KEY PROVISIONS OF

THE TAX CUTS AND JOBS ACT (TCJA) OF 2017

BGW CPA
Balance. Growth. Wisdom.

New tax laws resulting from the TCJA represent the most significant changes in our tax structure in more than 30 years. Most provisions for individuals sunset after 2025, but business code changes are considered “permanent”.

Personal Income Tax Brackets

2018 Rate	Single Filer	Joint Filer
10%	$0 - $9,525	$0 - $19,050
12%	$9,526 - $38,700	$19,051 - $77,400
22%	$38,701 - $82,500	$77,401 - $165,000
24%	$82,501 - $157,500	$165,001 - $315,000
32%	$157,501 - $200,000	$315,001 - $400,000
35%	$200,001 - $500,000	$400,001 - $600,000
37%	$500,000+	$600,000+

Standard Deduction

The standard deduction will increase from $6,350 (individual)/$12,700 (joint) to $12,000/$24,000. There is also a repeal of the personal exemption and the surtax imposed by the phasing out of the benefit from your itemized deductions.

Individual State and Local tax (SALT) Deductions

Individuals can deduct no more than $10,000 of a combination of state and local property taxes and either sales or income taxes from their federal taxes. Previously, individuals could deduct all SALT (up to a certain limit for high-earners). Exceptions:

- Tax imposed at entity level.
- Property tax for residential rental property or business property.

Dependent Exemption

Eliminated

Child and Dependent Tax Credit

The final bill doubles the child tax credit to $2,000, provides a credit for each child under the age of 17, raises the earnings phase-out threshold for couples from $110,000 to $400,000 and caps the refundable portion at $1,400 in 2018. Previous law included a $1,000 credit for each child under the age of 17 that was partially refundable to qualified taxpayers earning more than $3,000.

There is now also a $500 credit for each non-child dependent in the taxpayer's care.

529 Plans

Funds from 529 college savings plans can now be used to pay for private school tuition (up to $10,000 per student each year) at the elementary and secondary school level.

Mortgage Interest Deduction

The bill lowers the cap on mortgage debt eligible for deductions from $1 million to $750,000 and eliminates deductions for home

equity debt (previously capped at $100,000), except if the homeowner uses the money for home improvements, in which case the ceiling on both is $750,000. The deduction for second homes survived the final bill, with the $750,000 cap applying in aggregate to mortgage debt. New mortgage debt caps will apply only to new mortgages.

Medical Expense Deduction

This deduction will actually be expanded for the tax years of 2017 and 2018. Current law allows taxpayers to deduct medical expenses exceeding 10% of Adjusted Gross Income (AGI), while the new law will reduce

the threshold to 7.5% for two years. After 2018, the deduction reverts to 10% of AGI.

Alternative Minimum Tax (AMT)

An individual or married couple pays the higher amount between regular income tax and the AMT. The Senate approach, which prevailed in the final bill, retained the AMT while increasing the exemption amount and phase-out threshold.

The AMT exemption is the amount you subtract from your Alternative Minimum Taxable Income (AMTI) – which (as opposed to regular taxable income) does not allow the standard deduction, personal exemptions or many itemized deductions – for calculating AMT tax liability. Think of the AMT exemption as the standard deduction for AMT payers.

The current AMT exemption is $54,300

(individual)/$84,500 (joint). The new law would raise it to $70,300/$109,400. The exemption gradually phases out as AMTI increases. Under current law, the exemption phases out at a rate of 25 cents for every dollar of additional AMTI above $120,700 (individual)/$160,900 (joint). Under the new law, the exemption begins phasing out at $500,000/$1 million.

Changes to the AMT exemption and phase-out thresholds, combined with fewer itemized deductions, a higher standard deduction and new lower income tax brackets, will dramatically reduce the number of people and amount of income subject to the AMT.

Capital Gains Rates + Surtax on Investment Income--A Fourth Bracket

The TCJA maintains the top rate for long-term capital gains and qualified dividends at 20%. The surtax on investment income at the top rate on capital gains and dividends remains in place, keeping the top rate at 23.8%.

Qualified dividends for all taxpayers will continue to be taxed at capital gains tax rates rather than ordinary income tax rates. This amendment, accompanied by the net investment tax (NIIT), creates four tax brackets for the long-term capital gains and dividend income as follows:

2018 Capital Gains & Qualified Dividends Tax Rates + Surtax on Investment Income

Rate for Taxpayers	Married, Filing Jointly	Single
0%	**$0 - $77,200**	**$0 - $38,600**
15%	**$77,201 - $250,000**	**$38,601 - $200,000**
15% + 3.8%* = 18.8%	**$250,001 - $479,000**	**$200,001 - $425,800**
20% + 3.8%* = 23.8%	**$479,001+**	**$425,801+**

***Net investment income tax**

Other Individual Changes to Note

- Casualty losses will now only come from federally-declared disaster areas.
- Alimony deduction/inclusion repealed for divorces executed after 12/31/18.
- Moving expenses deduction repealed.
- Kiddie tax now at estates/trusts rate.

Corporate Tax Rate

The corporate tax rate will be cut from 35% to 21%, with the new rate taking immediate effect in 2018. The final bill also eliminates the corporate Alternative Minimum Tax (AMT).

Business Income From Pass-Through Entities

Business owners of sole-proprietorships,

partnerships, S corporations and LLCs reporting business income on personal tax returns will now be able to deduct 20% of "qualified business income." Qualified Business Income (QBI) is the net amount

of qualified income, gains, deductions and losses for the business. However, in an effort to limit the appeal of business owners reclassifying their wages as business income eligible for the pass-through rate (i.e. an employee leaving their firm and then contracting back via a pass-through entity), the new bill puts a number of restrictions in place. Most notably, QBI does not include certain investment-related income, deductions, losses, "reasonable compensation" to S corp shareholders (to prevent them from under-paying themselves to minimize tax liability) and guaranteed payments to partners in an LLC or partnership.

The deduction is limited to the lesser of 20% of business income or 50% of total W-2 wages paid by the business. Thus, a high-income business with few employees would likely be limited to a deduction of 50% of wages. However, a controversial provision (which was not part of the original House or Senate bills) was inserted into the final bill providing relief for capital-intensive businesses with few employees, such as real estate entities and machine-heavy factories. The provision creates an alternative wage limit of 25% of wages plus 2.5% of the unadjusted basis of depreciable property that kicks in if the individual's taxable income exceeds a threshold of $157,500 (individual) /$315,000 (joint).

Finally, the deduction for QBI does not fully apply to specified service businesses, including healthcare, consulting, law, accounting, financial services, performing arts and athletics, where the principal asset of the business is the reputation or skill of one or more of its employees. Specified service business owners with income exceeding $157,500 (individual)/$315,000 (joint) will phase out of the QBI deduction at the next 50,000/$100,000 of income ($207,500/$415,000).

The aforementioned last-minute change to pass- through provisions in the bill excluded engineers and architects from these service business limitations.

Misc. Itemized Deductions Subject to 2% AGI -- no longer deductible

- Unreimbursed employee expenses
- Tax prep fees
- Hobby expenses
- Investment fees/expenses
- Legal fees associated with producing income
- Safe deposit fees
- Gambling losses (in excess of winnings)

Affordable Care Act Impact

- Individual mandate repealed for 2019 forward (still in effect for 2017 and 2018).
- 2017 penalty: Higher of 2.5% of yearly household income OR $695 per person ($347.50 per child under age 18).

Changes to Charitable Contributions

- AGI limitation increased to 60% for cash contributions (up from 50%).
- No 80% deduction for right to purchase athletic tickets.
- Exception to contemporaneous written acknowledgement requirement is repealed (must be obtained now for any contribution ≥$250).

Changes to Fringe Benefits/Entertainment Expense

- Repeal of business entertainment expenses
- Repeal of deduction for qualified transportation fringe benefits
- Repeal of exclusion for bicycle commuting reimbursement
- Repeal of exclusion for employee reimbursed moving expenses
- Other changes to employee fringe benefits

Net Operating Loss Provisions

- No longer allowed to carryback NOLs (carried forward indefinitely)
- 80% of taxable income may be reduced by NOL

Other Business Changes to Note

- New limits on executive compensation deduction
- Changes for Sec. 1031 exchanges
- Changes to carried interest rule
- Expenses for employers operating eating facilities now 50% (no longer fully deductible)
- New credit for paid family and medical leave

Asset Location In Taxable And Tax-Deferred Account

The disparity between tax rates for qualifying dividends and long-term capital gains compared to ordinary income tax rates may offer a significant planning opportunity for investors in terms of where assets are held.

Taxable vs. Tax-Deferred Accounts

Dividends carry a maximum tax rate of 23.8% (20% dividends rate plus the 3.8% NII surtax on investment income), while ordinary income tax rates may be as high as 40.8% (37% ordinary income tax rate plus the 3.8% NII surtax on investment income). The lower tax rate on dividends suggests placing higher dividend-paying securities in taxable rather than tax-deferred accounts. Investors lose the opportunity to defer current taxes on these dividends, but it may be preferable to paying the ordinary income tax rate when taking distributions from tax-deferred accounts. With the maximum long-term capital gains rate at 23.8% it may be appropriate to hold long-term property in taxable accounts and short-term (actively managed) property in tax-deferred accounts. If dividend and capital gains rates increase in future years, this strategy may need to be reconsidered.

Investments that generate higher tax liabilities, such as high dividend-paying investments, may be appropriate to hold in tax-deferred accounts.

Tax-Deferred Accounts: Traditional IRA vs. Roth IRA Accounts

Qualified distributions from a Roth IRA are tax-exempt, meaning investors do not pay taxes on the long-term growth of the assets.

In contrast, qualified distributions from a tax-deferred account (such as a traditional IRA, 401(k) and tax-deferred annuities),

are taxed as ordinary income with no distinction between principal and growth. Because of these differences in taxation, it may be advantageous to place assets with greater expected returns in tax- exempt accounts.

The decision regarding which assets to hold in tax-deferred and taxable accounts is a function of many factors, only one of which is taxes. Consult with both your CPA and your wealth advisor.

Estate Tax and Wealth Transfer Planning in 2018

For an estate of any decedent dying during calendar year 2018, the basic exclusion amount is $11,180,000 or $22,360,000 for a married couple. The annual gifting exclusion was increased to $15,000 per recipient per year.