The New Tax Legislation **November 10, 2017**

Chances are, you've heard that tax "reform" is right around the corner—that is, if you can call it "reform" when hundreds or perhaps thousands of new pages are about to be added to the tax code. First, the White House released its tax legislation wish list. Now the Republicans in the House of Representatives have released a proposal called the "Tax Cuts and Jobs Act," which fleshes out some of the details.

The House bill would reduce the number of tax brackets from seven currently (10%, 15%, 25%, 28%, 33%, 35% and 39.6%) to four: 12% (up to $45,000 income for singles; $90,000 for joint filers), 25% ($200,000 single; $260,000 joint), 35% (over $500,000 for singles; $1 million joint) and 39.6% (above $1 million for single filers; $1.2 million joint). The impact on any individual is complicated; people who are currently in the 15% bracket and the bottom of the 25% bracket would, under the new bill, pay taxes at a lower 12% rate. People who were previously in the 28% bracket would tumble down into the 25% rate. But people making between $20,000 and $40,000, and those between $200,000 and $500,000 would actually experience a tax increase as they move into a higher marginal rate.

It gets more complicated, because there's effectively a fifth tax bracket that nobody is talking about, perhaps because it only impacts the highest-income Americans. Anybody who thinks tax "reform" is making the system less complicated should ponder how this would be calculated; once a person or couple has income sufficient to reach the top bracket, they would subsequently add on a 6% surtax to the amount over that top bracket threshold until the entire benefit of their 12% rate has been phased out. In effect, individuals with taxable income between $1 million and $1.207 million, or joint filers with taxable income between $1.2 million and $1.614 million, would face a special 45.6% tax bracket. After that, they revert back to the 39.6% rate. This is simplification?

The dreaded alternative minimum tax would be eliminated under the new bill; however, the AMT credit carryforwards would still be deductible. The bill would continue the current capital gains rate structure of 0% (for those with up to $51,700 individual/$77,200 joint in taxable income), 15% (up to $425,800 individual/$479,000 joint) and a 20% rate for those in the top tax bracket. The 3.8% Medicare surtax on net investment income (which includes capital gains and dividend income) would be retained and added onto the 15% and 20% capital gains rates. So the actual capital gains rates would be 15%, 18.8% and 23.8%.

Meanwhile, the personal deduction and standard deduction would be combined into an expanded standard deduction of $12,000 for individuals, $24,000 for joint filers. Some families with more than three children would lose benefits under this proposal, since their personal deductions under the old system would have exceeded the expanded standard deduction in the newly proposed one. A higher standard deduction, by itself, would reduce the number of people claiming itemized deductions, but in addition, the bill would greatly reduce the list of qualified deductions, reducing the number of itemizers even more. Under the new proposal, people would no longer be able to deduct any state or local income taxes paid, but they WOULD be able to deduct local real property taxes (like a home and/or a vacation home) up to a maximum of $10,000 a year. The mortgage interest deduction would be limited to debt on the first $500,000 of a home mortgage (down from $1 million today).

Miscellaneous deductions like the electric drive motor vehicle credit, the adoption tax credit and the credit for moving expenses to a new job would all be eliminated.

Corporate tax rates would be lowered dramatically. The C-corporation (which is publicly traded companies) would see a maximum 20% tax rate, while pass-through companies like S corporations, partnerships and LLCs would be subject to a maximum rate of 25%—with some very complicated provisions designed to keep their owners from shifting personal income into and through the company to take advantage of potentially lower rates.

Finally, for the very few people who pay estate taxes, the good news is that the exemption limit, currently $5.6 million, would double to $11.2 million per person, $22.4 million for married couples, and the estate tax, according to the language of the bill, would be eliminated altogether in 2024. Gift tax limits would also go up to the exemption amounts.

Would any of this affect your tax bill in 2017? No. The provisions, if enacted, would impact the 2018 tax year.

What are the odds of passage? Who knows? The Senate is reported to have its own ideas about tax "reform."

Sources:

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