H.R.1, Tax Cuts and Jobs ACT – High-level Observations

December 31, 2017

Introduction

The joint conference committee between the U.S. Senate and the U.S. House of Representatives approved the report on the agreement of H.R. 1 "The Tax Cuts and Jobs Act". It should be known that the agreement is a compromise between the original bills presented by both the House of Representatives and the Senate. The conference report was sent to the House and Senate where a floor debate took place. After the bill went back for debate, it was approved and then sent to the President of the United States for his signature.

Background

This tax reform bill process started in June 2016 with the release of the "House GOP Blueprint". Even though the GOP Blueprint never became an official bill, it started conversations within Republican circles that revisions should be made to the current tax code. Most of the discussions were centered on a reduction in the corporate tax rate and reform around the taxation of international business income. After the election of Donald Trump, the momentum for tax reform increased within the GOP. This momentum was mainly increased because after the November 2016 election the House, Senate and Office of the President are GOP based.

However, most of 2017 saw little progress on tax reform because the Republican congress focused more on healthcare and how to repeal provisions of the Affordable Care Act. After those efforts, congress turned their efforts to tax reform.

On September 27, 2017, the "Big Six" Republican principals released the 9-page "**Unified Framework on Tax Reform"**. The framework was very broad and didn't give details on the proposed tax reform. It gave high-level proposals on which areas to focus on in an effort to begin the tax reform processes. After the framework was released, the House and Senate started drafting their own tax bills that mirrored the framework. On November 2, 2017 the House Ways and Means Committee released legislative proposal "Tax Cuts and Jobs Act". The bill was then approved on November 16th and sent to the Senate. During the same time, on November 9th, the Senate Finance Committee released their proposed bill and then made amendments on November 16th. The Senate bill passed on December 2, 2017.

After the passing of both bills and their approvals, the House and Senate conferees were appointed on December 4th to reconcile the differences between the two bills.

Lastly, it should be known that the individual tax changes are temporary and the business changes are permanent. This whitepaper is an overview of the individual changes that are due to expire at the end of 2025.

Ordinary Individual Tax Rates

The unified conference agreement modifies the current individual income tax rate structure. Under current law, the individual tax rates are 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. The conference agreement still keeps seven tax rates that would go into effect for tax years beginning in 2018. Those new rates are 10%, 12%, 22%, 24%, 32%, 35%, and 37%. Taxpayers must realize that because of these tax rate changes, each outcome should be measured on a case-by-case basis. Below are the new tax rate tables for your reference:

Married Filing Jointly			
2018 Current Law		Conference Agreement	
Tax Rate	If Taxable Income is:	Tax Rate	If Taxable Income is:
10%	$0 to $19,050	10%	$0 to $19,050
15%	$19,051 to $77,400	12%	$19,051 to $77,400
25%	$77,401 to $156,150	22%	$77,401 to $165,000
28%	$156,151 to $237,950	24%	$165,001 to $315,000
33%	$237,951 to $424,950	32%	$315,001 to $400,000
35%	$424,951 to $480,050	35%	$400,001 to $600,000
39.60%	$480,051 or more	37%	$600,001 or more

Married Filing Separately			
2018 Current Law		Conference Agreement	
Tax Rate	If Taxable Income is:	Tax Rate	If Taxable Income is:
10%	$0 to $9,525	10%	$0 to $9,525
15%	$9,526 to $38,700	12%	$9,526 to $38,700
25%	$38,701 to $78,075	22%	$38,701 to $82,500
28%	$78,076 to $118,975	24%	$82,501 to $157,500
33%	$118,976 to $212,475	32%	$157,501 to $200,000
35%	$212,476 to $240,025	35%	$200,001 to $300,000
39.60%	$240,026 or more	37%	$300,001 or more

Head of Household			
2018 Current Law		Conference Agreement	
Tax Rate	If Taxable Income is:	Tax Rate	If Taxable Income is:
10%	$0 to $13,600	10%	$0 to $13,600
15%	$13,601 to $51,850	12%	$13,601 to $51,850
25%	$51,851 to $133,850	22%	$51,851 to $82,500
28%	$133,851 to $216,700	24%	$82,501 to $157,500
33%	$216,701 to $424,950	32%	$157,501 to $200,000
35%	$424,951 to $453,350	35%	$200,001 to $500,000
39.60%	$453,351 or more	37%	$500,001 or more

Single			
2018 Current Law		Conference Agreement	
Tax Rate	If Taxable Income is:	Tax Rate	If Taxable Income is:
10%	$0 to $9,525	10%	$0 to $9,525
15%	$9,526 to $38,700	12%	$9,526 to $38,700
25%	$38,701 to $93,700	22%	$38,701 to $82,500
28%	$93,701 to $195,450	24%	$82,501 to $157,500
33%	$195,451 to $424,950	32%	$157,501 to $200,000
35%	$424,951 to $426,700	35%	$200,001 to $500,000
39.60%	$426,701 or more	37%	$500,001 or more

New Indexing for Inflation Adjustments

Currently, annual inflation adjustments are made to the consumer price index (CPI). The CPI is used to determine the increase of certain tax adjustments, which are used to compute either taxable income, tax liabilities, or tax refunds. The new method of indexing tax rate thresholds, standard deduction amounts, and other amounts will be "chained CPI".

Chained CPI takes into account consumers' preferences for cheaper substitute goods instead of normally priced goods. Chained CPI will more than likely results in smaller increases to the indexed amounts mentioned above.

Filing Status, Exemptions and Standard Deductions

It should be known that under new tax law the filing status will not change. They are the following:

- Single
- Head of Household

- Married Filing Separately
- Married Filling Jointly
- Qualifying widow(er) with dependent child

The new standard deduction in 2018 will be $12,000 for single and married filing separately taxpayers, $18,000 for head of household taxpayers, and $24,000 for married filing jointly (and surviving spouses). The additional standard deduction for elderly and blind will be retained under the new law. It should also be known that under the new conference agreement, the increased standard deduction is intended to compensate for the repeal of the individual exemption amounts. The individual exemption amount for 2018 would've been $4,150.

Kiddie Tax

Currently, net unearned income of a child is taxed at the higher of the parents' tax rate or the child's tax rate. Under the new law, the taxing of unearned income for children is simplified by taxing that income at the ordinary and capital gains rates that applied to trusts and estates.

Child Tax Credits and Qualifying Dependent Credits

Under the new law the child tax credit will be increased to $2,000 ($1,000 previously) per qualifying child. There will also be a temporary $500 nonrefundable credit for those qualifying dependents that are not qualifying children.

It should be known that under the new rule, $1,400 of the child tax credit will be considered refundable. The income phase out for the credit is also set to change to $110,000 to $400,000 for married filing jointly and $75,000 to $200,000 for single filers. Lastly, the earned income credit is going to be lowered to $2,500. Lastly, taxpayers should know that all credits and thresholds will be indexed based on the new indexing methodology of "chained CPI".

Capital Gains and Dividend Income

There will be no change to the taxation of capital gains and dividends, which are subject to a maximum rate of either 15% or 20% (depending on income levels). The 3.8% net investment income tax will also stay in place going forward.

Itemized Deductions and Exclusions

Deduction for Property Taxes and State & Local Taxes

All of the following taxes are now limited to a $10,000 deduction combined: Property Taxes, State and Local Taxes, and Sales Tax. It should be known that this cap doesn't apply to these taxes when apart of business activity.

Home Mortgage Interest and Home Equity Loans

Under the new law the deduction for home mortgage interest is limited to the indebtedness of $750,000 (reduced from $1,000,000). Also, taxpayers would are no longer permitted to deduct mortgage interest incurred by a home equity loan. Lastly, any debt incurred prior to 12/15/2017 would still be permitted for deduction.

Percentage Limitation for Charitable Contributions

Under the new law the gross income limitation for charitable contributions (i.e. cash contributions) to qualified organizations is increased to 60% (up from 50%).

Casualty and Theft Losses

Under the current law, taxpayers could deduct all casualty and theft losses that would qualify as so. Under the new law, casualty and theft losses can only be deducted if incurred in a declared disaster area by the Federal Government.

Miscellaneous Itemized Deductions (2% Floor)

All miscellaneous itemized deductions subject to the 2% floor are no longer allowed for federal income tax purposes. A big item that falls into this category would be unreimbursed employee expenses.

Medical Expense Deduction

Under the new law taxpayers can deduction medical expenses in excess of 7.5% of adjusted gross income for tax years 2017 and 2018. After 2018, the excess must be more than 10% of adjusted gross income.

Itemized Deduction Limitation

Under the new law the overall limitation of itemized deductions is suspended. The current law states allowable deductions are reduced by 3% of the amount by which the taxpayers AGI begins to exceed a certain threshold.

Alternative Minimum Taxes

Under the new law it temporarily increases the Alternative Minimum Tax (AMT) exemption amount and phase out thresholds. The exemption amount and phase out threshold are now the following:

- Married – Exemption Amount ($109,000); Phase Out Threshold (increased from $164,000 to $1,000,000)

- Married Filing Separate – Exemption Amount ($54,700); Phase Out Threshold (increased from $82,050 to $500,000)
- Individual – Exemption Amount ($70,300); Phase Out Threshold (increased from $123,000 to $500,000)

Estate and Gift Taxation

The estate tax exclusion will now be doubled to $10,000,000 per individual. This applies to estates, gifts, and generation skipping transfers occurring after 2017.

Student Debt Discharge

Under new law, any income that is the result of the discharge of student debt due to death or disability is now excluded.

Education Savings Plans (529 Plans)

The new definition of higher education expenses is now expanded to include public, private, and religious elementary and secondary schools, and home school. For the prior mentioned educational establishments, the tax-free distribution is limited to $10,000 per student per year. This limitation still does not apply to post-secondary education (i.e. colleges and universities).

Lastly, this is one of the provisions in the new law that is not subject to expiration.

Alimony Payments

Under the new law, alimony payments are no longer deductible for the payor spouse and no longer considered income to the payee spouse. This is only effective for any divorce or separation occurring after 12/31/2018 and for agreements executed before but modified after that date.

Affordable Care Act

The excise tax that was previously imposed on taxpayers would did not have adequate healthcare coverage is now repealed as of 2019. This provision is not subject to expiration.

Retirement Savings

The special rule allowing contributions to one type of IRA to be recharacterized as a contribution to another type of IRA would no apply to a conversion of a Roth IRA going forward. A conversion contribution to a Roth IRA during the tax year is no longer allowed to be recharacterized as a contribution to a traditional IRA.

Passthrough Entities and Sole Proprietorships

Deduction of 20% for certain passthrough entities

Under the new law (effective 2018) individual taxpayers (including trusts and estates) will be allowed a 20% deduction of the domestic qualified business income from a partnership, sole proprietorship, or S-corporation. The deduction will be limited based on either wages paid or the same wages paid plus a capital element. All wages and wages paid must be in connection with the trade or business with involved qualified property. Qualified property is tangible property, which is subject to depreciation that is:

- Held by and available to use in the qualified trade;
- Is used at any point during the tax year in the production of qualified business income;
- For which the depreciable period has not yet ended

An individual's qualified business income for the tax year is the net income of domestic qualified income, gain, deduction and loss in connection to the qualified business. A qualified business is any trade or business other than a service oriented business. Service businesses such as health, law, accounting, actuarial science, performing arts, consulting, athletic etc. are excluded. However, it should be known that the deduction may apply to service oriented businesses with taxpayers with taxable income less than $315,000 (married taxpayers) and $157,000 (all other taxpayers).

20% of any dividends from a real estate investment trust (other than the capital gain portion) would be qualified items of income. Qualified business income would not include the amount paid to a taxpayer by an S-corporation as compensation. It would also not include the payment partnership payment to a partner in exchange for services.

Lastly, the 20% deduction would not be used in computing adjusted gross income. It will be used as a deduction from taxable income.

Conclusion

This high level whitepaper does not go into a detailed analysis. It also does not provide every change to the tax code. Corporate tax law changes (domestic and international) were not covered. Also, some personal tax topics were not covered because we saw that they may not affect a huge population of taxpayers. One cannot say that everyone is affected positively or negatively in regards to the new tax law changes. However, you can say that all taxpayers are affected in some way. In order to understand how each taxpayer is affected, an analysis must be done. Some taxpayers may see a decrease in their tax liability (or small refund increase) while others may see an increase in their tax liability.

The one thing that is apparent, the corporate tax changes (tax rate reductions or other repeals) are permanent.

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