Highlights of the GOP’s Tax Cuts
A Closer Look at its Impacts and Strategies to Implement
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On December 20th, Congress approved the final version of the tax bill which is the most comprehensive change to tax law in over 30 years. Although we will not know how successful or costly this overhaul will be for a number of years, we can take a look at some of the immediate impacts of the bill and what changes should be considered to position savings and portfolios as we head into 2018.

Before we review the major headlines of the bill and the investment implications, it is important to briefly discuss the projections of the costs (i.e. deficits) and ultimately the economic growth that it triggers. The Congressional Budget Office (CBO) and Joint Committee on Taxation (JCT) published their final analysis of the Senate’s initial version of the bill earlier this month. **The Senate’s version of tax reform most closely resembles the final reconciled version. The analysis, which is published on CBO’s website, projects that the costs would add $1.4 trillion to the deficit over the next 10 years. That estimate does not assume any additional economic growth from tax reform. JCT estimates that tax reform would boost the level of GDP relative to CBO’s baseline forecast (1.8% expected growth) by an average of 0.8% over the next 10 years. This economic expansion is expected to reduce the deficit by $407 billion over the same 10 year period, resulting in a net cost of $1 trillion.

The important points from their projections is that they are modeling a $1 trillion cost of tax reform with a 2.6% average rate of GDP growth through 2027. The ultimate cost will not be studied for many years and a lot of it will depend on corporate and individual behavior and collectively how we respond to these changes. Will corporations reinvest in capital, their employees or their shareholders? Will individual tax payers see wage growth that has been stunted for the past decade and how would they respond to bigger after-tax paychecks? Many of these questions are impossible to know right now but the level of expansion in the economy will determine whether this bill is “revenue-neutral” or not.

Impact to Individuals

The original intent for tax reform was to simplify the way it’s constructed. However, this version makes subtle changes versus outright eliminations. The number of marginal tax brackets will remain at 7 and in general, rates fall at all income levels. The lone exception is for couples between $400,000 and $424,950 and single filers between $200,000 and $424,950. For the most part, tax brackets for married couples are now twice that of a single...
filer, reducing the “marriage penalty”. Capital gains and dividends will continue to have 3 brackets and will be tax-free if taxable income for couples is under $77,200 and for single if under $38,600. These changes will sunset after 2025 and revert back to the laws in effect for 2017.

Changes to standard and itemized deductions got a lot of attention and especially for taxpayers in high-tax states and in markets with high property values. Elimination of the personal exemption ($4,050 deduction for each taxpayer plus dependents) and the increase of the standard deduction, which almost doubled, are permanent changes. This may move many households that typically itemized deductions toward standard. The most notable changes for itemized deductions are the limits on state, local and property taxes (will be capped at $10,000) and mortgage interest deductions on the first $750,000 loan. Previous mortgages will be grandfathered in but these combined changes will be felt by high income earners in high tax states that itemize deductions and could potentially impact resale value of expensive real estate. Also, deductions for interest payments from home equity loans will be eliminated.

Charitable cash donations will now be deductible up to 60% of AGI compared to the current 50% limit. However, it may be worthwhile accelerating charitable contributions into 2017 versus 2018 IF the filer anticipates a change in 2018 from itemized to standard deductions. One of the rare retroactive changes will be made to medical expenses. Effective for 2017 and 2018 only, medical expenses will be deductible as long as they exceed 7.5% of AGI, compared to 10% previously.

AMT exemptions will increase, ultimately reducing the number of people subject to alternative taxes. Exemptions for couples will increase from $84,500 to $109,400 in 2018 and from $54,300 to $70,300 for single filers. The exemption is the amount of income that isn’t subject to AMT. Phase-out levels will also increase from $160,900 to $1,000,000 for couples and from $120,700 to $500,000 for single filers. The phase-out refers to taxpayers that don’t qualify for the exemptions. These changes will reduce the number of people paying AMT and the amount.

A significant change that will have a sizable impact for families and extended families interested in gifting or funding educational expenses pertains to 529 accounts. 529 plans will now be able to distribute up to $10,000 per year to cover K-12 expenses for public, private or religious school. The only previous tax-advantaged vehicle to fund K-12 expenses was a Coverdell ESA. However, there were restrictions for contributions for high-income earners. 529 plans are not subject to income tests and allow for higher annual contribution amounts. Certain state-specific plans allow for state tax deductions as well, which should increase the popularity of these education saving vehicles.

Impact to Corporations

C-Corporations stand to benefit greatly from tax changes, especially those that generate a high percentage of domestic sales and pay higher effective tax rates. Tax rates for C-Corps will now be taxed at a flat rate of 21% beginning in 2018 compared to the current 35% levied now (**many U.S. companies currently have much lower effective tax rates due to international sales and accounting practices). This will have an immediate impact to below-the-line earnings for corporations (S&P 500 earnings) as tax expenses and cash outflows will fall.

The final bill also sets a one-time mandatory tax of 15.5% on cash and cash equivalents (8% rate on illiquid assets) held overseas by U.S. companies that elect to repatriate back into the U.S. There are roughly $2.6 trillion in U.S. business profits held overseas that could get freed up to reinvest in the business, pay down debt or increase shareholders distributions. Sectors that have a large percentage of overseas profits include Information Technology and Health Care.

Pass-through businesses (S-Corps, Sole-Proprietorships and Partnerships) also stand to benefit from tax changes. The final version of the bill creates a 20% deduction for the first $315,000 of net business taxable income for joint filers. For income above this threshold, the bill phases in limits, producing a top effective tax rate of 29.6%.
The changes being made for pass-through businesses will sunset after 2025 but the reduced C-Corp tax rate will be permanent.

**Where this is Headed?**

The provisions of this bill are quantifiable but how it impacts businesses and individuals over the next decade will be fluid and driven by many unknowns. Behavior is constantly changing and will largely depend on the health of the global economy. There are many that will win and many that will lose with this legislation and it is incredibly important to position assets and gear strategies that can put you ahead.

You have a dedicated Team here at the Popovich Financial Group that would be happy to discuss these topics with you and how it could impact your future financial related endeavors.