates applicable to trusts and estates.

Individual health insurance mandate

The bill repeals the individual health insurance mandate under the Affordable Care Act, which required individuals to buy health insurance or pay a penalty if they didn't.

The repeal of the individual mandate starts in 2019.

3.8 percent net investment income tax and 0.9 percent additional Medicare tax

The bill leaves both of these taxes imposed by the Affordable Care Act in place even though the individual mandate is repealed.

Federal gift/estate tax

The new bill keeps the estate tax rate at 40 percent, but the estate and gift tax exemption will double for estates of decedents dying and gifts made after December 31, 2017, and before January 1, 2026 to $11.2 million per person ($22.4 million for a couple) in 2018.

Observation: It is important to note that this change does not affect "state" estate tax or state inheritance tax. This provision will also sunset after 2025. If an estate plan was drafted with estate/gift taxes in mind, it should be reviewed in light of this change.

Trust tax rate

The top rate for trusts will be decreased to 37 percent beginning in 2018. However, the highest marginal rates for trusts continue to be reached at low levels of income. For example, the 37 percent rate begins at $12,500 while single individuals do not hit the top rate until income exceeds $500,000.

Re-characterization of Roth IRA contributions

Beginning in 2018, the ability to re-characterize a Roth IRA contribution as a Traditional IRA contribution is repealed. Re-characterization was typically done when the value of the converted funds declined or there was a change in a client's financial circumstances. Re-characterization could be done until October 15 of the year following the conversion.

Observation: Individuals that have completed a Roth Conversion in 2017 and are thinking of re-characterizing it as a Traditional IRA contribution need to do so by the end of 2017.

Summary

When the President signs the bill into law, it will represent the most significant tax reform in more than 30 years. These sweeping changes are intended to provide a more competitive tax system for business taxpayers and improved economic opportunities for individuals and families. Individuals and business owners should review the provisions that may affect them and take any needed action. Many of the provisions will take effect January 1, 2018, so there will be very little time to take advantage of the current tax rules and to position and prepare for the changes.