Understanding and Planning for the Changes Made by the New Federal Tax Laws

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Overview

On December 20th, Congress passed and sent The Tax Cuts and Jobs Act to President Trump's desk for his signature. The resulting overhaul to the federal tax code will affect individuals and businesses alike in several ways. The following article summarizes some of the key features of this tax reform:

For Individuals

- **Individual Income Tax Brackets.** Retains seven separate tax brackets for individuals but lowers marginal tax rates for each bracket by roughly 1-4 percentage points from current rates. That means that the last dollar of income you earn going forward will generally be subject to about 1-4% less tax than it will be this year.

    1. For example, the top marginal tax rate paid by single filers earning up to $82,500, and married couples earning up to $165,000, will be reduced from 25% to 22%. Additionally, the marginal tax rate applied to the top income earners will be reduced from 39.6% to 37%.

- **Standard Deduction.** Nearly doubles the standard deduction to $12,000 for single filers and $24,000 for married couples.

    1. Since only the LARGER of a taxpayer's standard deduction and total itemized deductions is used to reduce taxable income, this increase in the standard deduction will likely result in less taxpayers needing to account for and itemize deductions for payments like home mortgage interest, property taxes, medical expenses, charitable contributions, etc.

- **Personal Exemption.** Eliminates the personal exemption deduction of roughly $4,000.

- **Child Tax Credit.** Doubles the child tax credit to $2,000 per child (under the age of 17), with up to $1,400 refundable, and increases the threshold for phasing out eligibility for the child tax credit up to $400,000 for married couples.

    1. Unlike a deduction, which reduces the amount of income subject to tax, a tax credit serves as a dollar for dollar reduction of the actual amount of tax due at the end of the day.

- **Itemized Deductions and Other Miscellaneous Items.**

    1. Eliminates the cap on the overall amount of itemized deductions that can be claimed.
    2. Individuals will only be able to deduct up to $10,000 in amounts paid for state and local taxes (but this cap will not apply to state and local taxes incurred in carrying on a trade or business such as farming).
    3. Individuals can still deduct mortgage interest for loans up to $750,000 (down from $1 million). However, home equity loan debt will no longer be deductible.
    4. Individuals can still deduct out-of-pocket medical expenses and will actually be able to deduct more of these than under current law.
    5. Tuition waivers for graduate students will remain non-taxable.
    6. Students can still deduct student loan interest up to $2,500 per year.
    7. Families will be able to use up to $10,000 of 529 Plan funds to pay for private school K-12 tuition.
    8. Individuals will no longer be able to deduct 80% of their athletic seat-related contributions. Therefore, if you have season tickets to college athletic events and normally take advantage of itemized deductions, you might consider paying for next year's tickets in advance.

- **Estate Tax Exemption.** For the next 8 years only (January 1, 2018 to December 31, 2025), the estate tax exemption will be essentially doubled up to $11.2 million for individuals and $22.4 million for married couples. This means individual estates with a value less than those amounts will not have to pay estate taxes during that time period.

These changes for individual taxpayers will take effect for the 2018 tax year, but similar to the changes in the estate tax exemption, most of these changes for individual taxpayers are set to EXPIRE after 2025 (i.e. will not available for 2026).

For Businesses

- **Corporate Tax Rate.** Permanently reduces the top tax rate applied to corporations from 35% to 21%.

- **Deduction for Pass-Through Income.** Provide a 20% deduction for income earned by businesses organized as pass-through entities—S-Corporations, LLCs, and Partnerships. Although this income will still flow through the entity and be subject to each owner's individual tax, only 80% of such earnings will effectively be subject to tax due to this new deduction. The ability to claim this deduction will begin to phase out for taxpayers in certain industries – law, accounting, dental, etc. – making more than $157,000 individually or $315,000 for married couples.

- **Business Interest Deduction.** Caps the business interest deduction available to corporations at 80% of earnings for a given year.

- **Expensing.** Enhances ability to immediately expense up to $1 million (up from $500 million) for certain business expenditures.

- **1031 Exchanges.** Limits the deferral of taxable gain liability to like-kind exchanges involving real property only.

Exploring Strategies to Save Money

Based on the above changes, you may wish to consult your tax attorney or other tax specialist to explore strategies for you or your business to take advantage of these changes, potentially including, among other strategies:

- Shifting additional business activities into corporations or pass through entities now subject to these lower rates;

- Taking steps to maximize the use of itemized deductions in the 2017 tax year, such as the home mortgage interest, medical, and charitable deductions; and

- Paying real estate taxes for 2017 tax year in 2017 rather than waiting until the 2018 due date or prepaying 2017 fourth quarter income taxes.

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