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The Tax Cuts and Jobs Act
December 19, 2017

The House and Senate are expected to vote soon on tax legislation (H.R.1) called the "Tax Cuts and Jobs Act." Assuming it passes both houses, the President has indicated that he will sign it.

Since the text of this bill was not released until Friday December 15th, there has been little time to read and analyze this complex legislation. I have reviewed as much material as I can, in order to provide you with this summary. Please keep in mind that I work primarily with individuals, not businesses, so my focus is on the individual provisions, not on the business provisions. Although the legislation is not yet final, I did not want to delay communicating with you, as the year is nearly over, and the holiday season is also upon us.

While this legislation is long and complicated, it does not live up to the standard of "tax reform." Your 2018 Form 1040 will look very, very similar to your 2017 Form 1040, albeit with some different numbers. The dreaded Alternative Minimum Tax still applies, but should affect fewer taxpayers. The much-vilified estate tax is still around, but now, with a $10 million per person exemption, which should exempt the vast majority of Americans. For perspective, the individual reductions in tax rates are paid for almost dollar for dollar by the elimination of the personal exemption. Similarly, the reduction in AMT taxes is paid for, again almost dollar for dollar, by the reduction in deductions of state and local taxes. The vast majority of the $1.456 trillion dollar cost to this bill over a 10-year period is attributable to the reduction in the corporate tax rate to 21%. The Joint Committee on Taxation estimates the cost of this single provision to be $1.348 trillion dollars over 10 years.

MOST of these provisions are effective 1/1/2018 and MOST of them also expire on 12/31/2025, though there are some exceptions.

With that, here is a line by line summary (from the perspective of the tax return) of many of the changes you can expect. This is only a sample of the provisions that will be applicable to most taxpayers. There are plenty of other, smaller changes. Disclaimer: Due to the limited amount time to review the legislation, there could be errors in the following analysis.

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INCOME

Alimony Received: Will no longer be taxable income (but alimony PAID will also no longer be deductible) for divorce agreements executed or modified after 12/31/2017.

IRA Distributions: Conversions from an IRA to a Roth IRA may no longer be “recharacterized” or reversed (which would be done if the value of the converted assets plummeted following conversion)

DEDUCTIONS FOR ADJUSTED GROSS INCOME

Moving Expenses: No longer deductible, except for members of the Armed Forces.

Alimony Paid: No longer tax deductible, for divorce agreement executed or modified after 12/31/2017.

ITEMIZED DEDUCTIONS/STANDARD DEDUCTION

The Standard Deduction: (remember, you take the higher of your Standard or Itemized Deductions) Increased to $12,000 for singles, $18,000 for head of households, and $24,000 for married filing joint.

The Medical Expense Deduction: Adjusted so that the threshold for deducting medical expenses is reduced to 7.5% (down from 10%) of Adjusted Gross Income, but for 2017 and 2018 ONLY.

State and Local Tax Deduction (including real estate taxes): Now limited to a MAXIMUM of $10,000. This is probably the most punitive provision for my clients.

Home Mortgage Interest: Deductible interest is limited to $750,000 of “acquisition indebtedness” if incurred AFTER 12/31/2017. Loans made BEFORE 1/1/2018 are still limited to $1,000,000 of acquisition indebtedness.

Home Equity Interest: No longer tax deductible.

Casualty and Theft Losses: Only deductible for losses incurred in an area declared a disaster by the President.

Miscellaneous Itemized Deductions: No longer deductible.

Overall Limitation on Itemized Deductions: This reduction in itemized deductions for certain upper-income taxpayers is repealed.

PERSONAL EXEMPTIONS

The deduction for personal exemptions of $4,050 per person is repealed.

TAX RATES

Almost all tax rates are reduced, though you may now be taxed on a higher income, due to loss of some deductions.

The Alternative Minimum Credit exemption amount is increased, as is the income range to phase out the exemption, meaning that the AMT should apply only to joint filers with income over $1,000,000.

CREDITS

The child tax credit is doubled from $1,000 to $2,000 for children who have not yet attained the age of 17. The phaseout of this credit now begins at $400,000 of Adjusted Gross Income for those married filing jointly, an increase from $110,000 under current law.

A $500 credit has also been created for dependents who are NOT qualifying children. Presumably this is intended for children who are dependents and age 17 or older, as well as for parents or others who may be dependents.

OTHER PROVISIONS

The “health care shared responsibility payment” is repealed. This is the tax imposed on taxpayers who do not have the Federally required health insurance.

The estate tax exemption is increased to $10,000,000 per person or $20,000,000 per couple, those effectively ending the estate tax for all but the very wealthy.

Section 529 plan money can now be used to pay for K-12 education, in addition to the intended purpose of saving for college.

PLANNING FOR 2017 AND 2018 AND BEYOND

Planning for 2017 will be difficult, for several reasons:

There are not very many days left in 2017.

We do not have software available to tell us what any individual’s tax burden will be in 2018, as compared to 2017.

That being said, here are some things you can consider for 2017:

If you expect that you will owe any income tax on your 2017 state return, you should make an estimated payment, either online or by writing a check, prior to 1/1/2018. This will give you the chance to deduct it in 2017. This will NOT apply to a taxpayer who will be in AMT in 2017, as tax payments are NOT deductible for AMT purposes.

Since tax rates for MOST taxpayers will be lower in 2018 than in 2017, making additional charitable contributions in 2017 will likely provide a greater tax benefit than making them in 2018. Contributions to a Donor Advised Fund, such as Fidelity Charitable, Vanguard Charitable or Schwab Charitable can be deducted in 2017, and doled out to charities over future years.

If you have home equity debt, you may want to think about paying that loan off, if you can, as that interest will no longer be deductible after 2017.

Planning for 2018 and beyond will take some time, as we see how these new rules affect individual taxpayers. Some initial thoughts:

Bunching of deductions (making two years' worth of charitable contributions in one year) to allow taking the standard deduction and itemized deductions in alternating years, will be become more viable for higher income taxpayers, now that the deduction for state, local and real estate taxes is capped at $10,000.

Contributions to Roth accounts, particularly through 401k and 403B plans, will become more attractive, given the lower tax rates we will see for the next few years, and the likely pendulum swing of tax rates back to higher tax rates down the road.

There will be winners and losers with this tax bill. It all comes down to the individual numbers.

In general, those who will be winners are:

Corporations—due to the lower tax rates.

High income taxpayers—who will benefit the most from lower rates, as well as a much higher phaseout of the child credit.

Taxpayers with children under age 17—who will benefit from the higher child credit.

Taxpayers who have been subject to AMT—due to the higher exemption.

In general, those who lose with this bill include:

Taxpayers with large real estate and income taxes-due to the $10,000 limit on these deductions.

Taxpayers with dependent children over the age of 16—due to the loss of personal exemptions.

Purchasers of expensive homes-due to the limitation on mortgage interest deductions.

This article only scratches the surface of the impact of this legislation. More will be known as the bill is read and analyzed, and as regulations concerning the law are issued.