Re: 2017 Tax Cuts and Jobs Act: Impact on Families

Dear Client:

The federal Tax Cuts and Jobs Act (TCJA) made numerous important changes impacting virtually all taxpayers, including individual taxpayers and their families. These changes are generally temporary and affect tax years 2018 through 2025. Changes that may impact the tax liability of individual taxpayers and their families are detailed below and include the new qualified business income deduction; modifications to itemized deductions; repeal of the personal exemption; near doubling of the standard deduction; increased child tax credit; modifications to kiddie tax; decreased individual income tax rates; and modifications to the alternative minimum tax.

Pass-Through Businesses

Currently, up to the end of 2017, owners of partnerships, S corporations, and sole proprietorships – as "pass-through" entities – pay tax at the individual rates, with the highest rate at 39.6 percent. The Tax Cuts and Jobs Act allows a temporary deduction in an amount equal to 20 percent of qualified income of pass-through entities, subject to a number of limitations and qualifications.

The Tax Cuts and Jobs Act contains rules that will prevent pass-through owners—particularly service providers such as accountants, doctors, lawyers, etc.—from converting their compensation income taxed at higher rates into profits taxed at the lower rate.

Itemized Deductions Changed

The TCJA makes significant changes to popular itemized deductions, including the following changes relevant to families:

- *Mortgage interest deduction*. The itemized deduction for home mortgage interest is limited to interest on $750,000 of acquisition indebtedness ($375,000, in the case of married taxpayers filing separately) for tax years 2018-2025. The deduction of interest on home equity debt is also suspended.
- *State and local taxes*. The itemized deduction for all nonbusiness state and local taxes is limited to $10,000 ($5,000 for married taxpayers filing a separate return) for tax years 2018-2025. Property taxes are included in this limitation. Sales taxes may be included as an alternative to claiming state and local income taxes.
- *Miscellaneous itemized deductions*. For tax years 2018-2025, all miscellaneous itemized deductions that are subject to the 2% floor are repealed.
- *Medical expenses*. The threshold to claim an itemized deduction for unreimbursed expenses paid for medical care is reduced to 7.5% of adjusted gross income (AGI) for all taxpayers for tax years 2017 and 2018.

- *Personal casualty and theft losses*. For tax years 2018-2025, the itemized deduction for personal casualty and theft losses is limited to losses attributable to federally declared disasters.

Personal and Dependent Exemptions Suspended

The TCJA suspends the deduction for personal and dependent exemptions for tax years 2018-2025. Instead, the basic standard deduction amounts are nearly doubled to $24,000 for married individuals filing jointly (including surviving spouses); $18,000 for heads of household; and $12,000 for single individuals and married individuals filing separately. The additional amounts for the elderly and/or blind ($1,300 for joint filers, $1,600 for single taxpayers) are retained.

Standard Deduction Increased

The substantial increase to the standard deduction and modifications to itemized deductions means fewer individual taxpayers will benefit from itemized deductions. For the vast majority of married taxpayers filing jointly, only those with total allowable mortgage interest, state and local income/property taxes, and charitable deductions exceeding $24,000 will claim them as itemized deductions (absent extraordinary medical expenses).

Child Tax Credit Expanded

In order to compensate for the elimination of the exemption for dependents, the child tax credit is temporarily expanded to $2,000 (refundable portion of up to $1,400) per qualifying child. A $500 nonrefundable family credit for dependents other than qualifying children was also added. Finally, the phase-out threshold is increased to $400,000 for joint filers ($200,000 for all other taxpayers). These enhancements to the child credit are expected to lower overall tax liability for middle-class families and result in more families being able to benefit from the credit.

Kiddie Tax Changed

The Tax Code imposes a "kiddie tax" on the unearned or investment income of children who are under 19 (under 24 if a student). Beginning after 2017, legislation has simplified the calculation of the kiddie tax on a child's unearned income above a certain amount ($2,100 for 2018) by applying the tax rates applicable to trusts and estates.

Tax Rates Lowered; AMT Modified

The TCJA temporarily lowers tax rates for many individual taxpayers and increases the alternative minimum tax individual exemption amounts and phase-out thresholds.

Create a Flexible Tax Plan

Because all of the tax changes discussed above are interconnected, estimating the impact on individual taxpayers and families is challenging and requires a comprehensive tax planning strategy. When planning for the future, you should be mindful of the temporary nature of many of the tax law changes. In order to keep tax reform within budgetary parameters, the majority of the provisions impacting individuals expire after 2025. There is no guarantee that they will be extended by a future Congress. Creating a flexible tax plan will help you avoid negative tax implications if and/or when these provisions expire.