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Tax Cuts and Jobs Act Update

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With the passing of the Tax Cuts and Jobs Act on December 22, 2017, there are several significant changes to the way individuals will compute their individual income tax beginning in 2018. Although the actual impact the Act will have on each individual income tax return may be different, the following provides a general summary of the most significant changes made by the Act.

Tax Rates. The individual income tax rates, whether filing as single or married, have changed. Although there continues to be seven tax brackets, the tax rates and the amount of taxable income within each bracket have changed as shown in the tables below.

2017 Tax Rates	Single Filer	Married Filing Joint
10%	$0-$9,325	$0-$18,650
15%	$9,325-$37,950	$18,650-$75,900
25%	$37,950-$91,900	$75,900-$153,100
28%	$91,900-$191,650	$153,100-$233,350
33%	$191,650-$416,700	$233,350-$416,700
35%	$416,700-$418,400	$416,700-$470,700
39.60%	$418,400+	$470,700+

2018 Tax Rates	Single Filer	Married Filing Joint
10%	$0-$9,525	$0-$19,050
12%	$9,525-$38,700	$19,050-$77,400
22%	$38,700-$82,500	$77,400-$165,000
24%	$82,500-$157,500	$165,000-$315,000
32%	$157,500-$200,000	$315,000-$400,000
35%	$200,000-$500,000	$400,000-$600,000
37%	$500,000+	$600,000+

The capital gains tax rates remain at 0%, 15%, and 20% with slight adjustments to the thresholds amount. Beginning in 2018, the 15% rate will apply when adjusted gross income is in excess of $38,600 for single persons and $77,200 for married persons filing a joint return. The 20% rate will apply when adjusted gross income is in excess of $425,800 for single persons and $479,000 for married persons filing a joint return.

For children under the age of 19, or a fulltime student under 24, prior law required unearned income in excess of a base amount ($2,100 in 2017) to be taxed at the parent's marginal tax rate. The Act provides that, beginning in 2018, the unearned income is taxed at the rates applicable to trusts and estates.

In most instances, the changes in the tax rates and tax brackets from 2017 to 2018 are favorable to taxpayers. Although not shown here, persons filing as head of household will also be subject to new tax rates and tax brackets. In addition to changing the individual rates, the Act also made favorable changes to the corporate tax rates and tax brackets. As such, many taxpayers who are operating businesses as sole proprietors or through flow-through entities may want to consider incorporating.

Standard and Itemized Deduction. When computing taxable income, taxpayers can either take a standard deduction or itemize their deductions. The Act made significant changes to both of these alternatives. With respect to the standard deduction, the Act increased the standard deduction from $6,350 to $12,000 for single persons and from $12,700 to $24,000 for married persons filing a joint return. The Act maintains the enhanced deduction for the blind and elderly.

With respect to itemized deductions, the Act reduces the ability to deduct mortgage interest, real estate taxes, state income taxes and sales taxes. Beginning in 2018, the amount of mortgage indebtedness to be considered when determining the interest deduction is limited to $750,000 for new loans. The interest paid on home equity lines of credit is no longer deductible. The Act limits the deduction for real estate taxes, state income taxes, and sales tax to $10,000. Previously, there was no cap on these state tax deductions.

The Act eliminates the deductibility of moving expenses and the miscellaneous itemized deductions (unreimbursed employee expenses, investment advisory fees, tax preparation fees, safety deposit box rental, etc.). The Act changes the deductibility of medical expenses to those expenses in excess of 7.5% of adjusted gross income in 2018. In 2019, the threshold percentage for medical expenses will be 10% for taxpayers of all ages. Finally, the Act increases the limitation on charitable contributions from 50% to 60% of adjusted gross income and eliminates the ability to deduct contributions made for university athletic seating rights.

For those taxpayers who consistently use the standard deduction, the increased amount should amount to a nice reduction to their taxable income. On the contrary, for those taxpayers who *consistently itemize their deductions, they will likely see a decrease in their deductible amount and may be better off taking the standard deduction. Some taxpayers may decide that it is best to bunch up their charitable contributions and real estate taxes in an effort to itemize their deductions every other year. Taxpayers over 70 ½ should consider making their charitable contributions directly from an Individual Retirement Account ("IRA").*

Personal Exemption. In 2017, with exception for single persons with adjusted gross incomes in excess of $261,500 and married persons with adjusted gross incomes in excess of $313,800, taxpayers were able to claim a personal exemption amount of $4,050 for themselves, a spouse, and dependents. The Act removes the deduction for personal exemptions.

The loss of the personal exemptions has the potential to increase taxable income, especially for taxpayers with large families. However, if the taxpayer had income in excess of the phase out limitation or was subject to the alternative minimum tax, the taxpayer was likely receiving little or no benefit from this deduction anyway.

Alimony. Prior to the Act, there was an above the line deduction for alimony paid to an ex-spouse, with such amounts being included in the recipient spouse's income. Although this law remains in effect with respect to dissolution decrees entered into prior to December 31, 2018, alimony paid pursuant to decrees entered into after December 31, 2018 will no longer be deductible to the payor or included as income by the recipient.

Dissoulution attorneys and their clients will want to pay attention to this change when determining the amount of alimony and the property settlement.

Child and Dependent Credits. The credit for children under the age of 17 was increased from $1,000 to $2,000. The Act also provides a credit for dependents other than qualifying children in the amount of $500. Under prior law, single persons with adjusted gross income in excess of $75,000 and married persons filing a joint return with adjusted gross income in excess of $110,000 were phased out of receiving any benefit from the credit. The Act increases the adjusted gross income threshold to $200,000 for single persons and $400,000 for married persons filing a joint return. The Act also increases the refundable portion of the credit to 15% of earned income in excess of $2,500, with a maximum refundable credit of $1,400 per child.

The increase in the income threshold will allow more taxpayers to claim the child tax credit. This, *along with the increase in the amount of the credit, has the potential to be a significant break for families, especially for those taxpayers with large families.*

Alternative Minimum Tax. The Act changes the alternative minimum tax exemption amount and the income thresholds for the phase out of the exemption amount. The prior alternative minimum tax exemption amount was $54,300 for single persons and $84,500 for married persons filing a joint return. The Act increases these amounts to $70,300 for single persons and $109,400 for married persons filing a joint return. Further, the income thresholds at which the exemption gets phased out increased. Whereas, in 2017, the phase out began at income of $120,700 for single persons and $160,900 for married persons filing a joint return, the Act provides a threshold of $500,000 for single persons and $1,000,000 for married persons.

The alternative minimum tax has been criticized in recent years as it has applied to more and more taxpayers, catching the middle class along with the high income taxpayers that it was intended for. Although the increase in the exemption amount is significant, the increase in the income thresholds means that more taxpayers will receive the benefit of the exemption amount. This has the potential to be a significant tax break for those who have been subject to the alternative minimum tax in the past.

Qualified Business Income Deduction. The Act creates a new deduction with respect to the qualified business income of sole proprietors and from pass through entities. With certain limitations, the deduction is up to 20% of qualified business income, which is the net amount of income, gains, deductions and losses from any qualified trade or business. The deduction cannot exceed 20% of the taxpayer's taxable income, reduced by net capital gains. There are limitations based upon the amount of wages paid within the trade or business and, in some cases, the amount of unadjusted bases of certain qualified property. Finally, with respect to taxpayers with income from the performance of professional services (accounting, law, financial services, health, performing arts, etc.) the ability to take the deduction at all is subject to certain income thresholds.

The qualified business income deduction has the potential to be a significant deduction for those taxpayers receiving income from a qualified trade or business. The computation of the deduction is complex, as illustrated by the length of the regulations that were just released in August.

Depreciation and Section 179. The Act permits 100% bonus depreciation for qualifying property acquired and placed in service through 2022. The amount of bonus depreciation is phased down beginning in 2023 through 2026. Bonus depreciation can be applied to both new and used property. The Act also increases the annual depreciation limitations for passenger automobiles.

The Act provides the ability to deduct up to $1,000,000 under Section 179. The ability for a taxpayer to use the Section 179 deduction is phased out with annual purchases in excess of $2,500,000.

The adjustments to the depreciation and Section 179 rules are taxpayer friendly. The ability to determine how much Section 179 deduction to take each year, along with the accelerated bonus depreciation can significantly reduce or eliminate a person's tax liability.

Like-Kind Exchanges. Prior law allowed a taxpayer to defer income taxes on like-kind exchanges, for both real property and for personal property. The Act eliminates the ability to have a like-kind exchange of personal property.

Removing the ability to exchange personal property from tax deferred exchanges may result in unexpected consequences for those taxpayers who are trading machinery and equipment.

Estate and Gift Taxes. The Act increases the federal exemption amount for the estate tax and the generation skipping transfer tax from $5,000,000 to $10,000,000 (adjusted for inflation from the year 2010). The amount is per person and thus, when coupled with portability or effective estate planning, a married couple can transfer over $20,000,000 to their children without incurring any federal estate tax. In 2018, the annual gift tax exclusion amount is $15,000.

The increase in the federal exemption amount shifts the focus of estate planning from minimizing estate tax to minimizing future income tax. Of course, taxes are only one part of any estate plan as there are a number of other items that should be considered.

The above items are only a selection of the changes to the tax law made by the Act. Although the Act makes a significant number of changes to the current tax law, we cannot forget the current law as the Act provides that many of the changes being made will sunset, and the law will revert back to the current law beginning in 2026. Also, please note that the above changes are only with respect to federal law. State law and, in particular, Iowa law does not mirror federal law in all cases. Specifically, with respect to depreciation and Section 179, Iowa law requires separate computations.

If you have questions about any of these items or how they may impact your return, you should consult your tax advisor.

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