March 1, 2018

Estate Planning Update March 2018 - Income Tax Changes Under the New Tax Law

The Act also made many changes to the individual income tax. Most of the individual income tax changes will also sunset on January 1, 2026. We highlight some of these changes.

Home Mortgage Interest Deduction. For any mortgage made after December 15, 2017, to acquire or improve a first or second personal residence, the amount of interest paid on up to $750,000 ($375,000 for a married person filing separately) of mortgage debt is deductible. For any mortgage made before this date, the amount of interest paid on up to the prior limit of $1 million ($500,000 for a married person filing separately) of mortgage debt will still be deductible, even if the loan is refinanced. In addition, the interest paid on home equity indebtedness is no longer deductible unless the indebtedness was used to acquire or improve a residence.

State and Local Tax (SALT) Deductions. The Act limits the deduction for state and local income, sales and property taxes to $10,000 for both individuals and married couples ($5,000 for a married person filing separately). The SALT deduction limit will not be indexed for inflation. The SALT deduction limit does not apply if the state and local taxes are paid or accrued in connection with carrying on a trade or business or investment activities.

Miscellaneous Itemized Deductions. Miscellaneous itemized deductions—which include, among many others, deductions for investment management fees, tax planning expenses and tax preparation fees—are no longer allowed.

Increased Standard Deduction. The standard deduction has been increased to $24,000 for married couples ($12,000 for individuals). Because of this increase, coupled with the SALT deduction limitation, the new limits on the home mortgage deduction and the elimination of miscellaneous itemized deductions, many more taxpayers will be better off taking the standard deduction and will no longer itemize deductions. This means that many taxpayers will no longer recognize an income tax benefit for many previously-deductible expenses.

Charitable Contributions. As noted above, fewer taxpayers are expected to itemize deductions. That means that many taxpayers will no longer see a tax benefit for charitable contributions. However, taxpayers who will continue to itemize deductions may be able to take advantage of a change to the charitable deduction rules. The limitation on deductibility of cash contributions to public charities and certain other organizations has increased from 50 percent of modified adjusted gross income to 60 percent of modified adjusted gross income. The Act also eliminates a provision that allowed many donors to private foundations to avoid the substantiation requirement. Now, if you make a gift in excess of $250 to a charity, even if it is your own private foundation, you must have a receipt from the charity in order to claim the deduction.

Tax on a Child's Investment and Other Unearned Income (Kiddie Tax). Prior to the passing of the Act, if a child's interest, dividends and other unearned income totaled more than $2,100, that income was subject to tax at the parents' higher income tax rate instead of the child's tax rate. Under the Act, a child's unearned income in excess of $2,100 will be taxed at the highest ordinary income and capital gains tax rates, even if the parents are not in the highest tax bracket.

529 Accounts. Prior to the passing of the Act, funds in a 529 plan could be used to pay only for tuition, fees and certain expenses related to attendance at a college, university, vocational school or other postsecondary educational institution. Distributions from a 529 plan can now also be used to pay up to $10,000 annually for tuition for grades K-12.

Qualified Business Income Deduction. The Act creates a new deduction of 20 percent of "qualified business income" received from pass-through entities such as S-corporations, LLCs, partnerships and sole proprietorships. This effectively lowers the tax rate for many business owners. While there is great interest in this deduction, determining whether a business qualifies for it is complicated and, in many cases, uncertain.

If you have any questions about the Act or how the changes in the tax law might impact you or your family, please contact any of the attorneys in the Individual Clients Department at Day Pitney.