The New Tax Law: What It Means For Individuals

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The most sweeping federal tax changes since 1986 – the Tax Cuts and Jobs Act – changes the way individuals and businesses are taxed in more ways than we have seen in decades. This Client Alert outlines the changes individuals can expect to see in the way their income is taxed.

Tax Rate and Income Bracket Changes

The new tax law provides for a nominal reduction in tax rates for 2018. There are still seven tax rate levels for individuals, with 10% remaining as the baseline lowest level. The high end level has decreased from 39.6% to 37%.

The taxable income brackets for each tax rate level have also shifted for 2018. As a result, some single taxpayers will find themselves in the next tax bracket sooner under the new law.

The chart below shows the changes for single filers:

Old Tax Rate

Old Income Bracket

New Tax Rate

New Income Bracket

10%

On taxable income up to $9,325

10%

On taxable income up to $9,525

15%

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On taxable income from $9,326-$37,950

12%

On taxable income from $9,526-$38,700

25%

On taxable income from $37,951-$91,900

22%

On taxable income from $38,701-$82,500

28%

On taxable income from $91,901-$191,650

24%

On taxable income from $82,501-$157,500

33%

On taxable income from $191,651-$416,700

32%

On taxable income from $157,501-$200,000

35%

On taxable income from $416,701-$418,400

35%

On taxable income from $200,001-$500,000

39.6%

On taxable income over $418,400

37%

On taxable income over $500,000

Married taxpayers filing jointly will generally see a shift upward in how much taxable income they can have before they reach the next bracket.

The chart below shows the changes for married taxpayers filing jointly:

Old Tax Rate

Old Income Bracket

New Tax Rate

New Income Bracket

10%

On taxable income up to $18,650

10%

On taxable income up to $19,050

15%

On taxable income from $18,651-$75,900

12%

On taxable income from $19,051-$77,400

25%

On taxable income from $75,901-$153,100

22%

On taxable income from $77,401-$165,000

28%

On taxable income from $153,101-$233,350

24%

On taxable income from $165,001-$315,000

33%

On taxable income from $233,351-$416,700

32%

On taxable income from $315,001-$400,000

35%

On taxable income from $416,701-$470,700

35%

On taxable income from $400,001-$600,000

39.6%

On taxable income over $470,700

37%

On taxable income over $600,000

Higher Standard Deduction

The standard deduction for 2018 has been increased to $12,000 for a single taxpayer (up from $6,350 in 2017) and $24,000 for married taxpayers filing jointly (up from $12,700 in 2017). The standard deduction is indexed for inflation for subsequent tax years until 2026, at which point the increased standard deduction is set to expire.

Repeal of Personal Exemptions

To balance out the increase in the higher standard deduction, personal exemptions have been repealed. In effect, the personal exemption and standard deduction have been combined into the higher standard deduction.

Limitation of Mortgage Interest Deductions

For taxpayers who purchase new homes, the deduction for mortgage interest is lowered from the interest on up to $1,000,000 of debt to $750,000 of debt. This reduction does not apply to taxpayers who already owned their homes with their mortgages in place prior to December 15, 2017. In addition, mortgage interest is now deductible only for the taxpayer’s primary residence. Interest paid on loans that are taken out for buying vacation homes are no longer tax deductible unless, once again, you already own your vacation home. Likewise, interest on home equity lines of credit (HELOCs) are no longer tax deductible and, unlike the interest on vacation homes which are grandfathered, the loss of the deduction for interest on HELOCs includes both new and existing lines of credit.

Limitation on State and Local Tax (SALT) Deduction

In addition to the mortgage interest deduction limitation, there is now a limit on the deduction for state and local taxes - only allowing for a maximum deduction of $10,000 ($5,000 if married filing separately) for all state and local income taxes combined (i.e., property, sales, and income taxes).

Note: A basic analysis of the above tax law changes indicates that a single or married W-2 employee should bring home more of his or her paycheck due to the decrease in tax rates and doubling of the standard deduction. However, as the taxpayer earns a higher salary, the compressed higher rate brackets for single filers, combined with the loss of SALT deductions for everyone, may result in de minimis savings (or possible higher taxes) for taxpayers in states with a relatively high income tax, particularly if the taxpayer owns a home.

Qualified Business Income Deduction for K-1 Income

The new tax law gives investors in pass-through entities (such as partnerships, limited liability companies, and S corporations) a 20% qualified business income deduction, resulting in the taxpayer paying taxes on only 80% of his or her pass-through income **if** they are able to claim the full deduction. The "if" here is significant because this tax advantage is riddled with exceptions, with many claiming that this part of the new tax law is the most onerous to understand.

For example, the deduction is limited to the lesser of (i) 20% of qualified business income or (ii) the greater of either: (1) 50% of the entity's total wages (as reported on its W-2 tax forms); or (2) a formula using both wages and the entity's capital investment (i.e., 25% of wages + 2.5% of the entity's unadjusted basis in its depreciable property). This analysis is done on a business by business basis for any taxpayer owning more than one pass-through entity and the limitation under "(ii)" above does not apply if the taxpayer's taxable income is less than $157,500 for single taxpayers or $315,000 for married taxpayers filing jointly.

In addition, for some taxpayers, such as those providing personal services, the 20% deduction is available only if the business owner's taxable income is below certain thresholds ($157,500 for single taxpayers and $315,000 for married taxpayers filing a joint return), otherwise the deduction may be phased out. If the taxpayer misses the income threshold by less than $50,000 for single taxpayers (i.e., having more than $157,500 but less than $207,500 for single taxpayers) or less than $100,000 for married filing joint taxpayers (i.e., having more than $315,000 but less than $415,000 for married filers filing jointly), then the 20% deduction phases out gradually.

Alimony

Historically, alimony was taxable to the recipient and deductible for the payor unless the divorce decree or separation agreement provided otherwise. The new law reverses this treatment by eliminating the deduction for alimony payments, and by not requiring the payee to include alimony in income. The new law, however, does not affect the tax treatment of divorce decrees or separation agreements entered into before the end of 2018.

Elimination of Miscellaneous Itemized Deductions

The new law suspends all miscellaneous itemized deductions that were previously subject to the 2% floor, such as expenses attributable to an individual's employment and tax preparation expenses.

If you wish to discuss the impact of tax reform legislation on your personal tax circumstances or have questions concerning the topics presented in this Client Alert, please contact the authors, **Brian R. Selvin**, **Jo Ann Gambale**, and **Nita S. Vyas**.