The “Tax Cuts and Jobs Act”

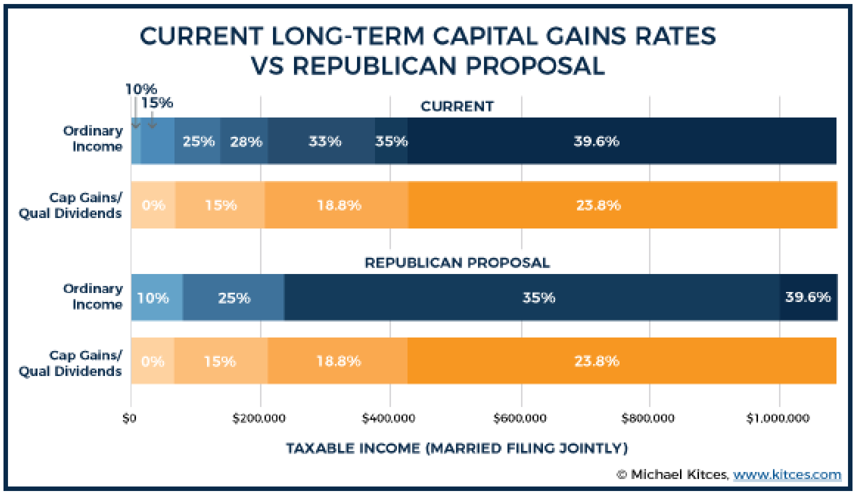
November 3, 2017: Yesterday House Republicans released details of the “Tax Cuts and Jobs Act” (link: Tax Bill). The plan calls for steep tax cuts in business tax rates, an eventual repeal of the estate tax, a reduction in the number of individual income tax brackets, elimination of the Alternative Minimum Tax, significant changes to itemized deductions and the standard deduction, as well as a host of other changes that have both positive and negative impacts to middle and high-income taxpayers.

The Tax Policy Center, a nonpartisan think tank based in Washington D.C., cites five big take-aways:

1. It is a tax cut, not tax reform.
2. It is not the biggest income tax cut in history – not even close.
3. For households, it will almost surely create winners and losers. Many middle-income households are likely to pay more under this plan, not less.
4. It is not tax simplification. Indeed, for many taxpayers the House bill would make filing more complicated
5. At the end of 10 years, it likely would end up increasing the deficit by far more than the advertised $1.5 trillion (TPC estimates $2.4 trillion and it will not lead to a 3 percent permanent economic growth).

The Bill is lengthy, with some provisions that affect all of our clients and some that affect none. Below is a summary of key components:

- **Tax Brackets:** The Act would reduce the number of tax brackets (ranging from 10% to 39.6%) from seven to four: 12%, 25%, 35%, and 39.6%.
    - The 39.6% bracket would begin at $1 million for joint returns/surviving spouses.
- **Capital Gains:** Capital gains rates would largely stay the same – 0% for taxpayers earning less than $77,200 (joint), 15% if earning less than $479,000, and 20% for all others.



- **Standard Deduction:** The Act would increase the standard deduction to $24,400 for joint filers, $18,300 for single filers with at least one qualifying child, and $12,200 in any other case.
    - This increase would significantly reduce the number of taxpayers who itemize their deductions.

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- **Itemized Deductions**
  - *Mortgage Interest:* The Act would retain the home mortgage interest deduction in its current form ($1 million cap) for mortgages that already exist on November 2, 2017, as well as for taxpayers who have entered into a binding written contract before that date to purchase a home. However, for newly purchased homes, the deduction will be limited to $500,000.
    - The Act would also limit taxpayers to deduct interest on only one qualified residence.
  - *State and Local Taxes:* The Act would eliminate the deduction for State and local income or sales tax, but would retain the deduction for real property taxes, subject to a $10,000 maximum.
  - *Medical Expenses:* The Act would eliminate the deduction for medical expenses.

- **"Pass Through" Business Tax Rate:** The Act would provide a new maximum rate of 25% on the business income of individuals. The Act sets out a formula under which it reduces the tax that would otherwise apply to "qualified business income" in order to achieve this maximum rate.
  - Passive business activity qualifies for 100% of income to be taxed at the new maximum rate.
  - Active business activity qualifies for at least 30% at the new rate, but the remainder taxed at potentially higher, ordinary income rates.
    - However, certain personal services business – law, accounting, consulting, etc. – wouldn't be eligible at all for the 25% business income rate.

- **Corporate Tax Rate:** The corporate tax rate would generally be a flat 20% rate beginning in 2018, eliminating the current graduated rates of 15%, 25%, 34%, and 35%. This would bring the U.S. in line with the rest of the other 34 industrialized countries in the OECD, which have an average statutory corporate income tax rate of 21.97 percent.

- **100% Cost Recovery Deduction:** Taxpayers would be able to fully and immediately expense 100% of the cost of qualified property acquired and placed in service, but this provision would sunset in five years.

- **Education Incentives**
  - The Act would consolidate three higher education credits under current law – the American Opportunity Tax Credit (AOTC), the Hope Scholarship Credit (HSC), and the Lifetime Learning Credit (LLC) – into an "enhanced" AOTC.
  - No new contributions to Coverdell education savings accounts after 2017.
  - The Act would treat up to $10,000 per year for elementary and high school expenses as "qualified expenses" from Section 529 plans.

- **Retirement Savings – Roth IRA Recharacterization:** The Act would repeal the current-law provisions under which an individual may re-characterize a contribution to a traditional IRA as a contribution to a Roth IRA (and vice versa) and may also recharacterize a conversion of a traditional IRA to a Roth IRA.

- **Gain from Sale of Principal Residence:** In order to exclude gain from the sale of a principal residence (up to $500,000 for joint filers; $250,000 for others), a taxpayer would have to own and use as a home the residence for <u>five out of the previous eight years</u> (as opposed to two out of five years under current law).
  - The exclusion could only be used once every five years

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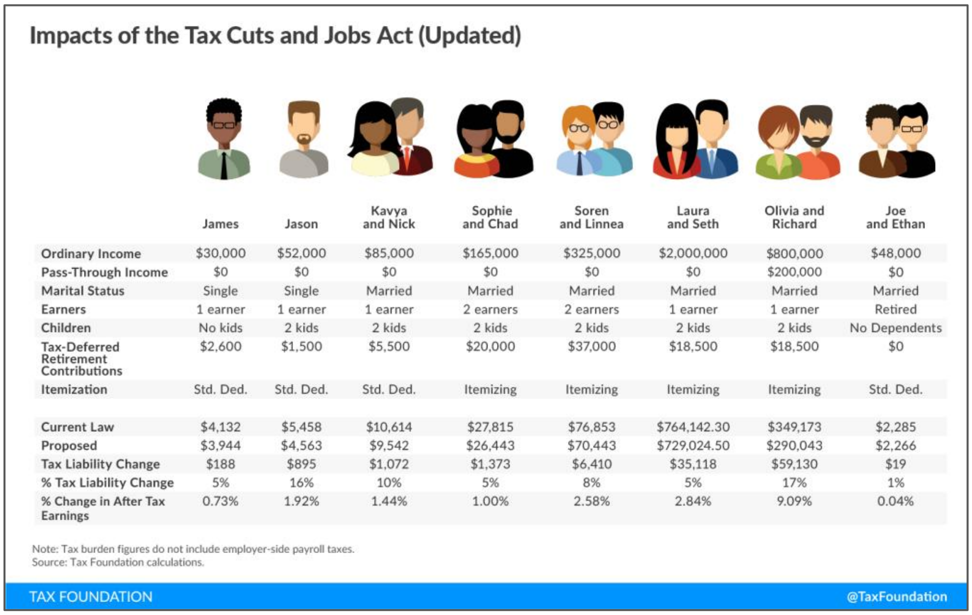
- **Estate Taxes:** The Act would double the base exclusion amount of $5 million (as indexed for inflation; $5.6 million for 2018 per taxpayer) to $10 million.
  - The Act would repeal the estate tax for decedents dying after December 31, 2023, while still maintaining a beneficiary's stepped-up basis in estate property.
  - The Act would lower the gift tax to a top rate of 35% for gifts made beginning in 2024.

- **Alternative Minimum Tax:** The Act would repeal the AMT.

- **Effective Date:** Generally all provisions are effective January 1, 2018.



Impacts of the Tax Cuts and Jobs Act (Updated)

	James	Jason	Kavya and Nick	Sophie and Chad	Soren and Linnea	Laura and Seth	Olivia and Richard	Joe and Ethan
Ordinary Income	$30,000	$52,000	$85,000	$165,000	$325,000	$2,000,000	$800,000	$48,000
Pass-Through Income	$0	$0	$0	$0	$0	$0	$200,000	$0
Marital Status	Single	Single	Married	Married	Married	Married	Married	Married
Earners	1 earner	1 earner	1 earner	2 earners	2 earners	1 earner	1 earner	Retired
Children	No kids	2 kids	2 kids	2 kids	2 kids	2 kids	2 kids	No Dependents
Tax-Deferred Retirement Contributions	$2,600	$1,500	$5,500	$20,000	$37,000	$18,500	$18,500	$0
Itemization	Std. Ded.	Std. Ded.	Std. Ded.	Itemizing	Itemizing	Itemizing	Itemizing	Std. Ded.
Current Law	$4,132	$5,458	$10,614	$27,815	$76,853	$764,142.30	$349,173	$2,285
Proposed	$3,944	$4,563	$9,542	$26,443	$70,443	$729,024.50	$290,043	$2,266
Tax Liability Change	$188	$895	$1,072	$1,373	$6,410	$35,118	$59,130	$19
% Tax Liability Change	5%	16%	10%	5%	8%	5%	17%	1%
% Change in After Tax Earnings	0.73%	1.92%	1.44%	1.00%	2.58%	2.84%	9.09%	0.04%

Note: Tax burden figures do not include employer-side payroll taxes.
Source: Tax Foundation calculations.

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Again, this is only a fraction of the provisions included in the Bill. We look forward to sharing another update with you in the coming days or weeks as additional information is made available. Please do not hesitate to call us if you have questions on how this may impact your income tax situation.

Sources: Kitces.com, Taxfoundation.org, Wsj.com, Taxpolicycenter.org

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