Individual Tax Change Highlights for 2018

The Tax Cuts and Jobs Act, signed into law by President Trump on December 22, will bring with it many significant tax changes for both individuals and businesses. Here's an overview of some of the key changes for individual taxpayers.

A married couple filing jointly with taxable income of $85,000 in 2018 will have a marginal tax rate of 22% under the new law, compared with 25% under the prior law. A married couple filing jointly whose taxable income in 2018 is $250,000 will have a marginal tax rate of 24% under the new law, compared with 33% under the prior law.

Tax Rates Are Reduced

Under the rules in effect prior to 2018, seven income tax rates apply to individuals: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. The new tax law retains seven tax rates, but modifies them as follows: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. As under the prior law, rates increase with taxable income, and the income ranges for each bracket vary depending on filing status (single, married filing jointly/surviving spouse, married filing separately, or head of household).

Changes to the income tax brackets will lower the rates at many income levels. Here are a couple of general examples. A married couple filing jointly with taxable income of $85,000 in 2018 will have a marginal tax rate of 22% under the new law, compared with 25% under the prior law. A married couple filing jointly whose taxable income in 2018 is $250,000 will have a marginal tax rate of 24% under the new law, compared with 33% under the prior law.

The income levels affected by each tax rate will be adjusted annually for inflation. However, the new brackets are currently set to expire after the 2025 tax year.

Your Taxable Income Is Likely to Change

In addition to lowering the tax rates applied to your taxable income, the new law also modifies how taxable income is calculated. Here are some of the changes:

- The basic *standard deduction* for 2018 is $12,000 for a single individual and $24,000 for a married couple filing jointly -- compared to standard deductions of $6,500 and $13,000, respectively, under the prior rules.

- The itemized deduction for *mortgage interest* payments is now allowable only on mortgage interest paid on underlying indebtedness of up to $750,000, as compared to $1,000,000 under prior law. Additionally, the act suspends the deduction for interest paid on home equity loans and lines of credit, unless they are used to buy, build, or substantially improve the home that secures the loan.

- The total itemized deduction for *all state and local property and income (or sales) taxes* is capped at $10,000 ($5,000 for a married taxpayer filing a separate return).
- The *personal exemption*, which had been scheduled to be $4,150 under prior law, has been eliminated.

Under the new law, many more taxpayers are expected to find that claiming the standard deduction is more valuable than itemizing deductions, simplifying their filing tasks. Others may find that their itemized deductions have been substantially limited, particularly people who live in places with relatively high state and local taxes and housing costs.

The four changes listed above are set to expire after the 2025 tax year.

Future IRS Inflation Adjustments Will Be Smaller

Under the prior law, the IRS used the Consumer Price Index for "all-urban consumers" (CPI-U) to adjust various thresholds and limits each year to compensate for inflation. Under the new law, the IRS will use the so-called chained Consumer Price Index (chained CPI-U) instead.

CPI-U assumes that consumers buy the same things in the same amounts year after year and do not alter their behavior when prices change. Chained CPI-U assumes that consumers do shift their preferences to less costly alternatives. The differences between the indexes appear small from year to year, but over longer periods of time, chained CPI-U is expected to show noticeably less inflation than CPI-U. That is expected to reduce the amount of inflation indexing applied to tax brackets, deductions, and credits.

The new law makes this change permanent.

The Alternative Minimum Tax Lives On, But With Less Punch

The floor for triggering the alternative minimum tax has been raised. For married couples filing joint returns, the exemption is now $109,400 -- up from the previously-scheduled exemption of $86,200. For those filing as single taxpayers, the new exemption amount is $70,300 -- up from $55,400. Additionally, the income levels at which the exemption is phased out have increased.

These changes are set to expire after 2025.

Other Changes to Note

- Child credit -- Starting with the 2018 tax year, taxpayers can claim a $2,000 per child tax credit, or double the prior credit amount. The refundable portion of the credit has been increased to $1,400 per qualifying child, and other restrictions on the credit have been eased.

- Charitable contributions -- Generally, for those who itemize their deductions, the limit for claiming deductions for *cash* donations to qualified charitable organizations has increased from 50% to 60% of the taxpayer's "contribution base" (generally, adjusted gross income exclusive of net operating loss carrybacks for the year).

- Health insurance -- Beginning in 2019, consumers will no longer be subject to penalty taxes if they lack health insurance.

- Divorce and separation agreements -- Generally, alimony paid pursuant to a post-2018 divorce decree or separation agreement will not be deductible by the payer and will not be included in the recipient's gross income.

- Education savings -- Distributions from 529 plans will not be included in gross income where used to pay up to $10,000 per year of qualified education expenses at elementary and secondary public, private, or religious schools. Under prior law, only distributions for qualified *higher* education expenses were tax free. The $10,000 limitation on qualified elementary and secondary school expenses will apply on a per-student (not per-account) basis.

- Estate and gift tax exemption -- The basic exclusion amount has been increased to an estimated $11.2 million, up from $5.6 million under prior law.

Please keep in mind that this is a summary of selected highlights and should not be considered tax advice. To fully understand how the new tax laws affect your situation, please consult a qualified tax advisor.