The Tax Cuts and Jobs Act:
Where Have All the Deductions Gone?

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You don't need to remember Pete Seeger's iconic folk song about flowers and war to realize many former income tax deductions are now pushing daisies in the graveyard created by the Tax Cuts and Jobs Act (TCJA) of 2017. A closer examination of the new tax law and the deductions it suspended will help us better anticipate its impact on our personal income tax liability.

Corporate and business taxes

The TCJA accomplishes many things in the name of cutting taxes – primarily for businesses. Most significantly, the newly enacted law reduces the top marginal tax rate for corporations from 35% to 21%. Corporate Alternative Minimum Tax (AMT) is eliminated under the new law. Owners of entities like sole proprietorships, S corporations, partnerships and limited liability companies (LLCs), are now eligible for a 20% qualified business income deduction. However, this income deduction is subject to a complex array of qualification requirements, income phase-out thresholds, as well as wage and asset limitations.

While business tax cuts are certainly the cornerstone of the TCJA, the elimination of two corporate tax deductions is worth noting from a social and cultural perspective. First, in recognition of the #MeToo movement, the new law disallows the deduction of settlement payments and attorneys' fees associated with sexual harassment and sexual abuse claims if those payments are subject to a non-disclosure agreement. Secondly, while employers have retained their ability to deduct 50% of their food and beverage expenses associated with operating their business (e.g. employee meals when traveling), the TCJA eliminates any business deduction for activities related to entertainment, amusement or recreation, as well as membership dues for clubs or facilities organized for business, pleasure or social purposes.

Individual taxation

Understanding just how the TCJA reduces taxes for individuals may be a trickier proposition. Most taxpayers – particularly those married filing jointly – will notice their marginal tax rates have been reduced between two and nine percentage points. However, this phenomenon of lower rates is not universal. Under the new law, single taxpayers with taxable income between roughly $200,000 and $400,000 will now face a 35% marginal rate, rather than their old 33% rate.

The primary source of uncertainty as to how the TCJA will impact individual taxpayers lies in the in the relationship between a more favorable standard deduction, and the new limitations and reductions involving most itemized deductions. Throw in the elimination of the personal dependent exemption, an enhanced dependent child credit, and a myriad of other tax tweaks that only a CPA (Certified Public Accountant) would love, and you may be left with many questions about whether the TCJA actually lives up to its name for individuals.

1040-EZ basics

Taxpayers are permitted a handful of deductions for the purpose of determining their Adjusted Gross Income (AGI). A couple of these "above the line" deductions have been eliminated under the new law.

For instance, moving expenses are no longer deductible, except those pertaining to the job relocations of military personnel. Beginning in 2019, the deduction for alimony paid will be eliminated. Even old divorce decrees will be governed by the new law's non-deductibility provision. Although alimony received will no longer be included in the recipient's taxable income, alimony payers are nearly always in higher tax brackets than alimony recipients. Accordingly, the net effect of the new treatment of alimony will be more dollars lost to the IRS (Internal Revenue Service) from the incomes of divorcing and divorced couples.

After arriving at a calculation of AGI, taxpayers can choose to reduce this figure by either:

1. a standard deduction, or
2. the sum of itemized deductions

Of course, taxpayers select the largest number, because that number will best reduce their taxable income figure.

As shown in the table below, the TCJA nearly doubles the aforementioned standard deduction for all taxpayers regardless of filing status.

Year	Single	Married Filing Jointly (Qual Widow)	Married Filing Separately	Head of Household
2017	$ 6,350	$12,700	$ 6,350	$ 9,350
2018 Under TCJA	$12,000	$24,000	$12,000	$18,000

Deductions, exemptions, credits – Who comes out ahead?

What the TCJA 'giveth' in the nearly two-fold increase in the standard deduction amounts, it 'taketh away' by eliminating personal and dependent exemptions. For example, in 2017 each personal or dependent exemption reduced taxable income by $4,050. Thus, for a married couple with 1 dependent child filing a joint return in 2018, the $11,300 increase (from $12,700 to $24,000) in their standard deduction amount will be more than offset by the loss of $12,150 ($4,050 multiplied by 3) in their personal and dependent exemption amount.

Unfortunately, an apples-to-apples comparison using standard deduction and personal and dependent exemption amounts is woefully incomplete. For most taxpayers, there are multiple layers to this give and take analysis comparing their tax liability under prior and current law. One such layer for some taxpayers is the child tax credit.

> The TCJA increases the child tax credit from $1,000 to $2,000, while dramatically increasing the income levels at which this dollar-for-dollar tax savings begins to phase out.

The table below helps show that some of the trade-offs involved with child tax credits and personal and dependent exemptions. Depending on their family size, make-up and income levels, not all taxpayers will benefit under the new law.

Differences in the Child Tax Credit

Provision	Old Law (2017)	New Law
Personal and Dependent Exemption	$4,050 per exemption	Eliminated
Child Tax Credit	$1,000 per qualifying child	$2,000
Child Tax Credit (Other provisions)	Phase out begins $110,000; Refundable up to $1,000; Credit for children only	Phase out begins $400,000; Refundable up to $1,400 $500 credit for qualifying other family members

Therefore, before taking advantage of those lower personal tax rates established by the TCJA, taxpayers must first calculate their taxable income amid this swirl of favorable and unfavorable changes to deductions, exemptions, and credits. As mentioned previously, one critical step in determining taxable income is selecting between the higher figure of the new more favorable standard deduction amount and the sum of itemized deductions, which deductions have been significantly reduced.

The disappearing and shrinking itemized deductions

Focusing on the more restrictive rules and limits pertaining to itemized deductions helps illuminate the type of taxpayers who – if not harmed – certainly benefit the least from those purported "tax cut" provisions of the new law. Under the TCJA, tax deductions for property taxes, state and local income taxes, and the interest paid on mortgages and home equity loans have been curtailed. Miscellaneous deductions like investment advisory and tax preparation fees, as well as deductions for casualty and theft losses have been effectively eliminated.

Changes to Certain Itemized Deductions

Deduction	Old Law	TCJA (2018 Law)
Medical Expenses	Deductible to the extent exceeding 10% AGI.	For 2 years, deductible to extent exceeding 7.5% of AGI*
State and Local Taxes (SALT)	Property taxes and state and municipal income taxes are deductible. Taxpayers can elect to deduct sales tax in lieu of state income tax.	Deduction retained, but limited to $10,000 for year. Foreign real property tax is not deductible.
Mortgage Interest	Deductible up to $1,000,000 mortgage on primary and secondary home; as well as interest on up to $100,000 of home equity debt.	Interest deduction limited to $750,000 of secured, acquisition debt on primary or secondary home.
Tier 2: Miscellaneous Itemized Deductions	Miscellaneous expenses such as unreimbursed business expenses, tax preparation fees and investment expenses are deductible to the extent they exceed 2% AGI.	Eliminated.

Changes to Certain Itemized Deductions *(continued)*

Deduction	Old Law	TCJA (2018 Law)
Casualty and Theft Losses	Allowed to extent unreimbursed by insurance and loss exceeds 10% AGI and $100 floor.	Eliminated except for casualty losses attributable to federally declared disasters.
Charitable Donations	Current year deduction limited to 50% AGI for cash donations to public charity. *(Other deduction limitations apply; balances carryforward).*	Increases deduction limit to 60% AGI for cash donations to public charities*.
Overall Limitation on Itemized Deductions	‘Pease’ limitations apply.	*Eliminated.

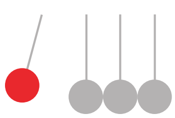
**Relative to prior law, these provisions are favorable to the taxpayer*

The itemized deduction for charitable gifts emerges from the TCJA relatively unscathed. A taxpayer’s cash donations to a public charity now enjoy a more favorable first-year deduction limitation (60%, up from 50%) with respect to AGI. In prior years taxpayers at fairly high income levels could find the tax savings accompanying their charitable gifts were muted by complex formulas, phase outs, and exclusions of other deductions imposed by the Pease limitation and/or the Alternative Minimum Tax (AMT) schedule.

Now that the Pease limitation has been repealed, and the AMT exemptions increased, taxpayers making *significant* gifts to charity can realize more tax savings as a result of their philanthropy. Of course, charitable donations may decline for those taxpayers whose itemized deductions fall below their standard deduction figure.

Impact on taxable income and tax liability

By eliminating and restricting some very significant itemized deductions, the TCJA achieves one of its primary goals: tax simplification. A large percentage of taxpayers will no longer need to track and document a shrinking field of itemized deductions whose sum total is likely to fall below the former standard deduction numbers, let alone the new, more ‘generous’ ones.



Many former “itemizers” will select the higher standard deduction figure to subtract from their AGI, but still see their taxable incomes rise in 2018 due to the loss of personal and dependent exemptions and other factors. Other taxpayers will still itemize, but with a much smaller sum of itemized deductions than prior years, their taxable incomes will increase as well.

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> For many taxpayers, particularly those who expend a large portion of their income on real estate taxes and/or state and local income taxes, the loss of these itemized deductions will effectively increase their taxable income relative to their 2017 number.

Conclusion

Like the flowers vanishing in Pete Seeger's classic song, many of the old reliable tax deductions have gone missing under the TCJA, leaving open questions for taxpayers and advisers alike.

Will the reduction of tax rates in 2018 be enough to counteract potential increases in the taxable income figure? Does the TCJA actually cut the taxes you have to pay? Or will these disappearing itemized deductions leave taxpayers wondering, "where have all the tax refunds gone?"

Interestingly, most of the individual tax provisions – including those impacting itemized deductions – are scheduled to expire at the end of 2025. If no additional changes are made (and that's a big "if"), the pre-TCJA provisions and all the old itemized deductions – will be resurrected! Until then though, a majority of deductions are, as Pete Seeger would say, "gone to graveyards".

To learn more, please consult with your Key Private Bank Advisor.

About the Author

As Director of Family Wealth Consulting, Tim Malloy focuses on the estate, philanthropic and business succession needs of Key Private Bank clients. He has over 30 years of experience in the legal and financial services industry with the last 20 coming at Key Private Bank—specializing in working with high-net-worth individuals, business owners, and corporate executives.

Tim specializes in providing strategic advice for: business ownership transitions, complex financial and estate planning, establishment of philanthropic foundations, and the formation of trusts to mitigate taxes and help Key Private Bank clients accomplish their values-based financial goals.

Tim graduated cum laude (BA in Philosophy) from the University of Notre Dame, and holds a J.D. from Georgetown University Law Center. He is a Certified Exit Planning Advisor and a Chartered Advisor in Philanthropy.