PIECES OF THE PUZZLE

December 2017

2017 Tax Reform: Individual Tax Changes in the "Tax Cuts and Jobs Act"

On December 22, 2017, the Tax Cuts and Jobs Act was signed by President Trump. The following is a summary of changes that affect individual taxpayers.

New Income Tax Rates and Brackets

For tax years beginning after December 31, 2017 and before January 1, 2026, seven tax rates apply for individuals: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The Act also provides four tax rates for estates and trusts: 10%, 24%, 35%, and 37%.

Standard Deduction Increased

For tax years beginning after year December 31, 2017 and before January 1, 2026, the standard deduction has increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other taxpayers. These amounts will be adjusted for inflation in tax years beginning after 2018. No changes were made to the current law for the additional standard deduction for the elderly and blind.

Personal Exemption Suspended

For tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for personal exemptions is effectively suspended by reducing the exemption amount to zero.

Kiddie Tax Modified

For tax years beginning after December 31, 2017, the taxable income of a child attributable to earned income is taxed under the rates for single individuals, and taxable income of a child attributable to net unearned income (interest, dividends, capital gains, etc.) is taxed according to the brackets applicable to trusts and estates (see above).

Capital Gains Provisions Conformed

The adjusted net capital gain of a non-corporate taxpayer (e.g. an individual) is taxed at maximum rates of 0%, 15%, or 20%. The Act generally retains present law maximum rates on net capital gains and qualified dividends.

Carried Interest

In general, the receipt of a capital interest for services provided to a partnership results in taxable compensation for the recipient. However, under a Safe Harbor rule, the receipt of a profits interest in exchange for services provided is not a taxable event to the recipient if the profits interest entitles the holder to share only on gains and profits generated after the date of issuance (and certain other requirements are met). Effective for tax years beginning after December 31, 2017, the Act effectively imposes a three year holding period requirement in order for certain partnership interests received in connection with performance of services to be taxed as a long term capital gain.

Deduction for Personal Casualty and Theft Losses Suspended

For tax years beginning after December 31, 2017 and before January 1, 2026, the personal casualty and theft loss deduction is suspended, except for personal casualty losses incurred in a federally declared disaster. However, were a taxpayer has personal casualty gains; the loss suspension doesn't apply to the extent that such loss doesn't exceed the gain.

Gambling Loss Limitation Modified

For tax years beginning after December 31, 2017 and before January 1, 2026, the limitation on wagering losses is modified to provide that all deductions for expenses incurred in carrying out wagering transactions (e.g. transportation, admission fees), and not just gambling losses, are limited to the extent of gambling winnings.

Child Tax Credit Increased

For tax years beginning after December 31, 2017 and before January 1, 2026, the Child Tax Credit has increased to $2,000 for each qualifying child under the age of 17. Changes are made to phase outs and refund ability during the same period. The income levels at which the credit phases out are increased to $400,000 for married taxpayers filing joint and $200,000 for all other taxpayers.

State and Local Tax Deduction Limited

For tax years beginning after December 31, 2017 and before January 1, 2026, subject to the exception described below, State, local, and foreign property taxes, and State and local sales taxes, are deductible only when paid or accrued in carrying on a trade or business or an activity generally for the production of income. However, a taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the aggregate of (i) State and local property taxes not paid or accrued and carrying on a trade or business and (ii) State and local income, were profits and excess profits taxes (or sales taxes in lieu of income, etc.) paid or accrued in the tax year.

Mortgage and Home Equity Indebtedness Interest Deduction Limited

The deduction for interest on home equity indebtedness is suspended and the deduction for mortgage interest is limited to underlying indebtedness for up to $750,000. For tax years after December 31, 2025 the prior $1,000,000 limitation is restored. The suspension for home equity indebtedness also ends for tax years beginning after December 31, 2025. The new lower limit doesn't apply to acquisition indebtedness incurred before December 15, 2017.

Further, the $1,000,000 limitation continues to apply to taxpayers who refinance existing qualified residence indebtedness that was incurred before December 15, 2017, so long as the indebtedness resulting from the refinancing doesn't exceed the amount of the refinanced indebtedness.

Medical Expense Deduction Threshold Temporarily Reduced

For tax years beginning after December 31, 2016 (this means calendar year 2017) and ending before January 1, 2019, the threshold on medical expenses deduction is reduced to 7.5% (the previous limitation was 10% of adjusted gross income) for all taxpayers.

Charitable Contribution Deduction Limitation Increased

The deduction for an individual's charitable contribution is limited to prescribed percentages of the taxpayer's "contribution base" (modified adjusted gross income). Under pre-Act law, the applicable percentages were 50%, 30%, or 20% and depended on the type of organization to which the contribution was made and whether the contribution consisted of capital gain property. Further, no charitable contribution is allowed for contributions of $250 or more unless the donor substantiates the contribution by contemporaneous written acknowledgement (CWA) from the donee organization.

For contributions made in the tax years beginning after December 31, 2017 and before January 1, 2026, the 50% limitation for cash contributions to public charities is increased to 60%. And, for contributions made in tax years beginning after December 31, 2016 (this begins in 2017) the requirement for the CWA is repealed.

No Deduction for Amounts Paid for College Athletics Seating Rights

For contributions made in tax years beginning after December 31, 2017, no charitable deduction is allowed for any payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event.

Alimony Deduction by Payor/Inclusion by Payee Suspended

For any divorce or separation agreement executed after December 31, 2018, or executed before that date but modified after it (if the modification expressly provides that the new amendments apply), alimony and separate maintenance payments are not deductible by the payor spouse and are not included in the income of the payee spouse. Rather, income use for alimony is taxed at the rate applicable to the payor spouse.

Miscellaneous Itemized Deduction Suspended

For the tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for miscellaneous itemized deductions that are subject to the 2% floor of adjusted gross income is suspended.

Overall Limitation ("Pease Limitation") Itemized Deduction Suspended

Under pre-Act law, higher income taxpayers who itemized their deductions were subject to a limitation or a phase out on these deductions (commonly known as the "Pease limitation"). For tax years beginning after December 31, 2017 and before January 1, 2026, the "Pease limitation" on itemized deductions is suspended. In other words, there is no longer a phase out or a reduction of itemized deductions.

Exclusion for Moving Expense Reimbursement Suspended

Under pre-Act law, an employee could exclude qualified moving expense reimbursements from his or her gross income and from his or her wages for employment tax purposes. For tax years beginning after December 31, 2017 and before January 1, 2026, the exclusion for qualified moving expense reimbursements is suspended, except for members of the Armed Forces on active duty (and their spouses and dependents) who move pursuant to a military order and incident to a permanent change of station.

Moving Expenses Deductions Suspended

Under pre-Act law, taxpayers could claim a deduction for moving expenses incurred in connection in starting a new job if the new work place was at least 50 miles farther from the taxpayer's former residence than the former place of work. For tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for moving expenses is suspended, expect for members of the Armed Forces on active duty who move pursuant to a military order and incident to a permanent change of station.

Repeal of the Affordable Care Act ("Obamacare") Individual Mandate

For months beginning after December 31, 2018 the amount of the individual shared responsibility payment is reduced to zero. This means that after 2018, the individual mandate requiring minimum essential coverage or the requirement to pay a penalty with your federal tax return is repealed permanently. However, the Act leaves intact the 3.8% net investment income tax and the 0.9% additional Medicare tax, both enacted by the Affordable Care Act.

Alternative Minimum Tax (AMT)

For tax years beginning after December 31, 2017 and before January 1, 2026, exemptions for individuals are as follows:

Joint returns and surviving spouses, $109,400
Single taxpayers, $70,300
Married filing separately, $54,700

Expanded Use of 529 Account Funds

Under pre-Act law, funds in a Code section 529 College Savings Account could only be used for a qualified higher education expenses. For distributions after December 31, 2017, "qualified higher education expenses" include tuition at an elementary or secondary public, private, or religious school, up to a $10,000 limit per tax year.

New Deferral Election for Qualified Equity Grants

Generally effective with respect to stock attributable to options exercised or restricted stock units (RSUs) settled after December 31, 2017 (subject to a transition rule), a qualified employee can elect to defer, for income tax purposes, recognition of the amount of income attributable to qualified stock transferred to the employee by the employer. The election applies only for income tax purposes; the application of FICA and unemployment is not affected.

The election must be made no later than 30 days after the first time the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier.

Repeal of the Rule Allowing Re-Characterization of IRA Contributions

Under pre-Act law, if an individual makes a contribution to an IRA (traditional or Roth) for a tax year, the individual is allowed to re-characterize the contribution as a contribution to the other type of IRA (traditional or Roth) by making a trustee-to-trustee transfer to the other type of IRA before the due date of the individual's income tax return for that year. For tax years beginning after December 31, 2017, the rule that allows a contribution to one type of IRA to be re-characterized as a contribution to the other type of IRA does not apply to conversion contributions to a Roth IRA. Thus, re-characterization cannot be used to unwind a Roth conversion.

Certain Self-Created Property Not Treated as Capital Asset

Effective for dispositions after December 31, 2017, certain assets such as patents, inventions, models, or designs (whether or not patented), and secret formulas or processes, which are held either by the taxpayer who created the property or by a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created), are excluded from the definition of a "capital asset" and therefore not subject to capital gain treatment upon disposition.

Estate and Gift Tax Increased Exemption

For estates of decedents dying and gifts made after December 31, 2017 and before January 1, 2026, the Act doubles the base the estate and gift exemption amount from $5,000,000 to $10,000,000. The $10,000,000 amount is indexed for inflation occurring after 2017 and is expected to be approximately 11.2 million in 2018 (22.4 million per married couple).

This sweeping tax reform measure has been the most significant in over thirty years since the Tax Reform Act of 1986. We hope this summary provides you with needed information. If you have any questions, please feel free to contact us.

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