THE TCJA-PROVISIONS AFFECTING INDIVIDUALS

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The Tax Cuts and Jobs Act includes provisions that significantly affect the taxation of individuals.

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On 12/22/17, President Trump signed the Tax Cuts and Jobs Act (TCJA) **1** into law, as promised in his campaign, the most sweeping change to the Internal Revenue Code since the Tax Reform Act of 1986. This Act will affect every individual and business by significantly changing the filing of 2018 tax returns. Unless noted, the effective date for the provisions discussed in this article is 1/1/18, and the sunset date is 12/31/25. This article primarily highlights those changes affecting individual taxpayers.

The Tax Policy Center, a nonpartisan think tank, estimates TCJA will provide 80% of U.S. households with a tax cut in 2018, while 15% of taxpayers will see little or no change, with the remaining 5% paying more. Middle class households will see their taxes cut by roughly $900 or 1.6%, while lower income households will realize a more modest tax cut. The top 1% of taxpayers, making $733,000 and more, will have taxes cut by approximately $50,000 or 3.4%. Among middle-income households, approximately 90 percent will pay less, while 7 percent will pay more.

Change in tax rates

The TCJA reduces individual tax rates for tax years 2018 through 2025 **2** (see Exhibit 1). The prior law maximum capital gains tax rates and qualified dividend tax rates remain the same, including the **Section**

121 exclusion of gain on the sale of a primary residence. The maximum tax rate for depreciation recapture is 25% while gains from collectibles is 28% and net capital losses remain capped at $3,000 annually. The marriage penalty comes back into effect for high earners as the top tax rate for single individuals begins at $500,000, whereas the top tax rate kicks in at $600,000 for taxpayers filing as married filing jointly, not $1,000,000.

The TCJA also changed the tax rates on the unearned income of minor children, the kiddie tax, from the parents' respective tax rates to the trust tax rates for 2018-2025. The kiddie tax is simplified in that taxpayers do not have to wait until the parents' tax return is completed; however, the 37% tax bracket starts at $12,500. As a result, parents and grandparents may want to move assets into **Section 529** plans to avoid these punishing tax rates.

Changes to personal exemptions and standard deduction

The TCJA made significant changes to personal exemptions, the standard deduction, and the child

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tax credit. The personal exemption of $4,150 was eliminated, the standard deduction almost doubled for each of the filing statuses **3** , and the child tax credit doubled; this child tax credit coupled with the adjusted gross income (AGI) phase-out threshold allows more families to qualify for this credit. The White House Council of Economic Advisers estimates the number of Americans claiming itemized deductions will drop from just over 26% under prior law to less than 8% under the new tax reform. In other words, 92% of taxpayers will use the standard deduction.

Exhibit 2 reflects the increase in the standard deduction from 2017 to 2018 across all filing statuses. The increases cover 2018 through 2025 and are indexed for inflation annually after 2018, albeit using a slower inflation factor than previously.

The standard deduction for an individual who may be claimed as a dependent by another taxpayer may not exceed the greater of (1) $1,050, or (2) the sum of $350 and the individual's earned income. With the increases in the standard deduction, there will be fewer taxpayers itemizing deductions. Furthermore, for some taxpayers, medical expenses, mortgage interest, state and local taxes, charitable contributions, and gambling losses will no longer provide any tax benefit.

As a planning point, taxpayers may consider bunching charitable contributions together as the new standard deduction may eliminate the tax benefit. Taxpayers can maximize their charitable contribution deduction in several ways. They can bunch two years of contributions in one year and none the next year, employ a donor advised fund to prepay several years of charitable contributions into one year, or use a charitable transfer from an IRA to the extent of the required minimum distribution.

Changes to child tax credit (family tax credit)

The child tax credit has been expanded into a new family tax credit which more than makes up for the loss of the personal exemption. The family tax credit consists of a $2,000 credit per qualifying child who is not 17 by the close of the tax year, and a $500 credit for each dependent of the taxpayer who is not a qualifying child under 17. 4

Prior to 2018, the child tax credit phased out once AGI reached $75,000 for single and

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head of household filers, and $110,000 for married filing jointly taxpayers. The real bonus with this new family tax credit is the phase-out range starts at $200,000 for those filing single and head of household, and $400,000 for those filing married filing jointly. The refundable amount of the family tax credit for a qualifying child increased from $1,000 to $1,400 in 2018.

The requirements of a valid social security number to claim the child tax credit has been erased and does not impact the family tax credit. Due to the increased phase-out amounts, many more clients will qualify for the child tax credit, but it adds another compliance requirement for paid preparers as Form 8867 must be completed to claim the family tax credit.

Changes to itemized deductions

The TCJA generates significant changes in the area of itemized deductions, including suspending the overall limitation on itemized deductions from 2018 to 2025. 5

Medical expenses.

The medical expense floor is reduced to 7.5% of AGI for both the regular tax and the alternative minimum tax (AMT) for 2018 and reverts back to 10% for 2019 and later. 6 With rising medical costs, it may be prudent to bunch medical expenses into one year if possible to help qualify for the medical expense deduction.

SALT deduction.

The deduction for property taxes and state and local income taxes or sales tax has been limited to $10,000. 7

Mortgage interest.

The ceiling on acquisition indebtedness was reduced to $750,000 unless incurred prior to 12/15/17, where the taxpayer is grandfathered under the prior ceiling limit of $1,000,000. [8] In addition, the deduction for home equity indebtedness has been suspended up to 2025. Since home equity interest is no longer treated as qualified residence interest, the only way for the interest on home equity debt to be deductible is if the debt is secured by the home and used to improve the home, it is considered acquisition indebtedness and subject to the acquisition debt limitation.

Charitable contributions.

For the most part, the charitable contribution deduction remained the same except that the AGI threshold limitation for gifts to public charities was increased to 60% from 50%. [9] Additionally, the new law eliminates a charitable contribution deduction for payments made to colleges or universities for the right to purchase tickets or seats at athletic events. [10]

Casualty and theft losses.

The new law also limits the personal casualty and theft loss deduction to only those losses attributed to federally-declared disasters. [11]

Miscellaneous itemized deductions.

All miscellaneous itemized deductions subject to the 2% floor are eliminated and have been suspended through 2025. [12] This includes all tax preparation fees, unreimbursed business expenses, investment expenses, and the home office deduction for an employee working from home. Miscellaneous itemized deductions *not* subject to the 2% AGI floor such as gambling losses continue to be deductible. In addition, the new law also makes other expenses related to gambling, such as travel, deductible to the extent of gambling winnings.

Other important changes

Moving expenses.

The moving expense deduction has been eliminated except for active members of the Armed Forces moving pursuant to a military order. [13] For taxpayers receiving reimbursement for qualified moving expenses, the new law suspends the exclusion from gross income.

Alimony.

With the new law, Congress eliminated the deduction for alimony paid and therefore makes all alimony received nontaxable. **14** This is effective for any divorce or separation instrument executed after 12/31/18, but does not apply to previously-agreed-upon prenuptial agreements.

Alternative minimum tax.

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President Trump wanted to repeal the alternative minimum tax (AMT), but Congress could not make its budget reconciliation work with that repeal; instead, both the exemption amount and the exemption amount phase-out thresholds were increased effective 1/1/18 through 2025. **15** The AMT exemption amount increased to $109,400 for married taxpayers filing a joint return, and $70,300 for all other taxpayers. Also, the AMT exemption threshold phase-out was increased to $1,000,000 for married filing jointly taxpayers and $500,000 for all other taxpayers.

As a planning point, fewer people will be subject to AMT beginning in 2018 as the top three preference items-personal exemptions, state and local taxes, and miscellaneous itemized deductions-have been eliminated or curtailed.

Higher education expenses.

The TCJA modifies the definition of qualified higher education expenses, **16** allowing distributions of up to $10,000 per student from a **Section 529** account for tuition and other eligible expenses at a public, private, or religious elementary or secondary school. This does not sunset after 2025. Also, amounts from 529 plans can be rolled over to an ABLE account (**Section 529A** accounts) without penalty, provided the ABLE account is owned by the designated beneficiary of that **Section 529** account, or a member of the designated beneficiary's family.

The discharge of student loan debt is excludible from income if the discharge of debt is due to death or a permanent disability. **17**

IRAs.

The TCJA repeals the law allowing taxpayers who convert traditional pre-tax IRA contributions into a post-tax Roth IRA to later reverse the conversion. The new law, effective 1/1/18, still allows Roth IRA contributions to be recharacterized as traditional IRA contributions as long as the recharacterization is completed by the due date of the tax return. **18** Consistent with prior law, conversion of a traditional IRA to a Roth IRA triggers immediate taxation.

Estate tax exemption.

Effective for deaths and gifts made after 12/31/17 and up to 1/1/26, the exemption for decedents dying in 2018 is $11,180,000. **19** With TCJA, the step-up in basis rules are retained with the top marginal estate tax rate at 40%.

Health insurance penalty.

The individual responsibility payment with respect to health coverage status was enacted as part of the Affordable Care Act. **20** The TCJA reduced the amount of the individual responsibility payment to zero for months beginning after 12/31/18 and before 1/1/26; however, the 3.8% net investment income tax was retained.

Changes affecting business owners

The TCJA established a new deduction based on an individual's qualified business income. **21** The new law provides that an individual taxpayer generally may deduct 20% of "qualified business income" (QBI) from a partnership, S corporation, sole proprietorship, or farm, as well as 20% of the aggregate qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income, subject to income phase-outs.

Changes affecting real estate

Under the prior law, **Section 1031** allowed for tax-deferred exchanges of appreciated like-kind property. Effective 1/1/18, tax-deferred exchanges are no longer allowed for personal property assets; however, tax-deferral is still allowed for like-kind exchanges involving real estate transactions.

Conclusion

The TCJA is the most significant reform to the Internal Revenue Code since 1986 and dramatically changes the 2018 tax law for individuals. As 2018 comes to a close, tax practitioners should take the opportunity to meet with clients as early as possible to minimize any negative impact while maximizing the tax benefits available to individuals from the TCJA.

Exhibit 1. Tax Rates for Individuals

Tax Bracket	Single Individuals	Head of Household	Married Filing Separately	Married Filing Jointly
10%	$0 - $9,525	$0 - $13,600	$0 - $9,525	$0 - $19,050
12%	$9,526 - $38,700	$13,601 - $51,800	$9,526 - $38,700	$19,051 - $77,400
22%	$38,701 - $82,500	$51,801 - $82,500	$38,701 - $82,500	$77,401 - $165,000
24%	$82,501 - $157,500	$82,501 - $157,500	$82,501 - $157,500	$165,001 - $315,000
32%	$157,501 - $200,000	$157,501 - $200,000	$157,501 - $200,000	$315,001 - $400,000
35%	$200,001 - $500,000	$200,001 - $500,000	$200,001 - $300,000	$400,001 - $600,000
37%	$500,001+	$500,001+	$300,001+	$600,001+

Exhibit 2. Standard Deduction

	2017	2018
Married Filing Jointly (MFJ)	$12,700	$24,000
Head of Household	$9,350	$18,000
Single & Married Filing Separately	$6,350	$12,000
65+/blind bonus – MFJ	$1,250	$1,350
65+/blind bonus – Single	$1,550	$1,600

1 P.L. 115-97, 12/22/17.

2 Section 1 .

3 Section 63(c)(7) .

4 Section 24(h) .

5 Section 68 .

6 Section 213 .

7 Section 164(b)(6) .

8 Section 163(h)(3) .

9 Section 170(b)(1)(G) .

10 Section 170(l) .

11 Section 165(h)(5) .

12 Section 67(g) .

13 Section 217(k) .

14 Repeal of Section 71 .

15 Section 55(d)(4) .

16 Section 529(e)(3) .

17 Section 108(f)(5)(A) .

18 Section 408A(d)(6)(B) .

19 Section 2010(c)(3) (indexed for inflation).

20 Section 5000A .

21 Section 199A .