AFS AFFLUENT FINANCIAL SERVICES LLC

CERTIFIED PUBLIC ACCOUNTANTS

Tax Reform Provisions - Individuals

The 2018 Tax Brackets

In President Trump's campaign tax plan, he proposed reducing the number of tax brackets from seven to three, and the House of Representatives' original tax reform bill contained four brackets. However, the final bill kept the seven-bracket structure but with mostly lower tax rates.

Marginal Tax Rate	Single	Married Filing Jointly	Head of Household	Married Filing Separately
10%	$0-$9,525	$0-$19,050	$0-$13,600	$0-$9,525
12%	$9,525-$38,700	$19,050-$77,400	$13,600-$51,800	$9,525-$38,700
22%	$38,700-$82,500	$77,400-$165,000	$51,800-$82,500	$38,700-$82,500
24%	$82,500-$157,500	$165,000-$315,000	$82,500-$157,500	$82,500-$157,500
32%	$157,500-$200,000	$315,000-$400,000	$157,500-$200,000	$157,500-$200,000
35%	$200,000-$500,000	$400,000-$600,000	$200,000-$500,000	$200,000-$300,000
37%	Over $500,000	Over $600,000	Over $500,000	Over $300,000

Data source: Joint Explanatory Statement of the Committee of Conference.

For comparison, here are the 2018 tax brackets that were set to take effect under previous tax law.

Marginal Tax Rate	Single	Married Filing Jointly	Head of Household	Married Filing Separately
10%	$0-$9,525	$0-$19,050	$0-$13,600	$0-$9,525
15%	$9,525-$38,700	$19,050-$77,400	$13,600-$51,850	$9,525-$38,700
25%	$38,700-$93,700	$77,400-$156,150	$51,850-$133,850	$38,700-$78,075
28%	$93,700-$195,450	$156,150-$237,950	$133,850-$216,700	$78,075-$118,975
33%	$195,450-$424,950	$237,950-$424,950	$216,700-$424,950	$118,975-$212,475
35%	$424,950-$426,700	$424,950-$480,050	$424,950-$453,350	$212,475-$240,025
39.6%	Over $426,700	Over $480,050	Over $453,350	Over $240,025

Data source: IRS.

The marriage penalty is (mostly) gone

One thing to notice from these brackets is that the so-called marriage penalty, which many Republican leaders (including President Trump) wanted to eliminate, is almost absent.

If you're not familiar, here's a simplified version of how the marriage penalty works. Let's say that two single individuals each earned a taxable income of $90,000 per year. Under the old 2018 tax brackets, both of these individuals would fall into the 25% bracket for singles. However, if they were to get married, their combined income of $180,000 would catapult them into the 28% bracket. Under the new brackets, they would fall into the 24% marginal tax bracket, regardless of whether they got married or not.

In fact, the married filing jointly income thresholds are exactly double the single thresholds for all but the two highest tax brackets in the new tax law. In other words, the marriage penalty has been effectively eliminated for everyone except married couples earning more than $400,000.

Standard deduction and personal exemption

While it's being sold as a tax cut, the higher standard deduction really falls more under the category of a simplification.

Yes, the standard deduction has roughly doubled for all filers, but the valuable personal exemption has been eliminated. For example, a single filer would have been entitled to a $6,500 standard deduction and a $4,150 personal exemption in 2018, for a total of $10,650 in income exclusions. Under the new tax plan, they would just get a $12,000 standard deduction. Is it better? Yes. But it's not really "doubled."

Having said that, here's a comparison between the standard deductions of the new and old tax laws.

Tax Filing Status	Previous Standard Deduction (Set to Take Effect in 2018)	New Standard Deduction
Single	$6,500	$12,000
Married filing Jointly	$13,000	$24,000
Married filing Separately	$6,500	$12,000
Head of household	$9,350	$18,000

Data source: IRS and Tax Cuts and Jobs Act.

Capital gains taxes

The general structure of the capital gains tax system, which applies to things like stock sales and sales of other appreciated assets, isn't changing. However, there are still a few important points to know.

For starters, short-term capital gains are still taxed as ordinary income. Since the tax brackets applied to ordinary income have changed significantly, as you can see from the charts above, your short-term gains are likely taxed at a different rate than they formerly were.

Also, under the new tax law, the three capital gains income thresholds don't match up perfectly with the tax brackets. Under previous tax law, a 0% long-term capital gains tax rate applied to individuals in the two lowest marginal tax brackets, a 15% rate applied to the next four, and a 20% capital gains tax rate applied to the top tax bracket.

Instead of this type of structure, the long-term capital gains tax rate income thresholds are similar to where they would have been under the old tax law. For 2018, they are applied to maximum taxable income levels as follows:

Long-Term Capital Gains Rate	Single Taxpayers	Married Filing Jointly	Head of Household	Married Filing Separately
0%	Up to $38,600	Up to $77,200	Up to $51,700	Up to $38,600
15%	$38,600-$425,800	$77,200-$479,000	$51,700-$452,400	$38,600-$239,500
20%	Over $425,800	Over $479,000	Over $452,400	Over $239,500

Data source: Tax Cuts and Jobs Act.

Finally, the 3.8% net investment income tax that applied to high earners stays the same, with identical income thresholds. If Congress is successful in repealing the Affordable Care Act, this could potentially go away, but it remains for the time being.

Tax breaks for parents

The personal exemption is going away, which could disproportionally affect larger families. However, this loss and more should be made up for by the expanded Child Tax Credit, which is available for qualified children under age 17. Specifically, the bill doubles the credit from $1,000 to $2,000, and also increases the amount of the credit that is refundable to $1,400.

In addition, the phaseout threshold for the credit is dramatically increasing.

Tax Filing Status	Old Phaseout Threshold	New Phaseout Threshold
Married filing jointly	$110,000	$400,000
Individuals	$75,000	$200,000

Data source: Tax Cuts and Jobs Act.

If your children are 17 or older or you take care of elderly relatives, you can claim a nonrefundable $500 credit, subject to the same income thresholds. Each child must have a Social Security number before the due date of your 2018 return (including extensions) to be claimed as a qualifying child for the child tax credit or additional child tax credit.

Furthermore, the Child and Dependent Care Credit, which allows parents to deduct qualified child care expenses, has been kept in place. This can be worth as much as $1,050 for one child under 13 or $2,100 for two children. Plus, up to $5,000 of income can still be sheltered in a dependent care flexible spending account on a pre-tax basis to help make child care more affordable. You can't use both of these breaks to cover the same child care costs, but with the annual cost of child care well over $20,000 per year for two children in many areas, it's safe to say that many parents can take advantage of the FSA *and* credit, both of which remain in place.

Education tax breaks

Earlier versions of the tax bill called for reducing or eliminating some education tax breaks, but the final version does not. Specifically, the Lifetime Learning Credit and Student Loan Interest Deduction are still in place, and the exclusion for graduate school tuition waivers survives as well.

One significant change is that the bill expands the available use of funds saved in a 529 college savings plan to include levels of education other than college. In other words, if you have children in private school, or you pay for tutoring for your child in the K-12 grade levels, you can use the money in your account for these expenses.

Mortgage interest, charitable contributions, and medical expenses

These three deductions remain, but there have been slight tweaks made to each.

- First, the mortgage interest deduction can only be taken on mortgage debt of up to $750,000, down from $1 million currently. This only applies to mortgages taken after Dec. 15, 2017; pre-existing mortgages are grandfathered in. And the interest on home equity debt can no longer be deducted at all, whereas up to $100,000 in home equity debt could be considered.
- Next, the charitable contribution deduction is almost the same, but with two notable changes. First, taxpayers can deduct donations of as much as 60% of their income, up from a 50% cap. And donations made to a college in exchange for the right to purchase athletic tickets will no longer be deductible.
- Finally, the threshold for the medical expenses deduction has been reduced from 10% of adjusted gross income (AGI) to 7.5% of AGI. In other words, if your adjusted gross income is $50,000, you can now deduct any unreimbursed medical expenses over $3,750, not $5,000 as set by prior tax law. Unlike most other provisions in the bill, this is retroactive to the 2017 tax year.

The SALT deduction

Perhaps the most controversial aspect of tax reform on the individual side was the fate of the SALT deduction. Early versions of the bill proposed eliminating the deduction (which stands for "state and local taxes"), which didn't sit well with some key Republicans in high-tax states.

The final version of the bill keeps the deduction, but limits the total deductible amount to $10,000, including income, sales, and property taxes.

Depreciation

Some laws regarding depreciation deductions have changed. A taxpayer may elect to expense the cost of any section 179 property and deduct it in the year the property is placed in service. The new law increased the maximum deduction from $500,000 to $1 million. It also increased the phase-out threshold from $2 million to $2.5 million.

529 Education Savings Plan Changes

Taxpayers, beneficiaries, and administrators of 529 and Achieving a Better Life Experience (ABLE) programs can rely on the rules described in Notice 2018-58 until the Treasury Department and IRS issue regulations clarifying these changes.

Deductions that are disappearing

While many deductions are remaining under the new tax law, there are several that didn't survive, in addition to those already mentioned elsewhere in this guide. Gone for the 2018 tax year are the deductions for:

- Casualty and theft losses (except those attributable to a federally declared disaster)
- Unreimbursed employee expenses
- Tax preparation expenses
- Other miscellaneous deductions previously subject to the 2% AGI cap like tax preparation fee, investment including investment management expenses, job search expenses, hobby losses, safe deposit box fee, etc.
- Moving expenses
- Employer-subsidized parking and transportation reimbursement

Itemizing won't be worthwhile anymore for millions of households

While we're on the topic of deductions, many of these may now be a moot point, even to taxpayers who have been using them for years. Even though most major deductions are being kept in place, the higher standard deductions will make itemizing not worthwhile for millions of households.

For example, let's say that a married couple pays $8,000 in mortgage interest, makes $4,000 in charitable contributions, and pays $5,000 in state and local taxes. This adds up to $17,000 in deductions, which when compared with the previous $13,000 standard deduction makes itemizing look like a smart idea.

However, with the new $24,000 standard deduction for married couples, it would no longer be worth it to itemize.

In fact, the Joint Committee on Taxation estimates that 94% of households will claim the standard deduction in 2018, up from about 70% now.

Obamacare penalties will be going away

Republicans were unsuccessful in their efforts to repeal the Affordable Care Act, otherwise known as Obamacare, in 2017. However, the tax reform bill repeals the individual mandate, meaning that people who don't buy health insurance will no longer have to pay a tax penalty.

It's worth noting that this change doesn't go into effect until 2019, so for 2018, the "Obamacare penalty" can still be assessed.

The pass-through deduction

The new tax code makes a big change to the way pass-through business income is taxed. This includes income earned by sole proprietorships, LLCs, partnerships, and S corporations.

Under the new law, taxpayers with pass-through businesses like these will be able to deduct 20% of their pass-through income. In other words, if you own a small business and it generates $100,000 in profit in 2018, you'll be able to deduct $20,000 of it before the ordinary income tax rates are applied.

There are phaseout income limits that apply to "professional services" business owners such as lawyers, doctors, and consultants, which are set at $157,500 for single filers and $315,000 for pass-through business owners who file a joint return.

Alternative minimum tax

The alternative minimum tax (AMT) was implemented to ensure that high-income Americans paid their fair share of taxes, regardless of how many deductions they could claim. Essentially, higher-income households need to calculate their taxes twice -- once under the standard tax system and once under the AMT -- and pay whichever is higher.

The problem is that the AMT exemptions weren't initially indexed for inflation, so over time, the AMT started to apply to more and more people, including the middle class, which it was never intended to affect.

So, the tax reform bill permanently adjusts the AMT exemption amounts for inflation in order to address this problem, and makes them significantly higher initially in 2018. Here's how the AMT exemptions are changing for 2018.

Tax Filing Status	2017 AMT Exemption Amount	2018 AMT Exemption Amount
Single or head of household	$54,300	$70,300
Married filing jointly	$84,500	$109,400
Married filing separately	$42,250	$54,700

Data source: Tax Cuts and Jobs Act.

In addition, the income thresholds at which the exemption amounts begin to phase out are dramatically increased. Currently, these are set at $160,900 for joint filers and $120,700 for individuals, but the new law raises these to $1 million and $500,000, respectively.

The estate tax exemption

The estate tax already applied to a small percentage of households. Essentially, the 40% estate tax rate applied only to the portion of an estate that was valued at $5.59 million or more per individual, or $11.18 million per married couple.

The new tax law doubles these exemptions. Now, for 2018, individuals get a $11.18 million lifetime exemption and married couples get to exclude $22.4 million. As you can probably imagine, this won't leave too many families paying the estate tax.

Most of the individual tax breaks are temporary

So far, we've discussed the tax changes that will affect individuals. It's also important to point out that most of the changes to individual taxes made by the bill are temporary -- they're set to expire after the 2025 tax year.

The notable exception is the change to the Chained CPI as a means to calculate inflation. In simple terms, this means that the income thresholds for each marginal tax bracket will rise more slowly than they previously would, which will presumably make a greater portion of each worker's income subject to higher marginal tax rates over time.

The combination of the temporary nature of the tax cuts and the permanent switch to the Chained CPI is expected to have the eventual effect of *higher* taxes on the middle class as compared to current tax law.

Summary

- Tax rates: The new law lowers tax rates for individuals and adjusts the bracket amounts. For 2018 through 2025, the tax rates are 10%; 12%, 22%; 24%; 32%; 35% and 37%. In addition, a chain CPI index will be used for future indexing, thereby reducing the size of annual adjustments.

- Standard deductions: The standard deduction is effectively doubled to $12,000 for single filers and $24,000 for joint filers, while the additional standard deductions for the elderly and blind are retained.

- Personal exemptions: Personal exemptions, including exemptions available for qualified for dependent children and relatives, are repealed. Accordingly, the personal exemption phase out (PEP) rule also goes away.

- Alternative minimum tax: The alternative minimum tax (AMT) system is retained, but exemption amounts, as well as the thresholds for phasing out exemptions, are significantly increased. In addition, these figures will be indexed for inflation in future years.

- Child tax credit: The child tax credit (CTC) is doubled from $1,000 per qualified child to $2,000, subject to a phase-out for high-income taxpayers. Under a late amendment, $1,400 of this credit is refundable. In addition, the new law creates a $500 nonrefundable credit for non-child dependents.

- State and local taxes: In a controversial provision, the TCJA limits the deduction for state and local income taxes (SALT) to $10,000 annually for any combination of state and local property taxes or (2) state and local income taxes or sales taxes.

- Mortgage interest: Although deductions for prior debt is grandfathered, the new law limits the mortgage interest deduction to interest paid on the first $750,000 of acquisition debt, down from $1 million. It also eliminates deductions for interest paid on home equity debt.

- Medical expenses: While other itemized deductions are eliminated or scaled back, the deduction for medical expenses is temporarily improved. For 2017 and 2018, the threshold for deducting medical expenses reverts to 7.5% of AGI, the threshold in effect prior the law prior to the Affordable Care Act (ACA).

- Casualty and theft losses: This itemized deduction is eliminated, but it is preserved, with certain modifications, for losses incurred in federal disaster areas.

- Section 529 plans: The list of qualified expenses for Section 529 plans is expanded to include tuition at an elementary or secondary public, private or religious school, plus home schooling expenses, for up to $10,000 per year.

- Roth IRAs: The rule permitting taxpayers to recharacterize a Roth IRA back into a traditional IRA after a conversion is repealed.

- Health insurance: The new law repeals the health insurance mandate for individuals established by the ACA. This change doesn’t take effect until 2019.

- Estate tax: The federal estate tax exemption is doubled, resulting in an inflation-indexed exemption of $11.2 million in 2018.

Contact Us

For inquiries or to request a proposal for audit, accounting or tax services, please contact:

Ajit S. Chawla, CPA, CA, CGMA

Managing Partner

Affluent Financial Services LLC

Certified Public Accountants

9211 Corporate Boulevard, Suite 330

Rockville, MD 20871

301-921 8585

ajit@affluentcpa.com

www.affluentcpa.com