The Tax Cuts and Jobs Act[1]

Last week the House and Senate completed the reconciliation between their competing bills to reform tax legislation. The House and Senate will each vote on the proposed legislation this week (currently scheduled for Tuesday). If the Bill is approved in both chambers (widely expected) it moves to the President for signature. Below is a broad outline of some of the elements of the proposed bill. If the Bill is enacted into law it becomes effective January 1, 2018. Almost every element of the individual tax changes will expire on December 31, 2025 with the rules resetting back to today's existing law.

TAX RATE CHANGES

Current Law

Business income, salaries, interest income are subject to rates at 10%, 15%, 25%, 28%, 33%, 35% and 39.6%.

Proposed Law

The final bill reduces most of the tax rates, including the top rate from 39.6% to 37%. In the sample table below, you can see broad rate reductions at almost every level (except a small pocket between $400K and ~$425K highlighted below). These rate reductions will broadly reduce tax bills.

MARRIED FILING JOINT RATE COMPARISON

Taxable Income	Today's Rates	Proposed Rates
$0-$19,050	10%	10%
$19,050-$77,400	15%	12%
$77,400-$156,150	25%	22%
$156,151-$165,000	28%	22%
$165,001-$237,950	28%	24%
$237,951-$315,000	33%	24%
$315,001-$400,000	33%	32%
$400,001-$424,950	33%	35%

[1] Sourced from the text of the Tax Cuts and Jobs Act, the Tax Foundation, Forbes Magazine and the Journal of Accountancy

$424,951-$480,050	35%	35%
$480,051-$600,000	39.6%	35%
More than $600,000	39.6%	37%

LONG-TERM CAPITAL GAINS & QUALIFIED DIVIDENDS RATES

Current Law

Under current law, taxpayers in the 10% and 15% brackets (MFJ income less than $77,400) pay a 0% tax on qualified dividends and on long term capital gains. Above those income limits, taxpayers pay at a 15% rate until income reaches the start of the 39.6% bracket ($420,000 if single, $480,000 if married). For those in that top bracket, the rate on capital gains and dividends is 20%.

Proposed Law

The final bill makes no changes to today's capital gain structure.

STANDARD DEDUCTION

Current Law

The standard deduction is $6,350 for single taxpayers and $12,700 for married taxpayers. You may deduct this amount or your "itemized deductions" if greater.

Proposed Law

The final bill increases the standard deduction to $12,000 for single taxpayers and $24,000 for taxpayers filing married jointly.

PERSONAL EXEMPTIONS

Current Law

You are entitled to a $4,100 deduction for yourself, your spouse, and any dependents. The exemptions are phased out for high-income taxpayers.

Proposed law

Personal exemptions are eliminated. The Child Tax Credit which is generally available for children under the age of 17 — will be increased from $1,000 to $2,000. There will be a new $500 credit for for non-child dependents, such as an elderly parent. The phase out based on income limits for these credits will rise from from $75,000 to $200,000 for single taxpayers and from $110,000 to $400,000 for married taxpayers.

ITEMIZED DEDUCTIONS

Below are some common itemized deductions and the differences under the proposed law.

Property Taxes & State and Local Income Taxes: Under current law these taxes are deductible. Under the proposed law, property taxes will be *combined* with state and local income taxes and subject to a $10,000 cap (you can see your total 2016 state and local deduction your tax return Schedule A, Line #9). This new cap may be particularly costly for residents in high tax states such as NJ, NY and CA. But if you glance at Page 2, Line #45 of last year's tax return, and there is AMT tax on line #45, the loss of these deductions may be less costly for you. This is because you are not getting the full benefit for these deductions due to AMT. More on this later and how you can begin to consider the overall impact of tax reform on you.

TIP: If you make quarterly (estimated) tax payments to the state, you should consider paying your fourth quarter 2017 payment before December 31st instead of on January 15, 2018. If you typically owe your state money with your year end tax filing, you should consider paying that liability before December 31st rather than with your tax return next year. Call us if you need help making this payment.

Mortgage Interest Expense: Under current law, mortgage interest is deductible with a cap at $1 million of mortgage debt and $100,000 of home equity debt. Under the proposed law, existing mortgage debt is grandfathered (i.e., no change). But for purchases of new homes, mortgage interest will be deductible on $750,000 of mortgage debt. The deduction for home equity debt goes away.

Medical Expenses: Under current law, deductible medical out of pocket expenses must exceed 10% of your adjusted gross income. Under the proposed law the 10% floor is reduced to 7.5%.

Other Miscellaneous Expenses: These are common deductions like investment advisory fees, accountant tax preparation fees, unreimbursed employee expenses. Under current law, these expenses are deductible when they exceed 2% of adjusted gross income. Under the proposed law, these items are no longer deductible. For many taxpayers these items did not exceed the 2% threshold.

ALTERNATIVE MINIMUM TAX

Current Law

There is a parallel universe in tax. Its called Alternative Minimum Tax. Your tax liability is computed under regular income tax and then compared to the alternative minimum tax. You pay the greater of the two. If you have tax on Line #45 of your 2016 tax return, then your alternative minimum tax was greater than your regular tax liability last year and you paid AMT. Under the alternative minimum tax calculation certain regular deductions (e.g., real estate taxes, state income taxes, etc.) are considered to be non-deductible while certain income items (e.g., exercise of incentive stock options, private activity bond income) are considered to be taxable. After making these adjustments, each taxpayer is allowed an exemption amount from the alternative income computation (married exemption is $84,500). But the exemption is quickly phased out for married taxpayers with income above $160,900. The alternative minimum tax rate starts at 26% and caps at 28%. These rates are applied to the preceding computation.

Proposed Law
The alternative minimum tax is retained. But importantly, the exemption amount is increased from $84,500 to $109,400 (married) and the phase out has been increased to $1 million (married). This means many individuals who were paying alternative minimum tax will no longer pay it.

TIP: Take a look at your 2016 tax return line #45 to see how much alternative minimum tax you paid. This could be an area of tax savings for you.

ALIMONY
Current Law
Alimony is deductible by the payor, and includible in the recipient's income.

Proposed Law
Alimony will no longer be deductible by the payor, nor will it be includible in the recipient's income for divorce or separation instruments executed after December 31, 2018.

EDUCATION ITEMS
Current Law
A taxpayer, depending on specific facts and income limits, who pays tuition to a college or university may be eligible for a Lifetime Learning Credit, a Hope Credit, or an American Opportunity Tax Credit. In addition teachers may deduct certain out of pocket classroom expenses and there is a student loan interest deduction.

Proposed Law:
No changes.

However, the use of 529 plan accounts will be expanded. Under current law, 529 accounts may only be used for college expenses. Under the proposed law 529 accounts may be used for K-12 expenses (up to a maximum of $10,000). This makes 529 accounts that much more attractive.

THE SALE OF YOUR PRIMARY RESIDENCE
Current Law
A taxpayer who sells his or her home may exclude up to $250,000 of gain ($500,000 if married filing jointly), provided the taxpayer has owned and used the home as his or her primary residence for two of the previous five years.

Proposed Law

No change. This was a surprise. The House and Senate bills both leaned toward a change to require taxpayers to own and live in the home for 5 of 8 years. It was dropped and the current law remains in place.

ESTATE TAXES
Current Law
The first $5.5 million of your assets are exempt from estate tax ($11 million for a married couple).

Proposed Law
The estate tax exemption would immediately double to $11 million for single taxpayers ($22 million for a married couple). The estate tax will not be repealed.

INDIVIDUAL INSURANCE MANDATE
Current Law
Any individual who doesn't maintain "minimum essential health care coverage" during the year must pay a penalty of $695 to the IRS.

Proposed Law
The final bill would fully repeal the individual mandate effective January 1, 2019. This is the one individual change that will not expire on December 31, 2025.

BUSINESS CHANGES:
"PASS THROUGHS" - SOLE-PROPRIETORS, S CORPORATIONS, PARTNERSHIPS, LLC'S
Current Law
These forms of doing business do not pay a "business level tax". Instead the income "flows through" the business and is taxed on the individual's personal tax return.

Proposed Law
The head line item in the proposed law is the drop of the Corporate tax rate from 35% to 21% and the implementation of a "territorial tax system". Because corporations received a rate reduction, the proposed law sought to give a break to flow through business owners. Flow through business owners will be allowed a deduction equal to 20% of their allocable flow through business income. But, because there is a natural tension between flow through business income and what otherwise could be employee income, the proposed law has a series of provisions meant to curb potentials for abuse and serves to limit the deduction to flow through business owners:

- Broadly the deduction is limited to 50% of your allocable share of W-2 wages paid by the business. This eliminated the deduction for flow through businesses without employees. So an alternative was provided whereby the limitation can be computed as 25% of your allocable share of the W-2 wages paid by the business, plus 2.5% of the unadjusted basis (the original purchase price) of property in the business. Finally, if your taxable income is below $315,000 (married) or $157,500 (single) the W-2 limitation does not apply.

- Personal service businesses (e.g., accountants, doctors, lawyers, etc) may not take the deduction, unless their taxable income is less than $315,000 (married) or $157,500 (single).
- The income limits are phased in above $100,000 (married) and $50,000 (single).

PULLING IT ALL TOGETHER

The impact of the proposed law on you is highly idiosyncratic primarily dependant on your personal income level, the effect of the revised alternative minimum tax, and your mix/magnitude of state deductions. It's impossible to generalize the impact -- but we can give you some broad guideposts to help you think about it:

- There is rate relief for most individuals (glance at the rate table above) typically worth one to four points of savings (against taxable income, not gross), and
- For taxpayers making less than $1 million (joint) or $500,000 (single) there should be AMT relief. If you are under $1 million (joint) $500,000 (single) the amount on line #45 of your 2016 tax return should likely go to zero or drop substantially, and
- The cap of your state and local deductions (Schedule A, Line #9) at $10,000 will offset the savings in the first two bullets. The effect of the loss of this deduction is complicated due to itemized deduction phase outs, the new standard deduction and AMT.
    - For taxpayers where state and local taxes are their primary deduction (e.g., no mortgage), the loss of the deduction may not be as substantial as you think, since all of your deductions will be replaced with a new larger $24,000 standard deduction.
    - For taxpayers that paid AMT on their 2016 tax return, the loss of state and local deductions may not be as significant as you think, since the value of this deduction was diluted from the historical disallowance under AMT, and
    - Finally, for taxpayers, where their mortgage interest and charity exceed $24,000 AND did not pay AMT in 2016, the loss of these deductions could be more material and roughly approximated by their nominal value minus $10,000 times 20%-35% (depending on your tax rate and deduction phase outs).

ITEMS TO CONSIDER BEFORE DECEMBER 31:

If you did not pay AMT last year and you make estimated state tax payments, you should consider making your final 2017 Q-4 state income tax payment before year end rather than in January of 2018. If you did not pay AMT last year and you typically owe your state when filing your income taxes you should consider making that payment before year end rather than in 2018 when you file your taxes.

If you believe that next year you will be a standard deduction filer (e.g., your mortgage interest and charity are under $14,000), consider opening a donor advised fund this year. A donor advised fund allows you to make a deductible contribution now, but direct the fund on which charities to give to over time. In essence, you can accelerate a few years of charity into the current year.