Individual Income Tax Provisions

This article is the second in a five-part series regarding the Tax Cuts and Jobs Act *signed into law December 22, 2017*

MOST TAXPAYERS WILL BENEFIT FROM LOWER TAX BRACKETS AND HIGHER STANDARD DEDUCTIONS

When the *Tax Cuts and Jobs Act* ("The Act") was signed into law on December 22, 2017, American taxpayers were promised tax reductions beginning in 2018. This article will focus on the individual tax provisions of The Act.

INCOME TAX RATE REDUCTIONS

Individuals compute their federal income tax using the tax brackets applicable to their filing status, i.e., single, married filing jointly, married filing separately and head of household. Under prior law, the seven tax brackets culminated with a maximum tax bracket of 39.6% imposed on taxable income in excess of $470,700 for the "married filing jointly" category of taxpayers. Under the new tax law, the seven brackets cover different income amounts and have new tax rates, culminating in a maximum tax bracket of 37% imposed on taxable income in excess of $600,000 for the "married filing jointly" category of taxpayers. The new tax brackets are listed below.

For Married Individuals Filing Joint Returns, and Surviving Spouses

Taxable Income Is More Than	But Not More Than	Tax Is
0	$19,050	10%
$19,050	$77,400	$1,905 plus 12% of the excess over $19,050
$77,400	$165,000	$8,907 plus 22% of the excess over $77,400
$165,000	$315,000	$28,179 plus 24% of the excess over $165,000
$315,000	$400,000	$64,179 plus 32% of the excess over $315,000
$400,000	$600,000	$91,379 plus 35% of the excess over $400,000
$600,000		$161,379 plus 37% of the excess over $600,000

For Single Individuals (Other Than Heads of Households and Surviving Spouses)

Taxable Income Is More Than	But Not More Than	Tax Is
0	$9,525	0%
$9,525	$38,700	$952.50 plus 12% of the excess over $9,525
$38,700	$82,500	$4,453.50 plus 22% of the excess over $38,700
$82,500	$157,500	$14,089 plus 24% of the excess over $82,500
$157,500	$200,000	$32,089 plus 32% of the excess over $157,000
$200,000	$500,000	$45,689.50 plus 35% of the excess over $200,000
$500,000		$150,689.50 plus 37% of the excess over $500,000

In the final analysis, the new tax brackets drop most taxpayers' overall tax liability by 3-4%.

When you compare 2017 to the new 2018 brackets, it appears as though only the Married Filing Jointly filers with incomes above $400,000 will be taxed at a higher rate. But this higher rate only applies to a small portion of their income. The bulk of their income falls into lowered brackets, so their overall tax liability is still lower.

INCREASE IN STANDARD DEDUCTION AND LOSS OF PERSONAL EXEMPTIONS

In an attempt to simplify the tax code, The Act increases the standard deduction for all taxpayers. In 2017, the standard deduction for married filing jointly taxpayers was $12,700. Under the new tax law, the standard deduction is now $24,000.

For single filers or married filing separately, the standard deduction was $6,350 in 2017, and rises to $12,000 under the new law. For heads of households, the 2017 standard deduction was $9,350; under the new law it rises to $18,000.

Personal exemptions – which were generally allowed for the taxpayer, the taxpayer's spouse and any dependents, are eliminated by the new tax law. The new tax brackets and other changes to the individual tax code are temporary, unless Congress votes to extend the law beyond Dec. 31, 2025.

Example 1: Married Taxpayers, No Children, with No Itemized Deductions

	Tax Year 2017	Tax Year 2018
Adjusted Gross Income	$100,000	$100,000
Less: Standard Deduction	($12,700)	($24,000)
Less: Personal Exemptions	($8,100)	0
Equals Taxable Income	$79,200	$76,000
Federal Tax	$11,284	$8,739

The decrease in tax is attributable to the reduction of taxable income because the standard deduction increased to $24,000 (from $12,700). The higher standard deduction more than offsets the elimination of personal exemptions. In addition, much of the couple's taxable income now falls into the new 12% tax bracket instead of the old 15% bracket.

Example 2: Married Taxpayers, No Children, Total Itemized Deductions of $18,000		
	Tax Year 2017	Tax Year 2018
Adjusted Gross Income	$100,000	$100,000
Less: Standard Deduction	($18,000)	($24,000)
Less: Personal Exemptions	($8,100)	0
Equals Taxable Income	$73,900	$76,000
Federal Tax	$10,156	$8,739

Note that the tax for 2018 is the same in both examples. The increase in the standard deduction means that the taxpayers in Example 2 above, no longer derive any benefit from itemizing their deductions, so they no longer need to itemize. Elimination of the need to itemize is viewed by Washington as part of tax simplification.

ITEMIZED DEDUCTION LIMITATIONS

One of the most controversial sets of provisions is the new limitations on itemized deductions.

The rules concerning state and local taxes (SALT) and related deductions will be discussed in next week's article, but many other traditional itemized deduction rules have been changed.

Prior to The Act, individuals itemizing their deductions could deduct certain miscellaneous itemized deductions to the extent that these deductions exceeded 2% of adjusted gross income.

Miscellaneous itemized deductions include tax preparation fees, safe deposit box rentals, unreimbursed employee business expenses and most investment-related expenses such as IRA fees, broker advisory fees, etc. The Act eliminates these deductions for the years 2018 through 2025.

CHILD TAX CREDIT CHANGES

For the tax years 2018 through 2025, the child tax credit is increased from $1,000 to $2,000 per qualifying child under the age of 17.

Before The Act, the child tax credit phased out gradually for higher incomes, starting at $110,000 of adjusted gross income for married filers, and $75,000 of adjusted gross income for single filers. The child tax credit will now phase out starting at $400,000 of adjusted gross income for married filers, and $200,000 for all others.

EDUCATION DEDUCTION AND ABLE ACCOUNTS

Funds in a Code Sec. 529 college savings account may now be used for tuition at an elementary or secondary public, private or religious school, up to $10,000 per tax year. Prior to The Act, funds from these accounts were restricted to qualified expenses related to colleges, universities, vocational schools and other eligible post-secondary schools.

Under Code Sec. 529A, ABLE accounts allow persons with disabilities and their families to fund special tax-preferred accounts for disability-related expenses. In 2017, contributions to ABLE Act savings accounts were limited to $14,000 per tax year. In 2018, the limit went up to $15,000, and in addition, The Act now provides that the ABLE account's designated beneficiary may be permitted to contribute additional amounts up to specified limits.

ALIMONY DEDUCTIONS

Prior to The Act, alimony and separate maintenance payments were deductible by the spouse paying the alimony and includable in income of the spouse receiving the alimony. These rules will remain unchanged for taxpayers who are currently divorced and are paying or receiving alimony.

For any divorce or separation agreement executed after December 31, 2018, or executed before that date but modified after it, alimony and separate maintenance payments are not deductible by the payor spouse and are not included in the income of the payee spouse.

In a bizarre bit of tax planning, individuals contemplating a divorce may want to consider how the timing affects them. The spouse who will likely be paying the alimony may want to accelerate their decision so that the divorce agreement is executed prior to December 31, 2018. Of course, the spouse who will probably be receiving alimony would be advised to delay and not sign any agreement until 2019.

REPEAL OF AFFORDABLE CARE ACT INDIVIDUAL MANDATE

The Affordable Care Act exacted a penalty, sometimes called a "shared responsibility payment," from individuals who were not covered by a health plan that conformed to specified requirements. The Act has essentially revoked this provision by permanently reducing the penalty to zero. **FT**

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