# An Overview of the 2017 Tax Legislation: Impact to Individuals

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# Summary of the Bill

On Friday, December 15, the House and Senate Tax Cuts and Jobs Act Conference Committee released details of the tax reform bill. The proposed bill comes after several weeks of negotiations to resolve differences in the House and Senate versions. The compromised reform bill was then signed into law by the President on December 22, 2017. Given that the use of the bill's original title was barred, this newly signed legislation went into law without a notable title. In this document, we will refer to the signed bill as the Act, or the Tax Reform Act.

As stated in the released Policy Highlights, the purpose of the Act is to overhaul "America's tax code to deliver historic tax relief for workers, families, and job creators, and revitalize our nation's economy."

In order to obtain this goal, the Committee must abide by rules which prevent creating too much of a deficit. As a result, the Bill is reflective of the balancing act between providing cuts and creating revenue in other areas to offset lost revenue. The Act's effective date is January 1, 2018, with most provisions not applicable for the 2017 tax year.

Highlights

- 21% corporate tax rate (reduced from the current 35% top rate)
- 37% top individual tax rate (reduced from the current top rate of 39.6%)
- Significant increase in the standard deduction amount
- Modification of the itemized deduction rules
- Retention of the individual AMT (corporate AMT repealed), but with increased exemptions
- Federal estate and gift tax retained with the doubling of estate and gift tax exemptions
- New tax regime for pass-through entities (e.g., S Corporations and Partnerships)
- More generous expensing for businesses



* Analysis conducted on 2018 inflation adjusted numbers if the law was not changed, as applicable.

# Individual Tax Provisions – What is Changing?

| | Previous Law – 2018 Rates* | Tax Reform Act | How to Take Action/Comments |
|---|---|---|---|
| **Top Tax Rate** | 39.6% | 37.0% | |

**Tax Bracket Income Thresholds – Single Filers & Married Filing Jointly (MFJ)**

Previous Law – 2018 Rates*

| Rates | Single | MFJ |
|---|---|---|
| 10% | < $9,525 | < $19,050 |
| 15% | < $38,700 | < $77,400 |
| 25% | < $93,700 | < $156,150 |
| 28% | < $195,450 | < $237,950 |
| 33% | < $424,950 | < $424,950 |
| 35% | < $426,700 | < $480,050 |
| 39.6% | Over $426,700 | Over $480,050 |

Tax Reform Act

| Rates | Single | MFJ |
|---|---|---|
| 10% | < $9,525 | < $19,050 |
| 12% | < $38,700 | < $77,400 |
| 22% | < $82,500 | < $165,000 |
| 24% | < $157,500 | < $315,000 |
| 32% | < $200,000 | < $400,000 |
| 35% | < $500,000 | < $600,000 |
| 37% | Over $500,000 | Over $600,000 |

**How to Take Action/Comments**

Rate changes expire after 2025.

The top rate reduced to 37% from the current 39.6%, and begins at higher income threshold for all filers.

New act retains same number of brackets (7), but reduces most rates and expands the thresholds for most income levels.

**Significance**: Due to lower rates, including the reduction of the top rates and the increase in the standard deduction, overall taxes will likely be lower. This saving though may be reduced or completely offset by the other changes in the tax act, most importantly being the changes to itemized deduction rules.

**Tax Tip**: If possible defer income till next year when tax rates are lower.

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| **Index Used for Inflation Adjustments** | Consumer Price Index (CPI) | Chained CPI | This change does not expire in 2025.<br><br>This change will likely result in smaller inflation adjustments than using CPI, resulting in smaller increases to tax items indexed for inflation (e.g. income thresholds, standard deduction increases, etc.).<br><br>**Significance:** Smaller inflation adjustments will result in an increase in taxes in subsequent years, the Tax Policy Center estimates that this change will result in $125 billion more tax revenue in the next 10 years; then nearly $500 billion in the subsequent 10 years. |
| **Standard Deduction** | Individuals - $6,500<br>MFJ - $13,000 | Individuals - $12,000<br>MFJ- $24,000 | Standard deduction amounts nearly doubled, increases expire after 12/31/2025.<br><br>**Significance**: Will result in less filers itemizing their deductions and generally less taxes for those who currently do not itemize. |
| **Itemized Deductions** | The range of eligible expenses are broad and include: state and local income taxes paid, medical expenses, certain job expenses and other miscellaneous deductions.<br>The amount of allowable itemized deductions are reduced at certain AGI phase-out thresholds ($320,000 for MFJ, $266,700 for single filers) | Most itemized deductions are modified or suspended.<br><br>No reduction to itemized deductions based on income level. | Taxpayers may itemize their deductions if the amount itemized exceeds the standard deduction.<br><br>Increase in the standard deduction will likely result in fewer individuals itemizing their deductions.<br><br>See following chart for additional details regarding tax reform act modification of certain itemized deductions. |



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# Individual Tax Provisions – What is Changing?

| | Previous Law – 2018 Rates* | Tax Reform Act | How to Take Action/Comments |
|---|---|---|---|
| **Capital Gains Taxes** | 2018 Long Term Capital Gain Threshold<br>Rates / Single / MFJ<br>10% / $0-$38,700 / $0-$77,400<br>15% / $38,700-$426,700 / $77,400-$480,050<br>20% / Over $426,700 / Over $480,050 | Retains the current law rates on net capital gains and qualified dividends, with same breakpoint amounts under present law. | No real changes to capital gain taxes in the new law, which follows the House and Senate versions of the act. |
| **Capital Gain Exclusion for Sale of Primary Residence** | Allows individuals to exclude up to $500,000 for MFJ and $250,000 for single filer of capital gains on a sale of a primary residence.<br><br>Homeowner must live in home 2 out of previous 5 years to be able to qualify for the exclusion, can utilize every 2 years. | Retained | Note: The House and Senate versions of the act required a homeowner to live in the residence 5 out of the previous 8 years, and allowed the exclusion to be used only once every 5 years. |
| **Net Investment Income (Medicare Surtax)** | As part of The Affordable Care Act, a 3.8% tax was levied on net investment income.<br><br>Tax applies to single filers with over $200,000 and MFJ with over $250,000 of modified AGI. | The tax reform act does not address the surtax, and therefore remains unchanged. | No real changes, tax remains intact. |

2018 Long Term Capital Gain Threshold

| Rates | Single | MFJ |
|---|---|---|
| 10% | $0-$38,700 | $0-$77,400 |
| 15% | $38,700-$426,700 | $77,400-$480,050 |
| 20% | Over $426,700 | Over $480,050 |



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# Individual Tax Provisions – What is Changing?

| | Previous Law – 2018 Rates* | Tax Reform Act | How to Take Action/Comments |
|---|---|---|---|
| **Personal Exemptions** | Can deduct $4,150 each for yourself, spouse, and dependents<br>Indexed for inflation<br>Currently, the benefit of personal exemption phases out for filers with income of $266,700 for single filers & $313,800 for MFJ. | Repealed | Repeal of Personal Exemption expires after 12/31/2025.<br><br>**Significance:** The inability to utilize personal exemptions would reduce the benefit of doubling the standard deduction but this negative impact can be mitigated by the increase in the child tax credit. Per the Joint Committee on Taxation, this repeal will result in $1.22 trillion in revenue over next 10 year period. |
| **Child Tax Credit** | $1,000 per child<br>(not indexed for inflation)<br><br>Phase out:<br>$110,000 (MFJ)<br>$75,000 Single | $2,000 per child<br>(not indexed for inflation)<br><br>Phase out:<br>$400,000 (MFJ)<br>$200,000 Single | Increase income thresholds will allow more households to utilize the credit than previously.<br><br>**Significance:** Increasing credit will offset some of the negative impact of the repeal of personal exemption since it is a credit which offset taxes on a dollar by dollar basis, and has been touted by Republicans as a major tax benefit for middle class families. |



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| **Alternative Minimum Tax (AMT)** | Alternate method to calculate tax liability and is imposed if it exceeds regular income tax – flat rates of 26% and 28%.<br><br>**<u>Exemption Amounts & Phase outs</u>**<br>MFJ: $86,200 (phase out at $164,100)<br>Single: $55,400 (phase out at $123,100) | Retained with higher exemption amounts.<br><br>**<u>Exemption Amounts & Phase outs</u>**<br>MFJ: $109,400 exemption (phase out at $1 million of income)<br>Single: $70,300 (phase out at $500k) | Exemption amount and phase out threshold increases are temporary and expire after 12/31/2025.<br><br>**Significance:** Increases to AMT exemption amount and substantial increase as to when these amounts are phased out will reduce AMT liability for those subject to it, plus due to the limitation and modification of itemized deductions fewer individuals will be subject to AMT. |
| **Section 529 Plans** | Distributions may be used for eligible college and for graduate expenses only. | Expanded to include tuition for students in K-12 private and parochial schools. Limited to distribution of $10,000 annually. | This change does not expire in 2025. |
| **Federal Estate & Gift Taxes** | $5.6 million exemption (single) in 2018 for both estate and gift tax purposes. | $10 million exemption (with inflation adjustment or $11.2 million per person in 2018) – no permanent repeal.<br><br>Law sunsets at the end of 2025. | The Tax Policy Center estimates that under current law (2017) 11,300 estate tax returns will be filed, with only 5,500 subject to federal estate taxes, with estimated estate taxes totaling $19.9 billion.<br><br>**Significance:** Doubling of the estate tax exemption under the new law will result in substantially less estate tax returns being filed. |

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# Itemized Deductions Under The New Tax Reform Act

| | Previous Law* | Tax Reform Act | How to Take Action/Comments |
|---|---|---|---|
| **State & Local Income Tax Deductions** | State and Local Income Taxes (SALT) are deductible as an itemized deduction.<br><br>The amount that can be deducted is unlimited (subject to overall limitation for all itemized deductions). | Caps the deductions for all non-business SALT, including property taxes, to $10,000 for MFJ and single filers.<br><br>Sale taxes can be included as well. | Could result in an increase in taxes for those who reside in states with high state income taxes like California and New York. Some of the increase may be offset by the higher standard deduction amount (depends on each taxpayer's individual situation).<br><br>$10,000 cap applies to non-business SALT and does not apply to SALT paid or accrued in carrying on a trade or business.<br><br>**Significance:** If your current itemized deductions including SALT are higher then the Act's increased standard deduction, you may incur higher taxes.<br><br>**Planning Tip:** Pay all state related taxes owed and imposed for 2017 tax year by the end of this year. (12/31/2017). If you live in a state with no income tax or utilize the sales tax deduction instead of the income tax deduction, purchasing large ticket items before the end of 2017 may be a good idea (cars, boats, refrigerators, etc.).<br><br>**Important Note:** A provision in the tax act disallows prepaying taxes in 2017 for taxes imposed for a year after 2017 (such as for 2018) to avoid the $10,000 limit. |



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## Itemized Deductions Under The New Tax Reform Act

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| **Mortgage Interest Deductions** | Can deduct the interest paid for acquisition debt of up to $1 million for MFJ and $500,000 for single filers.<br><br>Home equity debt interest up to $100,000 of debt deductible. | Limits mortgage interest deduction on up $750,000 to purchase of a principal residence and second home.<br><br>Mortgages incurred before 12/15/2017 are subject to the current $1 million limit.<br><br>Home equity interest deduction is repealed. | **Significance:** Since mortgages before 12/15/2017 are grandfathered, most taxpayers will not be substantially impacted unless their total itemized deductions do not exceed the new standard deduction amounts. |
| **Medical Expenses** | Deduction for out of pocket expenses which exceed a 10% adjusted gross income threshold (AGI). | Deduction is retained and enhanced by lowering the AGI threshold to 7.5% | Will allow taxpayers to obtain a larger deduction for medical expenses if they are able to itemize their deductions. |
| **Property & Casualty** | May claim a deduction for any loss sustained during the taxable year, which is not covered, by insurance or other means. | Deduction is only allowed for loss attributed to a natural disaster as declared by the President. | New law limits those who can utilize the deduction. |

- Outside of the above-mentioned deductions, and limitation imposed on deductions for wagering losses, most other deductions are suspended or repealed including Miscellaneous Itemized Deductions, subject to 2% floor.

- Deduction for alimony payments is repealed but not immediately. The new law will not apply to divorce or separation agreement entered into before 12/31/2018.

- Generally, these rules are effective until 12/31/2025.



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## Pass-Through Entities/ Pass-Through Tax Treatment

| | Previous Law* | Tax Reform Act | How to Take Action/Comments |
|---|---|---|---|
| **Tax Rate or Deduction of Pass-Through Earnings** | Top tax rate for income received from S corporations, partnerships, limited liability companies, or sole proprietorships is 39.6%, income taxed as ordinary income on individual's tax return. | Provides a new 20% deductions for qualified business income (QBI).<br><br>Deduction generally limited to 50% of allocable share of W-2 wages.<br><br>Owners of Pass-Through Entities would be able to deduct up to 20% of income, and is reduced if certain income thresholds are exceed. | Deduction expires at the end of 2025.<br><br>Will provide tax relief for owners of pass through entities.<br><br>**Tax Tip**: For those who currently own real estate personally, they may want to consider having these properties owned by a pass-through structure to take advantage of the deduction. |
| **Definition of Business Income** | NA | QBI defined as all domestic business income other than items such as investment income (e.g. dividends), investment interest income, short-term gains, etc. | |
| **Trust Ownership** | NA | Yes, applies to trust owned interest | Note: Senate version excluded trust ownership. |
| **Business Exclusions** | NA | Deduction generally not allowed for specified service trade or business (e.g. law, health, accounting, etc.) unless they are below certain income thresholds.<br><br>Phase out threshold for single filers starts at $157,000 and is completely phased out if income is over $207,500. For MFJ, phase out starts at $315,000 and is completely phased out if income is over $415,000. | Note: House version did not allow deduction for personal service companies, current version allows deduction if taxable income under certain thresholds. |



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