UNIVERSITY OF SAN FRANCISCO

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Tax Law Changes and You

The dream of making income taxes so simple that filing can be done on a postcard remains elusive. But a major increase in the standard deduction, coupled with pared-back itemized deductions included in the Tax Cuts and Jobs Act, means that only about 5% of taxpayers will itemize their deductions. For corporations, the Act ushers in significantly lower tax rates. Let's look at a few of the changes:

The New Tax Law and Individuals

Income Tax Rates

Old law: Seven tax brackets applied to individuals – 10%, 15%, 25%, 28%, 33%, 35% and 39.6%.

New law: Seven tax brackets – 10%, 12%, 22%, 24%, 32%, 35% and 37% – now apply. The 12% bracket applies to taxable income for joint returns up to $77,400 and single filers up to $38,700. Previously, a 25% rate would have applied to taxpayers at the upper range of those taxable income levels.

While the tax brackets are subject to annual inflation ajustments, a different method of computing the indexing will apply for years after 2018.

Single Individuals			**Joint Returns and Surviving Spouses**		
Column 1	Tax on Column 1	Rate on Excess	Column 1	Tax on Column 1	Rate on Excess
Taxable Income			Taxable Income		
$ 0	$ 0	10%	$ 0	$ 0	10%
9,525	952.50	12%	19,050	1,905	12%
38,700	4,453.50	22%	77,400	8,907	22%
82,500	14,089.50	24%	165,000	28,179	24%
157,500	32,089.50	32%	315,000	64,179	32%
200,000	45,689.50	35%	400,000	91,379	35%
500,000	150,689.50	37%	600,000	161,379	37%

These rates expire after 2025.

Investment Income

Tax rates remain the same on qualified capital gains and dividend income.

Tax bracket	Tax rate
10%, 12%	0%
22%, 24%, 32% and 35%	15%
37%	20%

Taxpayers with adjusted gross income in excess of $200,000 (single filers and heads of households) or $250,000 (joint filers) are subject to an additional 3.8% tax on net-investment income (dividends, capital gains, rents, royalties, nonqualified annuities, income from businesses that are passive activities and income from trading financial instruments or commodities).

Personal Exemptions

Old law: Taxpayers would have been entitled to personal and dependency exemptions of $4,150 for 2018. Exemptions began phasing out when adjusted gross income reached $266,700 (single taxpayers), $293,350 (heads of households) and $320,000 (joint returns). Affected taxpayers lost 2% of their personal exemptions for every $2,500 over the threshold amount.

New law: Through 2025, both the personal exemption and the phase-outs are eliminated.

Standard Deductions

Old law: The standard deductions for 2018 would have been as follows:

Single taxpayers	$ 6,500
Heads of households	9,550
Joint filers/surviving spouses	13,000

Additional deductions were available for taxpayers ages 65 and older and the blind.

New law: Standard deductions have nearly doubled.

Single taxpayers	$12,000
Heads of households	18,000
Joint filers/surviving spouses	24,000

Standard deductions will continue to be indexed annually for inflation, using a slightly different calculation than previously used. The additional standard deduction for those ages 65 and older and the blind has been retained. Single taxpayers and heads of households can take an additional $1,600 if blind or age 65; for married filers, the additional standard deduction is $1,300. Higher standard deductions expire after 2025.

Pointer ➤ Under the old tax laws, only about 30% of taxpayers itemized their deductions annually. It is estimated that with higher standard deductions, only about 5% of taxpayers will itemize.

Itemized Deductions

Home Mortgage Interest

Old law: Taxpayers could claim itemized deductions for interest paid on up to $1 million of acquisition indebtedness and $100,000 of home equity loans for a primary residence and a second home.

New law: Through 2025, the itemized deduction for

home mortgages is reduced to interest on up to $750,000 of acquisition indebtedness for a first and second home. The deduction for home equity loan interest is repealed. Interest on mortgages entered into prior to December 15, 2017, continues to be deductible up to the old limits.

Medical Expenses

Old law: A medical expense deduction was available only to the extent expenses exceeded 10% of adjusted gross income.

New law: For 2017 and 2018, a 7.5%-of-adjusted gross income threshold applies to medical expenses for all taxpayers. The deduction is available under both the regular and alternative minimum tax. After 2018, the threshold rises to 10% of adjusted gross income.

State and Local Taxes

Old law: Real estate tax and state income tax or sales tax were fully deductible against federal income taxes.

New law: Through 2025, a total of up to $10,000 is deductible for state and local taxes.

Moving Expenses

Old law: An above-the-line deduction was allowed for moving expenses incurred with a relocation in connection with work.

New law: Through 2025, the deduction is allowed only for certain members of the Armed Forces and their families.

Casualty Losses

Old law: A taxpayer could claim a deduction for casualty and theft losses that were unreimbursed by insurance. Losses were deductible only to the extent they exceeded 10% of adjusted gross income, and subject to a $100 minimum loss.

New law: The same limits apply for personal casualty losses, but through 2025, the deduction is available only if the loss was attributable to a disaster declared by the President.

Miscellaneous Itemized Deductions

Old law: Taxpayers could claim deductions for expenses such as subscriptions to professional publications, union dues, safe deposit box fees, work tools and supplies, tax return preparation and investment fees and expenses. The cost of appraisals for gifts to charity was included in this category. Expenses were deductible only to the extent they exceeded 2% of adjusted gross income.

New law: These expenses are no longer deductible, through 2025.

Alimony

Old law: A taxpayer paying alimony pursuant to a divorce or separation agreement can claim a deduction. The spouse receiving the alimony payments is required to include the amount received in income.

New law: Beginning with divorce or separation instruments executed after 2018, the taxpayer paying alimony is no longer entitled to a deduction.

Child Tax Credit

Old law: A maximum credit of $1,050 per child ($2,100 for two or more) is permitted, subject to adjusted gross income limits.

New law: Through 2025, the credit is increased to $2,000, fully refundable up to $1,400, up to certain income levels.

Retirement Accounts

Old law: Taxpayers who converted a traditional IRA to a Roth IRA had until October 15 to recharacterize the account to a traditional IRA. This was generally done where the value of the account declined since the time of the conversion.

New law: Once a traditional IRA is converted to a Roth IRA, recharacterizations are no longer allowed.

> *Pointer* ➤ Account owners owe income tax on any amount converted from a traditional IRA to a Roth IRA. If values dropped between the conversion and October 15, the recharacterization allowed the owners to avoid paying income tax on the higher amount.

Alternative Minimum Tax

Old law: The AMT was originally intended to guarantee high-income individuals could not avoid paying tax through the use of deductions and credits. Although the AMT rates of 26% and 28% are lower than ordinary income tax rates, they are applied to a wider base of income, with no deductions for state and local taxes and other preference items. Taxpayers must calculate both their regular income tax and the AMT and pay the greater.

New law: The AMT is retained for individuals (repealed for corporations), but AMT exemptions are increased through 2025. For 2018, the exemptions are $109,400 for married couples and $70,300 for other filers.

Estate and Gift Taxes

Old law: A federal estate tax applied to transfers at death. A credit sheltered estates up to $5.6 million in 2018. Estates above that amount paid tax at a 40% rate.

New law: The credit is doubled, sheltering estates up to $11.2 million per person in 2018, with inflation adjustments in future years. Married couples can shelter up to $22.4 million in 2018. The rate on excess amounts remains at 40%. The same shelter and tax rates apply to gift and generation-skipping taxes through 2025, with annual adjustments for inflation.

The New Tax Law and Corporations

Beginning in 2018, the top corporate rate permanently drops from 35% to a flat 21%. The Tax Cuts and Jobs Act includes other changes for corporations. Corporations and pass-through entities such as S corporations, LLCs, partnerships and sole proprietorships will also see significant cuts in top rates and the way income is taxed.

Pass-through Entities

Old law: Entities such as S corporations, LLCs, partnerships and sole proprietorships did not pay income tax, but instead the income from the businesses flowed through to the owners in proportion to their ownership interest. Owners paid tax at rates as high as 39.6%.

New law: The owners of pass-through entities can claim a 20% deduction on the first $315,000 of income for joint filers or $157,500 for single taxpayers. Beyond that amount, a 20% deduction applies to business profits resulting in an effective marginal rate of no more than 29.6%.

The New Tax Law and Charitable Giving

Although gifts to charity remain deductible, it is estimated that the higher standard deduction will result in only about 5% of taxpayers itemizing. The new law ushers in higher deduction limits for cash gifts.

Deduction Limits

Old law: For gifts to public charities, donors could claim deductions of up to 50% of adjusted gross income for gifts of cash and 30% for gifts of appreciated assets. Excess amounts could be carried over for up to five years.

New law: Cash gifts are now deductible up to 60% of adjusted gross income. The 30% limit for gifts of appreciated property and the carryover rules remain the same.

Pointer ➤ Although gifts to charity continue to be deductible, the higher standard deduction means that many donors will not be able to benefit from their generosity. There are several ideas for philanthropic taxpayers (see below).

Purchase of Athletic Tickets

Old law: A charitable deduction of up to 80% could be taken on an amount paid to a college or university in exchange for the right to purchase tickets to athletic events. No deduction was allowed for the tickets themselves.

New law: This deduction has been repealed.

Giving to Charity Under the New Rules

For millions of donors, giving to charity is not about the deduction. They give because they support the mission of the organization. The tax savings from the deduction do, however, enable some donors to give more than they might otherwise. And there are still some tax benefits to be received from gifts to charity.

Qualified Charitable Distributions (QCDs)

Donors age 70½ or older can direct the custodian of their IRAs to make distributions, up to $100,000 annually, to charity. Normally, any withdrawal from an IRA is subject to income, and minimum distributions are required beginning at age 70½.

Susan, age 73, must take distributions totaling $36,000 from her IRA in 2018, even though she doesn't need the funds. When added to her other income, the distribution will push Susan, a single individual, into the 24% income tax bracket and cost her up to $8,640 in taxes. Instead, Susan could have some or all of the $36,000 (or even more if she wants) sent to her favorite charity. She avoids all income tax on amounts forwarded from the IRA to charity, even though she is not entitled to a charitable deduction for this gift.

Charitable Remainder Trusts

With a charitable remainder trust, donors can make a gift to charity, reserve lifetime payments and claim an income tax charitable deduction. Payments can be of a fixed amount (annuity trust) or a percentage of the annual value of assets in the trust (unitrust). One attractive feature of charitable remainder trusts is that they can be funded with appreciated assets, with no loss to capital gains tax when the assets are sold by the trustee. Donors are entitled to charitable deductions for a portion of the value of the assets placed in the trust, which may enable them to itemize for the year of the gift. When the trust ends, all remaining assets pass to the named charity.

Warren and Lily, ages 77 and 74, transfer $100,000 of highly appreciated stock to a charitable remainder unitrust that will pay them 5% of the trust's value annually ($5,000 the first year) for their joint lives. If they had sold the shares, they would have paid capital gains tax on their profit and had less to reinvest. Their income tax deduction – nearly $50,000 – enables them to itemize in the year they fund the trust, and Warren and Lily have the satisfaction of knowing they have made a significant gift to charity.

Charitable Gift Annuities

In exchange for a gift of cash or appreciated securities, charitable gift annuities offer payments for life for one or two annuitants. A portion of the value of your gift qualifies for an income tax charitable deduction. When a gift annuity is funded with cash, a large portion of the payment received is tax-free income.

Marge gave $25,000 cash to fund a gift annuity that, at her age of 75, will make payments totaling $1,450 (5.8%) annually for her life. Of that amount, almost $1,100 is tax free during Marge's life expectancy. In her 24% income tax bracket, that's equivalent to about $1,797 of taxable income. In addition, Marge is entitled to a charitable deduction of more than $11,400, which may enable her to itemize her deductions in the year of the gift.

A charitable gift annuity funded with appreciated securities provides less tax-free income than one funded with cash, but the donor is able to avoid tax on the capital gain. Part of the gain is avoided entirely, while tax on the rest is paid over the donor's life expectancy. The remaining portion of the payment is taxed as ordinary income.

If Marge instead contributed stock worth $25,000, for which she originally paid $10,000, her annual payments and charitable deduction would remain the same, but her tax-free income would drop to nearly $440, with about $650 taxed at favorable capital gains tax rates. The balance is taxed as ordinary income.

Interest-free Loans

A taxpayer who makes a large interest-free loan to family members may be subject to income tax on the interest that *could* have been earned if the funds were invested. But a special provision allows interest-free cash loans to charity of up to $250,000 per organization. There is no charitable deduction because the gift can be recalled at any time. However, there is a tax advantage to the donor, who does not have to recognize income that might have been earned.

Larry makes an interest-free loan of $100,000 to charity. If this money was invested, he could probably earn 4%, but by making the loan, he does not have to recognize the $4,000, thereby saving on his income tax. The charity receives investment income, just as if it were receiving a gift from Larry. If he needs the funds at any time, he can simply recall the loan, or, he can forgive the loan in his will to make a magnificent gift to the organization.

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