Summary of Individual Income Tax Changes under the Tax Cuts and Jobs Act of 2017

On December 22, the President signed into law the Tax Cuts and Jobs Act of 2017 (TCJA). TCJA is the largest tax overhaul since the 1986 Tax Reform Act and it will affect almost every individual and business in the United States. Generally, the new law goes into effect in 2018, with many of the provisions relating to individuals expiring at the end of 2025.

Overview of TCJA Changes Affecting Individuals

The following is a brief overview of TCJA's key changes (and non-changes) affecting individuals.

Tax Rates and Brackets. TCJA provides seven tax brackets, with most rates being two to three points lower than the ones under present law (the top rate goes from 39.6 percent to 37 percent). The top rate kicks in at $600,000 of taxable income for joint filers, $300,000 for married taxpayers filing separately, and $500,000 for all other individual taxpayers.

Observation: While applicable rates at any given level of income generally go down by two to three points, some go up. For example, the rate for single individuals with taxable income between $200,000 and $416,700 goes from 33 percent to 35 percent.

Capital Gain Rates and Net Investment Income Tax. Tax rates on capital gains and the 3.8 percent net investment income tax (NIIT) are unchanged by TCJA.

Personal Exemptions and Standard Deduction. TCJA repeals the personal exemption deductions, but nearly doubles the standard deduction amounts to $24,000 for joint filers and surviving spouses, $18,000 for heads of household, and $12,000 for single individuals and married filing separately (additional amounts for the elderly and blind are retained).

Observation: The fact that the standard deduction has nearly doubled may create the misleading impression that you'll reap a large tax benefit from the change. But, because the increase in the standard deduction was coupled with the repeal of the deduction for personal exemption ($4,150, per exemption in 2018), the actual benefit is fairly modest. For example, the overall amount of income that is exempt from tax will increase by $2,700 for joint filers - a nice increase, but nowhere near double the $13,000 standard deduction under prior law.

Because the standard deduction is generally claimed only when its amount exceeds available itemized deductions, the increases will not benefit you if you itemize (the repeal of personal exemptions, by contrast, will affect you whether you itemize or not).

Exemption for Dependents and Child Tax Credit. As part of the repeal of personal exemption deductions, TCJA repealed exemptions for dependents. To compensate, TCJA increases the child tax credit to $2,000 ($1,400 is refundable), up from $1,000 (fully refundable) under present law. The modified adjusted gross income threshold where the credit phases out is $400,000 for joint filers and $200,000 for all others (up from $230,000 and $115,000, respectively). The maximum age for a child eligible for the credit remains 16 (at the end of the tax year).

TCJA also provides a $500 nonrefundable tax credit for dependent children over age 16 and all other dependents. Most families with non-child dependents will lose some ground here, as the $500 credit will generally be less valuable than the $4,150 exemption deduction it replaces.

Other Tax Breaks for Families Unchanged. The child and dependent care expenses credit, the adoption credit, and the exclusions for dependent care assistance and adoption assistance under employer plans are all unchanged by TCJA.

Passthrough Tax Break. TCJA creates a new 20 percent deduction for qualified business income from sole proprietorships, S corporations, partnerships, and LLCs taxed as partnerships. The deduction, which is available to both itemizers and nonitemizers, is claimed by individuals on their personal tax returns as a reduction to taxable income. The new tax break is subject to some complicated restrictions and limitations, but the rules that apply to individuals with taxable income at or below $157,500 ($315,000 for joint filers) are simpler and more permissive than the ones that apply above those thresholds.

Example: In 2018, Joe receives a salary of $100,000 from his job at XYZ Corporation and $50,000 of qualified business income from a side business that he runs as a sole proprietorship. Joe has no other items of income or loss. Joe's deduction for qualified business income in 2018 is $10,000 (20 percent of $50,000).

Observation: The effective marginal tax rate on qualified business income for individuals in the top 37-percent tax bracket who are able to fully apply the new deduction will be 29.6 percent - fully 10 points lower than the top rate under current law.

Deduction for State and Local Taxes (SALT). TCJA imposes a $10,000 limit on the deduction for state and local taxes, which can be used for both property taxes and income taxes (or sales taxes in lieu of income taxes) and repeals the deduction for foreign property taxes. There is no limit on the amount of the SALT deduction under present law.

Mortgage Interest Deduction. TJCA reduces to $750,000 (from $1 million) the limit on the loan amount for which a mortgage interest deduction can be claimed by individuals, with existing loans grandfathered. TCJA also repeals the deduction for interest on home equity loans.

Deduction for Medical Expenses. An early version of the tax overhaul passed by the House would have repealed the deduction for unreimbursed medical expenses. TCJA retains that deduction and enhances it for 2017 and 2018 by lowering the adjusted gross income (AGI) floor for claiming the deduction from 10 percent to 7.5 percent for all taxpayers.

Deduction for Casualty and Theft Losses. TCJA repeals the deduction for casualty and theft losses, except for losses incurred in presidentially declared disaster areas.

Observation: The new law does, however, provide enhanced relief for victims in federally declared disaster areas in 2016 and 2017.

Deduction for Charitable Contributions. TCJA retains the charitable contribution deduction and increases the maximum contribution percentage limit from 50 percent of a taxpayer's contribution base to 60 percent for cash contributions to public charities.

Deduction for Certain Miscellaneous Expenses. TCJA repeals the deduction for any miscellaneous itemized deductions subject to 2-percent of AGI floor.

Repeal of Alimony Deduction. TCJA repeals the deduction for alimony paid and also the corresponding inclusion in income by the recipient, effective for tax years beginning in 2019. Alimony paid under separation agreements entered into prior to 2019 will generally be grandfathered under the old rules.

Education-Related Tax Breaks Preserved. TCJA retains deductions for student loan interest and educator expenses, and also exclusions for graduate student tuition waivers and employer educational assistance programs.

Alternative Minimum Tax. TCJA increases alternative minimum tax (AMT) exemption amounts by 27 percent, and sharply increases the income level where the exemption is phased out. Combined with the effects of other TCJA changes, many individuals who are currently subject AMT in 2017, will not be in 2018 and beyond.

Expanded Uses for 529 Plan Distributions. TCJA allows up to $10,000 in aggregate 529 distributions per year to be used for elementary and secondary school tuition. Under present law, 529 distributions can only be used for higher education expenses.

Repeal of Individual Healthcare Mandate. TCJA repeals the tax penalty on individuals who fail to carry health insurance enacted as part of the Affordable Care Act (ACA).

Estate and Gift Tax Exclusion. TCJA permanently doubles the basic exclusion amount for estate and gift tax purposes from $5.6 to $11.2 million. A provision fully repealing the estate tax beginning in 2025 was passed by the House, but didn't make it into TCJA, so the estate tax will remain in effect with the higher exclusion amount.

As you can see, the provisions in the TCJA are quite extensive and also quite complicated.

Please call me at your convenience so we can discuss how these changes will impact your tax situation, and what kind of strategies we can adopt to ensure that you get the best possible outcomes under the new rules.

Sincerely,

Urban, Thielemann, Oltmann & Herms, LLP