

Tax Cuts and Jobs Act

Dan Caine

Welcome! The Webinar will begin at 12:30pm EST.

- Due to the amount of material we hope to cover, and the number of attendees, we expect that we will not be able to respond to chat during the presentation.
- You may send questions to support@FamilyLawSoftware.com at any time.
- If appropriate, we will send a follow-up e-mail with additions, clarifications, or corrections.
- The Webinar is being recorded.
- The Webinar and the Powerpoint slide show will be available on our website.



Tax Cuts and Jobs Act

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Topics we will cover

- Overview of changes.
- Standard deduction vs itemizing now.
- Child tax credit changes.
- Pass-through business deductions.
- Alternative minimum tax revisions.
- Mortgage interest limitations.
- Overall impact in sample cases.
- Impact on child support.
- Reversion after 2025.
- The coming (2019) alimony changes.

Overview of basic changes

- Changed rates.
- Changed brackets.
- Exemptions (for party and children) not deductible.
- Standard deduction increased.
- State and local and real estate tax deduction limited to \$10,000 in aggregate.
- Eliminated itemized deduction phase-out.
- Child Tax Credit Increased.

Changed rates

- Were: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%.
- Now: 10%, 12%, 22%, 24%, 32%, 35%, and 37%.
- Reduction is 0% to 3%.

Changed brackets

Old rates and brackets.

| | 10% | 15% | 25% | 28% | 33% | 35% | 39.6% |
|--------|------------|------------|------------|------------|------------|------------|--------------|
| Single | \$0 | \$9,525 | \$38,700 | \$93,700 | \$195,450 | \$424,950 | \$426,700 |
| H of H | \$0 | \$13,600 | \$51,850 | \$133,850 | \$216,700 | \$424,950 | \$480,050 |

New rates and brackets.

| | 10% | 12% | 22% | 24% | 32% | 35% | 37% |
|--------|------------|------------|------------|------------|------------|------------|------------|
| Single | \$0 | \$9,525 | \$38,700 | \$82,500 | \$157,500 | \$200,000 | \$500,000 |
| H of H | \$0 | \$13,600 | \$51,800 | \$82,500 | \$157,500 | \$200,000 | \$500,000 |

Effect of changed brackets

- Lower incomes get tax reduction (up to 3%).
- In \$200,000 to \$300,000 range, not much change.
- Above \$300,000, tax reduction again (up to 3%)
- Other factors will come into play in ultimate result.

Overview of additional changes

- Slight increase in some people's medical expense deduction in 2018.
- Mortgage interest deduction limited for new mortgages over \$750,000.
- Home equity interest deductions eliminated for all mortgages.
- Miscellaneous itemized deductions eliminated
- Deduction for owners of pass-through businesses.
- Alternative Minimum Tax thresholds increased.
- Kiddie tax simplified.
- More cash contributions allowable.

Standard deduction vs itemized

- Standard deductions are significantly higher:
 - Single: \$6,500 -> \$12,000
 - Joint: \$13,000 -> \$24,000
 - Head of household: \$9,550 -> \$18,000

Standard deduction impact

- What taxpayers who itemized deductions would now use standard?

Lower income of affected taxpayers:

- Income \$70,000 and state taxes of 5%, \$3,500.
- Mortgage of \$70,000, so interest of \$2,000.
- Property taxes of \$1,000

Upper income of affected taxpayers:

- Income \$100,000 and state taxes of 5%, \$5,000.
- Mortgage of \$150,000, so interest of \$4,300.
- Property taxes of \$2,700.

Standard deduction impact

- People with more itemized deductions than this would still itemize.
- People with fewer itemized deductions than this would still claim the standard deduction.

Child Tax Credit

- Has been \$1,000 per child who is under the age of 16 at the end of the year.
- Determined by who claims exemption.
- Parties could negotiate this.

Child Tax Credit

- Basic idea: double the credit, now \$2,000 per qualifying child.
- Also, allow higher-income taxpayers to claim the credit.
- Refundable portion now up to \$1,400 per qualifying child.
- Increase here roughly balances loss of exemption for many taxpayers.

Child Tax Credit – Phase-out

- Previous law: The child tax credit phases out for incomes above a threshold: \$75,000 if single or head of household, \$55,000 if married filing separately, \$110,000 if filing jointly.
- Phase-out range is the \$20,000 above phase-out start.
- Current law: The phase-out start was increased to \$200,000 (\$400,000 if filing jointly), with a \$40,000 phase-out range.
- Allows higher-income taxpayers to claim the credit.

Child Tax Credit – how allocated

- Our reading of statute is that the determination of Exemption still determines who claims child tax credit.
- Exemption itself has no tax impact (during term of Act).
- But still important because of its impact on child tax credit.

Pass-Through Businesses

- Basic idea is a deduction of 20% of net income from the business.
- On a per-business basis.

Pass-Through Phase-Out

- If taxable net income (before deduction) is \$157,500 or less, no phase-out.
- Many small businesses will be able to deduct the full 20%.

Pass-Through Phase-Out

- If taxable net income is over \$157,500, some or all of the deduction is phased out.
- If a business does not pay W-2s, and uses no capital, and if the taxpayer's taxable income before this deduction is \$207,500, then the deduction is completely phased out – there is no deduction in that case.
- Many sole-proprietorships use little capital and do not pay W-2s.

Pass-Through Phase-Out

- W-2 income paid can shield the business income from phase-out.
- If 50% of allocable W-2 income paid is more than 20% of the business's allocable net income, then the deduction does not phase out at all.
- For business net income of \$200,000, allocable W-2's paid of \$80,000 would do the trick.

Pass-Through Phase-Out

- Capital assets also help shield the business income from phase-out.
- For example, if 2.5% of the original cost of all capital in service and not depreciated by year end is more than 20% of the business's net income, then the deduction does not phase out at all.
- For business net income of \$200,000, capital in service that cost \$1.6M would do the trick.

Pass-Through Phase-Out

If the party does not have enough W-2 income and the business does not have enough capital assets in use, then the deduction phases out in a two-step calculation.

1. Take the greater of 50% of W-2 income or 25% of W-2 income + 2.5% of capital in use. That amount is deductible (up to 20% of net business income).
2. The gap between this amount and 20% of business income is phased out as taxable income (before this deduction) increases through the range of \$157,500 to \$207,500.

Pass-Through – Service Businesses

- Service businesses have further limitations.
- For service businesses, if taxable income is less than the \$157,500 threshold, there is no limitation. 20% is deductible.
- For taxable incomes above that, the income of the service business for purposes of the deduction, and the W-2 and capital amounts are reduced.
- The reduction is so much of taxable income as lies in the range between \$157,500 and \$207,500. For example, if taxable income is \$167,500, then the reduction is 20%, and so 80% of income, W-2 payments, and capital assets are considered for purposes of the deduction.
- If taxable income is over \$207,500, then the reduction is 100%, and the deduction is fully phased-out, and W-2 and capital assets can not help.

Pass-Through – Service Businesses

- Service businesses include financial services providers, accountants, doctors, and lawyers.
- Explicit exceptions cover architects and engineers. People providing these services are not affected by the service business limitation.

Pass-Through – Final limitation

- The deductions from all businesses combined may not exceed 20% of taxable income (before the deduction).

Pass-Through Calculations

| Business Income (assume no other income or deductions) | Service business? | W-2 allocable | Assets in service | Deduction before taxable income limitation | Comment |
|---|--------------------------|----------------------|--------------------------|---|--|
| \$150,000 | No | 0 | 0 | \$30,000 | Simple case |
| \$200,000 | No | 0 | 0 | \$24,128 | Partial phase-out |
| \$200,000 | No | \$100,000 | 0 | \$40,000 | |
| \$300,000 | No | 0 | 0 | \$0 | Full phase-out |
| \$300,000 | No | \$100,000 | | \$50,000 | W-2 allocation limits the phase-out. |
| \$300,000 | No | 0 | \$1,000,000 | \$25,000 | Assets in service limit the phase-out. |

Pass-Through Calculations

| Business Income (assume no other income or deductions) | Service business? | W-2 allocable | Assets in service | Deduction before taxable income limitation | Comment |
|---|--------------------------|----------------------|--------------------------|---|---|
| \$150,000 | Yes | 0 | 0 | \$30,000 | Simple case |
| \$200,000 | Yes | 0 | 0 | \$14,554 | Greater phase-out |
| \$200,000 | Yes | \$100,000 | | \$24,128 | Greater phase-out |
| \$300,000 | Yes | 0 | 0 | \$0 | Full phase-out |
| \$300,000 | Yes | \$100,000 | | \$0 | High-income service business not rescued by W-2 paid. |
| \$300,000 | Yes | 0 | \$1,000,000 | \$0 | High-income service business not rescued |

Pass-Through Calculation caveats

- The phase-outs are affected by taxable income.
- Calculations of the pass-through deduction will vary depending on the state of residence and all other income and deductions.

Alternative Minimum Tax

- The AMT income level for “no AMT tax” is increased from \$55,400 to \$70,300 for single individuals (\$86,200 to \$109,400 if joint).
- The AMT income level after which the benefit of this “no AMT tax” region is phased out increased from \$123,100 to \$500,000 for single individuals (\$164,100 to \$1 million for joint).

Alternative Minimum Tax

The following factors reduce the likelihood of AMT applying:

- Increase in “zero tax” amount.
- Huge increase in threshold for phasing out exemption.
- Limitation on state and local tax deductions (less to add back for AMT).
- No exemptions (ditto)

Alternative Minimum Tax

The result:

- Almost no one with income under \$1 million will be subject to AMT.
- AMT is all but repealed.

Alternative Minimum Tax Example

Sample case:

- Income of \$400,000
- Real estate taxes of \$30,000

Result:

- AMT: \$0
- AMT in 2017: \$8,954.
- At income of \$600,000 and above, no AMT in 2017 or 2018.
- This is because regular tax (39.6%/37%) was higher than AMT rate.

Mortgage Interest Limitations

- No deductions on home equity loans used for credit card refinancing, vacations, etc. in 2018 and going forward.
- High-balance limitations in 2018 and going forward: For new mortgages, may deduct mortgage interest only on \$750,000 used to buy or renovate the main or a second home.

Overall Impact in Sample Cases

- Will look at 3 sample cases in New York (high-tax state):
 1. Lower income, with children
 2. Higher income, itemized deductions
 3. High income

1. Lower income, with children

- Each party has \$30,000 wages.
- 2 children, living with with Party A.

- Party B (Single)

| 2017 | 2018 | Difference |
|---------|---------|-------------|
| \$2,478 | \$1,973 | \$391 (20%) |

- Party A (Head of Household)

| 2017 | 2018 | Difference |
|-----------|-----------|---------------|
| (\$4,302) | (\$6,140) | \$1,838 (30%) |

2. Higher incomes, itemizers

- Each party has \$100,000 wages.
- Each party pays \$6,000 mortgage interest.
- Each pays \$7,000 property taxes and \$5,000 state income taxes.

- Party B (Single)

| 2017 | 2018 | Difference |
|----------|----------|------------|
| \$15,233 | \$14,456 | \$777 (5%) |

- Party A (Head of Household)

| 2017 | 2018 | Difference |
|----------|---------|---------------|
| \$10,971 | \$8,594 | \$2,377 (22%) |

3. High incomes

- Each earns \$500,000 wages
- Each pays \$12,000 mortgage interest
- Each pays \$15,000 property taxes, \$25,000 state income taxes
- Single

| 2017 | 2018 | Difference |
|-----------|-----------|--------------|
| \$136,060 | \$142,990 | \$6,930 (5%) |

- Head of household

| 2017 | 2018 | Difference |
|-----------|-----------|--------------|
| \$132,884 | \$141,598 | \$8,714 (6%) |

Sample Cases Observations

- Tax reduction in lower-income cases may be a higher percent.
- Tax reduction in higher-income cases is definitely a higher dollar amount.

Impact on Child Support

- Both parties' net incomes will be higher.
- Higher-income party's income will be higher by a greater amount.
- Sample situation, look at several states.

Impact on Child Support

Sample situation:

- Incomes of \$20k for Party A, \$100k for Party B.
- Each pays \$7,000 of real estate tax
- Each pays about \$5,100 of mortgage interest
- State income tax calculated per state.
- Two children, 100 overnights.

Impact on Child Support

| State | Support in 2017 | Support in 2018 | % change |
|--------------|-----------------|-----------------|----------|
| California | \$1,699 | \$1,682 | -1% |
| Colorado | \$948 | \$948 | 0% |
| Connecticut | \$1,530 | \$1,530 | 0% |
| Florida | \$1,458 | \$1,462 | < 1% |
| Illinois | \$914 | \$1,061 | 16% |
| Minnesota | \$1,129 | \$1,129 | 0% |
| New Jersey | \$689 | \$689 | 0% |
| New York | \$1,635 | \$1,635 | 0% |
| Ohio | \$869 | \$869 | 0% |
| Pennsylvania | \$1,402 | \$1,417 | <1% |

Impact on Child Support

Why not more dramatic?

- Some states' guidelines do not use federal taxes (Colorado, Minnesota, New York, New Jersey, Ohio).
- Tax often does not change dramatically.
- Lower-income taxpayer has slightly higher tax benefit. So payer has lower percent of higher basic amount.
- Guidelines are in net income ranges, so to make a guideline change, income has to change enough to move out of the net income range.

Impact in High-Income Situation

- Incomes of \$20k for Party A, \$500k for Party B.
- All other inputs the same.
- Connecticut support: \$4,572 -> \$4,472. Went down!
- Why? Itemized deductions lost, tax higher in 2018.

Impact on Child Support

- Effect likely not dramatic.
- Could go either way.
- Have to calculate each situation.

Alimony Deduction

- For agreements entered into in 2018, no change.
- For agreements entered into in 2019, alimony is not deductible/includable.
- Does NOT revert in 2026.
- Will increase after-tax cost to payer.
- Will increase after-tax benefit to recipient.
- Removes classic opportunity for tax arbitrage.
- May cause states to re-think their alimony formulas.

Reversion after 2025

- Taxes snap back
- High-mortgage interest becomes deductible
- Alimony changes do NOT revert.



Thank you!