

Dec. 20, 2017

## Tax Reform Passes: Republican Lawmakers Get Their Holiday Wish

On Wednesday the House and Senate passed the Tax Cuts and Jobs Act ("the Act"), ushering in the first significant overhaul of the federal tax code in more than 30 years. The president is expected to sign the legislation into law within the next several weeks. Several proposals that would have rocked benefit and retirement plans and their sponsors were left out of the final package; however, other provisions will significantly impact businesses and individuals.

**Webinar invitation:** This Alert provides a high-level summary of what's in (and out) of the Act. Please join us for a webinar on Jan. 10 at 2 p.m. CST for more details about the package, what it means for plan sponsors and what other changes may be coming in 2018. Please register [here](#).

### Benefit Plan-Related Provisions IN the Act

- **Affordable Care Act's (ACA) Individual Mandate:** The Act eliminates the penalty for not having health insurance, beginning in 2019. Lower-income individuals who buy individual coverage through an ACA marketplace will still qualify for premium reduction subsidies.
- **Qualified Moving Expenses:** The Act eliminates current rules allowing individuals to exclude from taxable income amounts an employer pays for some job-related moving expenses, except for certain active-duty members of the armed forces. Additionally, job-related moving expenses paid for by the individual and not reimbursed by an employer are taxable. This change applies for the 2018 through 2025 tax years.
- **Transportation Fringe Deduction:** Beginning in 2018 employers can no longer deduct expenses for parking, transit passes and vanpool benefits provided to their employees. The current law allowing *employees* to exclude the amounts from income tax remains. However, employer reimbursements for bicycle commuting expenses are taxable (i.e., subject to payroll taxes and income tax withholding).
- **Employer Credit for Paid FMLA Leave:** For 2018 and 2019, employers that pay employees while on FMLA leave can claim a tax credit for a portion of the wage payments if the payments meet certain requirements.

### Benefit Plan-Related Provisions NOT in the Act

- **ACA Taxes for Group Health Plans and Sponsors:** The Act does not modify or eliminate ACA taxes like the Cadillac tax (set to begin in 2020), employer mandate penalties or the health insurer tax (this tax was deferred for the 2017 year). As [reported](#) last week, the House is considering a separate package to delay these and other ACA-imposed taxes.

- **Retirement Plans:** Although earlier drafts threatened retirement savings programs such as 401(k) plans and Individual Retirement Accounts (IRAs), the Act's final version does not significantly impact these programs.
- **Nonqualified Deferred Compensation:** Similarly, while earlier versions of the Act threatened to effectively eliminate nonqualified deferred compensation plans, they too escape significant changes.
- **Dependent Care Flexible Spending Arrangements (Dependent Care FSAs):** The Act retains current rules allowing up to \$5,000 in pre-tax contributions to dependent care FSAs. Earlier versions would have eliminated this popular benefit.
- **Adoption Assistance Programs:** Employer-provided adoption assistance benefits remain non-taxable up to certain thresholds. The Act also preserves the adoption tax *credit*.
- **Education Assistance:** The Act makes no changes to the current rule allowing employers to pay employees up to \$5,250 in tax-free education assistance.
- **Employer-Provided Child Care Credit:** The Act retains the tax credit of up to \$150,000 per year for employers that provide on-site child care to dependents of employees.

### The Act's Impact on Businesses

- **Corporate Rate:** The Act lowers the corporate tax rate from 35 percent to 21 percent beginning in 2018.
- **Pass-Through Deduction:** Under federal tax law, subchapter S-corporations and partnerships (including most LLCs, which are taxed as partnerships) pass their income through to their shareholders, so that federal tax on that income is paid at the *individual* level, rather than at the corporation or partnership level. These entities are called "pass-through" entities, because the taxable income passes through the business to the individual shareholders or partners.

**Lockton comment:** This tax treatment is different than with subchapter C-corporations. Those corporations pay tax on their taxable income, then owners pay taxes on distributions of earnings.

Under the Act, beginning in 2018 the first 20 percent of S-corporation and partnership income is deducted from the income passed through to shareholders and partners for taxation. However, the Act eliminates this deduction for shareholders and partners in most service businesses unless their taxable income is less than \$315,000 if married (\$157,500 if single). Further, wages paid to shareholders or partners in a pass-through organization remain subject to ordinary income tax rates.

This change applies for the 2018 through 2025 tax years.

- **Territorial Tax:** Today, businesses owe tax on all their profits, regardless of where the income is earned. They're allowed to defer paying tax on their foreign profits until they bring the money back to the U.S. Beginning in 2018 the Act generally exempts U.S. corporations from domestic (but not foreign) tax on foreign profits. Companies will pay a one-time tax on their existing overseas profits of 15.5 percent on cash assets and 8 percent on non-cash assets (e.g., equipment abroad in which profits were invested).
- **Alternative Minimum Tax (AMT):** The Act eliminates the corporate AMT beginning in 2018.

## The Act's Impact on Individuals

All the following changes apply for the 2018 through 2025 tax years, except where otherwise noted (some provisions phase out after 2025):

- **Individual Rates:** The Act sets seven marginal tax brackets for individual and joint filers at the following rates (current rates are shown in parentheses): 10 (10), 12 (15), 22 (25), 24 (28), 32 (33), 35 (35) and 37 (39.6) percent.

Here's how much taxable income would apply to the new rates:

- 10 percent (income up to \$9,525 for individuals; up to \$19,050 for married couples filing jointly)
  - 12 percent (over \$9,525 to \$38,700; over \$19,050 to \$77,400 for couples)
  - 22 percent (over \$38,700 to \$82,500; over \$77,400 to \$165,000 for couples)
  - 24 percent (over \$82,500 to \$157,500; over \$165,000 to \$315,000 for couples)
  - 32 percent (over \$157,500 to \$200,000; over \$315,000 to \$400,000 for couples)
  - 35 percent (over \$200,000 to \$500,000; over \$400,000 to \$600,000 for couples)
  - 37 percent (over \$500,000; over \$600,000 for couples)
- **Personal Exemption and Standard Deduction:** The Act eliminates the \$4,050 personal exemption for the individual taxpayer, his or her spouse and each dependent. However, it roughly doubles the standard deduction, from \$6,350 for individuals and \$12,700 for joint-filers under current law, to \$12,000 and \$24,000 for individuals and married couples, respectively.
  - **Individual AMT:** The Act maintains the individual AMT, but reduces the number of filers who will trigger it by raising the income exemption levels to \$70,300 for singles, up from \$54,300 today; and to \$109,400, up from the current \$84,500 threshold, for married couples.
  - **State and Local Tax Deduction:** The Act preserves the deduction for state and local taxes but caps the deductible amount at \$10,000. Today the deduction for state and local tax payments is unlimited.
  - **Mortgage Interest Deduction:** The Act does not change the deduction for mortgage interest for all homeowners with existing mortgages. For homeowners with new mortgages (after 2017 and before 2026) on a first or second home, the home mortgage interest deduction will be available for home loans up to \$750,000, down from \$1 million today.
  - **Child Tax Credit:** The Act expands the child tax credit from \$1,000 to \$2,000. The tax credit is fully refundable up to \$1,400 (meaning it will be paid out to anyone eligible for the credit even if they do not owe taxes) and begins to phase-out for families making over \$400,000. A \$500 nonrefundable credit is also available for dependents who are not children (e.g., an aging parent).
  - **Other Popular Credits/Deductions:** The Act expands the medical expense deduction and the deductions for charitable contributions and retains the deductions for student loan interest and classroom supplies bought with a teacher's own money. It also preserves the tax-free status of tuition waivers for graduate students.
  - **Estate Tax:** The Act doubles the amount of money exempt from the estate tax, currently set at \$5.49 million for individuals and \$10.98 million for married couples.

- **Section 529 Education Savings Accounts:** Currently, section 529 tax savings accounts offer tax-free earnings and tax-free withdrawals when distributions from the accounts are used to pay for college. The Act allows tax-free withdrawals up to \$10,000 per year for elementary and high school expenses, beginning in 2018 and does not sunset after 2025.

## **Next Steps**

The president has been a vocal supporter of the tax-overhaul package and is expected to formally sign the legislation into law within the coming weeks. Debate on the changes will certainly not go away. Large pieces of legislation like this typically require technical corrections, so there may be additional changes before the true impact is known when individuals and businesses file their tax returns for 2018.

Regardless, we expect politicians on both sides of the aisle to craft narratives about the Act to influence voters in advance of the 2018 midterm elections.

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