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Tax Cuts and Jobs Act

by
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As Congress debates, revises, and “marks up” the House Tax Cuts and Jobs Act (TCJA), we thought it was a good idea to provide a brief synopsis of the provisions that will affect you. Please note this is not an exhaustive review, but rather, a summary of the provisions likely to affect your federal income tax liability. As you may already know, the proposed reforms reduce the existing number of tax brackets from seven to four:

Tax Rate	Lower Income Treshold	Upper Income Treshold
0%	$0	$23,999
12%	$24,000	$89,999
25%	$90,000	$259,999
35%	$260,000	$999,999
39.6%	$1,000,000	

The TCJA also provides for a maximum tax rate of 25% on pass-through business income. Consequently, this provision can provide tax relief to business owners with income exceeding $260,000.

In an effort to simplify filing personal income tax returns, the TCJA will increase the standard deduction as follows:

$12,200 for Single
$24,400 for Married Filing Joint (MFJ)
$18,300 for Head of Household

In light of the new deduction reforms, just as with the current rules, taxpayers should elect the standard deduction if their itemized deductions are less than the above standard deduction amounts. The TCJA repeals the personal exemption, and several itemized deductions including the deduction available for state and local income taxes paid. The bill also limits the deductibility of real estate/ property taxes to $10,000.

Finally, the bill also reduces the home mortgage acquisition indebtedness threshold from $1,000,000 to $500,000. Consequently, if a taxpayer were to borrow more than $500,000 to purchase a home, s/he could not deduct the interest attributable to the amounts borrowed over that threshold.

Deductibility of charitable contributions remains unchanged. Consequently, there is no rush to make charitable contributions in anticipation of repeal of this provision. However, higher income earners may consider making charitable contributions to take advantage of a higher net deduction if they face a higher effective income tax rate under existing rates versus those proposed under the TCJA.

One aspect of the TCJA that certainly reduces complexity of the code is the renewal of the the anachronistic alternative minimum tax (AMT).

RETIREMENT PLANS

Foremost, the TCJA will not affect the available pre-tax treatment of 401k contributions. However, the option to reduce the maximum amount, $18,500 for 2018, remains “on the table”.

Other notable changes under this topic include an extension of the period of time a borrower can repay a loan under an employer-sponsored retirement plan (e.g., a 401k plan) after leaving a job. Currently borrowers have 60 days to repay any outstanding loans against their 401k plans upon leaving a job. Failing to do so results in the inclusion of the loan amount in taxable income and subjects this amount to an early distribution penalty. The TCJA extends the deadline from repayment until the due date of the tax return for the tax year in which the 401k owner borrowed the money. For example, a January 2018 loan for someone leaving a job would have until April 2019 to repay the loan without any income tax implication.

Hardship distributions would also allow the account owner to withdraw against account earnings and employer contributions (currently unavailable), and also permit the account owner to continue contributing to his or her retirement plan. Current rules institute a six-month suspension of account contributions after an account owner borrows from his or her plan.

Although there is no clear direction on whether they will repeal the ability to convert Traditional IRA assets to a Roth IRA, the TCJA does repeal the ability to re-characterize those conversions. To clarify, a re-characterization is the "mulligan" permitted to undo a conversion. Re-characterizations are advantageous when the value of converted assets fall in value subsequent to the conversion because you do not pay tax on the higher converted amount. The act eliminates the ability to undo the conversion.

CHILDREN

The most prominent provision under this topic is the increase in the child tax credit from $1,000 to $1,600. The TCJA also increases the adjustable gross income (AGI) threshold $110,000 to $230,000. It also establishes a temporary (for six years) Non-child Dependent Credit of $300, and a $300 Family Flexibility Credit when caring for non-child dependents. Both of these credits expire in 2022. However, the TCJA also repeals the Dependent Care Credit (e.g., think daycare expenses).

EDUCATION:

The TCJA offers an extension of half of the American Opportunity Credit (AOC) for one more year beyond the currently available four-year term. Currently the AOC provides for a maximum tax credit of $2,500. The TCJA would permit a taxpayer to claim up to a $1,250 income tax credit in year five. Otherwise, the TCJA repeals the Lifetime Learning Credit (currently available indefinitely) and student Loan interest deduction. It also eliminates the tax-free treatment of US Savings Bond interest used for educational expenses.

The TCJA prohibits contributions to a Coverdell ESA (which no one really uses) after 2017. However, the TCJA would expand the scope of qualified distributions from 529 plans for elementary and secondary (high school) education.

OTHER NOTABLE PROVISIONS

There are three important sections of the TCJA that are not receiving much media attention. First, with the increase of the standard deduction, as you might deduce, Congress is eliminating other itemized deductions. Among the eliminated deductions are deductions for moving expenses, alimony paid, tax preparation, and investment expenses. Conse-quently, if you are considering a work-related move that would qualify you for the deduction, do so before the end of the year! The same is true for anyone finalizing a divorce. Payment of alimony will be deductible only for divorce agreements finalized before year end.

Second, the TCJA repeals the adoption tax credit available for qualified adoption expenses.

Third, the TCJA increases the period of time taxpayers must own and occupy a principal residence to qualify for the capital gain exclusion on the sale of that home. Current rules require a taxpayer(s) to own and occupy the home as their principal residence for at least two of the five years prior to sale to avoid including the capital gain from such sale in their income. The exclusion permits Single and Married Filing Joint (MFJ) filers to exclude up to $250,000 and $500,000 of gain respectively.

New rules under the TCJA require that tax payer(s) occupy the home for at least five of the eight years prior to the year of sale. The TCJA will also institute reduction (but not complete phase out) of this exclusion for Single/MFJ filers if their respective AGIs exceed $250,000/$500,000. Consequently, if you find yourself selling a home with the prospect of capital gain, and do not meet the new 5/8 years requirement, you may wish to close the sale prior to the enactment of the TCJA.

ESTATE TAX REPEAL? EVENTUALLY…

Finally, the TCJA would increase the unified credit exemption amount (i.e., the value of an estate below which the estate avoids estate tax liability) to $10 million/person. The TCJA establishes this higher exemption amount for the next six years at which time it repeals the estate tax. However, unlike the temporary 2010 repeal, the TCJA also maintains the cost basis step-up for inherited assets. As such, heirs receiving such bequests would be able to adjust their cost basis in an asset to the fair market value as of the date of the decedent's death.

Senate Revisions: November 15, 2017

Yesterday Senate Republicans added a provision to repeal the healthcare coverage mandate imposed under the 2010 Affordable Care Act (ACA). With the additional tax revenue (resulting from the anticipated decline in subsidies under the ACA) the Senate proposed to reduce marginal income tax rates and increase the Child Tax Credit to $2,000. The Senate proposal reduces the proposed marginal income tax rates to 22%, 24%, and 32% (from the suggested 25%, 25%, and 35%). Under these changes the income tax cuts for individuals and pass-through businesses would expire after 2025.

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