Chapter 1: New Legislation — Individual Concerns

Please note. Corrections were made to this workbook through January of 2019. No subsequent modifications were made. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

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TAX CUTS AND JOBS ACT: INDIVIDUAL TAXPAYER PROVISIONS[1]

On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act (TCJA). The TCJA decreases individual income tax rates and lowers the top individual rate from 39.6% to 37%. It temporarily repeals many individual deductions and credits and increases others. Two significant changes include temporarily repealing personal exemptions and temporarily increasing the standard deduction. The TCJA also doubles the exemption amount for the estate and gift tax. Most of the changes to the taxation of individuals are effective for tax years beginning after December 31, 2017 and ending before January 1, 2026.[2]

Note. The time period during which the TCJA is in effect (tax years beginning after December 31, 2017 and ending before January 1, 2026), is referred to as the **TCJA period** in this section. At the time these materials were prepared, legislation was being discussed that would make many of the individual changes permanent.

The following material summarizes the most significant provisions in the TCJA that affect individual taxpayers.

Note. The TCJA also makes significant changes to business income taxation. These changes are explained in the 2018 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: New Legislation — Business Concerns.

TAXES AND RETURNS

Income Tax Rates

Old Law. Seven income tax rates apply to individual taxpayers. These rates are 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%.

New Law. The 2018 tax rates are shown in the following tables.

Single Taxpayers

Income Range	Tax Rate
$0 to $9,525	10%
Over $9,525 but not over $38,700	12%
Over $38,700 but not over $82,500	22%
Over $82,500 but not over $157,500	24%
Over $157,500 but not over $200,000	32%
Over $200,000 but not over $500,000	35%
Over $500,000	37%

1. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20 Statement.pdf] Accessed on Jan. 4, 2018; *The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law.* Sherlock, Molly F. and Marples, Donald J. Feb. 6, 2018. Congressional Research Service. [fas.org/sgp/crs/misc/R45092.pdf] Accessed on Feb. 14, 2018.

2. *Joint Committee on Taxation, Macroeconomic Analysis of the Conference Agreement for H.R. 1, the "Tax Cuts and Jobs Act"* (JCX-69-17), Dec. 22, 2017.

Heads of Household (HoH)

Income Range	Tax Rate
$0 to $13,600	10%
Over $13,600 but not over $51,800	12%
Over $51,800 but not over $82,500	22%
Over $82,500 but not over $157,500	24%
Over $157,500 but not over $200,000	32%
Over $200,000 but not over $500,000	35%
Over $500,000	37%

Married Filing Joint Returns (MFJ) and Surviving Spouses

Income Range	Tax Rate
$0 to $19,050	10%
Over $19,050 but not over $77,400	12%
Over $77,400 but not over $165,000	22%
Over $165,000 but not over $315,000	24%
Over $315,000 but not over $400,000	32%
Over $400,000 but not over $600,000	35%
Over $600,000	37%

Married Filing Separate Returns (MFS)

Income Range	Tax Rate
$0 to $9,525	10%
Over $9,525 but not over $38,700	12%
Over $38,700 but not over $82,500	22%
Over $82,500 but not over $157,500	24%
Over $157,500 but not over $200,000	32%
Over $200,000 but not over $300,000	35%
Over $300,000	37%

Trusts and Estates

Income Range	Tax Rate
$0 to $2,550	10%
Over $2,550 but not over $9,150	24%
Over $9,150 but not over $12,500	35%
Over $12,500	37%

The rate structures shown in these tables do not apply to tax years beginning after the TCJA period.

The 3.8% tax on net investment income remains in effect.

Capital Gains Rates

Old Law. Capital gains and qualified dividends are taxed at the following rates for individual taxpayers.

Taxpayer's Regular Income Tax Rate	Capital Gain Rate
10% or 15%	0%
25%, 28%, 33%, or 35%	15%
39.6%	20%

New Law. The tax rates on net capital gains and qualified dividends are generally unchanged. The breakpoints between the 0% and 15% capital gains rates are based on the same amounts as the breakpoints in effect before passage of the TCJA. These breakpoints have been indexed for inflation. The 0%, 15%, and 20% capital gains rates apply to taxpayers with taxable income in the ranges shown in the following table.[3]

Filing Status	0%	15%	20%
MFJ or surviving spouse	$0–$77,200	$77,201–$479,000	Over $479,000
HoH	0– 51,700	51,701– 452,400	Over 452,400
MFS	0– 38,600	38,601– 239,500	Over 239,500
All other individuals	0– 38,600	38,601– 425,800	Over 425,800
Estates and trusts	0– 2,600	2,601– 12,700	Over 12,700

Alternative Minimum Tax

Old Law. An alternative minimum tax (AMT) is imposed on individual taxpayers in an amount by which the tentative minimum tax exceeds the regular income tax for the tax year. Individuals are allowed to exempt a certain amount of income from AMT. For tax years beginning in 2017, the AMT exemption amounts are:

- $84,500 for MFJ taxpayers and surviving spouses,
- $54,300 for single taxpayers and HoH, and
- $42,250 for MFS taxpayers.

For tax years beginning in 2017, the exemption amounts are phased out by 25% of the amount by which the individual's alternative minimum taxable income (AMTI) exceeds:

- $160,900 for MFJ taxpayers and surviving spouses,
- $120,700 for single taxpayers and HoH, and
- $80,450 for MFS taxpayers.

A taxpayer's AMTI is calculated by increasing the taxpayer's taxable income by certain preference items and is further modified by AMT adjustments. These adjustments include, but are not limited to, the following.

- Miscellaneous itemized deductions are not allowed.
- Itemized deductions for state and local taxes are not allowed.
- The standard deduction and the deduction for personal exemptions are not allowed.

3. IRC §1(j)(5)(B).

New Law. For years within the TCJA period, the AMT exemption is increased to:

- $109,400 for MFJ taxpayers and surviving spouses,
- $70,300 for single taxpayers and HoH, and
- $54,700 for MFS taxpayers.

The income phaseout thresholds for the AMT exemption are increased to:

- $1 million for MFJ taxpayers and surviving spouses, and
- $500,000 for all other taxpayers.

The AMT exemption and income phaseout amounts are indexed for inflation.

As discussed later, miscellaneous itemized deductions subject to the 2% floor are not allowed for regular tax purposes for tax years in the TCJA period. Therefore, no further adjustment for such expenses is needed for purposes of calculating AMT.

> **Note.** For 2018, the exemption amount for trusts and estates is $24,600, and the phaseout threshold is $500,000.[4]

> **Note.** The corporate AMT is completely repealed for tax years beginning after December 31, 2017. For more information, see the 2018 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: New Legislation — Business Concerns.

Kiddie Tax

Old Law. A "kiddie tax" is imposed on the net unearned income of certain children. The kiddie tax applies if: [5]

- The child is either under age 18 by the end of the tax year, is under age 19 and does not provide more than half of their own support with their earned income, or is a full-time student under age 24 and does not provide more than half of their own support with their earned income;
- Either of the child's parents is alive at the end of the tax year;
- The child's unearned income exceeds $2,100 (for 2017); and
- The child does not file a joint return.

Under the kiddie tax rules, the child's net unearned income (unearned income over $2,100 for 2017) is taxed at the parents' tax rates if the parents' tax rates are higher than that of the child. The rest of a child's taxable income is taxed at the child's rates.

> **Note.** A dependent who has both earned and unearned income generally must file a return if the dependent's gross income is the greater of $1,050, or $350 plus the dependent's earned income, up to a maximum of $6,350 for 2017.[6] This is the amount of the dependent's standard deduction.

4. Rev. Proc. 2018-18, 2018-10 IRB 392.
5. IRC §1(g).
6. IRS Pub. 929, *Tax Rules for Children and Dependents.*

New Law. The TCJA simplifies the kiddie tax by applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. Taxable income attributable to net **unearned income** is taxed under the brackets that apply to trusts and estates, and **earned income** is taxed at rates and brackets that apply to unmarried taxpayers. Therefore, the child's tax is unaffected by the tax of the child's parent or the unearned income of the child's siblings. The unearned income threshold remains $2,100. This provision applies to tax years within the TCJA period.

Note. For tax years beginning in 2018, the standard deduction amount for an individual who can be claimed as a dependent by another taxpayer cannot exceed the greater of $1,050, or the sum of $350 and the individual's earned income.[7]

Example 1. In 2018, Steve, age 15, has $1,600 of earned income from working for his father and $6,000 of rental income from his interest in his grandfather's limited liability limited partnership (LLLP).

Steve's standard deduction is $1,950 ($1,600 earned income + $350). Steve's taxable income is $5,650 ($1,600 earned income + $6,000 rental income – $1,950 standard deduction), all taxed as unearned income because his standard deduction of $1,950 is greater than his earned income of $1,600.

The first $2,100 is below the kiddie tax threshold and is taxed at single taxpayer rates. The remaining taxable income is taxed at trust and estate rates.

Steve's tax liability is calculated as follows.

Amount		Rate		Tax
$2,100	×	10% (single taxpayer rate)	=	$210
2,550	×	10% (trust and estate rate)	=	255
1,000	×	24% (trust and estate rate)	=	240
$5,650				$705

The trust and estate rates and brackets are shown earlier in the chapter.

Inflation Adjustment

Old Law. Many provisions in the Code are adjusted for inflation. Most of the adjustments are based on annual changes in the level of the consumer price index for all urban consumers (CPI-U). The CPI-U measures prices paid by typical urban consumers on a broad range of products.

The individual income tax provisions that are adjusted for inflation include the following.

- Regular income tax brackets
- Basic standard deduction
- Additional standard deduction for the aged and the blind
- Personal exemption amount
- Thresholds for the limitation on itemized deductions and the personal exemption phaseout
- The phasein and phaseout thresholds of the earned income credit
- Individual retirement arrangement (IRA) contribution limits and deductible amounts
- Saver's credit

7. Rev. Proc. 2018-18, 2018-10 IRB 392.

New Law. The TCJA requires the use of the chained consumer price index for all urban consumers (C-CPI-U) to adjust tax provisions that were previously indexed by the CPI-U. The C-CPI-U differs from the CPI-U in that it accounts for the ability of individuals to alter their consumption patterns in response to relative price changes. The C-CPI-U does this by providing for consumer substitution between item categories in the market basket of consumer goods and services that make up the index. In contrast, the CPI-U only allows for modest substitution within categories. For example, pork and beef are two separate item categories. If the price of beef remains stable while the price of pork increases, consumers may buy more beef and less pork. In this situation, the C-CPI-U would rise, but at a lower rate than an index based on fixed purchase patterns.[8]

The switch to the C-CPI-U takes effect for tax years beginning after December 31, 2017. **This provision is permanent.**

> **Note.** According to the Congressional Budget Office, the C-CPI-U results in lower estimates of inflation than the CPI-U does.[9] One of the effects of this provision is that taxpayers will pay more taxes than they would without the change. The Joint Committee on Taxation estimates that tax revenues for the 2018–2027 fiscal years will increase by approximately $134 billion because of this change in indexing.[10]

Repeal of ACA Individual Mandate

Old Law. The Affordable Care Act (ACA) mandates that individuals be covered by health insurance that provides minimum essential coverage (MEC). Individuals who do not have MEC are subject to a tax (also referred to as a penalty). This tax is imposed for any month that an individual does not have MEC unless they qualify for an exemption.

New Law. Effective January 1, 2019, the tax imposed on individuals who do not maintain health insurance that provides at least MEC is reduced to zero.

No other ACA provisions were affected by the TCJA. Therefore, applicable large employers who fail to offer MEC to their employees may still be subject to shared responsibility payments under IRC §4980H. In addition, individual taxpayers who do not have MEC are not eligible for the premium tax credit.

> **Note.** For more information about minimum essential coverage, the individual mandate, the premium tax credit, and other aspects of the ACA, see the 2015 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: New Developments and the 2014 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 3: Affordable Care Act Update. These can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

8. *Frequently Asked Questions about the Chained Consumer Price Index for All Urban Consumers.* Jun. 29, 2016. Bureau of Labor Statistics. [www.bls.gov/cpi/additional-resources/chained-cpi-questions-and-answers.htm] Accessed on Mar. 5, 2018.

9. *Differences Between the Traditional CPI and the Chained CPI.* McClelland, Rob. Apr. 19, 2013. Congressional Budget Office. [www.cbo.gov/publication/44088] Accessed on Dec. 19, 2017.

10. Joint Committee on Taxation, *Estimated Revenue Effects of the "Tax Cuts and Jobs Act" As ordered Reported by the Committee on Finance on November 16, 2017.* JCX-59-17 (Nov. 17, 2017); *The Hutchins Center Explains: The Chained CPI.* Ng, Michael and Wessel, David. Dec. 7, 2017. Brookings Institution. [www.brookings.edu/blog/up-front/2017/12/07/the-hutchins-center-explains-the-chained-cpi/] Accessed on Dec. 19, 2017.

HoH Preparer Due Diligence Requirement

Old Law. Tax return preparers must comply with due diligence requirements when they prepare returns claiming any of the following credits to ensure that clients who claim these credits are eligible.[11]

- Earned income credit
- Child tax credit
- Additional child tax credit
- American opportunity credit

Tax return preparers who are paid to prepare a claim for any of these credits must complete Form 8867, *Paid Preparer's Due Diligence Checklist.* The tax preparer must submit this form with every electronic or paper return or claim for refund for any of these credits. Tax return preparers who fail to comply with due diligence requirements are subject to a $500 penalty for each such failure. The penalty amount is adjusted annually for inflation.

New Law. Effective for tax years beginning after December 31, 2017, tax return preparers are required to exercise due diligence in determining eligibility for HoH filing status. Preparers failing to comply with this requirement are subject to a $520 penalty for each such failure. This amount is adjusted annually for inflation.[12] **This provision is permanent.**

On July 18, 2018, the IRS issued proposed regulations that detail the rules for the tax return due diligence penalty.[13] The proposed regulations can be found at **uofi.tax/18a1x2** [www.irs.gov/irb/2018-32_IRB#REG-103474-18].

Following is a draft version of the 2018 Form 8867.

11. *Refundable Credit Due Diligence Law.* IRS. [www.eitc.irs.gov/tax-preparer-toolkit/preparer-due-diligence/due-diligence-law/eitc-due-diligence-law-and-regulation] Accessed on Mar. 6, 2018.

12. IRC §6695(g); Rev. Proc. 2018-18, 2018-10 IRB 392.

13. REG 103474-18, IRB 2018-32.

Form **8867**

Department of the Treasury
Internal Revenue Service

Paid Preparer's Due Diligence Checklist

Earned Income Credit (EIC), American Opportunity Tax Credit (AOTC), Child Tax Credit (CTC) (including the Additional Child Tax Credit (ACTC) and Credit for Other Dependents (ODC)), and Head of Household (HOH) Filing Status

▶ To be completed by preparer and filed with Form 1040, 1040NR, 1040SS, or 1040PR.

▶ Go to *www.irs.gov/Form8867* for instructions and the latest information.

OMB No. 1545-0074

2018

Attachment Sequence No. **70**

Taxpayer name(s) shown on return | **Taxpayer identification number**

Enter preparer's name and PTIN

Part I **Due Diligence Requirements**

Please check the appropriate box for the credit(s) and/or HOH filing status claimed on this return and complete the related Parts I–V for the benefit(s), and/or HOH filing status claimed (check all that apply).	EIC	CTC/ ACTC/ODC	AOTC	HOH
	☐	☐	☐	☐

1	Did you complete the return based on information for tax year 2018 provided by the taxpayer or reasonably obtained by you?	☐ **Yes**	☐ **No**	
2	If credits are claimed on the return, did you complete the applicable EIC and/or CTC/ACTC worksheets found in the Form 1040, 1040SS, 1040PR, or 1040NR instructions, and/or the AOTC worksheet found in the Form 8863 instructions, or your own worksheet(s) that provides the same information, and all related forms and schedules for each credit claimed?	☐ **Yes**	☐ **No**	☐ **N/A**
3	Did you satisfy the knowledge requirement? To meet the knowledge requirement, you must do both of the following. • Interview the taxpayer, ask questions, and document the taxpayer's responses to determine that the taxpayer is eligible to claim the credit(s) and/or HOH filing status. • Review information to determine that the taxpayer is eligible to claim the credit(s) and/or HOH filing status and the amount of any credit(s) claimed.	☐ **Yes**	☐ **No**	
4	Did any information provided by the taxpayer or a third party for use in preparing the return, or information reasonably known to you, appear to be incorrect, incomplete, or inconsistent? (If "Yes," answer questions 4a and 4b. If "No," go to question 5.)	☐ **Yes**	☐ **No**	
a	Did you make reasonable inquiries to determine the correct, complete, and consistent information?	☐ **Yes**	☐ **No**	
b	Did you document your inquiries? (Documentation should include the questions you asked, whom you asked, when you asked, the information that was provided, and the impact the information had on your preparation of the return.)	☐ **Yes**	☐ **No**	
5	Did you satisfy the record retention requirement? To meet the record retention requirement, you must keep a copy of your documentation referenced in 4b, a copy of this Form 8867, a copy of any applicable worksheet(s), a record of how, when, and from whom the information used to prepare Form 8867 and any applicable worksheet(s) was obtained, and a copy of any document(s) provided by the taxpayer that you relied on to determine eligibility for the credit(s) and/or HOH filing status or to compute the amount of the credit(s)	☐ **Yes**	☐ **No**	
	List those documents, if any, that you relied on.			
6	Did you ask the taxpayer whether he/she could provide documentation to substantiate eligibility for the credit(s) and/or HOH filing status and the amount of any credit(s) claimed on the return if his/her return is selected for audit?	☐ **Yes**	☐ **No**	
7	Did you ask the taxpayer if any of these credits were disallowed or reduced in a previous year? . . . . (If credits were disallowed or reduced, go to question 7a; if not, go to question 8.)	☐ **Yes**	☐ **No**	☐ **N/A**
a	Did you complete the required recertification Form 8862?	☐ **Yes**	☐ **No**	☐ **N/A**
8	If the taxpayer is reporting self-employment income, did you ask questions to prepare a complete and correct Form 1040, Schedule C?	☐ **Yes**	☐ **No**	☐ **N/A**

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 26142H Form **8867** (2018)

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Part II **Due Diligence Questions for Returns Claiming EIC** (If the return does not claim EIC, go to Part III.)

		EIC	CTC/ ACTC/ODC	AOTC	HOH
9a	Have you determined that this taxpayer is, in fact, eligible to claim the EIC for the number of children for whom the EIC is claimed, or to claim the EIC if the taxpayer has no qualifying child? (Skip 9b and 9c if the taxpayer is claiming the EIC and does not have a qualifying child.)	☐ **Yes** ☐ **No**			
b	Did you explain to the taxpayer that he/she may not claim the EIC if the taxpayer has not lived with the child for over half of the year, even if the taxpayer has supported the child?	☐ **Yes** ☐ **No**			
c	Did you explain to the taxpayer the rules about claiming the EIC when a child is the qualifying child of more than one person (tiebreaker rules)?	☐ **Yes** ☐ **No** ☐ **N/A**			

Part III **Due Diligence Questions for Returns Claiming CTC/ACTC/ODC** (If the return does not claim CTC, ACTC, or ODC, go to Part IV.)

		EIC	CTC/ ACTC/ODC	AOTC	HOH
10	Have you determined that each qualifying person for the CTC/ACTC/ODC is the taxpayer's dependent who is a citizen, national, or resident of the United States?		☐ **Yes** ☐ **No**		
11	Did you explain to the taxpayer that he/she may not claim the CTC/ACTC if the taxpayer has not lived with the child for over half of the year, even if the taxpayer has supported the child, unless the child's custodial parent has released a claim to exemption for the child?		☐ **Yes** ☐ **No** ☐ **N/A**		
12	Did you explain to the taxpayer the rules about claiming the CTC/ACTC/ODC for a child of divorced or separated parents (or parents who live apart), including any requirement to attach a Form 8332 or similar statement to the return?		☐ **Yes** ☐ **No** ☐ **N/A**		

Part IV **Due Diligence Questions for Returns Claiming AOTC** (If the return does not claim AOTC, go to Part V.)

		EIC	CTC/ ACTC/ODC	AOTC	HOH
13	Did the taxpayer provide the required substantiation for the credit, including a Form 1098-T and/or receipts for the qualified tuition and related expenses for the claimed AOTC?			☐ **Yes** ☐ **No**	

Part V **Due Diligence Questions for Claiming HOH** (If the return does not claim HOH filing status, go to Part VI.)

		EIC	CTC/ ACTC/ODC	AOTC	HOH
14	Have you determined that the taxpayer was unmarried or considered unmarried on the last day of the tax year and provided more than half of the cost of keeping up a home for the year for a qualifying person?				☐ **Yes** ☐ **No**

Part VI **Eligibility Certification**

► **You will have complied with all due diligence requirements for claiming the applicable credit(s) and/or HOH filing status on the return of the taxpayer identified above if you:**

A. Interview the taxpayer, ask adequate questions, document the taxpayer's responses on the return or in your notes, review adequate information to determine if the taxpayer is eligible to claim the credit(s) and/or HOH filing status and to determine the amount of the credit(s) claimed;

B. Complete this Form 8867 truthfully and accurately and complete the actions described in this checklist for any applicable credit(s) claimed and HOH filing status, if claimed;

C. Submit Form 8867 in the manner required; **and**

D. Keep all five of the following records for 3 years from the latest of the dates specified in the Form 8867 instructions under *Document Retention.*

1. A copy of Form 8867,
2. The applicable worksheet(s) or your own worksheet(s) for any credit(s) claimed,
3. Copies of any taxpayer documents you may have relied upon to determine eligibility for the credit(s) and/or HOH filing status,
4. A record of how, when, and from whom the information used to prepare this form and the applicable worksheet(s) was obtained, and
5. A record of any additional questions you may have asked to determine eligibility for and the amount of the credit(s) and/or eligibility for HOH filing status, and the taxpayer's answers.

► **If you have not complied with all due diligence requirements, you may have to pay a $520 penalty for each failure to comply related to a claim of an applicable credit or HOH filing status.**

15	Do you certify that all of the answers on this Form 8867 are, to the best of your knowledge, true, correct, and complete?	☐ **Yes** ☐ **No**

Form **8867** (2018)

INCOME AND EXCLUSIONS

Alimony

Old Law. Alimony payments and separate maintenance payments are deductible by the payor spouse[14] and must be included in the income of the recipient spouse.[15]

New Law. The TCJA **permanently** repeals the deduction for alimony and separate maintenance payments by the payor spouse and the inclusion in income by the recipient spouse for the following situations.

- Divorce or separation instruments executed after December 31, 2018
- Pre-January 1, 2019 agreements modified after December 31, 2018, if the modification expressly provides that the repeal applies

Note. For more information about the tax implications of alimony, see the 2018 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 5: Divorce.

Recharacterization of IRA Contributions

Old Law. Individuals can make contributions to two types of IRAs: traditional IRAs,[16] to which both deductible and nondeductible contributions can be made;[17] and Roth IRAs, to which only nondeductible contributions can be made.[18] The principal difference between traditional IRAs and Roth IRAs is that traditional IRAs are generally funded with pretax contributions and Roth IRAs with after-tax contributions.

Under previous law, contributions could be recharacterized from one type of IRA to another before the due date (including extension) for the individual's income tax return for that year. This allowed a taxpayer to elect to treat a contribution made to one type of IRA as being made to the other type of IRA. Taxpayers could convert and reconvert between the two types of IRAs to reduce their tax liability.

Example 2. In January 2017, Alicia established a traditional IRA. In March 2017, on the advice of her brother, she converted the traditional IRA to a Roth IRA. In April 2017, her tax accountant informed her that a traditional IRA would allow her to reduce her tax liability, so she reconverted the Roth to a traditional IRA.

New Law. When an individual makes a contribution to a traditional IRA and later converts the traditional IRA to a Roth IRA, the TCJA precludes unwinding the conversion through a recharacterization. This provision is effective for tax years beginning after December 31, 2017, and is **permanent.**

Example 3. Use the same facts as **Example 2,** except Alicia establishes the traditional IRA in January 2018 and converts it to a Roth IRA in March 2018. She cannot reconvert the Roth to a traditional IRA.

Recharacterization is still permitted for other contributions. For example, an individual can make a contribution to a Roth IRA and recharacterize it as a contribution to a traditional IRA before the due date (including extension) for the individual's tax return for that year.

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14. IRC §§62(a)(10) and 215.
15. IRC §61(a)(8).
16. IRC §408.
17. IRC §§219(a) and 408(o).
18. IRC §408A.

Rollover of Plan Loans

Old Law. Qualified retirement plans, 403(b) plans, and governmental 457(b) plans may provide loans to employees. A plan may provide that an employee's obligation to repay a loan can be accelerated in certain circumstances, such as the termination of employment. If the loan is not repaid in accordance with the terms of the loan, the loan is canceled and the amount in the employee's account balance is offset by the unpaid loan balance (referred to as the **loan offset).** A loan offset is treated as a distribution from the plan equal to the unpaid loan balance. The distribution is includable in the employee's gross income and may be subject to the 10% additional tax on early distributions under IRC §72(t). To prevent a loan offset from resulting in a taxable distribution, the loan offset amount may be rolled over tax-free to another eligible retirement plan within 60 days of the loan offset. However, the plan is not required to offer a direct rollover of a plan loan offset amount.

New Law. For plan loan offset amounts treated as distributed in years beginning after December 31, 2017, the TCJA increases the time period during which a qualified plan loan offset amount can be contributed to an eligible retirement plan. Under the new rules, the contribution can be made at any time up to the filing due date (including extensions) of the tax return for the tax year in which the loan offset occurs. However, this time extension only applies when the loan offset amount occurred as a result of:

- Termination of the plan, or
- Failure to meet loan repayment terms due to the employee's severance from employment.

This provision is permanent.

Discharge of Student Loans

Old Law. A taxpayer's gross income generally includes a discharge of the taxpayer's indebtedness. However, a taxpayer's gross income does not include any amount from the forgiveness of certain student loans in the following circumstances.[19]

- The taxpayer works for a certain period in certain professions for a broad class of employers.
- The loans are made by educational organizations (and certain tax-exempt organizations if the loan is refinanced) if the loan proceeds are used to pay costs of attendance at an educational institution or to refinance any outstanding student loans and the student is not employed by the lender organization.
- The loan repayment amount is made under the National Health Service Corps loan repayment program or certain state loan repayment programs that are intended to provide for the increased availability of healthcare services in underserved or health professional shortage areas.

New Law. The TCJA modifies the exclusion of student loan discharges from gross income by allowing exclusions of certain discharges because of the **death or the total and permanent disability** of the student. The exclusions available under the old law still apply.

Loans eligible for the exclusion under the TCJA are those made by:

- The United States (or an instrumentality or agency thereof);
- A state (or any political subdivision of a state);
- Certain tax-exempt public benefit corporations that control a state, county, or municipal hospital and whose employees have been deemed to be public employees under state law;
- An educational organization that originally received the funds from which the loan was made from the United States, a state, or a tax-exempt public benefit corporation; or
- Private education loans as defined in section 140(7) of the Consumer Protection Act.

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19. IRC §108(f).

Example 4. In January 2018, Janelle had a federal student loan with an outstanding balance of $10,000. In February, Janelle was totally and permanently disabled as the result of a skiing accident. The government forgave the loan balance because of her disability. None of the forgiven indebtedness is includable in Janelle's gross income.

The provision applies to discharges of loans occurring **only during the TCJA period.**

Bicycle Commuting

Old Law. Qualified bicycle commuting reimbursements of up to $20 per month are excludable from an employee's gross income.[20] Amounts that are excluded from an employee's gross income for income tax purposes are also excluded from wages for employment tax purposes.

New Law. The TCJA suspends the exclusion from gross income and wages for qualified bicycle commuting reimbursements. The exclusion is not allowed for tax years within the TCJA period.

Moving Expense Deduction/Reimbursement

Old Law. Employer reimbursements for qualified moving expenses are generally excludable from an employee's gross income.[21] Additionally, taxpayers can claim an above-the-line deduction for moving expenses incurred as a result of employment (or self-employment) at a new location if certain conditions are met.[22]

New Law. The deduction for moving expenses and the exclusion from gross income of qualified moving expense reimbursements are suspended for the TCJA period except for members of the Armed Services. The moving expense tax deduction is retained for members of the Armed Services on active duty (or their spouses or dependents). Moreover, the rules for exclusion of in-kind moving and storage expenses (and reimbursements or allowances for these expenses) are also retained. However, the move must be pursuant to a military order and incident to a permanent change of station.

The suspension of the moving expense deduction applies only during the TCJA period.

Modification of Rules for 529 Qualified Tuition Programs

Old Law. Under a 529 qualified tuition program (QTP), a taxpayer can establish an account for the benefit of a designated beneficiary to provide for that beneficiary's qualified **higher education expenses.** For purposes of receiving a tax-free distribution from a QTP, qualified higher education expenses include the following.

- Tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution
- Special-needs services incurred in connection with the enrollment or attendance of a special-needs beneficiary
- Room and board for students who are enrolled at least half-time
- Purchase of computer technology or equipment, or Internet access or related services, if the technology or services is used primarily by the beneficiary during any of the years the beneficiary is enrolled at an eligible institution

No specific dollar limit is imposed on contributions to qualified tuition accounts. However, the QTP must have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary's qualified higher education expenses. Contributions are not deductible for federal income tax purposes, but they may be deductible for state tax purposes. The earnings on the contributions are not taxable for federal tax purposes.

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20. IRC §132(f)(1)(D).

21. IRC §132(a)(6).

22. IRC §217.

New Law. The TCJA modifies 529 QTPs to allow such plans to distribute tax free up to $10,000 in expenses for tuition incurred during the tax year for enrollment or attendance of the designated beneficiary at a public, private, or religious **elementary or secondary school.** This limit applies on a per-student basis, rather than a per-account basis. Accordingly, an individual may be the designated beneficiary of multiple accounts but may receive no more than $10,000 in tax-free distributions.

This provision applies to distributions made after December 31, 2017, and is **permanent.**

On July 29, 2018, the IRS and the Treasury issued a notice announcing that they intend to define "elementary or secondary" to mean kindergarten through grade 12 as determined under state law, consistent with the definition for Coverdell education savings account.[23]

Note. State rules for QTPs may not allow distributions for elementary or secondary school tuition expenses.

DEDUCTIONS AND CREDITS

Increase in Standard Deduction

Old Law. The standard deduction amount varies depending on the taxpayer's filing status and is adjusted for inflation annually. Before the TCJA was passed, the standard deduction for 2018 would have been $6,500 for single taxpayers, $9,550 for HoH taxpayers, and $13,000 for MFJ taxpayers. The additional standard deduction amount for the elderly or the blind is $1,300. This additional standard deduction is $1,600 if the individual is unmarried and not a surviving spouse.[24]

New Law. The standard deduction is **temporarily increased** for individuals in all filing statuses. The amount of the standard deduction is indexed for inflation for tax years beginning after December 31, 2018. These increased deductions do not apply to tax years beyond the TCJA period.

The additional standard deduction for the elderly and the blind remains at $1,300. The additional standard deduction remains at $1,600 if the taxpayer is unmarried and not a surviving spouse.

The 2018 amounts are shown in the following table.

Filing Status	Standard Deduction	Elderly	Blind
MFJ	$24,000	$1,300	$1,300
HoH	18,000	1,600	1,600
Unmarried and not surviving spouse	12,000	1,600	1,600
All other individual taxpayers	12,000	1,300	1,300

Personal Exemptions

Old Law. A taxpayer calculates taxable income by subtracting from their adjusted gross income (AGI) the appropriate number of personal exemptions (i.e., for the taxpayer, spouse, and dependents) multiplied by the personal exemption amount and either the standard deduction or the total itemized deductions. Before the TCJA was enacted, the personal exemption amount would have been $4,150 for 2018.[25]

New Law. Effective with the 2018 tax year, the personal exemption amount is zero for income tax purposes during the TCJA period. The suspension of personal exemptions does not apply after the TCJA period.

23. IRS News Release IR-2018-156 (Jul. 30, 2018); Notice 2018-58.

24. Rev. Proc. 2017-58, 2017-45 IRB 489.

25. Ibid.

Child Tax and Family Credit[26]

Old Law. A taxpayer can claim a nonrefundable child tax credit (CTC) of up to $1,000 per qualifying child. The CTC begins to phase out for taxpayers with modified adjusted gross income (MAGI) over $75,000 for single taxpayers, $110,000 for MFJ taxpayers, or $55,000 for MFS taxpayers.

To the extent that the CTC exceeds the taxpayer's tax liability, the taxpayer can qualify for a refundable additional child tax credit (ACTC) equal to 15% of earned income in excess of $3,000. The maximum ACTC is $1,000 per child.

Taxpayers who claim the CTC and the ACTC must provide the taxpayer identification number of each qualifying child. This identification number is generally the child's social security number (SSN) or individual taxpayer identification number (ITIN). The identification number must have been issued on or before the tax return due date.

New Law. The CTC is increased to $2,000 per qualifying child. The maximum refundable ACTC amount is $1,400 per qualifying child. The ACTC earned income threshold is reduced to $2,500. The maximum ACTC amount will be adjusted for inflation beginning in 2019. All other inflation parameters related to the child credit are not indexed for inflation.

In order to receive this credit, the taxpayer must include an SSN for each qualifying child on the tax return. The SSN must have been issued before the tax return due date.

The previous-law age limit for a qualifying child is retained. Therefore, a qualifying child is an individual who has not attained age 17 during the tax year.

The credit is further modified to provide a $500 nonrefundable credit for qualifying dependents other than qualifying children. The definition of "dependent" is unchanged from previous law. An SSN is **not** required for non-child dependents for whom the $500 credit is claimed. A qualifying child who is ineligible for the child tax credit because the child did not have an SSN may qualify for the nonrefundable $500 credit.

The credit phases out for MFJ taxpayers with MAGI in excess of $400,000. For all other taxpayers, the phaseout range begins at $200,000. These thresholds are **not indexed for inflation.**

The modified credit provisions apply to tax years within the TCJA period.

Deduction for Medical Expenses

Old Law. An individual could claim an itemized deduction for unreimbursed medical expenses to the extent that such expenses exceed 10% of the taxpayer's AGI.[27] For tax years beginning after December 31, 2012, and ending before January 1, 2017, the 10% threshold was reduced to 7.5% for taxpayers who attained the age of 65 before the end of the tax year. For MFJ taxpayers, the 7.5% threshold applied if either spouse attained the age of 65 before the end of the tax year.[28]

New Law. For tax years beginning after December 31, 2016, and ending before January 1, 2019, taxpayers can claim an itemized deduction for unreimbursed medical expenses that exceed 7.5% of AGI. All taxpayers regardless of age are eligible for the 7.5% threshold, which applies for both AMT and regular tax purposes. The threshold reverts to 10% of AGI for tax years beginning after December 31, 2018.

26. IRC §24.

27. IRC §213(a).

28. IRC §213(f)(1).

State and Local Taxes

Old Law. Individuals are allowed to claim a deduction for certain taxes, regardless of whether they are incurred in a taxpayer's trade or business. These taxes include the following.

- State and local real and foreign property taxes
- State and local personal property taxes
- State, local, and foreign income, war profits, and excess profits taxes

A taxpayer can elect to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes.

A taxpayer may be allowed a deduction in calculating their AGI if the taxes are incurred in connection with property used in a trade or business. Otherwise, such taxes are an itemized deduction.

New Law. Under the TCJA, an individual may generally deduct state, local, and foreign property taxes, and sales taxes that are deductible in calculating the individual's income on Schedule C, *Profit or Loss From Business;* Schedule E, *Supplemental Income and Loss;* or Schedule F, *Profit or Loss from Farming*. Therefore, an individual may generally deduct such items only if the taxes were imposed on business assets.

The TCJA contains an **exception to the preceding rule.** Under this exception, a taxpayer may claim an itemized deduction on Schedule A, *Itemized Deductions,* of up to $10,000 ($5,000 for MFS taxpayers) of the total amount paid for:

- State and local property taxes not paid in carrying on a trade or business; and
- State, local , and foreign income taxes (or sales taxes in lieu of income taxes), war profits, and excess profit taxes.

A taxpayer cannot deduct foreign real property taxes.

This provision applies to tax years within the TCJA period. Furthermore, an individual cannot claim an itemized deduction for 2017 on a prepayment of **state income tax** for a future tax year in order to avoid the dollar limitation applicable to tax years beginning after 2017. This provision does not eliminate the deduction for prepayment of current year estimated state income tax due on January 15 of the following year, paid prior to December 31 of the current year.

On December 27, 2017, the IRS issued an advisory in response to questions from tax professionals concerning the deductibility of **prepaid real property taxes.** The advisory states that "whether a taxpayer is allowed a deduction for the prepayment of state or local real property taxes in 2017 depends on whether the taxpayer makes the payment in 2017 and the real property taxes are assessed prior to 2018. A prepayment of anticipated real property taxes that have not been assessed prior to 2018 are not deductible in 2017. State or local law determines whether and when a property tax is assessed, which is generally when the taxpayer becomes liable for the property tax imposed." The following examples are based on examples found in the December 2017 IRS New Release IR-2017-210.

Example 5. Adkins County assesses property tax on July 1, 2017, for the period July 1, 2017, through June 30, 2018. On July 31, 2017, Adkins County sends notices to residents notifying them of the assessment and billing the property tax in two installments. The first installment is due September 30, 2017, and the second installment is due January 31, 2018. The taxpayer paid the first installment in 2017. They may choose to pay the second installment on December 31, 2017, and may claim a deduction for this prepayment on their 2017 return.

Example 6. Brown County assesses and bills its residents for property taxes on July 1, 2017, for the period July 1, 2017 through June 30, 2018. Brown County intends to make the usual assessment in July 2018 for the period July 1, 2018 through June 30, 2019. However, because county residents wish to prepay their 2018–2019 property taxes in 2017, Brown County revised its computer systems to accept prepayment of property taxes for the 2018–2019 property tax year. Taxpayers who prepay their 2018–2019 property taxes in 2017 are not allowed to deduct the prepayment on their federal tax returns because the county does not assess the property tax for the 2018–2019 tax year until July 1, 2018.

Home Mortgage Interest Deduction

Old Law. Qualified residence interest is allowed as an itemized deduction, subject to limitations. Qualified residence interest is defined as interest paid or accrued during the tax year on either acquisition indebtedness or home equity indebtedness. A **qualified residence** is defined as the taxpayer's principal residence and one other residence of the taxpayer selected to be a qualified residence.[29]

Acquisition indebtedness is defined as indebtedness incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer and is secured by the residence.[30] The maximum amount that can be treated as acquisition indebtedness is $1 million ($500,000 for MFS taxpayers).

Home equity indebtedness is defined as indebtedness other than acquisition indebtedness secured by a qualified residence. The maximum amount of home equity indebtedness is $100,000 ($50,000 for MFS taxpayers) and cannot exceed the fair market value (FMV) of the residence reduced by the amount of the acquisition indebtedness. Interest on qualifying home equity indebtedness is deductible, regardless of how the loan proceeds are used.

New Law. For tax years within the TCJA period, a taxpayer may treat no more than $750,000 as acquisition indebtedness ($375,000 for MFS taxpayers).

For acquisition indebtedness incurred **before December 15, 2017,** the limit is $1 million ($500,000 for MFS taxpayers). If a taxpayer entered into a written binding contract before December 15, 2017, to close on the purchase of a principal residence before January 1, 2018, and purchased the residence before April 1, 2018, the $1 million limit ($500,000 for MFS taxpayers) applies.[31]

In addition, refinanced indebtedness is treated as incurred on the date that the original indebtedness was incurred to the extent that the amount of the debt resulting from the refinancing does not exceed the amount of the refinanced indebtedness.[32] Therefore, acquisition debt incurred prior to December 15, 2017, retains its status, even if the debt is refinanced. The maximum dollar amount that can be treated as principal residence acquisition indebtedness does not decrease because of refinancing.

> **Example 7.** Homer bought a house that he used for his principal residence in 2010. The original amount of his mortgage was $1 million. Over the years, he paid down the loan to $925,000, the outstanding mortgage balance on March 5, 2018. Homer refinanced the loan on March 5th for $975,000. He can only deduct interest on $925,000, because that was the mortgage balance on the date of refinancing.

The rule that applies the $1 million (or $500,000 for MFS taxpayers) limit to refinanced debt does not apply to either of the following. [33]

- Indebtedness after the original loan term expires
- If the principal of the original debt is not amortized over its term, the earlier of the date that the first refinancing of the debt expires or 30 years after the date of the first refinancing

For tax years beginning **after** theTCJA period, a taxpayer may treat up to $1 million ($500,000 for MFS taxpayers) as acquisition indebtedness.

29. IRC §163(h)(4)(A)(i).

30. IRC §163(h)(3)(B)(i).

31. IRC §163(h)(3)(F)(i)(IV).

32. IRC §163(h)(3)(F)(iii).

33. IRC §163(h)(3)(F)(iii)(II).

The TCJA suspends the deduction for interest on certain types of **home equity indebtedness.** Interest paid on home equity loans and home equity lines of credit is **not deductible unless the loans are used to buy, build, or substantially improve the taxpayer's home that secures the loan.**[34] This applies to tax years within the TCJA period. During these years, for example, interest on a home equity loan used to build an addition to an existing home is typically deductible, while interest on the same loan used to pay personal expenses is not.[35] The $750,000 limit ($375,000 for MFS taxpayers) applies to the combined amount of loans used to buy, build, or substantially improve the taxpayer's principal residence and second home (if applicable).[36]

Example 8. In March 2018, Joy took out a $500,000 mortgage to purchase a home that had an FMV of $800,000. She uses the home as her principal residence. In April 2018, Joy took out a $250,000 home equity loan to build an addition on the home. All of the interest Joy pays on the loans is deductible because the total amount of both loans does not exceed $750,000 and the loans were used to buy, build, or substantially improve her principal residence.[37]

Example 9. Use the same facts as **Example 8,** except Joy uses the proceeds from the home equity loan to pay off student loans and to finance a dream vacation to Europe. None of the interest on the home equity loan is deductible.

Example 10. Jake took out a $500,000 mortgage to purchase his principal residence in January 2018. The loan is secured by his principal residence. In July 2018, Jake took out a $250,000 loan to purchase a vacation home. The loan is secured by the vacation home. Because the total amount of both loans does not exceed $750,000, Jake can deduct all the interest paid on both loans.[38]

Because certain types of home equity debt are no longer treated as qualified residence debt, the deductibility of interest paid on such debt must now be determined under the interest-tracing rules.[39] Therefore, the interest on a home equity loan used for rental activities is deductible on Schedule E. Likewise, interest on a home equity loan used for trade or business activities is deductible on the sole proprietor's Schedule C.

Charitable Contributions of Cash

Old Law. Individual taxpayers who itemize their deductions can deduct charitable donations of cash or property to qualifying organizations. Limits apply to the total dollar amount that a taxpayer can deduct. Before the TCJA was enacted, most cash contributions were generally limited to 50% of the taxpayer's contribution base. The **contribution base** is the taxpayer's AGI, computed without any net operating loss (NOL) carryback to the tax year under IRC §172.[40] The limit applies to donations to charitable organizations described in IRC §170(b)(1)(A), which include public charities, private foundations other than nonoperating private foundations, and certain governmental units. Other limits may apply, depending on the type of organization to which the contribution was made and the type of property contributed.

A taxpayer who claims a deduction for a charitable contribution must maintain written records regarding the contribution. This rule applies regardless of the amount of the contribution. To claim a charitable deduction of $250 or more, a taxpayer must generally obtain contemporaneous written acknowledgement from the donee organization. However, under IRC §170(f)(8)(D), contemporaneous written acknowledgement is not required if the donee organization files a return with the IRS that reports the information to be included in an acknowledgement.

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34. IRS News Rel. IR-2018-32 (Feb. 21, 2018).
35. Ibid.
36. Ibid.
37. Adapted from an example in IRS News Rel. IR-2018-32 (Feb. 21, 2018).
38. Ibid.
39. Temp. Treas. Reg. §1.163-8T.
40. IRC §170(b)(1)(H).

New Law. Individuals may deduct **cash** contributions **up to 60%** (previously 50%) of their contribution base for charitable contributions to organizations described in IRC §170(b)(1)(A). The increased deduction limit applies to tax years within the TCJA period.[41] The amount disallowed because of the 60% limitation can be carried forward for five years.

The limits are summaraized in the following table.[42]

Contribution Base Percentage Limits for Individual Taxpayers

Donee Organization	Ordinary Income Property and Cash	Capital Gain Property to the Recipient	Capital Gain Property for Recipient Use
Public charities, private operating foundations, and private distributing foundations	60%	30%	20%
Nonoperating private foundations	30%	20%	20%

The 30% and 50% limits for a tax year are applied by reducing the allowable contribution limit (but not below zero) for that year by the total cash contributions allowed under the 60% limit for the year.[43]

> **Example 11.** In 2018, Elizabeth has a contribution base of $100,000. She makes cash contributions totaling $20,000 to various public charities. Elizabeth's cash contribution limit for 2018 is $60,000 ($100,000 × 60%). She also contributes a car worth $15,000 to a public charity in 2018. Elizabeth's limit on contributions of capital gain property to public charities (and other qualified organizations) is $30,000 ($100,000 × 30%) reduced by her $20,000 cash contributions. Therefore, Elizabeth's contribution limit for 30% property is $10,000. Elizabeth can deduct $10,000 of the car's value in 2018 and carry forward the remaining contribution of $5,000 ($15,000 value of car – $10,000 allowed in 2018) to subsequent years.

The TCJA repeals the exception under IRC §170(f)(8)(D) that contemporaneous written acknowledgement is not required if the donee organization files a return that includes the same information. Consequently, **contemporaneous written acknowledgement is now required** for all contributions of $250 or more made in tax years beginning after December 31, 2016.

Charitable Contributions for Athletic Seating Rights

Old Law. When a taxpayer receives or expects to receive a substantial return for a payment to charity, the payment is not deductible as a charitable contribution. However, a special rule applies to certain payments to institutions of higher education in exchange for the right to purchase tickets or seating at an athletic event. Taxpayers can deduct 80% of charitable contributions made to a college or university in exchange for the **right to purchase** tickets to athletic events. The cost of the tickets is not deductible.

New Law. Taxpayers can no longer take a charitable contribution deduction for any amount paid to an institution of higher education in exchange for the right to purchase tickets or seats at an athletic event. The denial of this contribution is effective for years beginning after December 31, 2017. **This provision is permanent.**

41. IRC §170(b)(1)(G)(i).

42. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20 Statement.pdf] Accessed on Feb. 26, 2018.

43. IRC §170(b)(1)(G)(iii)(II).

Casualty and Theft Losses

Old Law. A taxpayer can claim a deduction for a loss incurred during the tax year for which they were not compensated by insurance or otherwise. For individual taxpayers, deductible losses are those incurred in a trade or business or that consist of property losses arising from casualty or theft. Personal casualty or theft losses are deductible only if they exceed $100 per casualty or theft and only to the extent that aggregate net casualty and theft losses exceed 10% of the taxpayer's AGI.

New Law. The TCJA temporarily modifies the deduction for personal casualty and theft losses. Under this provision, a taxpayer can claim a personal casualty loss only if the loss is attributable to a federally declared disaster.

However, a taxpayer can still offset personal casualty losses not attributable to a federally declared disaster against personal casualty gains to the extent that such losses do not exceed such gains.[44] When applying the 10% threshold to personal casualty losses attributable to a federally declared disaster, the amount of casualty gains taken into account is reduced by the portion of gains offset against casualty losses not attributable to **federally declared disasters.**[45]

Example 12. Ronald's AGI for 2018 is $125,000. In 2018, after applying the $100 floor for each casualty, he has $30,000 of federally declared disaster losses as well as $20,000 of other personal casualty losses. He also has $35,000 of personal casualty gains.

Ronald's $2,500 deductible loss is calculated as follows.

Total casualty losses from federally declared disasters		$30,000
Personal casualty gains	$35,000	
Casualty losses other than federally declared disasters	(20,000)	
Net casualty gains	$15,000	(15,000)
Disaster loss amount remaining after offset		$15,000
10% of Ronald's AGI ($125,000 × 10%)		(12,500)
Ronald's deductible federally declared disaster loss		$ 2,500

This provision is effective for losses incurred in tax years within the TCJA period.

Miscellaneous Itemized Deductions

Old Law. Individual taxpayers who itemize their deductions can deduct miscellaneous expenses to the extent that the total of such expenses exceeds 2% of the taxpayer's AGI. Expenses subject to the 2% threshold include the following.[46]

- Unreimbursed expenses attributable to the trade or business of being an employee, including the following
    - Business bad debt of an employee
    - Business liability insurance premiums
    - Damages paid to a former employer for breach of an employment contract
    - Depreciation on a computer that a taxpayer's employer requires them to use in their work
    - Dues to a chamber of commerce if membership helps the taxpayer perform their job

44. IRC §165(h)(5)(B)(i).

45. IRC §165(h)(5)(B)(ii).

46. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on Jan. 4, 2018; *The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law.* Sherlock, Molly F. and Marples, Donald J. Feb. 6, 2018. Congressional Research Service. [fas.org/sgp/crs/misc/R45092.pdf] Accessed on Feb. 14, 2018.

- Dues to professional societies
- Educator expenses
- Home office or part of a taxpayer's home used regularly and exclusively in the taxpayer's work
- Job search expenses in the taxpayer's present occupation
- Laboratory breakage fees
- Legal fees related to the taxpayer's job
- Licenses and regulatory fees
- Malpractice insurance premiums
- Medical examinations required by an employer
- Occupational taxes
- Passport fees for a business trip
- Repayment of an income aid payment received under an employer's plan
- Research expenses of a college professor
- Rural mail carriers' vehicle expenses
- Subscriptions to professional journals and trade magazines related to the taxpayer's work
- Tools and supplies used in the taxpayer's work
- Purchase of travel, transportation, meals, entertainment, gifts, and local lodging related to the taxpayer's work
- Union dues and expenses
- Work clothes and uniforms if required and not suitable for everyday use
- Work-related education

- Tax preparation fees
- Expenses for the production or collection of income, including the following[47]
  - Appraisal fees for casualty loss or charitable contribution
  - Casualty and theft losses from property used in performing services as an employee
  - Clerical help and office rent in caring for investments
  - Depreciation on home computers used for investments
  - Excess deductions allowed a beneficiary on termination of an estate or trust
  - Fees to collect interest and dividends
  - Hobby expenses, but generally not more than hobby income
  - Indirect miscellaneous deductions from pass-through entities

[47]. See IRS Pub. 529, *Miscellaneous Deductions.*

    - Investment fees and expenses
    - Legal fees related to producing or collecting taxable income or getting tax advice
    - Loss on deposits in an insolvent or bankrupt financial institution
    - Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed to taxpayer
    - Some repayments of income
    - Safe deposit box rental
    - Service charges on dividend reinvestment plans
    - Tax advice fees
- Other expenses
    - Trustee's fees on IRA if separately billed and paid
    - Repayments of income received under a claim of right (only subject to 2% floor if less than $3,000)
    - Repayments of social security benefits
    - Share of deductible investment expenses from pass-through entities

New Law. **No** miscellaneous itemized deductions **subject to the 2% of AGI floor** are allowed for tax years within the TCJA period.

Above-the-line deductions (i.e., expenses that are deductible in determining AGI) are unaffected by this provision. In addition, other miscellaneous deductions (reported on line 28 of the 2017 Schedule A, *Itemized Deductions)* are also unaffected by this provision and are therefore still deductible. Such expenses include the following.[48]

- Gambling losses (to the extent of gambling winnings reported on Form 1040, line 21)
- Federal estate tax on income in respect of a decedent
- Deduction for amortizable bond premium
- Ordinary loss attributable to a contingent payment debt instrument or an inflation-indexed debt instrument
- Repayment of amounts under a claim of right if over $3,000
- Certain unrecovered investment in a pension
- Impairment-related work expenses of a disabled person

Wagering Losses

Old Law. A taxpayer can deduct losses incurred during the tax year on wagering transactions only to the extent of the gains realized during the tax year from such transactions.[49] Gambling losses for most individuals are claimed as miscellaneous itemized deductions **not** subject to the 2% of AGI limitation.[50]

48. Instructions for Schedule A.

49. IRC §165(d).

50. IRC §67(b)(3).

Professional gamblers, however, report gambling activities on Schedule C. Professional gamblers are also subject to the restriction that limits wagering losses to the amount of wagering gains. The court in *Mayo v. Comm'r*[51] held that gambling expenses other than wagering losses are not subject to this restriction and are deductible if the taxpayer is a professional gambler. The IRS acquiesced in this result.[52]

> **Note.** For more information about the tax treatment of gambling winnings as well as a discussion about the principles used to determine whether a taxpayer is a professional gambler, see the 2017 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 2: Individual Taxpayer Issues.

New Law. The TCJA clarifies that the loss limitation applies not only to the actual costs of wagers incurred by an individual but also to other expenses incurred in connection with the conduct of that individual's gambling activity. For example, an individual's otherwise deductible expenses in traveling to and from a casino are subject to this limitation. This provision effectively reverses the court's decision in *Mayo.*

This provision is effective for tax years within the TCJA period.

Limit on Itemized Deductions

Old Law. The total amount of most otherwise allowable itemized deductions is limited for certain higher-income taxpayers. This limit is triggered when the taxpayer's AGI exceeds a threshold level. For 2017, the threshold amounts were:

- $261,500 for single taxpayers,
- $287,650 for HoH,
- $313,800 for MFJ taxpayers, and
- $156,900 for MFS taxpayers.

The limitation reduces itemized deductions by the lesser of:

1. 3% of the amount of AGI exceeding the threshold, **or**
2. 80% of the itemized deductions that would otherwise be allowable.[53]

All other limits on itemized deductions are applied before the overall limit on itemized deductions.[54] In addition, the following itemized deductions are not subject to this limit.

- Medical and dental expenses
- Gambling losses
- Casualty and theft losses
- Investment interest

New Law. The TCJA suspends the limitation on itemized deductions for higher-income taxpayers as previously described. This provision is effective for tax years within the TCJA period.

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51. *Mayo v. Comm'r,* 136 TC 81 (2011).
52. AOD 2011-06, IRB 2012-3.
53. IRC §68(a).
54. IRC §68(d).

RELIEF FOR DISASTER LOSSES

Distributions from Retirement Plans

Old Law. A distribution from a qualified retirement plan, a 403(b) plan, a governmental 457(b) plan, or an IRA is generally included in income. Unless an exception applies, a distribution from a qualified retirement plan, a 403(b) plan, or an IRA that the taxpayer receives before turning age 59½ is subject to a 10% early withdrawal tax on the amount includable in income.[55]

> **Note.** The 10% early withdrawal tax does not apply to distributions from a governmental 457(b) plan.

New Law. An exception to the 10% early withdrawal tax applies to a qualified disaster distribution from a qualified retirement plan, a 403(b) plan, or an IRA. In addition, income attributable to a qualified disaster distribution is included in income ratably over three years unless the individual elects not to have the ratable inclusion rule apply. Moreover, the amount of the distribution can be recontributed to an eligible retirement plan within three years.

A **qualified disaster distribution** is a distribution from an eligible retirement plan made on or after January 1, 2016, and before January 1, 2018. Such distribution must be made to an individual:

- Whose principal place of residence at any time during calendar year 2016 was located in a 2016 disaster area, and
- Who sustained an economic loss because of a federally declared disaster during 2016.

An **eligible retirement plan** is a qualified retirement plan, a 403(b) plan, a governmental 457(b) plan, or an IRA. The maximum amount of distributions to an individual from all eligible retirement plans that may be treated as qualified disaster distributions is $100,000.

A **2016 disaster area** is defined as any area for which a major disaster was declared by the president under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act during calendar year 2016.[56]

Any portion of a qualified disaster distribution may be recontributed to an eligible retirement plan at any time during the 3-year period beginning on the day after the date on which the taxpayer received the distribution. Any amount recontributed within the 3-year period is treated as a rollover. Therefore, such amounts are not includable in income. If any portion of the distribution has not yet been included in the taxpayer's income at the time of the recontribution, the remaining amount is not includable in income.

Example 13. In November 2016, Katrina, age 47, received a qualified disaster distribution of $60,000 from her 401(k). No portion of the $60,000 distribution is subject to the 10% early withdrawal tax.

Katrina included $20,000 in income in each year from 2016 to 2018. Katrina files her 2018 tax return in April 2019. In October 2019, Katrina recontributes $60,000 to her 401(k), and this amount is treated as a rollover. Katrina can file amended returns to claim a refund of the tax attributable to the amount previously included in income for the 2016, 2017, and 2018 tax years.

Example 14. Use the same facts as **Example 13,** except Katrina recontributes $60,000 to her 401(k) plan in March 2019. When she prepares her 2018 return in April 2019, she does not include the ratable $20,000 portion in her 2018 income. Katrina files amended returns to claim a refund for the tax attributable to the $40,000 she included in income for the 2016 and 2017 tax years.

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55. IRC §72(t).

56. TCJA §11028(a).

Itemized Deduction for Casualty Losses

Old Law. In 2016 and 2017, a taxpayer could generally claim a deduction for a loss sustained during the tax year and not compensated by insurance or otherwise. For individual taxpayers, deductible losses include property losses from fire, storm, shipwreck, or other casualty, or from theft. A taxpayer could take a deduction for personal casualty and theft losses only if the losses exceeded $100 per casualty or theft. In addition, a taxpayer could deduct aggregate net casualty and theft losses only to the extent they exceeded 10% of the taxpayer's AGI.

> **Example 15.** In 2016, Andrew's AGI was $125,000. He incurred a $4,000 personal casualty loss in 2016 that was **not** attributable to a federally declared disaster. He itemized his deductions on his 2016 return, and he had no other casualty or theft losses for the year.
>
> Andrew's $4,000 loss is first reduced by the $100 floor, so his net casualty loss is $3,900. This is less than 10% of his AGI, or $12,500, so he cannot claim an itemized deduction for the loss.

> **Note.** As explained earlier, the TCJA modifies the rules for personal casualty and theft losses for tax years within the TCJA period.

New Law. If an individual had a net disaster loss for either the 2016 or 2017 tax year, such losses are deductible regardless of whether the aggregate net losses exceed 10% of the taxpayer's AGI. To be deductible, the losses must exceed $500 per casualty. A **net disaster loss** is defined as the excess of qualified disaster-related personal casualty losses over personal casualty gains. The disaster-related personal casualty loss is one that occurred in a disaster area and that was attributable to the events that gave rise to a federal disaster declaration.[57]

> **Example 16.** Use the same facts as **Example 15,** except Andrew's 2016 loss was attributable to a federally declared disaster. He must reduce his $4,000 loss by the $500 floor attributable to disaster-related personal casualty losses. However, he does not have to further reduce the loss by 10% of his AGI. Therefore, he can claim an itemized deduction of $3,500 for the loss.

An individual who incurred a net disaster loss in 2016 or 2017 and does not itemize deductions can increase their standard deduction by the amount of the net disaster loss. The increase in the standard deduction amount is also allowed as a deduction for purposes of calculating alternative minimum taxable income (AMTI).[58]

> **Example 17.** Use the same facts as **Example 16,** except Andrew does not itemize deductions. He can increase the $6,300 standard deduction for the 2016 tax year by the $3,500 disaster-related loss. Therefore, his standard deduction for 2016 is $9,800. In addition, if Andrew is subject to AMT, he cannot deduct the $6,300 standard deduction from his AMTI but he can deduct the additional $3,500 disaster loss.

> **Note.** Tax preparers who have clients with net disaster losses for 2016 or 2017 should analyze whether their returns should be amended.

57. TCJA §11028(c).

58. TCJA §11028(c)(1)(D).

ABLE ACCOUNTS

Increased Contributions

Old Law. IRC §529A provides for a tax-favored savings program intended to benefit individuals with disabilities, known as the Achieving a Better Life Experience (ABLE) program. Contributions can be made for the benefit of an individual with disabilities to assist them in paying qualified disability expenses. Contributions, which are not tax deductible, are subject to an annual overall limit equivalent to the per-donee annual gift tax exclusion ($15,000 for 2018[59]).

Distributions from an ABLE account are excludable from income to the extent that the total distribution does not exceed the qualified disability expenses of the designated beneficiary during the year. **Qualified disability expenses** are expenses related to the designated beneficiary's blindness or disability that are paid for the benefit of the designated beneficiary.

> **Note.** For more information about ABLE programs, see the 2015 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: New Developments. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

New Law. The TCJA provides that beginning December 22, 2017, until December 31, 2025, a designated beneficiary of an ABLE account can make additional contributions after the per-donee annual overall limit ($15,000 for 2018) is reached. The maximum additional annual contribution amount that the designated beneficiary can make is the lesser of:

- The designated beneficiary's compensation for the year, or
- The federal poverty line for a 1-person household for the previous calendar year.[60]

> **Note.** The federal poverty line (also called the federal poverty level) for 2017 for a 1-person household is $12,060 for the 48 contiguous states and the District of Columbia.[61]

Example 18. Jasper lives in Illinois and is the designated beneficiary of an ABLE account. In 2018, Jasper's grandmother made the maximum per-donee contribution of $15,000 to his ABLE account.

Jasper earns $15,000 of wages in 2018. He can make an additional contribution of $12,060 (the applicable federal poverty line amount) to his ABLE account for 2018 because that amount is less than his compensation for the year.

A designated beneficiary who is allowed to make additional contributions to their ABLE account is one who is employed (or self-employed) and did not make a contribution during the tax year to a defined contribution plan, 403(b) plan, or 457(b) plan.[62]

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59. Rev. Proc. 2017-58, 2017-45 IRB 489.

60. IRC §529A(b)(2)(B)(ii)(II).

61. *2017 Poverty Guidelines.* U.S. Department of Health & Human Services. [aspe.hhs.gov/2017-poverty-guidelines] Accessed on Mar. 2, 2018.

62. IRC §529(b)(7)(A).

Rollovers to ABLE Accounts

Old Law. Amounts in an ABLE account can be rolled over without incurring tax liability to another ABLE account for the same beneficiary. In addition, amounts in an ABLE account can be rolled over to another ABLE account for the designated beneficiary's family member. **Family member** for this purpose includes a person with any of the following relationships to the designated beneficiary.[63]

1. Spouse
2. Child or descendant of a child
3. Brother, sister, stepbrother, or stepsister
4. Parent (or parent's ancestor)
5. Stepfather or stepmother
6. Niece or nephew
7. Aunt or uncle
8. Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law
9. Spouse of any individual in 2–8
10. First cousin

New Law. The TCJA allows amounts to be rolled over from 529 qualified tuition programs to an ABLE account without penalty if the ABLE account is owned by the designated beneficiary of the 529 plan or a designated beneficiary's family member (as described above). Any such rolled-over amounts count towards the overall annual limitation on contributions to an ABLE account. Any amount rolled over in excess of the limitation is includable in the distributee's gross income.

This provision applies to distributions made after December 22, 2017, and before January 1, 2026.

Saver's Credit

Old Law. Eligible taxpayers can claim a nonrefundable tax credit for qualified retirement savings contributions (saver's credit). The saver's credit is a percentage of an individual's contributions to qualified retirement savings accounts.[64] The maximum annual contribution eligible for the credit is $2,000 per individual. The credit rate depends on the taxpayer's AGI.

Qualified retirement savings contributions consist of the following.

- Elective deferrals to a 401(k) plan, a 403(b) plan, a governmental 457 plan, a savings incentive match plan for employees (SIMPLE) plan, or a salary reduction simplified employee pension (SARSEP) plan
- Contributions to a traditional or Roth IRA
- Voluntary after-tax employee contributions to a qualified retirement plan or 403(b) plan

> **Note.** For more information about the saver's credit, see the instructions to Form 8880, *Credit for Qualified Retirement Savings Contributions,* and the 2018 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 5: Retirement Plans for Small Businesses.

New Law. A designated beneficiary of an ABLE account is temporarily allowed to claim the saver's credit for contributions made to their ABLE account. No other changes were made to the saver's credit.

This provision applies to tax years within the TCJA period.

63. IRC §§529(c)(3)(C)(i)(III) and (e)(2).

64. IRC §25B.

TAX CUTS AND JOBS ACT: TRUSTS AND ESTATES

INTRODUCTION

In addition to broad changes to personal and corporate taxes, the TCJA[65] makes important changes to the tax rules for trusts and estates. Besides the direct changes to the trust and estate tax rules, the TCJA also has an indirect effect on the trust and estate tax rules through IRC §641(b).

IRC §641(b) requires the taxable income of a trust or estate to be computed in the same manner as that for an individual. Accordingly, several of the TCJA changes that affect individual taxpayers have an effect on the taxable income and tax liability of a trust or estate for the TCJA period.

TAX RATES AND BRACKETS

Old Law. Trusts and estates are subject to the same tax rates as individuals, but have different income brackets. Trust and estate tax brackets are adjusted for inflation using a consumer price index-based formula.

The following table provides the trust and estate tax brackets and rates in effect for 2017.[66]

2017 Trust and Estate Tax Rates and Brackets

Income Bracket	Tax Rate
Not over $2,550	15%
$2,551–$6,000	25%
$6,001–$9,150	28%
$9,151–$12,500	33%
Over $12,500	39.6%

New Law. The TCJA modifies individual tax rates and brackets. Because trusts and estates use the same rates as those for individuals, this results in a modification of the trust and estate tax rates.[67] These new rates, along with the modified inflation-indexing formula used by the TCJA, are effective for the TCJA period,[68] beginning with the 2018 tax year.

The new brackets and rates for trusts and estates are shown in the following table.[69]

Trusts and Estates

Income Range	Tax Rate
$0 to $2,550	10%
Over $2,550 but not over $9,150	24%
Over $9,150 but not over $12,500	35%
Over $12,500	37%

65. PL 115-97.

66. Rev. Proc. 2016-55, §3.01, 2016-45 IRB 707.

67. TCJA §11001(a), adding IRC §1(j).

68. TCJA §11001(c).

69. Rev. Proc. 2018-18, §3.01, 2018-10 IRB 392, modifying and superseding Rev. Proc. 2017-58, 2017-45 IRB 489.

SPECIAL DEDUCTIONS IN LIEU OF PERSONAL EXEMPTIONS

Old Law. Prior to the TCJA, trusts and estates could use specific deductions instead of personal exemptions and dependency deductions.[70] These specific deduction amounts, which are not indexed for inflation, are as follows.

- $600 for estates[71]
- $300 for simple trusts[72]
- $100 for complex trusts[73]

A **simple trust** is one that meets **all three** of the following requirements.[74]

1. The trust instrument requires that all income be distributed currently for the tax year (regardless of whether the current income distributions are actually made).
2. The trust instrument must not provide that any amounts are to be paid, permanently set aside, or used for charitable purposes.
3. The trust does not make distributions of principal (corpus) during the year.

All other trusts are complex trusts.

Simple trusts are entitled to a distribution deduction equal to the lesser of distributable net income (DNI) or fiduciary accounting income (FAI). Complex trusts are entitled to a distribution deduction only to the extent of DNI or FAI that is actually distributed.

A qualified disability trust (QDT) is a trust that meets the following two criteria.[75]

1. The trust qualifies as a disability trust under specific provisions of the Social Security Act.[76]
2. All of the beneficiaries of the trust are disabled, as defined in the Social Security Act.[77]

A trust generally may not claim a personal exemption. Instead, it claims the applicable deduction amount (listed earlier). A QDT is an exception to this rule. A QDT is entitled to claim a personal exemption in the same amount as that for an individual.[78]

New Law. The TCJA does not affect the specific deductions for trusts and estates for the TCJA period, despite eliminating personal exemptions for individual taxpayers.[79] These amounts continue to be available in the same manner to trusts and estates.

The TCJA, however, retains a modified amount for QDTs. A $4,150 annual exemption is provided for QDTs for 2018. This amount will be inflation adjusted for calendar years after 2018.[80]

70. IRC §642(b)(3).
71. IRC §642(b)(1).
72. IRC §642(b)(2)(B).
73. IRC §642(b)(2)(A).
74. Instructions for Form 1041.
75. IRC §642(b)(2)(C)(ii).
76. The provisions that the trust must meet are found in the Social Security Act at 42 USC §1396p.
77. Beneficiaries must meet the disability definition found in the Social Security Act at 42 USC §1382c(a)(3).
78. IRC §642(b)(2)(C)(i).
79. IRC §151(d)(5), as added by the TCJA.
80. IRC §642(b)(2)(C)(iii), as added by the TCJA.

MISCELLANEOUS ITEMIZED DEDUCTIONS

Old Law. Miscellaneous itemized deductions are deductible to the extent that, in the aggregate, they exceed 2% of the taxpayer's AGI.[81]

A trust's or estate's administrative expenses may be deductible. An administrative expense is defined as an expense that is ordinary and necessary in administering the trust or estate during the year and must be paid or incurred during the tax year. Moreover, the expenses must be incurred for one of the following purposes.[82]

- The production or collection of income
- The management, conservation, or maintenance of property held by the trust for the production of income
- The determination, collection, or refund of any tax

Whether an administrative expense of a trust or estate should be treated as an itemized deduction subject to the 2%-of-AGI floor or instead as a fully deductible expense has not always been clear. In a key Supreme Court case,[83] the Court noted that the "Courts of Appeals are divided on the question…" While the IRS has reserved Temp. Treas. Reg. §1.67-4T to provide guidance on this subject, no such guidance has been provided.[84] As a general rule, the types of expenses that typically constitute miscellaneous itemized deductions (as defined in IRC §67(b)) should be treated as such and subject to the 2% floor. However, the Code provides an exception to this rule for administrative costs that would not have been incurred had the trust or estate property not been held in a trust or estate. Such expenses are **not** considered miscellaneous itemized deductions.[85] If the cost is included in the definition of miscellaneous itemized deductions, is incurred by an estate or nongrantor trust, and is an expense that would commonly or customarily be incurred by a hypothetical individual holding the same property, that expense is subject to the 2% floor.[86]

> **Note.** For additional guidance on how to categorize and treat certain administrative expenses for a trust or estate, including property ownership costs, tax preparation fees, investment advisory fees, and certain bundled fees or commissions, see Treas. Reg. §1.67-4.
>
> Treas. Reg. §1.67-4 makes the distinction between administrative expenses incurred by a **grantor trust** and **nongrantor trust.** Generally, administrative expenses of a grantor trust that otherwise qualify for deduction are always subject to the 2% floor under the regulation. Such expenses of a nongrantor trust may qualify for full deduction if they are not expenses that the "hypothetical individual" would incur under the Supreme Court's test.

81. IRC §67(a); Temp. Treas. Reg. §1.67-1T.
82. IRC §§212 and 641(b).
83. *Michael J. Knight, Trustee of the William L. Rudkin Testamentary Trust v. Comm'r,* 552 U.S. 181 (2008).
84. Interim guidance solely on the subject of bundled investment management and advisory fees has been provided in Treas. Reg. §1.67-4.
85. IRC §67(e); Treas. Reg. §1.67-4(a).
86. Treas. Reg. §1.67-4(a).

New Law. The TCJA eliminates a trust's ability to claim miscellaneous itemized deductions during the TCJA period by adding IRC §67(g). Accordingly, **during the TCJA period:**

- Administrative expenses for a grantor trust, which are always considered miscellaneous itemized expenses subject to the 2% floor, are no longer deductible;
- Administrative expenses of a nongrantor trust or estate that are considered subject to the 2% floor after applying the Supreme Court's "hypothetical individual" test constitute nondeductible miscellaneous expenses; and
- Administrative expenses of a nongrantor trust or estate that are not considered miscellaneous itemized expenses under the Supreme Court's "hypothetical individual" test may still be deductible.

IRS Notice 2018-61 clarifies IRC §67(g). The rules identifying deductible expenses under the 2% rule of IRC §67(g) have not changed. The **deductibility** of those expenses **has** changed. If an expense is subject to the 2% rule, e.g., investment advice, the expense is now nondeductible. If an expense is **not** subject to the 2% rule (e.g., executor fees or attorney fees), the expense remains deductible.

Observation. The elimination of the ability to claim miscellaneous itemized deductions affects trusts and estates as well as individual taxpayers. Unlike trusts, however, individuals have the benefit of lower individual tax brackets and a higher standard deduction to offset any increase in tax liability resulting from the loss of the ability to claim MIDs.

QUALIFIED BUSINESS INCOME DEDUCTION

Old Law. Prior to the TCJA, qualifying trusts meeting the requirements under IRC §199 for the domestic production activities deduction (DPAD) could claim this deduction.

Note. For more information on the DPAD, see the 2012 *University of Illinois Federal Tax Workbook*, Volume B, Ch. 3: Small Business Issues. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

New Law. The TCJA repeals the DPAD for the TCJA period and replaces the DPAD with the **qualified business income deduction** (QBID) in IRC §199A.

Note. For further details on the QBID, see the 2018 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 2: Small Business Issues.

Because the QBID is available to noncorporate taxpayers,[87] a trust or estate may qualify for the deduction if all requirements for the deduction are met.[88] This may allow a trust or estate to deduct up to 20% of qualifying business income from partnerships, S corporations, or the direct conduct of a trade or business by a trustee during the TCJA period.

To prevent taxpayers from spreading assets across multiple trusts to circumvent the taxable income threshold requirements, Prop. Treas. Reg. §1.199A-6(d)(3)(v) provides an anti-abuse rule. Under this rule, trusts formed or funded with a significant purpose of receiving a QBID will not be respected.

87. IRC §199A(a).

88. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 21, 2018.

Moreover, the proposed regulations include a new regulation under IRC §643. Prop. Treas. Reg. §1.643(f)-1, which addresses multiple trusts, indicates that two or more trusts are aggregated and treated as a single trust if they have substantially the same grantor(s) and primary beneficiary or beneficiaries and a principal purpose for establishing the trusts (or contributing additional assets to the trusts) has a tax-avoidance purpose. Under this proposed regulation, a tax-avoidance purpose is presumed if a significant tax benefit results unless a significant nontax purpose exists that would not have been possible without the multiple-trust structure.

Note. While the proposed regulations include the anti-abuse rule, trusts and estates that have businesses may benefit from the proposed aggregation rules under Prop. Treas. Reg. §1.199A-4. These aggregation rules contain new grouping requirements that may be used by the taxpayer to aggregate two or more separate trades or businesses. Generally, under the proposed regulations, businesses may be aggregated if the same person or group of persons owns 50% or more of each trade or business. See Prop. Treas. Reg. §1.199A-4 for additional details, including reporting requirements.

While the proposed regulations, once finalized, clarify the application of the QBID rules to trusts or estates, IRC §199A(f)(1)(B) indicates that rules similar to those under the DPAD that were used to allocate relevant amounts between the trust or estate fiduciary and beneficiaries apply in the calculation of the QBID. Accordingly, the trust's or estate's QBI is apportioned between the fiduciary and beneficiaries under the new QBID rules in a similar fashion to how domestic production gross receipts are allocated between such taxpayers under the DPAD rules.

The final regulations, along with IRS Notice 2018-64, will provide additional guidance about rules to allocate and calculate W-2 wages, expenses, and losses for a trust or estate.

Note. The allocation rules referred to in IRC §199A(f)(1)(B) are found in IRC §199(d)(1)(B). For additional details, see the relevant DPAD allocation rules specified in the underlying regulations for IRC §199, particularly Treas. Regs. §§1.199-1, 1.199-5, and 1.199-9.[89]

Note. Under Prop. Treas. Reg. §1.199A-6(d), the grantor of a grantor trust computes the trust's QBI with respect to that part of the trust owned by the grantor as if that person directly conducted the trust activities. A nongrantor trust or estate claiming a QBID uses rules similar to the previous DPAD provisions. Under these rules, the QBI, W-2 wages, qualified property (QP) basis amounts, REIT dividends, and publicly traded partnership (PTP) income are allocated among the trust or estate and the various beneficiaries. Each beneficiary's share of W-2 wages is determined based on each respective beneficiary's proportion of distributable net income (DNI) for the tax year. Any proportionate amount of DNI not deemed distributed determines the trust's or estate's share of such items. If no DNI exists for the year, all QBI, W-2 wages, QP basis amounts, REIT dividends, and PTP income are allocable to the trust or estate, and not to any beneficiary.

The 2018 QBI threshold amount for a trust is $157,500. For purposes of determining whether a trust or estate has taxable income that exceeds the threshold amount, the taxable income is determined at the trust or estate level without first taking into account any distribution deductions.[90]

89. Prop. Treas. Reg. §1.199A-6(d)(3)(ii).

90. Prop. Treas. Reg. §1.199A-6(d).

CHANGES TO ELECTING SMALL BUSINESS TRUSTS (ESBT)

ESBT Qualifying Beneficiaries

Old Law. Ownership of S corporation shares is generally limited to U.S. citizens or residents,[91] estates,[92] and certain trusts.[93] Generally, a trust may own S corporation shares if it is treated as a trust that is owned by an individual who is a U.S. citizen or resident.[94]

Eligible S corporation shareholders include the following.

- Estates[95]
- The estate of a bankrupt individual[96]
- A qualified subchapter S trust (QSST)[97]
- An ESBT[98]

Each potential current beneficiary of an ESBT is treated as a direct shareholder in the S corporation for purposes of the small business corporations rules of IRC §1361(b)(1).[99] If there is no potential current beneficiary, the trust is considered the shareholder.[100] A **potential current beneficiary** is generally any person who is entitled to, or who may receive, a distribution from the ESBT income or principal.[101] Once the person becomes entitled to an ESBT distribution, or receives such a distribution, that person is regarded as a direct shareholder of the S corporation, and the qualified shareholder rules associated with S corporations[102] apply to that person. If the potential current beneficiary is not a qualified shareholder, the S corporation election terminates.[103] These rules regarding ESBT potential current beneficiaries provide an effective barrier to having a nonresident alien beneficiary in an ESBT.

New Law. The TCJA amends IRC §1361(c)(2)(B)(v) so that a nonresident ESBT potential current beneficiary is not considered a disqualifying S corporation shareholder. This is a **permanent** change to the Code, with an effective date of January 1, 2018.[104]

> **Observation.** Given this expansion of S corporation ownership through an ESBT to nonresident aliens, greater opportunities may exist for the use of S corporations when one or more nonresident alien shareholders are contemplated. However, because an ESBT has several tax disadvantages, including taxation at the maximum rate[105] (now 37% during the TCJA period) and no distribution deduction, the additional flexibility provided by this change may be limited.

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91. Treas. Reg. §1.1361-1(b)(iii).
92. Treas. Reg. §1.1361-1(b)(ii).
93. Ibid; IRC §1361(c)(2).
94. IRC §1361(c)(2)(A)(i).
95. IRC §1361(b)(1)(B).
96. IRC §1361(c)(3).
97. IRC §1361(d).
98. IRC §1361(c)(2)(A)(v).
99. Treas. Reg. §1.1361-1(m)(4)(i).
100. IRC §1361(c)(2)(B)(v).
101. Ibid.
102. IRC §1361(b)(1).
103. Treas. Reg. §1.1361-1(m)(5)(iii).
104. TCJA §13541(b).
105. IRC §§641(c)(2)(A) and 1(e).

> **Note.** Under Prop. Treas. Reg. §1.199A-6(d)(3)(iv), the IRS clarifies that an ESBT may qualify for a QBID. An ESBT may have interests that are characterized as an S portion, non-S portion, and grantor portion. Under this proposed regulation, an ESBT must separately take into account QBI and other items from these respective portions. For further guidance, see Treas. Reg. §1.641(c)-1.

Change to ESBT Charitable Deduction Rules

Old Law. A charitable contribution by an S corporation is treated as a separately stated item when allocated to the S corporation shareholders.[106] When an ESBT is an S corporation shareholder, the ESBT is subject to the charitable contribution rules for trusts as opposed to the rules applicable to individuals. The charitable contribution rules applicable to trusts are found in IRC §642(c).

Generally, the rules under IRC §642(c) require that the trust instrument itself provide for the payment of the charitable contributions from gross income in order for the contributions to be deductible for income tax purposes. For an estate, the will is the governing document that must provide for the charitable contribution. If the trust instrument or will does not address charitable contributions, a deduction for such a contribution is not permitted.[107] In addition, the IRC §642(c) rules do not provide trusts with any carryover rule for excess contributions.

New Law. The TCJA adds a provision to the Code[108] that removes ESBT charitable contributions from the more restrictive IRC §642(c) requirements. Instead, the more lenient rules for charitable contributions applicable to individuals apply.[109] This removes the need for a governing document to specifically address charitable contributions in order for a deduction to be allowed. The charitable deduction carryover rule applicable to individuals also applies to an ESBT.

ESBTs may now take advantage of the increase in the contribution base for individuals from 50% to 60% (discussed earlier) made effective by the TCJA. ESBTs may also now make use of the carryforward rules associated with charitable contributions for individuals.[110]

The EBST's charitable contribution base is calculated using the ESBT's AGI, calculated in the same manner as that for an individual. However, administrative costs incurred by the ESBT that would not have been incurred had the property not been held in the ESBT are considered in arriving at the AGI for contribution base purposes.[111]

ESTATE AND GIFT TAX CHANGES

The TCJA imposes new tax brackets and tax rates for both trusts and estates as noted earlier. The TCJA also introduced other important changes to estate and gift tax rules.

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106. IRC §1366(a)(1).

107. IRC §641(c)(1).

108. IRC §641(c)(2)(E)(i).

109. IRC §641(c)(2)(E).

110. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 21, 2018; TCJA §13542.

111. IRC §641(c)(2)(E)(ii).

Changes to the Basic Exclusion Amount

Old Law. On December 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010[112] (TRUIRJCA) established a $5 million basic exclusion amount for estates.[113] This basic exclusion amount also serves as the gift tax exclusion amount.[114] Since its introduction, it has been subject to annual inflation adjustments. The portability[115] feature provided extensive estate planning opportunities between spouses by allowing a surviving spouse to take advantage of the deceased spouse's unused basic exclusion amount.

> **Note.** For further details regarding the introduction of the basic exclusion amount and the portability feature, see the 2011 *University of Illinois Federal Tax Workbook*, Chapter 10: Estate Planning. For further discussion of portability and the application of the basic exclusion amount, see the 2015 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 4: Individual Taxpayer Issues. These chapters can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

With inflation indexing, the basic exclusion amount for 2018 was calculated as $5.6 million per taxpayer, as announced by the IRS on October 19, 2017, in Rev. Proc. 2017-58.

New Law. The TCJA makes a change to IRC §2010(c)(3)(C), which serves to **double** the basic exclusion amount during the TCJA period. The TCJA accomplishes this by doubling the TRUIRJCA's original $5 million base amount and indexing it for post-2011 inflation. This increase in the basic exclusion amount applies to the estates of decedents dying or gifts made during the TCJA period. Accordingly, for the 2018 tax year, the basic exclusion amount is $11.18 million.[116] This doubled basic exclusion amount continues to be indexed annually for inflation. Taxpayers may continue to take advantage of the portability feature using this doubled amount during the TCJA period. Portability gives the surviving spouse a potential basic exclusion amount of $22.36 million for 2018.

The exemption from the generation-skipping transfer (GST) tax is based upon the basic exclusion amount. Accordingly, the TCJA's doubling of the basic exclusion amount for estate and gift tax exemption purposes is also effective for GST exemption purposes.

> **Note.** For 2018, the annual gift tax exclusion increases to $15,000 (from the 2017 amount of $14,000).[117]

Decedents with Gifts Made in Prior Years

Old Law. For decedents who made gifts in previous years, gift tax payable is calculated using the tax rates effective at the date of death, not the tax rates that were in effect at the time the gift was made.[118]

New Law. Under the TCJA, the rule continues to be that gift tax payable is calculated using the tax rates effective at the date of death.[119] However, under changes made by the TCJA,[120] the Treasury Secretary has been directed to issue new regulations to clarify the application of this new rule.

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112. PL 111-312.
113. IRC §2010(c)(3)(A).
114. IRC §2010(a).
115. IRC §§2010(c)(2)(B) and (c)(4).
116. See Rev. Proc. 2018-18, 2018-10 IRB 392, which modifies and supersedes Rev. Proc. 2017-58.
117. Rev. Proc. 2017-58, 2017-45 IRB 489.
118. IRC §2001(g).
119. Ibid.
120. IRC §2001(g)(2).

BIPARTISAN BUDGET ACT OF 2018[121]

On February 9, 2018, President Trump signed into law the Bipartisan Budget Act of 2018 (BBA). Besides funding the government through March 23, 2018, the legislation contained a package of tax extenders, which provided a 1-year extension for many key provisions that had expired on December 31, 2016. Additionally, the legislation contained other tax-related provisions, including changes relating to tax relief for certain disasters.

Note. The provisions affecting individual taxpayers are described in this section. The provisions affecting businesses are described in the 2018 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: New Legislation — Business Concerns.

EXTENDERS

The following extender provisions affect individual taxpayers.

IRC Section	Provision	Expiration Date
108(a)(1)(E)	Extension and modification of exclusion from gross income of discharge of qualified principal residence indebtedness	December 31, 2017
163(h)(3)(E)(iv)	Extension of mortgage insurance premiums treated as qualified residence interest	December 31, 2017
222(e)	Extension of above-the-line deduction for qualified tuition and related expenses	December 31, 2017

Note. These extenders were retroactive for the 2017 tax year and may require an amended return for 2017.

IMPROPER LEVY ON RETIREMENT PLANS

Old Law. If the IRS improperly levies on an IRA or employer-sponsored retirement plan, a taxpayer may not be made whole even if the IRS refunds the levied amount with interest. In this situation, the taxpayer may lose the opportunity to have those funds accumulate on a tax-favored basis until retirement.

New Law. A taxpayer can contribute amounts, including interest, returned to the taxpayer from the IRS under a levy on an IRA or employer-sponsored plan without regard to normal contribution limits. The taxpayer must contribute such amounts not later than the due date (not including extensions) for filing the tax return for the year in which the money is returned. The contributed amounts are treated as rollover contributions.

In addition, the IRS must pay interest on an amount returned to the taxpayer because of a levy that is determined to be premature, otherwise not in accordance with administrative procedures, and for wrongful levies.[122]

This provision is effective for tax years beginning **after December 31, 2017.**

121. PL 115-123; Summary of the Tax Extenders Agreement. Senate Finance Committee.

122. IRC §6343(f).

MODIFICATION OF USER FEES FOR INSTALLMENT AGREEMENTS

Old Law. Installment agreements (IA) with the IRS give taxpayers who cannot afford to pay their full tax liability the option to pay monthly installments. The fee for entering into an IA on or after January 1, 2017, is $225. A reduced fee applies in certain situations.[123]

New Law. A provision in the BBA prohibits increases in the amount of user fees charged by the IRS for IAs. In addition, the IRS must waive fees imposed for IAs for taxpayers whose income is below 250% of the applicable poverty level and who have agreed to make payments electronically using a debit account. The taxpayer's fee will be reimbursed at the end of the IA period if their income is below 250% of the poverty level, they do not use a bank, and they successfully complete an IA.[124]

This provision applies to agreements entered into **on or after April 10, 2018** (60 days after enactment of the BBA).

NEW TAX FORM FOR SENIORS

Old Law. Persons required to file tax returns must do so in the form prescribed in Treasury regulations. The standard form used by individuals subject to income tax is Form 1040, *U.S. Individual Income Tax Return.* Alternatively, the taxpayer may use the simplified Form 1040A, *U.S. Individual Income Tax Return,* or Form 1040EZ, *Income Tax Return for Single and Joint Filers With No Dependents.*

New Law. The BBA requires the IRS to issue a simplified form designated as Form 1040SR, which can be used by persons who are age 65 or older at the end of the tax year. The form is to be similar to Form 1040EZ, except that:

- It may be used even if income for the tax year includes social security benefits; distributions from qualified retirement plans, annuities, or other deferred payment arrangements; interest and dividends; or capital gains and losses; and
- It can be used without regard to the amount of any item of taxable income or the total amount of taxable income.

This provision is effective for tax years beginning **after February 9, 2018** (the date of the BBA's enactment).

HARDSHIP DISTRIBUTIONS

Old Law. Elective deferrals under a 401(k) plan or a 403(b) plan generally may not be distributed to the employee before one or more events occur, including the employee's financial hardship. Treasury regulations provide that a distribution is made on account of hardship only if the distribution is made because of the employee's immediate and heavy financial need and is necessary to satisfy that need. The regulations provide a safe harbor under which a distribution is deemed necessary to satisfy an immediate and heavy financial need. One of the safe harbor's requirements is that the employee be prohibited from making elective deferrals and contributions to the employer's plans for at least six months after the employee receives the hardship distribution.[125]

In addition, hardship distributions may include only amounts contributed by the employee and cannot include account earnings or employer contribution amounts.

New Law. A provision in the BBA mandates that the Treasury modify regulations to delete the requirement that an employee be prohibited from making elective deferrals and contributions for six months after the employee receives a hardship distribution. Therefore, the modified regulation will provide that an employee is not prohibited from making elective deferrals and contributions for any period after they receive a hardship distribution.

The BBA also permits employers to allow hardship distributions including account earnings and employer contributions.

These provisions apply to plan years beginning **after December 31, 2018.**

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123. Treas. Reg. §300.1(b).

124. IRC §6159(f).

125. Treas. Reg. §1.401(k)-1(d)(3)(iv)(E).

TAX HOME FOR INDIVIDUALS SERVING IN COMBAT ZONE

Old Law. Under IRC §911, a taxpayer may elect to exclude from gross income certain foreign earned income. Generally, the taxpayer must have a **tax home** outside the United States to be eligible for the exclusion.

New Law. The BBA provides that an individual serving in an area designated by the president as a combat zone has a tax home outside the United States for purposes of the foreign earned income exclusion. This provision applies to tax years beginning after December 31, 2017.

TAX RELIEF FOR CALIFORNIA WILDFIRE DISASTER AREA

The BBA provides tax benefits for taxpayers in the California wildfire disaster area. The term **California wildfire disaster area** is defined as the area in which a major disaster was declared by the president because of wildfires in California between January 1, 2017, and January 18, 2018.[126]

> **Note.** The provisions that affect individual taxpayers are described in this section. Employers in the California wildfire disaster area may be eligible for an employee retention credit, which is described in the 2018 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: New Legislation — Business Concerns.

Rules for Use of Retirement Funds[127]

Old Law. A distribution from a qualified retirement plan or an IRA is generally included in income. Unless an exception applies, a distribution from a qualified retirement plan or an IRA that the taxpayer receives before turning age 59½ is subject to a 10% early withdrawal tax on the amount includable in income.[128]

New Law. The 10% early withdrawal tax under IRC §72(t) does not apply to withdrawals from retirement plans for any qualified wildfire distribution. A **qualified wildfire distribution** is defined as any distribution from an eligible retirement plan made on or after October 8, 2017, and before January 1, 2019, to an eligible individual. An **eligible individual** is one whose principal place of residence during any part of the period from October 8, 2017, to December 31, 2017, was located in the California wildfire disaster area and who sustained an economic loss because of the wildfires. The maximum amount that can be treated as qualified wildfire distributions is $100,000.

An individual who receives a qualified wildfire distribution must include the distribution in gross income ratably over the 3-year period beginning with the tax year in which the individual received the distribution unless the taxpayer elects otherwise.

An individual who receives a qualified wildfire distribution can make one or more contributions to an eligible retirement plan that accepts rollover contributions in an aggregate amount that does not exceed the amount of the distribution. These contributions must be made during the 3-year period beginning on the day after the date the distribution was received. The individual making the contribution is treated as having transferred the amount to an eligible retirement plan within 60 days of the distribution.

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126. PL 115-123 §20101.

127. PL 115-123 §20102.

128. IRC §72(t).

Charitable Contributions[129]

Old Law. Individual taxpayers who itemize their deductions can deduct charitable donations of cash or property to qualifying organizations. Limits apply to the total dollar amount that a taxpayer can deduct. Most cash contributions are generally limited to 50% of the taxpayer's contribution base. The **contribution base** is the taxpayer's AGI, computed without any NOL carryback to the tax year under IRC §172.[130] The limit applies to donations to charitable organizations described in IRC §170(b)(1)(A), which include public charities, private foundations other than nonoperating private foundations, and certain governmental units. Other limits may apply, depending on the type of organization to which the contribution was made and the type of property contributed.

> **Note.** The rules that apply to charitable contributions of cash under the TCJA are explained earlier in this chapter.

New Law. The 50% (or 60% in 2018) contribution-base limit that generally applies to charitable contributions under §170 does not apply to qualified contributions. A **qualified contribution** is any charitable contribution that satisfies the following requirements.

- It is paid during the period beginning on October 8, 2017, and ending on December 31, 2018, in cash to an organization described in §170(b)(1)(A).
- It is made for relief efforts in the California wildfire disaster area.
- The taxpayer elects qualified contribution treatment.
- The taxpayer obtains contemporaneous written acknowledgment that the contribution was used (or is to be used) for relief efforts.

A qualified contribution is allowed only to the extent that the aggregate amount of such contributions does not exceed the taxpayer's contribution base, less the amount of all other charitable contributions allowed. If the aggregate amount of qualified contributions in the contribution year exceeds the maximum allowable amount, the excess may be carried over to the succeeding five tax years.[131]

Casualty and Theft Losses[132]

Old Law. A taxpayer can claim a deduction for a loss incurred during the tax year for which they were not compensated by insurance or otherwise. For individual taxpayers, deductible losses are those incurred in a trade or business or that consist of property losses arising from casualty or theft. Personal casualty or theft losses are deductible only if they exceed $100 per casualty or theft and only to the extent that aggregate net casualty and theft losses exceed 10% of the taxpayer's AGI.

New Law. Qualified disaster-related personal casualty losses are deductible regardless of whether the aggregate net losses exceed 10% of the taxpayer's AGI. To be deductible, the losses must exceed $500 per casualty.[133] A **net disaster loss** is defined as the excess of qualified disaster-related personal casualty losses over personal casualty gains. For this purpose, the term **qualified disaster-related personal casualty losses** is defined as losses that arise in the California wildfire disaster area on or after October 8, 2017, and that are attributable to the wildfires in that area.

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129. PL 115-123 §20104(a).

130. IRC §170(b)(1)(H).

131. PL 115-123 §20104(a)(2)(ii); IRC §170(d)(1).

132. PL 115-123 §20104(b).

133. *Tax Law Provisions for Disaster Areas.* IRS. Apr. 12, 2018. [www.irs.gov/individuals/tax-law-provisions-for-disaster-areas] Accessed on May 2, 2018.

An individual who incurred a net disaster loss and does not itemize deductions can increase their standard deduction by the amount of the net disaster loss. The increase in the standard deduction amount is also allowed as a deduction for purposes of calculating AMTI.

Note. The rules pertaining to casualty and theft losses in the California wildfire disaster area are essentially the same as those that apply to deductions for disaster-related casualty losses under the TCJA (described earlier). However, the TCJA provisions apply to net disaster losses in 2016 or 2017, and the BBA provisions apply to disaster-related personal casualty losses on or after October 8, 2017.

OTHER PROVISIONS

The BBA contains several other tax-related provisions. The provisions affecting individual taxpayers are summarized in the following table.

BBA Section	IRC Section	Description
41103	N/A	Extension of waiver of limitations with respect to excluding from gross income amounts received by wrongfully incarcerated individuals
41107	62(a)	Attorney fees relating to whistleblower awards
41108	7623	Clarification of whistleblower awards