BPM

Tax Cuts and Jobs Act

Key Implications for Individuals

Overview

The 2017 Tax Reform legislation, the most significant federal tax law reform in over 30 years, was passed by both the House of Representatives and the Senate, and as of today, was signed into law by the President.

The following information addresses the new provisions the Tax Cuts and Jobs Act that may affect individuals. For individual taxpayers, most of the new tax provisions will apply for eight years, from 2018 and through 2025, except as noted below. Under Congressional budgeting rules, the temporary provisions will expire at the end of 2025, and the provisions in effect for 2017 will be resurrected beginning in 2026.

Individual Tax Rates

2018 tax rates and brackets under the new legislation are as follows:

Rate	Married Filing Jointly	Single Individual Filers	Head of Household
10%	Up to $19,500	Up to $9,525	Up to $13,600
12%	$19,501 - $77,400	$9,526 - $38,700	$13,601 - $51,800
22%	$77,401 - $165,000	$38,701 - $82,500	$51,801 - $82,500
24%	$165,001 - $315,000	$82,501 - $157,500	$82,501 - $157,500
32%	$315,001 - $400,000	$157,501 - $200,000	$157,501 - $200,000
35%	$400,001 - $600,000	$200,001 - $500,000	$200,001 - $500,000
37%	Over $600,000	Over $500,000	Over $500,000

The individual income tax brackets will be indexed for inflation for 2019 - 2025. Rates for net long-term capital gains and qualified dividend income are generally unchanged from the current rates.

The rates for net long-term capital gains and qualified dividends, based on taxable income, are as follows:

Capital Gain Rate	Married Filing Jointly	Single Individual Filers	Head of Household
0%	Up to $77,200	Up to $38,600	Up to $51,700
15%	$77,201 - $479,000	$38,601 - $425,800	$51,701 - $452,400
20%	Over $479,000	Over $425,800	Over $452,400

Itemized Dedications

Many individual itemized deductions are suspended under the new legislation, including the deduction for personal exemptions which is suspended beginning tax year 2018 through 2025. The standard deduction will be increased in an attempt to offset the changes for many individual taxpayers with limited deductions.

The new standard deductions for 2018 are $24,000 for joint filers, $12,000 for single individual filers, and $18,000 for head of household filers.

Mortgage Interest Deduction

The new legislation limits the mortgage interest deduction to $750,000 of acquisition indebtedness incurred in the purchase of a first or second personal residence after December 15, 2017. The new law allows current homeowners to deduct mortgage interest on acquisition loan balances incurred prior to December 16, 2017 of up to $1,000,000 (including refinances of grandfathered loans provided that the refinanced amount is not greater than the previous balance). The law contains a "binding contact" exception to the new rules for purchases of a principal residence that closes before January 1, 2018. Interest on home equity loan indebtedness is not deductible for tax years 2018 through 2025.

State and Local Income Taxes and Property Taxes
The individual itemized deduction for nonbusiness state and local taxes, including property taxes, is limited to $10,000 (for all taxpayers except for married filing separately taxpayers, for whom the limit is $5,000).

The legislation contains a specific provision to disallow a 2017 itemized deduction for the prepayment of 2018 state or local income taxes in 2017. This prepayment deduction disallowance is not applicable to property taxes. So, for example, California residents who pay their April 2018 property tax installment in 2017, should be entitled to claim a 2017 federal itemized deduction for the payment.

Medical Expenses
For 2017 and 2018, qualified medical expenses are allowed as an itemized deduction once the total eligible expenses exceed 7.5% of adjusted gross income (AGI) for the year. This threshold increases to 10% of AGI beginning in 2019. The AGI threshold is applicable for both regular tax and for the alternative minimum tax (AMT).

Charitable Contributions
The new law makes only minor changes to charitable contributions. Currently, contributions of cash to qualified charities are limited to 50% of a taxpayer's AGI for the year. Contributions in excess of the limitation are carried forward to the following five years. The new law increases the threshold for cash contributions to 60% of AGI. Additionally, beginning in 2018, the law denies a charitable contribution deduction for payments made in exchange for college athletic event seating rights.

Miscellaneous Itemized Deductions
Effective 2018, miscellaneous itemized deductions are disallowed. A non-exhaustive list of miscellaneous itemized deductions that are not deductible from 2018 through 2025 include:

- Investment management fees (including "portfolio expenses" passed through to individual from fund/partnership Schedules K-1)
- Tax preparation fees
- Unreimbursed employee expenses
- Job search expenses

Limitation on Itemized Deductions
The current law's phase-out of itemized deductions for higher income taxpayers is suspended for 2018 through 2025. Under the current law's so-called “Pease Limitation,” total itemized deductions are haircut by 3% (with a maximum reduction of 80%) for taxpayer's with AGIs above $313,800 (joint) and $261,500 (single).

Other Expenses

The new legislation affects numerous other expenses for 2018 through 2025. Among the changes are:

- Moving expenses – Not deductible and employee reimbursements received for moving expenses incurred are taxable compensation.
- Alimony – Divorce or separation instruments executed after 2018 (and, potentially, for pre-2019 agreements modified after 2018), alimony payments are not deductible by the payor and alimony received is not taxable to the recipient.
- Casualty and theft losses – The deduction for personal casualty and theft losses is modified for 2018 through 2025, to allow for a deduction only in the case of a federally-declared disaster.
- Net operating losses – Beginning in 2018, net operating losses (NOLs) can only be carried forward (not back two years as is the case for most NOLs incurred before 2018). In addition, the NOL deduction for NOLs arising in years after 2017 can only offset up to 80% of taxable income in the carry forward year.

Other Individual Tax Provisions

Increase in Child Tax Credit and Suspension of Personal Exemptions

The new law increases the child tax credit from $1,000 to $2,000 per qualifying child (generally under age 17) and increases the portion of the credit that is refundable. The credit begins to phase-out for joint filers with AGI over $400,000 (and $200,000 for other filers). The credit is further modified to provide a $500 nonrefundable credit for qualifying dependents other than qualifying children. The increase in the child tax credit, combined with the increase in the standard deduction, is intended to offset the suspension of the deduction for personal exemptions for 2018 through 2025.

Sales of Primary Residences

Both the House and the Senate proposed changes to the $250,000 ($500,000 for married joint filers) exclusion of gain on the sale of a primary personal residence. The exclusion provision was not changed in the final version of the legislation, so the current law that provides for the exclusion in the case that the taxpayer both own the residence, and occupy it as a primary residence for two of the five years prior to the sale date remains in effect.

Roth IRA Recharacterizations

The new law disallows taxpayers' the ability to "undo" a Roth IRA conversion beginning for tax years after 2018. Under the current law, if an individual converts a regular IRA into a Roth IRA, the initial conversion can be "undone" or recharacterized as late as the extended filing deadline for the tax return for the year of the conversion.

Section 529 Plans

Effective January 1, 2018, owners of Section 529 plans can make distributions of up to $10,000 per year for the plan beneficiary's elementary or high school tuition.

Credit for plug-in Vehicles

The House version of the bill proposed repealing the federal credit of up to $7,500 for purchase of plug-in electric vehicles (e.g., Teslas, Volts, etc.), but the final version of the legislation retains the credit in its current form.

The Alternative Minimum Tax

The new legislation will result in fewer taxpayers being subject to the federal AMT. Beginning in 2018, the AMT exemption amount is increased by about $25,000 to $109,400 for married taxpayers filing a joint return and $70,300 for single filers. Additionally, the amount at which AMT exemption begins to phase out is increased substantially—to $1,000,000 for married joint filers (up from the current $160,900) and $500,000 for others (up from the current $120,700 for single filers). When combined with the new itemized deduction limitation of $10,000 for state income and property taxes, and the disallowance of miscellaneous itemized deductions, it is expected that fewer taxpayers will be susceptible to the AMT.

Estate and Gift Taxes

The new law doubles the lifetime estate and gift tax exemption for estates of decedents dying and gifts made after December 31, 2017 and before January 1, 2026. The previously announced 2018 individual exemption of $5,600,000 therefore becomes $11,200,000 on January 1, 2018. The House provision that would have repealed the estate tax beginning in 2024 was dropped from the final law. Instead, as noted, the doubling of the exemption sunsets after 2025. The new law contains a directive for the IRS to prescribe regulations to address rules for differences in the exemption at the time of a decedent's death and the exemption (potentially higher) at the time of any gifts made by the decedent.

The annual exclusion for gifts is unaffected by the new law. Annual exclusion gifts do not reduce the lifetime estate and gift tax exemption. For 2017, the annual gift tax exclusion amount is $14,000 per donor, per recipient. The annual exclusion amount increases to $15,000 for 2018.

Business Provisions that Affect Certain Individuals

Deduction for Qualified Business Income from Pass-through Entities and Sole Proprietorship

The new law contains a completely new deduction for up to 20% of a pass-through entity's income reported on the entity owner's return. The new Section 199A deduction applies to qualified business income of an owner's S corporation, partnership, limited liability company (taxed as a partnership), and sole proprietorship. In general, qualified business income is non-portfolio income from a United States business other than service businesses in the fields of health, law, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of the business is the reputation or skill of one or more of its employees or owners. Additionally, the 20% deduction is limited to 50% of the W-2 wages paid by the business. An alternative limitation is available for businesses that are more capital-intensive and have little or no wages paid (e.g., rental real estate).

Owners of pass-through businesses below certain taxable income thresholds are allowed to deduct up to 20% of the entity's business income without regard to the W-2 wage limitation, even if the business is a service business. The 2018 taxable income threshold is $315,000 for the married filing jointly taxpayer (or $157,500 for all other filers). The thresholds will be indexed for inflation for years after 2018. The new 20% deduction allowed under Section 199A is effective for 2018 through 2025. After 2025, the provision is no longer applicable (unless it is extended by future legislation).

Depreciation and Section 179 Expensing of Assets

Bonus depreciation, or 100% expensing, of new and used business assets is allowed for most eligible property acquired and placed in service after September 27, 2017 and before December 31, 2022. The 100% bonus depreciation is reduced by 20% per year from 2023 through 2026 such that it is eliminated beginning in 2017. Residential and nonresidential buildings are not eligible for bonus depreciation. As is the case under current law, taxpayers can elect out of bonus depreciation for an entire class of assets.

Passenger automobiles deemed to be luxury autos are subject to a dollar limitation in computing the annual depreciation deduction. Under the new law, for automobiles placed in service after December 31, 2017, the maximum amount of depreciation is $10,000 for the first year, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years. As under current law, depreciation is only allowed for the annual business use percentage of the automobile.

In addition to bonus depreciation, business assets can be expensed under Section 179. Under current law, the limitation for Section 179 expensing is $500,000 per year and ability to expense the assets is phased out once the assets placed in service during the year exceeded $2,000,000. Under the new law, beginning for assets placed in service in 2018, up to $1,000,000 of assets can be expensed and the amount at which the ability to expense is limited and increased to $2,500,000. The new law expands the definition of property that is eligible to be expensed. Under Section 179, specific assets can be expensed and other assets can be depreciated using either bonus depreciation or regular depreciation rules. The annual Section 179 expense is limited to the taxpayer's taxable income from the business.

Limitations on Business Interest Expense Deduction

Beginning in 2018, the new law limits the deduction for net interest expense of businesses to 30% of the business's adjusted taxable income. Businesses with an average annual gross receipts of less than $15,000,000 are not subject to the limitation.

Limitation on Losses from Pass-Through Businesses

For tax years beginning in 2018, the new law disallows an excess business loss for non-corporate taxpayers. The disallowed losses are carried forward indefinitely as net operating losses of the business owner. At the individual tax level, the total business losses from all pass-through business are aggregated and disallowed if the net loss is greater than $500,000 for married filers or $250,000 for others. This provision expires beginning in 2026.

Entertainment Expenses

Current law provides that individuals or businesses may deduct up to 50% of entertainment expenses if the expense is directly related to the active conduct of one's trade or business. Similarly, a deduction for food or beverages is limited to 50% of the amount otherwise deductible. The new law provides that no deduction is allowed for business-related entertainment expenses. The allowance of a 50% deduction for business-related food and beverages (e.g., meals consumed by employees on work travel) is retained. The new law's provisions are effective from 2018 and through 2025.

BPM is Here to Assist You

The Tax Cuts and Jobs Act will have a significant impact on individuals. We encourage you to work with your BPM tax professional to understand how these changes specifically impact you.