MONEY MATTERS

ANALYSIS OF THE NEW TAX CUTS + JOBS ACT

By Jacob Ansel

THE TAX CUTS AND JOB ACT OF 2017 (TCJA) passed late last year has many of us scrambling to make heads or tails of its pros and cons. Almost every aspect of this tax bill is different from the previous bill, affecting virtually every taxpayer and all businesses. About 80% of households will get a tax cut, while about 5% will pay more in 2018. The GOP plan gives a large tax break to the wealthy and preserves certain tax savings for the middle class, including the student-loan interest deduction, the deduction for excessive medical expenses, and the tax break for graduate students.

The TCJA lowers the top tax rate for top earners. Under current law, the highest rate is 39.6% for married couples earning over $470,700. The GOP bill drops that to 37% and raises the threshold at which the top rate kicks in, $500,000 for individuals and $600,000 for married couples. This is a significant tax break for the very wealthy.

The child tax credit, CTC, was introduced in 1997, a small, nonrefundable credit of $400 for each qualifying child under 17. In the last 20 years, the CTC has undergone many changes. Under the TCJA, the CTC is worth up to $2,000 per qualifying child. While a wide range of families will benefit from the greatly expanded CTC, there's a new crackdown on the Kiddie Tax (subjected to trust tax rates instead of parents' tax rates). Under the Tax Reform Act of 1986, the Kiddie Tax was introduced to close a loophole through which wealthy folks were getting investment income taxed at lower rates by transferring assets to their children. The child's standard deduction and the Kiddie Tax threshold still remain at $1,050 each, so there's no tax on a child's unearned income of up to $2,100, just as before. However, the tax rate that applies to any income above that threshold is no longer the rate based on the parental income. For children with substantial income, this will be a disadvantage.

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The Tax Cuts and Jobs Act was signed into law late last year, the most sweeping federal tax legislation in more than three decades. Many of the law's provisions affect businesses, but it also includes significant changes for individual taxpayers, most of which take effect for 2018.

Currently, 529 plans offer tax-free earnings growth and tax-free withdrawals when funds are used to pay for college. With the new law, families will also be able to withdraw up to $10,000 per year tax-free for elementary, high school, and/or home school expenses.

Under the TCJA there are new rules to deducting home mortgage interest. Under the current tax code, the mortgage deduction had a limit of only deducting the interest on the first one million dollars of debt principal. Now the debt limit on deductibility for acquisition indebtedness is reduced to just $750,000 (albeit grandfathered for existing mortgages under the old higher $1M limit), and interest on home equity indebtedness is no longer deductible at all starting in 2018.

There's a new flat 21% tax rate for corporations. Under the old law, C Corps paid graduated federal income-tax rates of 15%, 25%, 34%, and 35%. Personal service corporations (PSCs) paid a flat 35% rate. Now, there's no longer a corporate alternative minimum tax (AMT). Previously, the AMT was 20%. (Corporations with average annual gross receipts of less than $7.5 million for the preceding three tax years were exempt.) Going forward, the TCJA repeals the corporate AMT.

Itemized deductions have allowed taxpayers to reduce taxable income by claiming a variety of deductions. These include mortgage interest, state and local income or sales taxes, property taxes on homes and cars, charitable contributions, and more. Almost one-third of taxpayers have itemized deductions. The new act limits the deduction of state and local taxes, including property taxes to a total of $10,000 which will have a negative impact on taxpayers in high tax rate states or high real estate tax states. There are fewer expenses to deduct and a higher standard to cross. A slew of itemized deductions and exemptions – including tax breaks for everything from moving to commuting by bike – have been eliminated.

As with any massive legislation, many questions about implementation and impact remain unanswered, especially since the TCJA offers a sweeping set of changes to taxes on individuals and businesses. It's never been more important to speak to your tax professional. ❑