Tax Cuts and Jobs Act (H.R.1)

The following is a brief summary of some of the major provisions affecting Dollars and Sense clients.

H.R. 1 impacts virtually every individual and business on a level not seen in over 30 years. This tax bill calls for the lowering of individual and corporate tax rates, repealing countless tax credits and deductions, enhancing the child tax credit, boosting business expensing and more. The bill also impacts the Affordable Care Act, effectively repealing the individual shared responsibility requirement.

Many of the changes to the Internal Revenue Code (IRC) in the bill are temporary. Most of the individual provisions will expire after 2025, while provisions to the corporate tax code are mostly made permanent.

Individual Summary

Pass-through deduction

There is a new 20% deduction for qualified business income from a partnership, LLC, S corporation or sole proprietorship. This appears to also be applicable to rental real estate property owners as "sole proprietors" of schedule E rental properties. This will benefit many of our self-employed and rental property owners.

Tax Rates

Temporary tax rates of 10%, 12%, 22%, 24%, 32%, 35% and 37% replace current income tax rates of 10%, 15%, 25%, 28%, 33%, 35% and $39.6%.

Standard Deduction

The bill calls for the near doubling of the standard deduction. It increases the standard deduction to $24,000 for married individuals filing a joint return, $18,000 for head of household filers and $12,000 for individuals. The impact of this will simplify tax filings for very few of our clients who itemize deductions.

Personal Exemptions

Personal exemptions are repealed at all income levels.

Alternative Minimum Tax (AMT)

Exemptions amounts increased to $109,400 (married) and $70,300 (single). The phase-out of exemption amounts increased to $1,000,000 (married) and $500,000 (single).

Itemized Deductions

Individual deductions for state and local taxes (SALT) for income, sales and property are now limited in the aggregate to $10,000. This is a provision that is likely to affect many of our clients.

Most miscellaneous itemized deductions that were subject to the 2% of AGI floor will no longer be allowed.

Capital gain/qualified dividend rate

Unchanged. The maximum tax rate on long-term qualified dividend income (before 3.8% net investment income tax) is 20%.

Medical Expenses

Floor is reduced to 7.5% of AGI for tax years 2017 and 2018.

Cost of Securities

Unchanged. Investors still have the ability to specifically identify which tax lot of a security is sold.

Mortgage Interest

Individuals are generally allowed an itemized deduction for interest on principal residence and second residence mortgages up to a combined $750,000. Pre-12/16/2017 mortgages are grandfathered and new purchase money mortgages may be grandfathered if the purchase contract is dated before 12/16/2017 and other conditions are met.

Refinancing of grandfathered mortgages are grandfathered, but not beyond the original mortgage's term/amount (some exceptions apply for "balloon payment" mortgages).

Capital Gain Exclusion for Primary Residence

Unchanged. Allows for individuals to exclude gain of up to $500,000 (for joint filers) from the sale of a primary residence. Taxpayers must own and use the house as a primary residence for 2 out of the previous 5 years and exemption can be used only once every two years.

1031 Exchanges (like-kind)

Only limits applicability to like-kind exchanges of real property that is not held primarily for sale. Does not expire in 2025. The law still allows for the disposal of an asset and the acquisition of another replacement asset without generating a current tax liability from the gain on the sale of the first asset.

Section 529 plans

In addition to higher (post-secondary) education, distributions from 529 plans of up to $10,000 per year per student can be used for tuition in connection with enrollment or attendance at an elementary or secondary public, private or religious school. Does not expire in 2025.

Charitable Deduction

Cash gifts to public charities are deductible as long as they do not exceed 60% of the taxpayer's AGI.

Gift/Estates and GST Tax Exemptions

Doubles the estate, gift and GST tax exemptions to $11.2 million. Will sunset in 2025.

Child Tax Credit

Increases to $2,000 per qualified child, with $1,400 being refundable. Phase-out begins at $200,000 (single) and $400,000 (married).

Individual Mandate

Individual mandate to purchase health insurance under Obamacare is repealed permanently.

Alimony

The bill repeals the deduction for alimony payments and their inclusion in the income of the recipient. This applies only to divorce or separation instruments executed after December 31s, 2018.

Energy

The final bill retains the credit for plug-in electric vehicles and did not adopt any of the other repeals of or modifications to energy credits from the House bill, which called for repealing many current energy tax incentives, including the credit for plug-in electric vehicles.

Net Operating Losses

The bill modifies current rules for net operating loss (NOLs). Generally, NOLs would be limited to 80% of taxable income for losses arising in tax years beginning after December 31st, 2017.

Moving Expenses

No longer deductible.

Business Summary

Business Summary of Tax Cuts and Jobs Act

Below is a summary of some of the key Business Provisions of the Tax Cuts and Jobs Act that went into effect January 1, 2018. Some of the provisions are made permanent, while others apply to the next 10 years.

Tax Rates – "C" Corporations will have a flat tax rate of 21%.

Prior to the new law, corporations had graduated tax rates from 10% – 35%.

Pass-Through Income Deduction – Individuals that receive income from an S-Corporation, LLC, Partnership or sole-proprietorship will be allowed a deduction of up to 20% of the qualified business income. The deduction will be taken at the individual level.

The deduction does not apply to high-income taxpayers receiving pass-through income from service businesses (doctors, dentists, attorneys, accountants, etc.) or other investment-type activities.

Prior to the change, all income from pass-through activities was taxed at the individual's tax rate (10%-39.6%). The law effectively lowers the tax rate on pass-through income to that of corporations.

Domestic Production Activities Deduction (DPAD) – The domestic production activities deduction is repealed for tax years beginning after December 31, 2017.

The DPAD was a deduction of up to 9% of qualified income for domestic businesses that are involved in a wide range of production related industries.

Depreciation Deductions

Section 179 – For property placed into service after December 31, 2017, taxpayers may elect to expense up to $1 million. The election begins to phase-out once a taxpayer places $2.5 million of assets into service during the year. The election applies to both new and used qualifying property.

Prior to the new law, Section 179 expensing was limited to $500,000 & phase-out began at $2 million.

Bonus Depreciation – Bonus depreciation has been retroactively increased to 100% for assets placed into service between September 27, 2017 and January 1, 2023. Bonus depreciation applies to both new and used property and does not phase-out based on assets purchased during the year.

Prior to change, bonus depreciation was limited to 50% and applied only to new property.

Alternative Minimum Tax (AMT) – The AMT has been repealed for corporations for tax years starting after December 31, 2017.

Like-Kind Exchange – The ability to defer gains and losses on the exchange of similar property will be limited to exchanges of real property (real estate) that is not held for resale.

Prior to the new law, like-kind exchange treatment was applied to the exchange of real property and personal property (equipment, vehicles, etc.).

Meals and Entertainment – The deduction for meals will remain at 50%; the deduction for entertainment has been eliminated.

Previously, both meals and entertainment were allowed as 50% deductions.

Cash Basis of Accounting – Taxpayers can use the cash basis of accounting if they satisfy the $25 million gross receipts test, regardless of industry.

Prior tax law required taxpayers with gross receipts over $10 million, or the need to account for inventory, to file their tax return using the accrual basis of accounting.