Tax Reform and How It Impacts You

A brief snapshot of the most impactful changes to the tax code under the Tax Cuts and Jobs Act of 2017 for financial advisors and their clients.

Within the first few weeks of 2019, Americans will start to collect their W2s and other tax documents in preparation for their first tax filing under the Tax Cuts and Jobs Act of 2017, the landmark legislature signed into law in December 2017 by President Donald Trump. Many Americans have already felt the first phase in their paychecks with changes to the individual tax brackets. *(See Page 2)*

5 Key Takeaways for Tax Reform

1. **Itemized deductions.** Review the full list of changes and see how you may be impacted. Speak with your tax advisor to see if taking the standard deduction makes more sense.

2. **Mortgage and home equity.** Determine if the lending options to buy a home or use your home equity will affect you.

3. **State and local taxes (SALT).** Understand how much you may be paying in income taxes and property taxes and what the implications are of those changes.

4. **Legacy plan and gifting.** Review your estate plan and any cash gifting or donations to charity you are making and what the increase of the limits means for you.

5. **Your plan, your process.** Start or update your financial plan and your planning process with your Oppenheimer financial advisor to adjust and plan for how these changes will impact your life!

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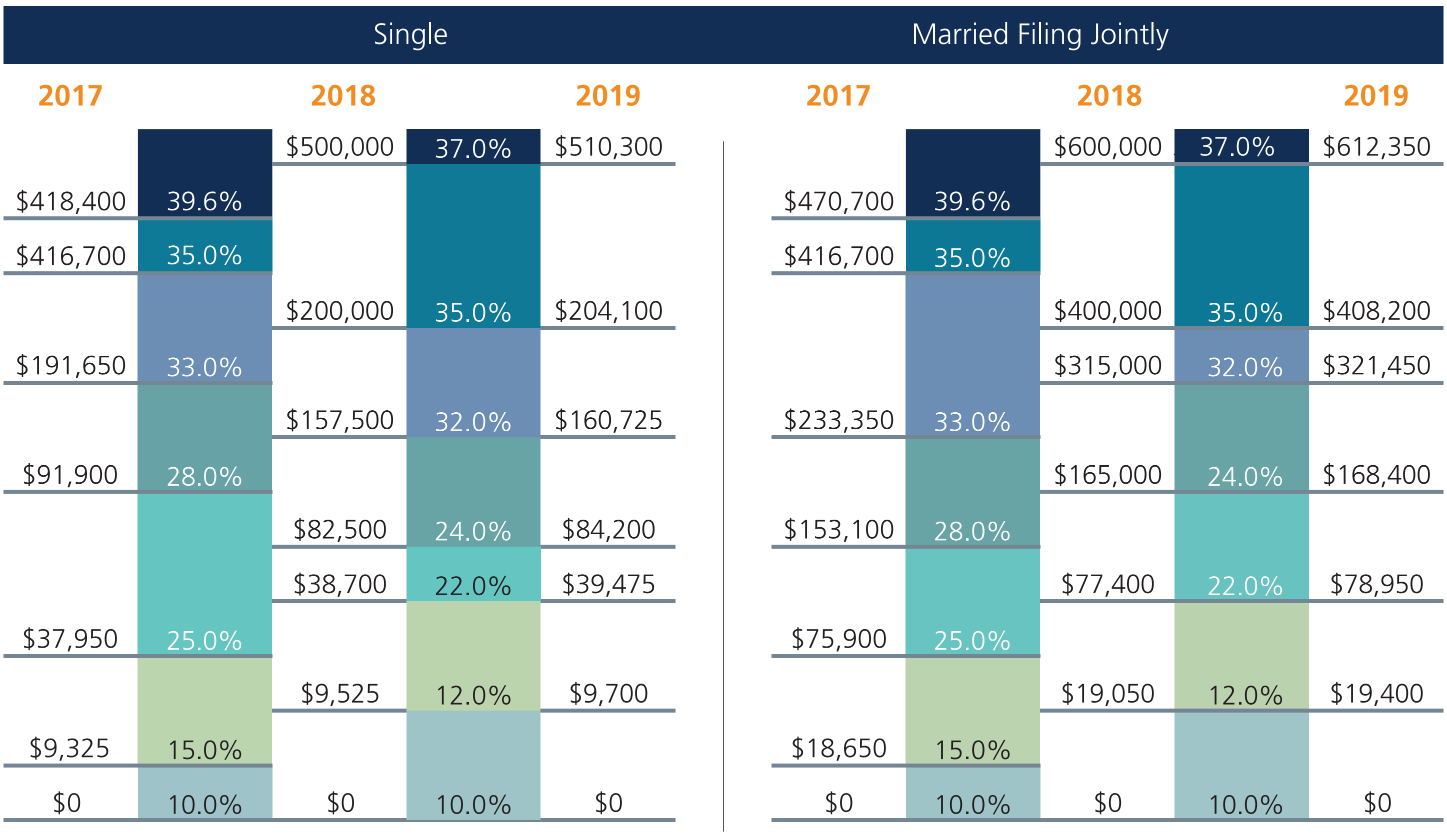
Now it's time to brace for (or embrace) the changes to expect in phase two. The entire law is online for you to read all 503 pages of it. We've highlighted the key takeaways, what they mean and the potential impact they may have on you.

Before you make any decision based on this material, please be sure to discuss the implications you may make with your tax professional. Oppenheimer does not provide legal or tax advice. Consult your tax advisor regarding all tax-related issues.

Individual Tax Brackets

Let's start with the piece of reform that you are probably already seeing in your paycheck. The marginal tax rates were reduced, almost entirely across the board for nearly every American. Most individuals saw their bracket reduced by about three to four percentage points. Some people witnessed it drop by almost 10 points. However, there are other individuals who saw a tax increase. Refer to the chart below for where you stood in 2017 versus 2018 and what the indexed brackets will look like for 2019.



A Higher Standard Deduction

The standard deduction is one of two options all taxpayers are allowed to use to reduce their adjusted gross income. The second option is itemized deductions. The changes to how we itemize deductions will be covered later.

When you file your annual tax return, the standard or itemized deduction is the third item listed after gross income (wages, salary, retirement account distributions), and any above-the-line adjustments such as IRA contributions or self-employment health insurance, where applicable.

Prior to recent tax reform, if you found yourself with several items to deduct, (mortgage interest, property taxes, medical expenses) then it might make more sense to itemize your deductions. If you did not have many items to deduct, then the standard deduction was more attractive to use.

These changes expire after Dec. 31, 2025.

Standard Deduction	2017	2018	2019
Single	$6,350	$12,000	$12,200
Married filing jointly	$12,700	$24,000	$24,400
Surviving Spouses	$12,700	$24,000	$24,400
Married filing separately	$6,350	$12,000	$12,200
Heads of Household	$9,350	$18,000	$18,350
Additional deduction for married and age 65 or older, or blind	$1,250	$1,300	$1,300
Additional deduction for single and age 65 or older, or blind	$1,550	$1,600	$1,600

Repeal of Personal Exemptions

The elimination of the personal exemption was one of the most overlooked changes to the tax code. Once it was determined which type of deduction you would use (standard vs. itemized) and what that dollar figure was, the next step was to subtract the personal exemption. For 2017, that dollar figure was $4,050 per individual in the household.

So, for a family of four, including both spouses and two children claimed as dependents, the credit would equal $16,200.

This deduction is no longer an option, having been somewhat absorbed by the increase to the standard deduction. This change is set to expire on Dec. 31, 2025.

Changes to the Child Tax Credit

Under the previous code, individuals were allowed to claim a $1,000 credit for qualifying children under age 17. The credit was also nonrefundable meaning that the only way to take advantage of it was to have an income tax liability prior to applying the credit.

New for 2018, the act temporarily doubles the child tax credit to $2,000 per qualifying child under age17. It also increases the amount of the refundable part of the credit to $1,400 from $1,100. The refundable kicker means that now, even if you don’t have any income tax liability you may now be able to take advantage of the credit as a refund to you. The credit is limited if your adjusted gross income exceeds $400,000 for married couples filing jointly or $200,000 for single filers.

This provision expires after Dec. 31, 2025.

Changes to How We Itemize Deductions

Arguably, the most significant changes to the tax code affects the way we itemize what we deduct from our income taxes. Elected officials in Congress have argued for ways to simplify the tax code and these changes are certainly a step in that direction.

For individuals or couples whose deductions exceeded $6,350 for single filers or $12,700 for married filers, it made sense to choose to itemize versus using the simpler standard deduction.

Applying the new law to the new figures means you would need to itemize more than $12,000 worth of deductions for individuals or $24,000 for married couples. Exceeding those figures just got a lot harder due to the repeal of or reduction of several of the most popular deductions. Here are some of the changes that may affect you:

Itemized Deduction Chart	2017	2018 - Dec. 31, 2025 Unless Otherwise Noted
Home Mortgage Interest	Up to $1,000,000	Up to $750,000
Home Equity Indebtedness	Up to $100,000	Suspended until 12/31/25
State and Local Taxes (SALT)	Deductible	Up to $10,000
Charitable Contributions to Public Charities	50% of Adjusted Gross Income (AGI)	60% of AGI
Unreimbursed Medical Expenses	Up to 10% of AGI	Up to 7.5% of AGI (2018 only)
Casualty and Theft Losses	Allowed, up to 2% of AGI	Suspended until 12/31/25
Investment Advisory Fees	Allowed, up to 2% of AGI	Suspended until 12/31/25
Tax Prep Fees	Allowed, up to 2% of AGI	Suspended until 12/31/25
Home office deduction for Self-Employed Individuals	Allowed, up to 2% of AGI	Suspended until 12/31/25
Work-related education	Allowed, up to 2% of AGI	Suspended until 12/31/25
Deduction and Inclusion of Alimony	Deductible by payer	Suspended until 12/31/25
	Included as income to recipient	Suspended until 12/31/25
College Savings Accounts	Higher education only	*College costs and up to $10k/yr for elementary or secondary school
Estate Exclusion Amount	$5.49 million	$11.18 M ($11.4 M for 2019)
Annual Gift Exclusion	$14,000	$15,000 (for 2018 & 2019)

Reduction of Home Mortgage Interest

Debt on the home, or what you owe your mortgage provider, was one of the most significant deductions a taxpayer could take. Before tax reform was passed, homeowners could deduct the interest they paid on the first $1 million of debt.

The Tax Cuts and Jobs Act of 2017 reduces that figure to $750,000 from $1 million.

There is a caveat. For people with a mortgage or debt prior to Dec. 16, 2017 or under a binding contract that was in effect before Dec. 16, 2017, and the home purchase closed before April 1, 2018, then you are grandfathered into the previous law.

This reduction is temporary and expires after Dec. 31, 2025. Thereafter, a taxpayer may treat up to $1 million of indebtedness as a deduction, regardless of when the debt occurred.

Elimination of Home Equity Indebtedness

One of the perks of home ownership was the ability to borrow against the equity you have paid into residence. On top of that luxury, you could claim interest owed on the home equity loan as a deduction, up to $100,000. The changes signed into law eliminate this deduction until Dec. 31, 2025.

Reduction of SALT Incurred as a Deduction

High-income filers and homeowners with high property taxes will feel this change, maybe more than any other demographic. As part of itemizing deductions, Americans were allowed to pool their state and local income taxes paid, or sales tax paid if higher, along with their property taxes and use that dollar figure as a deduction. For residents in high-tax states such as New York, New Jersey and California, this option could be crucial. The higher your income, or the higher the property value, the more valuable the deduction becomes. According to the Tax Foundation, individuals with income over $100,000 receive more than 88% of the SALT deduction benefits.

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Defenders of the SALT deduction argue that state, local, sales and real estate taxes are all mandatory and, therefore allowing you to use those dollars as a deduction prevents those dollars from being included in your taxable income and therefore taxed again! Opponents of SALT say the benefit costs the federal government trillions of dollars in missed revenue opportunity.

What Congress passed in 2017, that ultimately President Trump agreed to and signed into law was allowing taxpayers to deduct up to $10,000 a year in state and local property and income taxes. The caveat with this change is the $10,000 cap applies to both single filers and married couples. Meaning, a single person has the same cap as two married individuals.

As a result, states have publically discussed ways to soften the burden for their residents, such as creating charitable contribution loopholes that result in state income tax credits. The IRS proposed regulations in August 2018 that are aimed at blocking states that attempt to sidestep the new law.

Like the individual tax changes, these amendments also expire after Dec. 31, 2025. There has been debate in Washington D.C. on whether making the cap permanent or reverting back to previous law. It's too early to tell how this will play out.

Deduction for Charitable Contributions

The rules governing charitable donations for this type of deduction can be complicated. It's better to speak to your financial advisor or tax advisor before proceeding with any action in this area. Specifically, the deduction for contributions to charity for individuals has increased. The amount of deduction you may now take is up to 60% of your adjusted gross income for cash contributions to public charities and certain other organizations.

Repeal of Itemized Deductions Subject to 2% Floor

Certain items were allowed to be itemized as a deduction as long as they did not exceed 2% of the taxpayer's adjusted gross income. The following miscellaneous items have been suspended from claim as a deduction through Dec. 31, 2025:

- Causality and theft losses from property used in performing services as an employer
- Investment fees and expenses
- Tax preparation expenses
- Home office deduction for self-employed individuals
- Non-reimbursed employee business expenses such as travel, transportation, meals, entertainment, and gifts
- Work-related education

Repeal of Deduction for Medical Expenses

You are still allowed to claim a deduction for unreimbursed medical expenses. Only to the extent that they do not exceed 7.5% of one's AGI. This applies to all taxpayers. This policy is scheduled to revert back to its original 10% cap on Jan. 1, 2019.

Changes to Deduction and Inclusion of Alimony

Alimony payments are no longer deductible by the payor spouse and no longer included as income to the recipient spouse.

Repeal of Overall Limit on Itemized Deductions

This piece has covered only a few of the itemized deductions that were the most impactful to the most taxpayers. While the number of different options available has decreased, the dollar limit to qualify for this benefit has increased.

Going forward, the new law suspends any dollar threshold specific to one's total adjusted gross income that modifies or limits the amount of itemized deductions one can claim. This suspension expires after Dec. 31, 2025.

Repeal of Advisory Fee Deduction

One of the itemized deductions that were repealed as a result of the tax reform bill was the opportunity to deduct the fees an investor paid to have his or her portfolio professionally managed. A professionally managed retirement plan can still pay its own advisory fees without the cost being recognized as a contribution or a taxable distribution from the account. And for a pre-tax account such as an individual retirement account (IRA), the payment of the advisory fee directly from the account is essentially a pre-tax payment of the investment advisory fee. This suspension is in effect through Dec. 31, 2025.

Changes to Education Savings Rules

College savings accounts have been an incredibly popular method for parents and other loved ones to save, invest and grow money on a tax-free basis to pay for college. Tax reform has expanded the purpose of 529 accounts. Prior to the changes, 529s were only available for college expenses. You may now access up to $10,000 a year per-student federally tax-free to cover expenses associated with a public, private or religious elementary or secondary school.

This rule change is still a work in progress. These accounts have not just been a benefit on the federal level but also the state level. Some states grant a state tax deduction for contributions to a 529 plan. Due to changes to how these accounts are used, some states may not offer the same benefit on the state level as the federal government would. Speak to a tax advisor who is familiar with the rules in your state.

Increase to the Estate and Gift Tax Exemption Limit

Taxpayers are allowed to gift a certain amount of their assets without triggering a taxable event. That figure is identical when a person dies and their estate changes hands. Transfers to a surviving spouse or a charity upon death are generally a 100% deductible transaction regardless of dollar figure. Leaving savings, property or other assets to someone other than a spouse or charity could incur a tax. Under the new law, the threshold has doubled. Now, any estate valued below $11,180,000 per individual ($11.4 million in 2019) will not incur any estate tax. That is double the 2017 figure of $5.49 million, indexed for inflation.

Married couples still have portability. That is, when one spouse dies, he or she can leave their $11.1 million dollar exclusion ($11.4 million in 2019) to their surviving spouse, assuming the deceased left everything to his or her widow or widower. When the second spouse passes away he or she will now have an estate exclusion of $22.36 million ($22.8 million in 2019). This provision is effective for the estate of decedents and gifts made after Dec. 31, 2017 and before Jan. 1, 2026.

So what does this mean?

Your current income, debt management and legacy are just three of the areas of financial planning that were impacted by this legislation. This event should serve as a reminder that your financial plan is an ever-changing and evolving exercise. This law left very little unchanged with impacts on both your present and future financial well-being.

Speak to an Oppenheimer financial advisor to start or update your financial plan!

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