

Federal Tax Reform Summary: Individual Income Tax Planning Strategies

By Jim Schneidmiller

The Tax Cuts and Jobs Act (“the Act”) made many changes affecting individual taxpayers. Most changes were effective Jan. 1, 2018. While some taxpayers will see a reduction in their 2018 tax obligation, others will see an increase, principally due to the Act’s elimination or reduction of certain tax deductions. Tax planning for 2018 includes structuring your affairs to minimize the effect of the deduction cutbacks.

Tax Rates and Standard Deduction

The Act provides tax rates ranging from 10 percent to 37 percent. Married taxpayers filing jointly reach the top 37 percent tax bracket (down from 39.6 percent) at \$600,000 of taxable income, while singles reach the top tax bracket at \$500,000 taxable income. The tax brackets will be adjusted for inflation in future years.

Net long-term capital gains and qualified dividend income enjoy a special 15 percent maximum tax rate (20 percent for joint filers with taxable income over \$479,000 and singles with taxable income over \$425,800). However, the 3.8 percent net investment income tax (the tax that helps pay for Obamacare) remains, so many high-income taxpayers will see tax of 18.8 percent or 23.8 percent on capital gains and qualified dividend income.

The standard deduction amounts available to taxpayers who do not itemize their deductions are significantly increased to \$24,000 for married taxpayers filing jointly, \$18,000 for heads of household and \$12,000 for singles.

The Act repealed the deduction for personal and dependent exemptions.

Cutback or Repeal of Itemized Deductions

The Act repealed or restricted several deductions. These include:

- State and local taxes – Deduction is limited to \$10,000 annually for aggregated real estate taxes, state income taxes and state sales taxes.
- Mortgage interest – Limited to interest on \$750,000 of acquisition debt for a primary and/or second home while the prior law’s deduction for interest on up to \$1 million of acquisition debt is grandfathered for existing loans. No deduction is allowed for interest paid on home equity debt not used to substantially improve a qualified residence.
- Miscellaneous itemized deductions – Many popular itemized deductions are disallowed, including deductions for unreimbursed employee business expenses, investment management fees and tax preparation fees.

- Casualty losses – Limited to casualty losses incurred within a presidentially declared disaster area.
- Moving expenses – No deduction for out-of-pocket moving expenses, except for military moves. Moving expense reimbursements from employers are taxable income.

Strategies for Minimizing Tax Increases

The combination of increased standard deductions and decreased allowable itemized deductions will significantly decrease the number of taxpayers who itemize. Taxpayers may itemize in some years, but not others.

These changes may cause some taxpayers to reconsider how and when they give to charities, including as part of their estate plans. These on-the-fence itemizers can benefit from “bunching deductions” into certain tax years. The deduction that is most easily controlled as to its timing is charitable contributions. For example, a married couple considering a multi-year charitable pledge might pay the contribution in one tax year and exceed the applicable \$24,000 standard deduction for that tax year. Contributing via a “donor advised fund” can accelerate the charitable deduction while spreading out the gifts to the charity over multiple years. A donor advised fund is like an investment account to support charities. Donors who set up such funds get an immediate tax deduction then use the fund to make charitable donations.

Taxpayers over age 70 ½ should consider making charitable contributions (up to \$100,000) directly from their Individual Retirement Accounts. These contributions will reduce adjusted gross (and taxable) income even if these individuals do not itemize, while counting toward their annual required minimum distribution from their IRA accounts.

Employees should seek reimbursement for all expenses allowed under their employer’s expense reimbursement plan. For taxable reimbursements like moving expenses, ask the employer to “gross up,” the reimbursement to include an estimate of the taxes the employee will owe.

Taxpayers who have rental properties or a sole proprietorship should ask their tax preparer to calculate a separate portion of their return preparation fee, which can be claimed directly as a rental or business expense instead of being nondeductible.

Although there is no silver bullet that will prevent tax increases caused by the Act, the simple strategies described above can reduce tax in certain circumstances.

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