Key Takeaways from the Tax Cuts and Jobs Act of 2017

Amidst all the hustle and bustle of the holidays, tax reform is on the minds of individuals and businesses as we enter the final weeks of 2017. The Conference Committee last week reconciled differences between the House and Senate versions of the Tax Cuts and Jobs Act of 2017 to produce a unified piece of legislation, which passed the Senate Tuesday night and the House Wednesday afternoon.

We detail below several key tax changes as they pertain to individual taxpayers. Most provisions sunset after 2025, most notably excluding the new corporate tax rate. While it is not possible to know what changes or extensions Congress may make (if any) in the next several years, we wanted to share the information below so that you can coordinate our advice with that of your tax advisor.

Individual State and Local Tax (SALT) Deductions

Individuals can deduct no more than $10,000 of a combination of state and local property taxes and either sales or income taxes from their federal taxes. Previously, individuals could deduct all SALT (up to a certain limit for high-earners). The new provision may disproportionately hurt taxpayers (depending on their individual situation) in areas with high SALT, such as California, Maryland, Massachusetts, New Jersey and New York. Since our team members live and work in New Jersey, this hits close to home!

Mortgage Interest Deduction

The bill lowers the cap on mortgage debt eligible for deductions from $1 million to $750,000 and eliminates deductions for home equity debt (currently capped at $100,000), except if the homeowner uses the money for home improvements, in which case the $100,000 cap will still apply. The deduction for second homes survived the final bill, with the $750,000 cap applying in aggregate to mortgage debt. New mortgage debt caps will apply only to new mortgages, but all deductions for home equity loans will be eliminated (unless the money is used for home improvements).

Medical Expense Deduction

Early debate about the medical expense deduction centered on whether it would be repealed, but it will actually be expanded for the tax years of 2017 and 2018. Current law allows taxpayers to deduct medical expenses exceeding 10% of Adjusted Gross Income (AGI), while the new law will reduce the threshold to 7.5% for two years. After 2018, the deduction reverts back to 10% of AGI.

Standard Deduction

The standard deduction will increase from $6,350 (individual)/$12,700 (joint) to $12,000/$24,000.

Alternative Minimum Tax (AMT)

An individual or married couple pays the higher amount between regular income tax and the AMT, which was designed to prevent wealthier taxpayers from using deductions to avoid paying most taxes. The House proposed eliminating the AMT entirely. The Senate approach, which prevailed in the final bill, retained the AMT while increasing the exemption amount and phase-out threshold.

The AMT exemption is the amount you subtract from your Alternative Minimum Taxable Income (AMTI) – which (as opposed to regular taxable income) does not allow the standard deduction, personal exemptions or many itemized deductions – for calculating AMT tax liability. Think of the AMT exemption as the standard deduction for AMT payers.

The current AMT exemption is $54,300 (individual)/$84,500 (joint). The new law would raise it to $70,300/$109,400. The exemption gradually phases out as AMTI increases. Under current law, the exemption phases out at a rate of 25 cents for every dollar of additional AMTI above $120,700 (individual)/$160,900 (joint). Under the new law, the exemption begins phasing out at $500,000/$1 million.

Changes to the AMT exemption and phase-out thresholds, combined with fewer itemized deductions, a higher standard deduction and new lower income tax brackets, will dramatically reduce the number of people and amount of income subject to the AMT.

Personal Income Tax Brackets

2017 Rate	Single Filer	Joint Filer
10%	$0 to $9,325	$0 to $18,650
15%	$9,325 to $37,950	$18,650 to $75,900
25%	$37,950 to $91,900	$75,900 to $153,100
28%	$91,900 to $191,650	$153,100 to $233,350
33%	$191,650 to $416,700	$233,350 to $416,700
35%	$416,700 to $418,400	$416,700 to $470,700
39.6%	$418,400+	$470,700+

2018 Rate	Single Filer	Joint Filer
10%	$0 to $9,525	$0 to $19,050
12%	$9,525 to $38,700	$19,050 to $77,400
22%	$38,700 to $70,000	$77,400 to $165,000
24%	$70,000 to $160,000	$165,000 to $315,000
32%	$160,000 to $200,000	$315,000 to $400,000
35%	$200,000 to $500,000	$400,000 to $600,000
37%	$500,000+	$600,000+

Corporate Tax Rate

The corporate tax rate will be cut from 35% to 21%, with the new rate taking immediate effect in 2018. The original House and Senate versions featured a 20% corporate tax rate, which increased by 1% in the final bill to pay for a reduction in the top individual income tax rate. The final bill also eliminates the corporate Alternative Minimum Tax (AMT) after lobbying from business interests, who said the provision would crimp investment in research and development.

Business Income from Pass-Through Entities

Perhaps the most complex and controversial aspect of the tax bill is the treatment of income from pass-through entities, which constitute 95% of businesses in the United States.

Business owners (of sole-proprietorships, partnerships, S corporations and LLCs) reporting business income on personal tax returns will now be able to deduct 20% of "qualified business income." Qualified Business Income (QBI) is the net amount of qualified income, gains, deductions and losses for the business. However, in an effort to limit the appeal of business owners reclassifying their wages as business income eligible for the pass-through rate (i.e. an employee leaving their firm and then contracting back via a pass-through entity), the new bill puts a number of restrictions in place. Most notably, QBI does not include certain investment-related income, deductions, losses, "reasonable compensation" to S corp shareholders (to prevent them from under-paying themselves to minimize tax liability) and guaranteed payments to partners in an LLC or partnership.

The deduction is limited to the lesser of 20% of business income or 50% of total W-2 wages paid by the business. Thus, a high-income business with few employees would likely be limited to a deduction of 50% of wages. However, a controversial provision (which was not part of the original House or Senate bills) was inserted into the final bill providing relief for capital-intensive businesses with few employees, such as real estate entities and machine-heavy factories. The provision creates an alternative wage limit of 25% of wages plus 2.5% of the unadjusted basis of depreciable property that kicks in if the individual's taxable income exceeds a threshold of $157,500 (individual) /$315,000 (joint).

Finally, the deduction for QBI does not fully apply to specified service businesses, including healthcare, consulting, law, accounting, financial services, performing arts and athletics, where the principal asset of the business is the reputation or skill of one or more of its employees. Specified service business owners with income exceeding $157,500 (individual)/$315,000 (joint) will phase out of the QBI deduction at the next 50,000/$100,000 of income ($207,500/$415,000). The aforementioned last-minute change to pass-through provisions in the bill excluded engineers and architects from these service business limitations.

Child Tax Credit

The final bill will double the child tax credit to $2,000, provide a credit for each child under the age of 17, raise the earnings phase-out threshold for couples from $110,000 to $500,000 and cap the refundable portion at $1,400 in 2018. The current law includes a $1,000 credit for each child under the age of 17 that is partially refundable to qualified taxpayers earning more than $3,000.

Estate Tax

Estate and generation-skipping transfer tax exemptions double from $5.6 million to $11.2 million per person. A married couple gets double the exemption ($22.4 million combined).

529 Plans

Funds from 529 college savings plans can now be used to pay for private school tuition (up to $10,000 per student each year) at the elementary and secondary school level.

Individual Mandate in the Affordable Care Act (ACA)

The final bill will include a repeal of the individual mandate, which penalizes people who fail to buy health insurance. The original House bill kept the ACA's individual mandate intact, while the Senate bill repealed it.

Sources: Bloomberg, The Tax Foundation

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