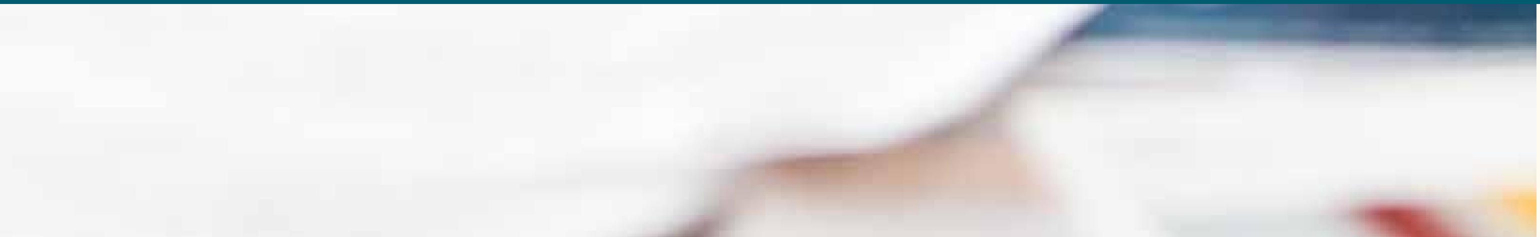
THE TRUMP TAX CUTS ARE HERE

HOW WILL THEY AFFECT YOU?

AVOID SURPRISES AT TAX TIME — TAKE A LOOK AT THE CHANGES THAT COULD AFFECT YOUR RETURN



It seems as if every few years, tax laws change, and taxpayers have to figure out whether, and how, those changes affect their own situation. This year is no different.

The Tax Cuts and Jobs Act (TCJA) passed in late December 2017. Most provisions of the new law went into effect on Jan. 1, 2018, which means they affect 2018 tax returns. The majority of changes pertaining to individual tax returns are temporary; they are scheduled to end Dec. 31, 2025 (when they revert to the pre-2018 tax code).

Employees who adjusted their 2018 W-4 form for tax withholding based on the new legislation may have already seen a change in their take-home pay. However, if you didn't change your W-4 from the previous year, your tax return could be a little different this year.

For a close-up view of how some of the new provisions may affect your tax return, check out the following changes and what each could mean to you.

INDIVIDUAL TAX BRACKETS

The new law retains the same number of income tax brackets (seven), but it made various changes to the income ranges and reduced the tax rate for each level.

2018 TAX BRACKETS[1]

TAX RATE	*SINGLE*	*HEAD OF HOUSEHOLD*	*MARRIED FILING JOINTLY & QUALIFYING WIDOW*	*MARRIED FILING SEPARATELY*
10%	Up to $9,525	Up to $13,600	Up to $19,050	Up to $9,525
12%	$9,526 to $38,700	$13,601 to $51,800	$19,051 to $77,400	$9,526 to $38,700
22%	$38,701 to $82,500	$51,801 to $82,500	$77,401 to $165,000	$38,701 to $82,500
24%	$82,501 to $157,500	$82,501 to $157,500	$165,001 to $315,000	$82,501 to $157,000
32%	$157,501 to $200,000	$157,501 to $200,000	$315,001 to $400,000	$157,001 to $200,000
35%	$200,001 to $500,000	$200,001 to $500,000	$400,001 to $600,000	$200,001 to $300,000
37%	$500,001 or more	$500,001 or more	$600,001 or more	$300,001 or more

WHAT COULD THIS MEAN FOR YOU?

Our tax system is progressive, so the more you make, the higher the tax rate on each block of subsequently higher income. In other words, even if your total income falls in a higher tax bracket, you won't pay that rate on all of your income. For example, a single person earning $225,000 in 2018 would pay the following rates (assuming there are no adjustments for deductions, credits, etc.):

10% on the first $9,525	=	$953
12% on the next $29,175 ($38,700 – $9,525)	=	$3,501
22% on the next $43,800 ($82,500 – $38,700)	=	$9,636
24% on the next $75,000 ($157,500 – $82,500)	=	$18,000
32% on the next $42,500 ($200,000 – 157,500)	=	$13,600
35% on the next $25,000 ($225,000 – 200,000)	=	$8,750
TOTAL TAX (unadjusted)	=	$54,440

INFLATION ADJUSTMENTS

The IRS will continue to adjust the income tax brackets for inflation. Previously, however, the tax code used the Consumer Price Index for All Urban Consumers (CPI-U) to make cost-of-living adjustments. Going forward, the new tax code uses the C-CPI-U.

The CPI-U measures price changes on commonly purchased items. The C-CPI-U refers to a "chained" index. The chained index assumes that when prices rise on commonly purchased items, many customers will swap out those items for lower-priced ones. For example, they may purchase turkey when chicken prices increase. This means the overall cost of inflation is less likely to impact those consumers, and that is the rate of inflation that the C-CPI-U tracks.[2]

WHAT COULD THIS MEAN FOR YOU?

Employers generally provide annual salary increases based on the CPI-U. Because the IRS will now be using the C-CPI-U, the income brackets that determine tax rates will not rise as quickly as taxpayer salaries. Over time, this will land more taxpayers in higher rate brackets — a phenomenon known as "bracket creep." Therefore, while there is a tax cut due to lower-level income brackets in 2018, over the scheduled eight years of the TCJA, the inflation adjustment will yield an inherent increase in tax revenues.[3]

STANDARD DEDUCTION, PERSONAL EXEMPTIONS AND CHILD CREDIT

The good news is that the standard deduction nearly doubles for each tax filer status. The bad news is that personal exemptions are eliminated altogether; however, there is still an additional standard deduction if you are age 65 or older or legally blind. One buffer for this is that the child credit has increased from $1,000 to $2,000 per child, and there is a $500 credit for other qualifying dependents, such as an elderly parent. These credits will not adjust for inflation going forward, and they are not available for single taxpayers whose income exceeds $200,000, or married households filing jointly with income that exceeds $400,000.[4]

WHAT COULD THIS MEAN FOR YOU?

You may not fully appreciate the impact of these changes until you complete your tax return. On the next page are examples of how various taxpayers may fare in 2018 compared to 2017.

HEAD OF HOUSEHOLD
ONE CHILD

	2017	2018
STANDARD DEDUCTION	$9,350	$18,000
PERSONAL EXEMPTIONS AGI<$156,900)*	2 x $4,050 = $8,100	$0
CHILD CREDIT	$1,000	$2,000
TOTAL ADJUSTMENT	$18,450	$20,000
NET DIFFERENCE	*+$1,550*	

SINGLE

	2017	2018
STANDARD DEDUCTION	$6,350	$12,000
PERSONAL EXEMPTIONS AGI<$156,900)*	$4,050	$0
CHILD CREDIT		
TOTAL ADJUSTMENT	$10,400	$12,000
NET DIFFERENCE	*+$1,600*	

MARRIED FILING SEPARATELY

	2017	2018
STANDARD DEDUCTION	$6,350	$12,000
PERSONAL EXEMPTIONS AGI<$156,900)*	$4,050	$0
CHILD CREDIT		
TOTAL ADJUSTMENT	$10,400	$12,000
NET DIFFERENCE	*+$1,600*	

MARRIED FILING JOINTLY
TWO CHILDREN

	2017	2018
STANDARD DEDUCTION	$12,700	$24,000
PERSONAL EXEMPTIONS AGI<$156,900)*	4 x $4,050 *=$16,200*	$0
CHILD CREDIT	$2,000	$4,000
TOTAL ADJUSTMENT	$30,900	$28,000
NET DIFFERENCE	*-$2,900*	

*AGI is adjusted gross income.

ITEMIZED DEDUCTIONS

In the past, filers could reduce their taxable income further with any number of itemized deductions. However, the criteria for itemized deductions has changed substantially; some deductions have more limitations, while others were eliminated altogether.

MORTGAGE INTEREST

The cap on mortgage amounts on which homeowners can deduct their interest payments is now $750,000. However, the interest cap applies only to mortgages taken out after Dec. 14, 2017. For previous mortgages, the cap remains at $1 million.

WHAT COULD THIS MEAN FOR YOU?

Residents who live in areas of the country where real estate is expensive could see significantly higher tax bills when they purchase a home. From a real estate market perspective, the new interest cap could discourage homeowners from taking out mortgages for more than $750,000. In turn, this could tighten the supply of midpriced homes available for sale, resulting in increased home values and subsequently higher property taxes.

STATE AND LOCAL TAXES

The new tax law limits the deduction for state and local taxes (SALT), which includes property taxes, state income taxes and local sales taxes (applicable only to taxpayers who live in states with no income tax). Under the new law, the maximum deduction for the total of state and local taxes is $10,000.

WHAT COULD THIS MEAN FOR YOU?

This will have a significant impact on folks who live in high tax states, such as California and Hawaii. For example, in 2015, the average state and local tax deduction for Californians was over $18,400 – $8,400 more than they can claim now.[5]

OTHER ITEMIZED DEDUCTIONS

Some deductions have been eliminated altogether, such as alimony income and investment fees and expenses. However, other tax provisions have been adjusted to create a greater benefit. For examples, please see the chart on the next page.

DEDUCTION	CHANGE	WHAT THIS COULD MEAN FOR YOU
CHARITABLE CONTRIBUTIONS	May deduct up to 60% of annual income (increased from 50%)	Major contributors may deduct a a higher amount than in previous years
PROPERTY AND CASUALTY LOSSES	Deductible only if they arise from FEMA-declared disasters	Make sure you are properly insured
HEALTH CARE EXPENSES	Deduct up to 7.5% of income (reverts back to 10% for 2019 return)	Greatest benefit achieved if you had expensive procedures in 2018

WHAT COULD THIS MEAN FOR YOU?

The total of all itemized deductions must exceed the increased standard deduction for your filing status in order to be claimed. You may choose only the higher of the two.

PASS-THROUGH INCOME DEDUCTION

Small-business owners who do not file a corporate return usually report all of their income on their individual tax return. To compensate for the fact that their business will not benefit from the significantly reduced corporate tax rate, they may now deduct 20 percent of this "pass-through" revenue when calculating their adjusted gross income (AGI).

WHAT COULD THIS MEAN FOR YOU?

A qualifying small-business owner (e.g., LLC, S corporation, sole proprietor) can basically reduce his or her personal taxable income by one-fifth. The deduction can be reduced or eliminated based upon the type of business or certain limitations based on wages paid and depreciable assets for single taxpayers who earn more than $157,500 a year ($315,000 for married couples filing jointly).

OTHER CHANGES

ALTERNATIVE MINIMUM TAX (AMT)

The AMT is still in effect. However, the exemptions for who it applies to have increased: income that is less than $109,400 for joint returns (up from $84,500); phase-out begins at $1 million (up from $160,000 for joint returns).

WHAT COULD THIS MEAN FOR YOU?

Fewer taxpayers will be subject to the AMT.

529 COLLEGE SAVINGS PLANS

Tax- and penalty-free distributions from a 529 plan may now be used to pay for qualified elementary and high school expenses up to $10,000 per student per year. This is a permanent tax code change.

WHAT COULD THIS MEAN FOR YOU?

You can use these funds to pay for private school tuition.

RETIREMENT PLANS

The tax bill has extended the timeframe to roll over money defaulted upon a loan from a 401(k) or other qualified retirement plan. Once an employee has stopped working for the plan sponsor, the time he or she has to roll over a defaulted loan has increased from 60 days to the tax return deadline (including any extensions) for the tax year in which the employee left the job. Beyond that window, any remaining balance is considered a distribution and taxable.[6]

Note, too, that the TCJA eliminated the ability to reverse the decision to convert a traditional IRA into a Roth IRA.

WHAT COULD THIS MEAN FOR YOU?

It's important to consult with your financial advisor before making any moves concerning money earmarked for retirement.

ESTATE TAXES

For 2018, the estate and generation skipping tax exclusion increased to $11.18 million per person, indexed for inflation. In 2019, it will be $11.4 million. Up to $15,000 per person may be gifted each year outside of the lifetime gift tax exemption.[7]

WHAT COULD THIS MEAN FOR YOU?

In 2026, the exemption amount returns to the base $5 million amount, which will be adjusted for inflation. High-net estates may want to consider gifting substantial assets while the estate tax threshold is considerably higher.

CORPORATE TAXES

The Tax Cuts and Jobs Act significantly reduced the corporate tax rate from 35 percent to 21 percent. It also eliminated the corporate AMT and authorized the U.S. to shift to the globally accepted territorial tax system. This means that multinational corporations will no longer have to pay U.S. taxes on revenues earned in other countries.

WHAT COULD THIS MEAN FOR YOU?

The reduced corporate rate is expected to help U.S. companies compete on a more level playing field with global competitors that have a lower tax rate. It gives domestic corporations greater incentive to retain their operations within U.S. borders, promote economic expansion, create more jobs and increase wages.

TAKEAWAY: SHOULD THE TRUMP TAX CUTS AFFECT YOU?

The new tax law is projected to reduce federal tax revenues by $1.456 trillion. Senate reconciliation rules mandate that new legislation may cause no more than a $1.5 trillion loss over the following 10 years — so this tax bill is just below that threshold.[8] Unfortunately, the reduction in revenues is one of the factors that has put the U.S. on track for nearly a $1 trillion deficit in fiscal 2019, up from $779 billion in fiscal 2018.[9]

Given this significant increase in the deficit and the likelihood that newly empowered Democrats are unlikely to work toward cutting government entitlement programs, further changes to the tax law may be back up for debate much sooner than 2025.

WHAT COULD THIS MEAN FOR YOU?

Recognize that taxes — much like stock prices, the direction of interest rates and how long we can expect to live — are variables that are largely out of our control. The one thing we can focus on is our individual financial goals.

Your financial advisor can coordinate with other qualified professionals, such as a tax professional and estate planning attorney, to help address any tax concerns in your comprehensive strategy. If you're not sure how these tax changes might affect your unique situation or your retirement income, contact your financial advisor.

SOURCES:

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