GIVING AND TAKING: THE TAX CUTS AND JOBS ACT
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December 2018

Major changes have been made to the US tax code, and the changes will affect every US taxpayer and tax return. Most of the changes go into effect for the current 2018 tax year and will be reflected on the tax returns we file in the upcoming tax season. This article will highlight some of the main changes for individual taxpayers, and we hope to publish more detailed information in upcoming issues of the Business Bulletin.

These tax changes fit the classic good news/bad news scenario. Congress giveth and Congress taketh away.

One question being asked, or it would be better said, one statement being made, is "Trump canceled the Obamacare penalty, right?" WRONG, at least in part. Trump's much-ballyhooed executive order regarding Obamacare, issued a few days after he was inaugurated, did not change the law requiring that a penalty be paid by those with no health coverage nor an exemption. The law that Congress passed under Obama is still the law, and the president doesn't have the authority to re-write it by himself. Congress must legislate any changes. In fact, IRS has been sending error notices to taxpayers that filed tax returns without reporting whether they had health coverage.

However, when the Tax Cuts & Jobs Act was passed in December 2017, it changed the Obamacare penalty to $0. It didn't eliminate the health coverage requirement; it only changed the penalty to $0. The implication of that is that a future Congress can easily substitute any amount it wants in place of the $0 to start charging the penalty again.

Another caveat is that the $0 penalty goes into effect for tax year 2019. So, in the tax season just past, we still had to have health coverage, or pay the penalty, or qualify for an exemption. Furthermore, for the current 2018 tax year, the penalty is still in effect. So, we will all be dealing with Obamacare on one more tax return, the one we file in the upcoming tax season for 2018. It's supposed to go away after that; we will see.

Another major change was increasing, in fact, nearly doubling, the standard deduction for all filing statuses. Here's one way to look at the standard deduction: it is an amount of tax-free income given to each tax return that is filed. For 2017, for a single person, the first $6,350 of income was tax-free. For 2018, that amount nearly doubles to $12,000. The married filing jointly standard deduction went from $12,700 in 2017 to $24,000 in 2018. For the head of household filing status (for example, a single mom supporting her children), the amount went from $9,350 to $18,000. This provision lowers everyone's taxable income. Congress giveth.

A long-standing provision in the tax code was the personal exemption amount. It represented even more tax-free income on top of the standard deduction. For 2017, the amount was $4,050 per family member. A family of five would deduct, in addition to the standard deduction mentioned above, a deduction of $4,050 x 5, or $20,250. If we add together the 2017 standard deduction, discussed above, and the personal exemption amount, the family of five had $32,950 of tax-free income on its 2017 tax return.

The bad news is that the personal exemption has disappeared starting in 2018. Where the family of five last year, on its 2017 tax return, had $32,950 of tax-free income, for 2018 it will have only the new standard deduction amount of $24,000. Congress taketh away.

Some very good news comes next. First, here is some background. For quite a few years, each child age 16 and under qualified for reducing the tax bill by $1,000. This is called the child tax credit, or CTC for short. It is a refundable credit, meaning that if not all the credit was needed to reduce the tax bill, the excess could be sent back to the taxpayer as a refund. This credit, along with the Earned Income Credit which was not substantially changed, has been the source of a lot of generous tax refunds for many families. The very good news? The credit has been doubled to $2,000 per child! So, in nearly all cases, this will more than make up for the loss described above of the personal exemption. Congress giveth.

However, the entire $2,000 is not refundable; only $1,400 of it is available to add to refunds. Congress taketh . . . But that's still $400 more refundable than under the prior law. Congress giveth.

Under the prior law, the personal exemption was normally available for children through the age of 18. With the personal exemption eliminated, do we get anything for children between the age of 16, when the CTC ends, and 18? A new $500 credit for these dependents is available to reduce the tax bill, and anyone else for whom you qualify to claim an exemption, such as a child over 18 that you are still supporting. I'm not sure if this change was giving or taking.

Let's move to itemized deductions. As a review, taxpayers can choose to use the standard deduction, now $24,000 for a married filing joint return, or they can itemize deductions, whichever yields the larger deduction. Only certain types of expenses can be included in itemized deductions. Since at least 1986, itemized deductions have included high medical expenses, state and local income tax, real estate tax, home mortgage interest, and donations to a charitable organization. With some limitations, unreimbursed employment-related expenses could also be included, such as a meal allowance for long-distance truckers who are on a company payroll, if the company did not reimburse for the meals.

First, far fewer tax returns will be claiming itemized deductions because the standard deduction, discussed above, will now be by far the bigger amount. The $24,000 standard deduction compared to, say, $14,000 or $16,000 of itemized deductions, is a no-brainer. It is estimated that possibly 2/3 of those who previously used itemizing will switch to the standard deduction starting with the 2018 tax year. This change is truly tax simplification, which can't be said of many of the other provisions in the new tax law. Several million taxpayers will be able to eliminate filing itemized deductions from their tax returns in exchange for a lower taxable income. Congress giveth.

But, it's not all good news in this area. For those that still file itemized deductions, some of the allowable deductions have been decreased. The state and local income tax portion of itemized deductions, including real estate tax, is now limited to a grand total of $10,000; previously there was no limit. Interest on a home equity loan is no longer deductible. Truckers on company payroll may be hit especially hard; the meal deduction will no longer be allowed. It, as well as all other unreimbursed employment-related expenses, are no longer deductible. (This provision does not affect the self-employed expenses.) Congress taketh.

Planning tip: Regarding the trucker, all is not lost. His employer can reimburse his meals or the amount of the standard meal allowance tax-free, so the trucking company and the trucker need to re-negotiate the employment agreement to accommodate this.

In addition to all the above changes, the tax rates have been lowered somewhat, plus more income is taxed at the lower rates. This will benefit all taxpayers. Congress giveth.

The above changes apply to all individuals that file tax returns. Self-employed and S corporation taxpayers have an additional set of changes to deal with. We'll address those in another article.