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# The New Tax Law: Impact on Individuals

On December 22, 2017 President Trump signed H.R. 1, known as the Tax Cuts and Jobs Act, into law making widespread changes to the Internal Revenue Code. These changes went into effect January 1, 2018, and it is no overstatement to say that this mammoth tax bill will have a significant impact on virtually every business and individual.

The following lists selected changes under the new law that we believe will have the greatest impact on individual taxpayers. Please note that the changes below impacting individual taxpayers will generally be first effective in 2018 and will sunset after 2025 unless noted otherwise.

**Changes in the individual income tax rates**

Your so-called "*ordinary*" income (e.g., compensation, interest income, most retirement income, and net short-term capital gains) is taxed at increasing tax rates that apply to different ranges of income. Under prior law, there were seven *"ordinary"* income tax rates as follows: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. Starting in 2018, although the *New Law* retains seven *ordinary* income tax brackets, it changes the rates as follows: 10%, 12%, 22%, 24%, 32%, 35%, and 37%.

Although the New Law lowers the actual tax rates at most income levels (regardless of filing status), determining the overall tax impact on a particular individual or family as compared to prior law will vary due to other changes in the New Law, such as: an increase in the standard deduction, loss of personal and dependency exemptions, the elimination or limitation of certain itemized deductions, increases in the child tax credit, higher income phase-outs for the child credit, a new credit for certain qualifying dependents, and others.

**Kiddie Tax on Children's Unearned Income**

For 2017, if children below certain ages have unearned income (e.g., interest, dividends, and capital gains) above $2,100, this unearned income is generally taxed at the child's parents' tax rates. This has traditionally been referred to as the "kiddie tax." Starting in 2018, the *New Law* contains a similar but revised "kiddie tax" rule whereby the unearned income (above $2,100 for 2018) of the child is taxed at the higher income tax rates that apply to trusts and estates. For example, under the *New Law*, the taxable income of a trust or estate for 2018 is taxed at the highest 37% rate once the taxable income exceeds $12,500. By contrast, under the *New Law*, for 2018, the 37% rate does not apply to a single taxpayer until taxable income exceeds $500,000.

**Minor Changes In The Tax Rates For Long-Term Capital Gains And Qualified Dividends.**

Starting in 2018, the *New Law* retains the same 0%, 15%, and 20% rates that apply for 2017 to long-term capital gains and qualified dividends. Under the *New Law,* the 0%, 15%, and 20% rates apply at income levels similar to prior law. Consequently, the income levels where the 0%, 15%, and 20% long-term capital gain rates apply have changed very little as a result of the *New Law.*

Caution! The *New Law* did not change the 3.8% Net Investment Income Tax on investment income (e.g., capital gains, dividends, passive income) which will continue to apply once the modified adjusted gross income of married taxpayers filing jointly exceeds $250,000 (exceeds $200,000 if single).

**Repeal of Personal Exemption Deduction**

Under prior law, to be a "dependent" of a taxpayer, the person had to be either the Taxpayer's "Qualifying Child" or "Qualifying Relative." Although the personal exemption deduction is repealed for dependents, the *New Law* retains the previous definitions of "Dependent," "Qualifying Child," and "Qualifying Relative," for other purposes, such as: Head-of-Household status; the earned income credit; and, the child credit.


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**Increased Standard Deduction**

The *New Law* increases the Standard Deduction to the following levels for 2018: Joint Return - $24,000 (up from $13,000); Single - $12,000 (up from $6,500); and Head-of-Household - $18,000 (up from $9,550).

**Enhanced Child Credit**

For 2017, subject to certain income phase-out thresholds, individuals were allowed a child credit of $1,000 for each "Qualifying Child" who had not reached age 17 by the end of the tax year. Starting in 2018, the *New Law* increases the child credit for each "Qualifying Child" (as defined under prior law) to $2,000. Under the *New Law*, this child credit begins phasing out as the individual's modified adjusted gross income (MAGI) exceeds the following amounts: Joint Return - $400,000 (up from $110,000); Others - $200,000 (up from $75,000).

Also, the *New Law* allows up to $1,400 (up from $1,000) of the child credit to be *"refundable"* to the extent of 15% of the taxpayer's earned income in excess of $2,500 (down from $3,000). A "refundable" credit generally means to the extent the credit exceeds the taxes you would otherwise owe with your individual income tax return without the credit, the IRS will send you a check for the excess.

Also, for purposes of the New Law's enhanced child credit, the term "Qualifying Child" has the same definition as under prior law (i.e., a child who meets certain residency, age, relationship, and support tests).

**New $500 Credit**

The *New Law* creates a new non-refundable credit of $500 for each person the taxpayer could have claimed as a dependent under prior law but who is not a Qualifying Child (e.g., a "Qualifying Relative" as defined under prior law). This $500 credit is added to any other child tax credits and the total credits begin phasing out once a taxpayer's MAGI exceeds $400,000 on a joint return or $200,000 for singles.

**Changes to the Alternative Minimum Tax for Individuals**

Although the *New Law* retains the "Alternative Minimum Tax" (AMT) for individual taxpayers, it offers new relief from the AMT by increasing the AMT Exemption amounts and repealing or limiting certain deductions that could have triggered the AMT under prior law. With these changes, it is expected that fewer individuals will be subject to the AMT after 2017.

Since the New Law repeals the deduction for personal exemptions, un-reimbursed employee business expenses, and most miscellaneous itemized deductions altogether, and also caps the deduction for state and local taxes at $10,000 (as discussed in more detail below), it is expected that fewer individuals will be subject to the AMT after 2017.

**Repeal of Certain "Above the Line" Deductions**

Under both prior law and the *New Law*, so-called "above-the-line" deductions reduce both your "adjusted gross income" (AGI) and your "modified adjusted gross income" (MAGI), while "itemized" deductions (i.e., below-the-line deductions) do not reduce either AGI or MAGI. Deductions that reduce your AGI (or MAGI) can potentially generate multiple tax benefits, for example by:

1) Reducing your taxable income and allowing you to be taxed in a lower tax bracket;
2) Freeing up deductions (and tax credits) that phase out as your AGI (or MAGI) increases (e.g., child credit; certain IRA contributions; certain education credits; adoption credit, etc.); and
3) Reducing your MAGI below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8 % NIIT only applies if MAGI exceeds $250,000 if married filing jointly; $200,000 if single). Although many of the popular "above-the-line" deductions were retained under the *New Law* (e.g., deductions for IRA and Health Savings Account (HSA) contributions, health insurance premiums for self-employed individuals, qualified student loan interest, and business expenses for a self-employed individual), as discussed immediately below, several notable above-the-line deductions were repealed:

**Repeal of the Deduction for Qualified "Moving Expenses"**

Under prior law, the deduction for qualified "Moving Expenses" was an above-the-line deduction. Starting in 2018, the *New Law* repeals the deduction for "Moving Expenses" except for members of the Armed Forces who move pursuant to military orders. Likewise, an employer is no longer allowed to reimburse an employee's moving expenses on a tax-free basis except for these qualifying members of the Armed Forces.

**Repeal of Deduction for Qualified "Alimony Payments"**

Currently, an individual making qualified alimony payments is allowed an "above-the-line" deduction for the payments and the recipient of the payments must include the payments in income. Effective for "Divorce or Separation Instruments" executed after 2018, the *New Law* repeals altogether the deduction for alimony payments, and the alimony payments will no longer be taxable to the payee. If the divorce instrument is executed before 2019, but modified after 2018, the alimony payments made after the modification will continue to be deductible by the individual making the payments (and taxable to the recipient) unless the modification expressly provides that the alimony payments are to be nondeductible to the payer and nontaxable to the recipient.

**New Limitations for and Repeal of Certain "Itemized Deductions"**

"Itemized Deductions" (i.e., below-the-line deductions) do not reduce your AGI or MAGI, but may still provide tax savings if they exceed in the aggregate your Standard Deduction. Since the *New Law* substantially increases the Standard Deduction, it will take a larger amount of itemized deductions to generate a tax benefit after 2017. However, the *New Law* not only increases the amount of the Standard Deduction, it also repeals or places new limits on several popular itemized deductions. Consequently, it is anticipated that fewer individuals will "itemize" deductions under the *New Law*. As under prior law, the *New Law* provides for an "additional" standard deduction for taxpayers who are disabled or blind of $1,300 for joint filers ($1,600 if single).

**New Limits on the Home Mortgage Interest Deduction**

For 2017, individuals are generally allowed an itemized deduction for home mortgage interest paid on up to $1,000,000 ($500,000 for married individuals filing separately) of "Acquisition Indebtedness" (i.e., Funds borrowed to purchase, construct, or substantially improve your principal or second residence and secured by that residence). For tax years beginning after 2017, the *New Law* reduces the dollar cap from $1,000,000 to $750,000 ($375,000 for married filing separately) for "Acquisition Indebtedness" incurred after December 15, 2017. The $1,000,000 cap remains for "Acquisition Indebtedness" incurred on or before December 15, 2017.

**Special Rule When Refinancing Acquisition Indebtedness**

Subject to limited exceptions, the refinancing of Acquisition Indebtedness is generally deemed to have been incurred on the date of the original indebtedness. So, for example, if a taxpayer incurred Acquisition Indebtedness on or before December 15, 2017, the refinancing of that indebtedness after December 15, 2017 will still be entitled to the $1,000,000 cap (to the extent of the outstanding balance of the original Acquisition Indebtedness on the date of the refinancing).

**Repeal Of Interest Deduction For "Home Equity Indebtedness"**

For tax years beginning after 2017, taxpayers may not deduct interest with respect to "Home Equity Indebtedness" (i.e., Up to $100,000 of funds borrowed that do not qualify for "Acquisition Indebtedness" but are secured by your principal or second residence). Unlike the interest deduction for "Acquisition Indebtedness," the *New Law* does not grandfather an interest deduction for "Home Equity Indebtedness" that was outstanding before 2018.

**Qualified Second Residence Still Allowed**

The *New Law* did not change the rule that Acquisition Indebtedness can be incurred with respect to your qualified "Second Residence" (as well as your "principal residence").

**New Limitation On The "State And Local" Tax Deduction**

Starting in 2018, the aggregate itemized deduction for state and local real property taxes, state and local personal property taxes, and state and local income taxes (or sales taxes if elected) is limited to $10,000 ($5,000 for married filing separately). However, deductions continue to be allowed for state, local, and foreign "property" taxes, and "sales" taxes paid or incurred in carrying on the taxpayer's trade or business (e.g., taxpayer's Schedule C, Schedule E, or Schedule F operations) or in connection with the taxpayer's production of income.

**Changes To The Charitable Contribution Deduction**

The *New Law* retains the charitable contribution deduction with the following changes starting in 2018: 1) The 50% AGI limitation under prior law for cash contributions to public charities and certain other organizations is increased to 60%, and 2) A charitable contribution deduction is no longer allowed for contributions made to colleges and universities in exchange for the contributor's right to purchase tickets or seating at an athletic event (prior law allowed the taxpayer to deduct 80% as a charitable contribution).

**Tax-Free Qualifying Transfers From IRAs To Charities Retained.**

The popular rule allowing taxpayers who have reached age 70½ to make a tax-free transfer of up to $100,000 from their IRAs directly to a qualified charity has been retained. The IRA transfer to the charity also counts toward the IRA owner's "Required Minimum Distributions" (RMDs) for the year. Planning Alert! Since this tax break effectively allows a qualifying taxpayer to exclude all or a portion of their otherwise taxable RMDs from taxable income, it has the same effect as allowing an "above-the-line" deduction for the charitable contribution.

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Therefore, the *New Law* makes this tax break even more valuable for those individuals who will not itemize deductions because of the increased standard deduction.

**Modifications To The Deduction For Qualified Medical Expenses**

The *New Law* generally retains the existing rules for medical expense deductions. However, for tax years beginning in 2017 and 2018, for both regular tax purposes and AMT purposes, a taxpayer may deduct medical expenses to the extent they exceed 7.5% (down from 10%) of his or her AGI. The 7.5% threshold reverts back to 10% after 2018.

**Elimination Of 3% Phase-Out Of Itemized Deductions**

For 2017, most itemized deductions began phasing out using a 3% phase-out rate once an individual's adjusted gross income (AGI) exceeds a certain amount. Starting in 2018, the *New Law* repeals this 3% phase-out rule.

**Repeal Of Miscellaneous Itemized Deductions Subject To The 2% Of AGI Reduction**

For 2017, certain "miscellaneous itemized deductions" (e.g., un-reimbursed employee business expenses, certain investment expenses) were allowed only to the extent they exceeded in the aggregate 2% of the taxpayer's adjusted gross income (AGI). Starting in 2018, the *New Law* not only repeals this 2% reduction rule, but also repeals the deduction for "Miscellaneous Itemized Deductions" that were subject to the 2% of AGI reduction.

Planning Alert! Under the *New Law*, employee business expenses that are not properly reimbursed by the employer under an accountable reimbursement arrangement are classified as Miscellaneous Itemized Deductions and, therefore, are not deductible after 2017. However, if any of these employee business expenses are reimbursed under your employer's accountable reimbursement arrangement, your employer will get a deduction for the reimbursement, and you will not be taxed on the reimbursement.

**Recharacterization Of Roth IRA Conversions No Longer Allowed**

Starting in 2018, the *New Law* prohibits recharacterizations of the conversion of a traditional IRA to a Roth IRA.

**Penalty For Failure To Purchase Health Care Coverage Repealed After 2018**

Starting in 2019, the *New Law* essentially eliminates the penalty for failure to purchase qualified health coverage by reducing the "Shared Responsibility Tax" (SR Tax) to zero. Planning Alert! The SR Tax for failure to purchase qualified health care coverage continues to apply for 2017 and 2018, unless an exemption from the tax applies.

**Changes In The Tax Incentives For Education Expenditures.**

Over the last 20 or so years, Congress has passed a legion of separate tax incentives related to education (e.g., American Opportunity Credit, Life-Time Learning Credit, Student Loan Interest Deduction, Section 529 Plans, etc.). Initially, the tax reform proposals introduced in 2017 recommended significant changes to the education tax incentives. However, very few of these proposed changes were included in the final legislation signed by the President. Consequently, most of the education tax breaks available for 2017 remain unchanged.

**529 Plans Allowed To Pay K-12 Tuition**

Starting in 2018, the *New Law* allows 529 plans to pay up to $10,000 per year of qualified tuition in connection with the enrollment or attendance of the designated beneficiary at a public, private, or religious elementary or secondary school.

Caution! This annual $10,000 limitation applies on a per-student basis. Thus, an individual who is a designated beneficiary of multiple §529 plans may receive total distributions for K-12 expenses during a taxable year of no more than $10,000.

**Current Unified Estate Tax Exclusion Amount And GST Exemption Amount Doubled**

Effective for individuals dying and generation skipping transfers after 2017 and before 2026, the *New* Law increases the Basic Unified Exclusion Amount for gift and estate tax purposes and the generation skipping exemption amount to $10,000,000 (as indexed for inflation [i.e, $11,200,000 for 2018]). Previously, the exclusion and exemption amounts for 2018 were scheduled to be $5,600,000.

The New Law did not change the current law provision allowing a deceased spouse's estate to elect to transfer the deceased spouse's unused Exclusion Amount (i.e., the portability election) to the surviving spouse.

For more information and to schedule a strategy session to reduce your overall tax liability please call our office at 802.878.1963 (Williston) or 802.775.7132 (Rutland).