Summary of the Tax Cuts and Jobs Act

This is a summary of the Tax Cuts and Jobs Act, which was first published late in the day on Friday, December 15, 2017. The Act is approximately 1097 pages, and this summary points out the highlights for business owners and individuals.

Waivers, disclaimers, and warnings: I am preparing this summary barely 48 hours after the Act was published; so, I haven't had time to study it carefully. Please understand that this bill has not been signed into law and may never be signed into law. Also, even if this is signed into law, there could be several modifications and adjustments made to it. The purpose of the summary is to give us an inkling of what may be in store for us in the years ahead. This summary does not address every single provision of the Act and has neglected to mention several sections that I don't think would be of interest to most readers. For the official, complete text of the Act, please download docs.house.gov/billsthisweek/20171218/CRPT-115HRPT-466.pdf.

Significantly, the Act reduces tax rates for most taxpayers. What follows are the new tax rates:

RATE TABLES.

(A) MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES.—The following table shall be applied in lieu of the table contained in subsection (a):

If taxable income is:	**The tax is:**
Not over $19,050	10% of taxable income.
Over $19,050 but not over $77,400	$1,905, plus 12% of the excess over $19,050.
Over $77,400 but not over $165,000	$8,907, plus 22% of the excess over $77,400.
Over $165,000 but not over $315,000	$28,179, plus 24% of the excess over $165,000
Over $315,000 but not over $400,000	$64,179, plus 32% of the excess over $315,000.
Over $400,000 but not over $600,000	$91,379, plus 35% of the excess over $400,000.
Over $600,000	$161,379, plus 37% of the excess over $600,000.

(B) HEADS OF HOUSEHOLDS.—The fol1owing table shall be applied in lieu of the table contained in subsection (b):

If taxable income is:	**The tax is:**
Not over $13,600	10% of taxable income.
Over $13,600 but not over $51,800	$1,360, plus 12% of the excess over $13,600.

Over $51,800 but not over $82,500	$5,944, plus 22% of the excess over $51,800.
Over $82,500 but not over $157,500	$12,698, plus 24% of the excess over $82,500.
Over $157,500 but not over $200,000	$30,698, plus 32% of the excess over $157,500.
Over $200,000 but not over $500,000	$44,298, plus 35% of the excess over $200,000.
Over $500,000	$149,298, plus 37% of the excess over $500,000.

(C) UNMARRIED INDIVIDUALS OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS.—The following table shall be applied in lieu of the table contained in subsection (c):

If taxable income is:	**The tax is:**
Not over $9,525	10% of taxable income.
Over $9,525 but not over $38,700	$952.50, plus 12% of the excess over $9,525.
Over $38,700 but not over $82,500	$4,453.50, plus 22% of the excess over $38,700.
Over $82,500 but not over $157,500	$14,089.50, plus 24% of the excess over $82,500.
Over $157,500 but not over $200,000	$32,089.50, plus 32% of the excess over $157,500.
Over $200,000 but not over $500,000	$45,689.50, plus 35% of the excess over $200,000.
Over $500,000	$150,689.50, plus 37% of the excess over $500,000.

D) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—The following table shall be applied in lieu of the table contained in subsection (d):

If taxable income is:	**The tax is:**
Not over $9,525	10% of taxable income.
Over $9,525 but not over $38,700	$952.50, plus 12% of the excess over $9,525.
Over $38,700 but not over $82,500	$4,453.50, plus 22% of the excess over $38,700.
Over $82,500 but not over $157,500	$14,089.50, plus 24% of the excess over $82,500.
Over $157,500 but not over $200,000	$32,089.50, plus 32% of the excess over $157,500.
Over $200,000 but not over $300,000	$45,689.50, plus 35% of the excess

	over $200,000.
Over $300,000	$80,689.50, plus 37% of the excess over $300,000.

E) ESTATES AND TRUSTS.—The following table shall be applied in lieu of the table contained in subsection (e):

If taxable income is:	**The tax is:**
Not over $2,550	10% of taxable income.
Over $2,550 but not over $9,150	$255, plus 24% of the excess over over $2,550.
Over $9,150 but not over $12,500	$1,839, plus 35% of the excess over $9,150.
Over $12,500	$3,011.50, plus 37% of the excess over $12,500.

As these tables show, the top rate has been reduced from 39.6% to 37%. For estates and trusts, while the top rate goes down to 37%, the ladder for rates remain short, with the top rate becoming effective for taxable income over $12,500. Also, tax rates for children with unearned income are modified. Finally, tax brackets listed above should be adjusted for inflation each year.

For tax return preparers, the IRS now imposes a duty of diligence in determining whether or not taxpayers are eligible for certain tax benefits. For example, return preparers must determine if taxpayers are eligible to file as head of household and for various tax credits. This Act indexes many thresholds for inflation, including the threshold for automobile depreciation, eligibility for certain tax credits, and the new standard deduction.

For taxpayers who have income from pass-through entities (LLC's and S-Corps), the Act provides for a deduction from taxable income in an amount equal to the lesser of the combined qualified income for that year, or an amount equal to 20% of the excess of the taxable income for that year over the amount of net capital gains for that year. Effectively, this 20% reduction in taxable income can have the effect of reducing the top rate from 37% to 29.6% on the first $315,000 of pass-through income. There are limitations which require taxpayers to combine similar trades or businesses when applying these rules. There are also rules which apply to W-2 income received from these trades or businesses. The IRS will issue rules that apply to short taxable years for these businesses, or when the taxpayer requires or disposes of a trade or business. Also, qualified business income, to which this deduction applies, shall not include reasonable compensation paid to the taxpayer nor any guaranteed payments paid.

This portion of the Act will affect a large number of taxpayers, yet there are several subsections under this section which dictate that the IRS will issue rules which clarify this. I think it is safe to say that income from pass-throughs will be taxed at a rate lower than the maximum is right, but that the actual computation of tax on that income has not yet been finalized.

The authors of the Act are obviously trying to stimulate investment in business within the Commonwealth of Puerto Rico. This is likely in response to the recent hurricane there and to the other economic hardships in Puerto Rico. There are different limitations for income derived from businesses located in Puerto Rico.

There is a new subset of rules pertaining to income from specified agricultural or horticultural activities. While these rules have the effect of reducing taxes on income from these activities, the rules are very narrow.

There are new rules for individuals whose tax return includes a net operating loss. Generally, those losses must now exceed certain thresholds, which will have the effect of limiting the use of those losses.

One of the provisions of the Act, which has been widely publicized, is the increase of the standard deduction beginning in taxable year 2018. The standard deduction is used by taxpayers who do not itemize deductions. Under the Act, the standard deduction is increased to $24,000. This number is adjusted for inflation annually.

In the final days of negotiating this bill, certain politicians would not approve it without an increase in the child tax credit. Initial drafts called for an increase from $1000 to $1400. The final draft increases the child tax credit to $2000. Also, the child tax credit does not apply to children who are not US citizens.

The Act increases the limitation for certain charitable contributions. For cash contributions, the limitation is increased from 50% of the taxpayer's contribution base (generally adjusted gross income) to 60% of the contribution base.

The Act provides for relief for 2016 disaster areas, defined as those areas to which a major disaster has been declared by the president. For those taxpayers, there are special rules for the use of retirement funds. Generally, taxpayers can withdraw up to $100,000 from their retirement account without incurring the early distribution penalty. As I read this new Act, given the number and severity of natural disasters in 2017, it would make more sense for this to apply to 2017 disasters. However, the Act clearly references the year 2016 in this section. There are also revised casualty loss limits related to 2016 major disasters.

The Act changes the treatment of student loans discharged because of death or total and permanent disability. Generally, individuals who passed away or become disabled will not include discharged student loans in their taxable income amount.

Section 529 accounts cannot be used in connection for tuition at the elementary or secondary (private, public or religious) schools. Prior to this Act, 529 plans could only be used for college or postgraduate education.

Interestingly, the Act provides for a suspension of deduction for personal exemptions. For taxable years beginning in 2018 and ending in 2025, the personal exemption amount is zero. This can work to the detriment of large families with several dependents. The personal exemption has been part of the tax code for several decades. Although it phases out for high income taxpayers, it has always been a hallmark of the code. For taxpayers subject to federal withholding from wages, the amount of withholding used to be calculated based on how many personal exemptions that taxpayer could claim. Under the Act, withholding will be determined by using the taxpayer's standard deduction.

Another section of the Act which has garnered much media attention is the limitation on deduction for state and local taxes. Under the Act, taxpayers' itemized deductions can include a deduction for State income taxes paid and real estate taxes up to a maximum of $10,000 ($5,000 for married individuals filing a separate tax return). This works to the detriment of taxpayers who live in States with a high income tax rate, or who own real estate that is charged a high real estate tax. In reading the commentary on the selection, politicians from states with low taxes argue that they were subsidizing taxpayers in high tax states. There are valid arguments on both sides of this change. However, this was one of the more polarizing changes made to the Act.

The Act limits the deduction for qualified residence interest. Formerly, interest was deductible on Mortgage principal amounts of not more than $1 million. The Act reduces that limitation to $750,000 for new purchases or refinancing after December 31, 2017. For mortgages that remain in effect, the former limitation applies.

The Act eliminates deduction of miscellaneous itemized deductions for tax years 2018 through 2025. Generally, these were itemized deductions subject to the 2% of AGI limitation, such as: tax return preparation fees, investment advisory fees, Union dues, safe deposit box fees, and employee business expenses. This particular provision of the Act did not get much media attention, but could make a huge difference for employees with unreimbursed business expenses. Also, the limitation on itemized deductions is eliminated. This limitation applied to high income taxpayers and served to reduce their itemized deductions.

The Act suspends the deduction for moving expenses for tax years 2018 through 2025. Generally, moving expenses were deductible if you moved your residence to another city to accept a job in that city.

The Act repeals the deduction for alimony payments, and also repeals a provision for inclusion of alimony in gross income. In the negotiation of a divorce settlement, the treatment of payments from one spouse to the other always takes into account the income tax ramifications. This section illuminates that consideration. Interestingly, this is a total repeal of those code sections, not just the suspension of the rules from 2018 to 2025, like many other new rules.

The Act increases the estate and gift tax exemption. Media coverage of these negotiations discussed the estate tax exemption increase, but no mention was made of the gift tax exemption. The Act, as written, doubles both the estate tax and the gift tax, to approximately $10.98 million for gifts made, or decedents dying, during the years of 2018 through 2025. There are no provisions for years after 2025. Unless new law is enacted, the rules would revert back to the current rules, which provide for an estate and gift tax exemption of just under $5.5 million, adjusted for inflation.

The Act extends the time limit for contesting an IRS Levy, from nine months to two years. Certain taxpayers were not aware that a levy had been lodged until after the prior contestability period had expired.

The new Act eliminates the shared responsibility payment for individuals failing to maintain minimum essential health insurance coverage. Under the Affordable Care Act, there was a tax levied on individuals who did not have minimum health insurance coverage. The new Act eliminates that tax, effective for months beginning after December 31, 2018.

With respect to the Alternative Minimum Tax (AMT), press coverage of negotiations mentioned that the AMT would be eliminated. In the final act, the AMT is limited for corporations, but not for individuals. For individuals, the AMT remains, but the exemption amount is increased from $78,750 to $109,400.

Another provision which got a lot of media exposure is the reduction of corporate tax rates from 35% to 21%. This reduction is intended to make the US more competitive, from a tax standpoint, than many other countries. Time will tell what the ultimate result is. Also, the dividend received deduction applicable to corporations has been reduced from 70% to 50%.

Small business can now expense more of their capital expenditures under the Act. The "Section 179" has been increased from $500,000 to $1 million. The phase out for equipment placed in service now begins at $2.5 million, up from $2 million.

Small businesses are now able to remain on the cash method of accounting if their average annual gross receipts for the three-year period preceding each tax year does not exceed $25 million, up from $5 million.

The Act greatly increases the amounts which can be deducted immediately for capital expenditures. Specifically, code section 168, accelerated depreciation, used to provide for accelerated depreciation equal to 50% of the cost of the asset, in the year that the asset was acquired. The remaining cost of each asset was then depreciated over its useful life. The Act now allows for the following deduction, based on the year that the asset is placed in service:

Property placed in service after September 27, 2017, thru 2022: 100%
Property placed in service during 2023: 80%
Property placed in service during 2024: 60%
Property placed in service during 2025: 40%
Property placed in service during 2026: 20%

This is a huge change, obviously intended to spur capital investment.

The Act increases the depreciation limits on automobiles, as follows:

Year since auto placed in service	Current Law	Act
1st	$2,560	$10,000

2nd	\$4,100	\$16,000
3rd	\$2,450	\$9,600
Each subsequent year	\$1,475	\$5,760

The Act places limitations on interested options for businesses. Generally, the interest expense is limited to an amount not to exceed the sum of a) business interest income of that business plus b) thirty percent (30%) of the adjusted taxable income for that business plus c) the floor plan financing interest for that business, if any. Any disallowed business interest expense can be carried forward to the subsequent tax year. For partnerships, LLS's and S-Corps, these limitations are applied at the entity level.

Businesses will not be limited in the amount of Net Operating Loss deduction that they can utilize each year. Generally, the NOL deduction is limited to 80% of taxable income computed without regard to the NOL deduction. Also, NOLs will no longer be carried backwards, but can be carried forward indefinitely.

The Act severely limits deductions for meals and entertainment. Deductions for entertainment are disallowed entirely, and deductions for meals are allowed only if the meal was provided on or near the business premises. The current 50% limitation on meals continues to apply. For companies with large entertainment budgets, this will eliminate their ability to deduct those costs. Also, the Act eliminates the deduction for meals provided at the convenience of the employer. This includes food or beverages provided at the employer's facility. This would include coffee and soda provided to employees.

The Act provides for the denial of deduction for settlements subject to nondisclosure agreements paid in connection with sexual harassment or sexual abuse.

The Act now prohibits cash gift cards and other non-tangible personal property as employee achievement awards. Interestingly, the Act does not provide that these costs are not deductible. Rather, these awards are now prohibited.

Interestingly, the Act eliminates the deduction for living expenses incurred by members of Congress.

For pharmaceutical companies, the orphan drug credit is reduced from 50% to 25%.

The Act provides for employee credit for paid family and medical leave, ranging from 12.5% to 25% of compensation paid.

There are substantial changes related to the life insurance industry, which will not affect most readers of this summary. In the interest of brevity, I have not summarized those provisions. There are also significant changes for banks and financial institutions, and the beer and wine industry.