

The Tax Cuts and Jobs Act of 2017

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June 8, 2018

The Tax Cuts and Jobs Act of 2017

- Major Elements of the Act
 - Reduction in tax rates for businesses and individuals
 - Increase in the standard deduction
 - Elimination of the personal exemption
 - Limitation on deductions for state and local taxes
 - Further limits on the mortgage interest deduction
 - Reduction in alternative minimum tax
 - Reduction in the number of estates impacted by the estate tax
 - Repeal of the individual mandate of the Affordable Care Act
 - Elimination in deduction for alimony
 - Increase in child tax credit

Reduction in Income Tax Rates

- The Congressional Budget Office (CBO) expects a short-term benefit to individuals but a long-term increase in taxes after 2027 under the current act.
- Could have another tax act pass prior to the 2027 expected increases in taxes
- Benefits of tax rate deductions partially offset by elimination of personal exemptions

Single Filer

2017 Law		Tax Cuts and Jobs Act	
10%	\$0-\$9,525	10%	\$0-\$9,525
15%	\$9,525-\$38,700	12%	\$9,525-\$38,700
25%	\$38,700-\$93,700	22%	\$38,700-\$82,500
28%	\$93,700-\$195,450	24%	\$82,500-\$157,500
33%	\$195,450-\$424,950	32%	\$157,500-\$200,000
35%	\$424,950-\$426,700	35%	\$200,000-\$500,000
39.60%	\$426,700+	37%	\$500,000+

Married Filing Jointly

2017 Law		Tax Cuts and Jobs Act	
10%	\$0-\$19,050	10%	\$0-\$19,050
15%	\$19,050-\$77,400	12%	\$19,050-\$77,400
25%	\$77,400-\$156,150	22%	\$77,400-\$165,000
28%	\$156,150-\$237,950	24%	\$165,000-\$315,000
33%	\$237,950-\$424,950	32%	\$315,000-\$400,000
35%	\$424,950-\$480,050	35%	\$400,000-\$600,000
39.60%	\$480,050+	37%	\$600,000+

Head of Household

2017 Law		Tax Cuts and Jobs Act	
10%	\$0-\$13,350	10%	\$0-\$13,600
15%	\$13,350-\$50,800	12%	\$13,600-\$51,800
25%	\$50,800-\$131,200	22%	\$51,800-\$82,500
28%	\$131,200-\$212,500	24%	\$82,500-\$157,500
33%	\$212,500-\$416,700	32%	\$157,500-\$200,000
35%	\$416,700-\$444,500	35%	\$200,000-\$500,000
39.60%	\$444,500+	37%	\$500,000+

Increase in Standard Deduction

- Single filers increase from \$6,350 to \$12,000
- Married filers increase from \$12,700 to \$24,000
- Head of household filers increase from \$9,350 to \$18,000
- Standard deduction is a dollar-for-dollar deduction in taxable income
- The benefit is the amount of the deduction multiplied by the marginal tax rate
- For a married taxpayer in the 25% tax bracket, the benefit is \$2,825 less in taxes, all else being equal
- However, this benefit is partially offset by the elimination of personal exemptions

Personal Exemption is Eliminated

- Personal exemption was \$4,050 per taxpayer or their dependents
- Loss of personal exemption results in partial offset for increase in standard deduction
- Impact on an actual client
 - 2017 had standard deduction of \$12,700 and personal exemptions of \$12,150 (3 people in household), for total reduction in taxable income of \$24,850
 - 2018 will get standard deduction of \$24,000 but no personal exemptions
- Impact will vary based on taxpayer situation

Limitation on deductions for state and local taxes, sales tax, and property tax (SALT)

- Limit is \$10,000
- Previously, there was no limit, other than a phaseout for high income earners
- Largest impact on high income earners in states with significant state income tax rates and persons who own real estate in expensive markets

Limits on Mortgage Interest Deduction

- Total loan balance limit decreased from \$1,000,000 to \$750,000
- Interest on home equity loans no longer deductible unless used for home improvements
- Probably will not affect many divorce clients

Reduction in Alternative Minimum Tax

- Increase in the exemption level from \$54,300 to \$70,300 for single and head of household taxpayers
- Increase in the exemption level from \$84,500 to \$109,400 for married taxpayers filing jointly
- Originally designed to make sure high income taxpayers paid a certain amount of tax, no matter how many deductions they have
- It is alternate way of calculating the tax owed

Reduction in Number of Estates Impacted by Estate Tax

- Increase in exclusion from \$5.6 million to \$11.2 million per individual
- Increase in exclusion from \$11.2 million to \$22.4 million for married couple that aggregates their exemptions
- Applies through 2025
- Changes often, depending on political climate
 - Typical to change for a period and then sunset to prior law

Repeal of Individual Mandate of Affordable Care Act

- May increase premiums on the health insurance exchanges, perhaps up to 10%
- Time will tell, based on market response and insurance company loss experience without mandate
- Will probably impact clients that purchase insurance on health insurance exchanges

Section 529 Education Accounts

- Can now be used for grades K-12
- Needs to be for private school tuition, if used for K-12
- Proposal included homeschools but homeschools were not included in the final bill

Capital Gains Rates Unchanged

- Frequent question in divorce cases
- Table of long-term capital gains rates:

Marginal Tax Rate	Single	Married Filing Joint	Head of Household
0%	Up to \$38,600	Up to \$77,200	Up to \$51,700
15%	\$38,600-\$425,800	\$77,200-\$479,000	\$51,700-\$452,400
20%	Over \$425,000	Over \$479,000	Over \$452,400

Elimination of Alimony Deduction

- No longer deductible to payer or taxable to recipient for divorce and separation agreements signed after December 31, 2018
- No longer a benefit to the parties' combined cash flow by shifting tax brackets from payer to recipient

Elimination of Alimony Deduction (cont.)

Estimate of After-Tax Cash Flow			
(cash flow after tax but before discretionary expenses)			
Monthly Alimony	\$ 10,000		
<i>Recipient</i>		<i>Payer</i>	
Income (Wages)		Income (Wages)	
Estimated Earnings	\$ -	Estimated Earnings	\$ 400,000
Alimony Received	120,000	Alimony Received	-
Total Income	120,000	Total Income	400,000
Less:		Less:	
Alimony Paid	-	Alimony Paid	120,000
Standard Deduction	6,300	Standard Deduction	6,300
Personal Exemptions	4,050	Personal Exemptions	4,050
Taxable Income	<u>\$ 109,650</u>	Taxable Income	<u>\$ 269,650</u>
FICA	-	FICA	13,147
Federal Tax	23,739	Federal Tax	72,514
State Tax	6,000	State Tax	14,000
Total Taxes	<u>\$ 29,739</u>	Total Taxes	<u>\$ 99,661</u>
After-tax Income	<u>\$ 90,261</u>	After-tax Income	<u>\$ 180,339</u>
Monthly Cash Flow	\$ 7,522	Monthly Cash Flow	\$ 15,028
Effective Federal Tax Rate	19.8%	Effective Federal Tax Rate	25.9%
Effective State Tax Rate	5.0%	Effective State Tax Rate	5.0%
Combined After-Tax Monthly Cash Flow	\$ 22,550		

Elimination of Alimony Deduction (cont.)

Estimate of After-Tax Cash Flow			
(cash flow after tax but before discretionary expenses)			
Monthly Alimony			
<i>Recipient</i>		<i>Payer</i>	
Income (Wages)		Income (Wages)	
Estimated Earnings	\$ -	Estimated Earnings	\$ 400,000
Alimony Received	-	Alimony Received	-
Total Income	-	Total Income	400,000
Less:		Less:	
Alimony Paid	-	Alimony Paid	-
Standard Deduction		Standard Deduction	6,300
Personal Exemptions		Personal Exemptions	4,050
Taxable Income	\$ -	Taxable Income	\$ 389,650
FICA		FICA	13,147
Federal Tax		Federal Tax	112,114
State Tax		State Tax	20,000
Total Taxes		Total Taxes	\$ 145,261
After-tax Income	\$ -	After-tax Income	\$ 254,739
Monthly Cash Flow	\$ -	Monthly Cash Flow	\$ 21,228
Effective Federal Tax Rate		Effective Federal Tax Rate	28.0%
Effective State Tax Rate		Effective State Tax Rate	5.0%
Combined After-Tax Monthly Cash Flow	\$ 21,228		

Elimination of Alimony Deduction (cont.)

- Simplifies the calculation of alimony needed to just needs-based analysis without adjusting for taxes
 - Court no longer needs to estimate tax impact of alimony
 - No longer risk of not getting in evidence regarding taxes

- Increased emphasis on ability-to-pay analysis for payer
 - Can no longer assume deduction and liability off-set, particularly in equalization cases

Elimination of Alimony Deduction (cont.)

Estimate of After-Tax Cash Flow			
(cash flow after tax but before discretionary expenses)			
Monthly Alimony	\$ 15,818		
<i>Recipient</i>		<i>Payer</i>	
Income (Wages)		Income (Wages)	
Estimated Earnings	\$ -	Estimated Earnings	\$ 400,000
Alimony Received	189,816	Alimony Received	-
Total Income	189,816	Total Income	400,000
Less:		Less:	
Alimony Paid	-	Alimony Paid	189,816
Standard Deduction	6,300	Standard Deduction	6,300
Personal Exemptions	4,050	Personal Exemptions	4,050
Taxable Income	<u>\$ 179,466</u>	Taxable Income	<u>\$ 199,834</u>
FICA	-	FICA	13,147
Federal Tax	43,287	Federal Tax	49,474
State Tax	9,491	State Tax	10,509
Total Taxes	<u>\$ 52,778</u>	Total Taxes	<u>\$ 73,131</u>
After-tax Income	<u>\$ 137,038</u>	After-tax Income	<u>\$ 137,053</u>
Monthly Cash Flow	\$ 11,420	Monthly Cash Flow	\$ 11,421
Effective Federal Tax Rate	22.8%	Effective Federal Tax Rate	23.5%
Effective State Tax Rate	5.0%	Effective State Tax Rate	5.0%
Combined After-Tax Monthly Cash Flow	\$ 22,841		

Elimination of Alimony Deduction (cont.)

- No longer a conceptual reduction to payer for after-tax amount paid
 - At times, was a psychological benefit in the past

Elimination of Alimony Deduction (cont.)

Recipient Budget (Need)	\$ 8,850			
Estimated Effective Tax Rate (State and Federal)	21%			
Need Grossed Up for Income Taxes	\$ 11,203			
Less: Recipient Imputed Income Before Tax	(2,500)			
Less: Estimated Interest Portion of Property Settlement	(2,200)			
Net Alimony Need to Recipient	\$ 6,503		\$ 4,552	Net Cost to Payer
Temporary Order Amount	\$ 4,150			
Estimated Effective Tax Rate (State and Federal)	25%			
Need Grossed Up for Income Taxes	\$ 5,533			
Alimony to Recipient	\$ 5,533		\$ 3,873	Net Cost to Payer

Increase in Child Tax Credit

- Threshold for phaseout of the child tax credit increased from \$110,000 AGI to \$400,000 for married filers and from \$75,000 AGI to \$200,000 for single and head of household filers
- The credit doubles from \$1,000 to \$2,000 per child, \$1,400 of which is refundable in certain cases
- Combination of threshold change and increase in credit very significant
 - Real-life example of \$6,000 benefit to taxpayer, even if nothing else changed
- Makes allocation of children for tax filing more significant
- Needs to be considered in conjunction with impact of elimination of alimony deduction

Increase in Child Tax Credit (cont.)

Estimate of After-Tax Cash Flow				
(cash flow after tax but before discretionary expenses)				
Monthly Alimony	\$	8,000		
Recipient			Payer	
Income (Wages)			Income (Wages)	
Estimated Earnings	\$	-	Estimated Earnings	\$ 210,000
Alimony Received		96,000	Alimony Received	-
Total Income		96,000	Total Income	210,000
Less:			Less:	
Alimony Paid		-	Alimony Paid	96,000
Standard Deduction		9,300	Standard Deduction	9,300
Personal Exemptions		8,100	Personal Exemptions	8,100
Taxable Income	\$	78,600	Taxable Income	\$ 96,600
FICA		-	FICA	10,392
Federal Tax		13,948	Federal Tax	18,448
Less: Child Tax Credit		-	Less: Child Tax Credit	-
State Tax		4,800	State Tax	5,700
Total Taxes	\$	18,748	Total Taxes	\$ 34,540
After-tax Income	\$	77,253	After-tax Income	\$ 79,461
Net Cash Flow	\$	77,253	Net Cash Flow	\$ 79,461
Monthly Cash Flow	\$	6,438	Monthly Cash Flow	\$ 6,622
Effective Federal Tax Rate		14.5%	Effective Federal Tax Rate	16.2%
Effective State Tax Rate		5.0%	Effective State Tax Rate	5.0%

Increase in Child Tax Credit (cont.)

- Under the old tax law, the child tax credit has no value to this couple because of the phaseout threshold
- Under the new law, the child tax credit has a value of \$2,000 per child (or \$6,000 for the 3 children total) if the payer claims the children
- Under the new law, the child tax credit has a value of up to \$1,400 refundable credit per child (or \$4,200 for the 3 children total) if the recipient claims the children and has enough in earned income
- If the recipient has little or not earned income, it is best for the payer to claim the children and get the full benefit, which can then be factored into ability to pay

Potential Impact on Business Valuations

- Potential increase in value due to lower corporate tax rates
 - Decrease in corporate rate from 35% to 21%
 - Decreases the impact of the so-called “double taxation”
 - Decreases difference in value between C Corporations and flow-through entities, such as LLCs and S Corporations

Questions?