

Your Money 2020: The WSJ Tax Guide

By Laura Saunders, Richard Rubin and the staff of The Wall Street Journal



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INTRODUCTION

Toward the end of 2019, lawmakers passed the most important changes to the nation's retirement system since 2006. They came just two years after Congress delivered the largest overhaul of the U.S. tax code in three decades.

Nearly every American has been affected in some way by these changes. They apply to a broad range of provisions, including popular deductions for mortgage interest and state taxes, child credits, estate-and gift-tax exemptions, the alternative minimum tax and retirement-savings incentives.

Many taxpayers remain confused. Last year, millions of filers were surprised to receive smaller refunds or owe higher taxes because they hadn't adjusted their paycheck withholding after the overhaul. Home sellers in some high-tax areas aren't getting prices as high as expected due to changes in state and local tax deductions.

The passage of the 2019 spending bill by Congress included what has been known as the Secure Act, and it made extensive changes to retirement provisions with bipartisan support. Now savers, retirees and workers on the cusp of retirement need to evaluate key changes to required withdrawals from their individual retirement accounts and planning for their so-called Stretch IRAs. Some will need to consider new savings options, such as whether to opt for an annuity in their 401(k) that would provide lifetime income but might have high fees.

This book was first written by the reporters and editors of The Wall Street Journal in 2018 to help dispel confusion about 2017 tax-law changes. This revision updates that information both for 2019 and 2020. It also includes what taxpayers need to know about the Secure Act, along with new links to relevant Journal articles on these topics. It reviews the promises and results of the 2017 overhaul as well.

Taxes touch Americans in many different areas of their lives, from paying for education, investing, and running a business to home buying or selling, coping with medical expenses and saving for retirement. With this book, taxpayers have a guide to the 2020 world of taxes.

—*Laura Saunders and Richard Rubin*

THE BIG PICTURE

TAX RATES AND BRACKETS

The 2017 tax overhaul changed rates and income brackets, but whether people owe more or less often depends on other provisions

The tax overhaul altered rates and brackets, but not as much as some proposed. Instead, the major changes affecting Americans often stem from other provisions, such as the expanded standard deduction or child tax credit.

Lawmakers also [switched to a less generous method for calculating inflation adjustments](#) to tax brackets and other key provisions. They are now adjusted using the typically slower-moving chained consumer-price index instead of a traditional method of inflation known as the CPI-U. The shift will cost Americans \$133.5 billion over a decade, according to Congress's Joint Committee on Taxation.



THE TOP AND BOTTOM RATES

The top tax rate was reduced to 37% from 39.6%; the lowest rate remains 10%. The changes to rates and brackets weren't as dramatic as some proposed.

For example, the new top tax bracket for individuals began at \$500,000 for 2018 and rose to \$510,300 for 2019 under the new inflation adjustment. The adjustment would have been to \$512,075 under the prior system, according to calculations by the Tax Foundation. By 2025, this gap between the old and new brackets is projected to be \$10,325.








While many thresholds in the tax code are adjusted for inflation, there are important exceptions. [Among those that aren't adjusted](#) are some tax breaks for homeowners, taxes on Social Security benefits, and certain taxes on investment income. As a result, millions of Americans are paying more to Uncle Sam because there's no indexing for such provisions.




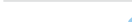



The tax code has seven income-tax brackets. The rate changes expire at the end of 2025, but the change to the inflation adjustment is permanent. The overhaul dropped the top rate from 39.6% to 37%. The lowest rate remains 10%, which takes effect at the first dollar of taxable income.

TAX RATES AND BRACKETS

However, taxpayers may have more or less income before the 10% rate applies than they did before the overhaul, due to changes to deductions, exemptions and other provisions.

—Richard Rubin and Laura Saunders

| Individual Income Tax Brackets for 2020 | | |
|---|------------------------|-------------------------|
| Individual income tax | Taxable income | |
| RATE | SINGLE | MARRIED, FILING JOINTLY |
|  10% | up to \$9,875 | up to \$19,750 |
|  12% | \$9,876 to \$40,125 | \$19,751 to \$80,250 |
|  22% | \$40,126 to \$85,525 | \$80,251 to \$171,050 |
|  24% | \$85,526 to \$163,300 | \$171,051 to \$326,600 |
|  32% | \$163,301 to \$207,350 | \$326,601 to \$414,700 |
|  35% | \$207,351 to \$518,400 | \$414,701 to \$622,050 |
|  37% | \$518,401 + | \$622,051 + |

| Tax Rates and Brackets, 2019 | | |
|---|------------------------|--------------------------|
| Individual income tax | Taxable income | |
| RATE | SINGLE FILERS | MARRIED, FILING JOINTLY* |
|  10% | up to \$9,700 | up to \$19,400 |
|  12% | \$9,701 to \$39,475 | \$19,401 to \$78,950 |
|  22% | \$39,476 to \$84,200 | \$78,951 to \$168,400 |
|  24% | \$84,201 to \$160,725 | \$168,401 to \$321,450 |
|  32% | \$160,726 to \$204,100 | \$321,451 to \$408,200 |
|  35% | \$204,101 to \$510,300 | \$408,201 to \$612,350 |
|  37% | \$510,301 + | \$612,351 + |

*And qualifying widow or widower
Source: Internal Revenue Service

STANDARD DEDUCTION AND PERSONAL EXEMPTION

The expansion of the standard deduction and repeal of the personal exemption affect millions of Americans

For many people, the tax overhaul's most sweeping changes are the near-doubling of the standard deduction and repeal of the personal exemption.

The standard deduction is the amount filers subtract from income if they don't break out deductions for mortgage interest, charitable contributions, state and local taxes and other items on Schedule A. Listing these deductions is called "itemizing."

The overhaul raised the standard deduction to \$24,000 per married couple filing jointly and \$12,000 for singles, up from \$12,700 for couples and \$6,350 for singles for 2017.

For 2019, this deduction rises to \$24,400 per couple and \$12,200 per single filer. For 2020, the standard deduction is \$24,800 per couple and \$12,400 per single filer.

As a result, the number of taxpayers who will itemize for 2019 is expected to drop by more than half compared with 2017—from nearly 47 million to about 18 million out of about 155 million tax returns, according to data from the Joint Committee on Taxation and Congressional Research Service.

Switching to the standard deduction will simplify the returns of nearly 30 million filers. It will also lighten the IRS's burden, because the agency will have fewer deductions to monitor.

But the change also means these filers won't get a specific benefit for having mortgage interest or making charitable donations. That could affect future decisions about donations or owning a home.



BUYING HOMES, MAKING DONATIONS

The larger standard deduction means tax returns will be simpler for millions of filers because they won't itemize their deductions. But they won't get a specific benefit for having a mortgage or making charitable donations, which could affect future decisions about owning a home or giving to charity.

STANDARD DEDUCTION AND PERSONAL EXEMPTION

PERSONAL EXEMPTION REPEALED

The repeal of the personal exemption is also a landmark shift. Before the overhaul, this provision was a subtraction from income for each person included on a tax return—typically the members of a family. The 2017 amount was \$4,050 per person, and it phased out for higher earners.

The personal exemption was also integral to figuring out an employee's correct withholding from pay.

The interaction of the expanded standard deduction, repealed personal exemption and expanded child credit is complex, and the effects on individuals will vary widely depending on their circumstances. In part that is because the personal exemption was a deduction from income, while the child credit is a dollar-for-dollar offset of taxes—and some taxpayers can get a portion of it even if they don't owe income taxes.

Many families with younger children will come out ahead under the new law, especially if they took the standard deduction in the past, because of the expanded child credit of up to \$2,000 per child that extends to far more households. But some others won't, especially if their dependents are age 17 or older. They will get a \$500 tax credit in place of the exemption.

The repeal of the personal exemption and the expanded standard deduction and child credit expire at the end of 2025.

—*Laura Saunders*

CHILD AND DEPENDENT TAX CREDITS

The child credit doubled and became available to more families, a move that more than offset the repeal of the personal exemption in many cases

The maximum child tax credit is now \$2,000, up from \$1,000 for each child in a family under age 17 at year-end.

Many more families are also eligible for this credit. For 2019 and 2020, it begins to phase out at \$400,000 of adjusted gross income for most couples and \$200,000 for most singles, compared with 2017 levels of \$110,000 for couples and \$75,000 for singles. Low and moderate earners may be eligible for a payment of up to \$1,400 per child due to the credit, even if they don't owe income tax.

The changes to this credit expire after 2025. The credit and income levels aren't adjusted for inflation, but the payment of up to \$1,400 per child to lower earners will be adjusted infrequently in coming years.



CHILD CREDIT VS. PERSONAL EXEMPTION

For many filers with children under 17, the expanded credit is a more valuable benefit than the personal exemption, which was suspended by the overhaul. A credit is a dollar-for-dollar offset of taxes, while the personal exemption was a deduction from income that phased out for higher earners.

For many middle-income filers with children under 17, the expanded credit will be a more valuable benefit than the personal exemption, which was suspended by the overhaul. A credit is a dollar-for-dollar offset of taxes, while the personal exemption was a deduction from income that phased out for higher earners. For 2017, it was \$4,050 for each household member.

For example, a married couple with three young children and taxable income of about \$200,000 in 2017 wouldn't have qualified for the prior child tax credit. The personal exemption for the children could have saved them about \$3,300 in tax, according to tax specialist Robertson Williams of the Tax Policy Center. For 2019, the child credit would save such a family \$6,000 of tax.

CHILD AND DEPENDENT TAX CREDITS

Families with dependents age 17 and older, such as college students or an elderly parent, often fare less well after the overhaul. The tax credit for each of these dependents drops to \$500, so in many cases the personal exemption would have provided more benefit.

The revised provisions don't alter existing tax-code rules defining who is a dependent.

—*Laura Saunders*

WITHHOLDING AND ESTIMATED TAX PAYMENTS

Employees should refigure paycheck withholding or risk unwelcome surprises

After the 2017 overhaul, the Treasury Department made automatic adjustments to paycheck withholding based on the law's changes that raised take-home pay for more than 90% of employees in 2018. The withholding changes also applied to pension payments.

However, these automatic withholding changes [led to confusion](#) during the 2019 filing season, as many taxpayers received smaller refunds or had larger payments due than expected when they filed their 2018 returns.

The changes to withholding remain in effect for 2019 and 2020 for many filers. Those who weren't happy with their refund size or taxes due last year [should have made revisions to their 2019 withholding](#).

The IRS posted a [calculator](#) on its website to help with decisions, and it has been updated for 2020. The agency has also revised the W-4 form that employees use to determine withholding.

The IRS waived penalties for some people who didn't pay enough taxes throughout the year in 2018, but these waivers don't apply to 2019 taxes. In general, filers can avoid penalties if they pay 90% of the current year's taxes owed, either through withholding or by making the correct quarterly estimated tax payments.

—Richard Rubin and Laura Saunders



WITHHOLDING AND TAX REFUNDS

Automatic changes to paycheck withholding raised take-home pay for millions in 2018, and many filers were surprised by smaller refunds or higher taxes due in 2019. To avoid penalties, taxpayers should check their withholding and estimated tax payments.

TAXES ON INVESTMENT INCOME

The overhaul made few changes to investment-income taxes, preserving the favorable rates for capital gains and dividends

The tax overhaul didn't change the favorable rates for long-term capital gains and many dividends, and a popular zero rate on these types of investment income for middle-income households is still in effect.

For 2019, the zero rate applies to married couples, filing jointly, up to a threshold of \$78,750 of taxable income (\$39,375 for singles). A 15% rate then takes effect for joint filers with up to a threshold of \$488,850 of taxable income (\$434,550 for singles). A 20% rate applies above that.

For 2020, the zero rate applies to married couples, filing jointly, up to a threshold of \$80,000 of taxable income (\$40,000 for singles). A 15% rate then takes effect for joint filers up to a threshold of \$496,600 (\$441,450 for singles). A 20% rate applies above that.

There is also a 3.8% surtax on net investment income for filers with higher incomes.

Long-term capital gains are net profits on investments held longer than a year. As in prior law, short-term capital gains on investments held a year or less are taxed at the same rates as ordinary income.

The favorable rates for dividends apply to those that are "qualified," which most are. Nonqualified dividends are taxed at ordinary-income rates.

HOW THE ZERO RATE APPLIES

Some readers have asked how the zero rate on investment income applies. Here is a simplified example.

Say that Susan is a single taxpayer with \$30,000 of taxable ordinary income for 2019 after deductions and exemptions, such as for tax-free municipal-bond interest or the sale of a home. Her taxable income is subject to regular rates up to 12%, as detailed in the tax brackets.

TAXES ON INVESTMENT INCOME

But Susan also has a \$20,000 long-term capital gain. This \$20,000 “stacks” on top of her \$30,000 of other taxable income, and the 15% bracket for capital gains begins at \$39,375 of taxable income. As a result, she would owe zero tax on \$9,375 of her gain and 15% on the remaining \$10,625.

3.8% SURTAX

The tax overhaul didn’t repeal the 3.8% surtax on net investment income. This levy takes effect at \$250,000 of adjusted gross income for most married couples and \$200,000 for most single filers. Those thresholds aren’t indexed for inflation.

As a result, top-bracket taxpayers typically owe 23.8% instead of 20% on their long-term gains and dividends. Some investors in the 15% bracket for this income owe the 3.8% surtax on part or all of it because their adjusted gross income is above the \$250,000/\$200,000 thresholds. Filers below these threshold don’t owe it.

Congress also preserved most tax exemptions for municipal-bond interest.

—*Laura Saunders*

ALTERNATIVE MINIMUM TAX

*Republicans kept this levy after vowing to kill it,
but they revised it to affect far fewer people*

The overhaul nearly repealed the alternative minimum tax, or AMT, a parallel tax system that is both complex and confusing. The purpose of the AMT is to limit tax breaks allowed by the regular tax system and ensure that high earners can't legally avoid all taxes.

In the end, lawmakers retained the AMT, but with important changes. The changes expire at the end of 2025.

Far fewer people will owe the revised AMT, according to the Tax Policy Center. It estimates that about 200,000 filers will owe the levy for 2019 and the same number for 2020, compared with 5 million filers for 2017. The AMT will also fall less heavily on those earning \$500,000 or less and more heavily on higher earners than in the past.

Several triggers of the prior AMT have been reduced or repealed, helping to lower the number of taxpayers who owe it. These prior triggers include state and local tax deductions, personal exemptions and miscellaneous deductions. In addition, the AMT exemption was expanded.

Tax specialists say the breaks triggering the revised AMT are likely to be more unusual items such as incentive stock options, interest from certain municipal bonds and net operating losses.

—*Laura Saunders*

INDIVIDUAL MANDATE

Obamacare requirement to have health insurance or pay a penalty is gone for 2019

Republicans used the tax overhaul to achieve a health-policy aim: eliminating the individual mandate to have health insurance, a centerpiece of the 2010 Affordable Care Act.

A principal feature of the ACA, often called Obamacare, was that most individuals had to pay a penalty if they didn't have health coverage that met new federal standards. The law exempted certain groups from the payment, including the very poor, members of certain religious groups and people with brief coverage gaps. Those exemptions were expanded in 2018, enabling people to claim the exemption without showing supporting documents.

FEWER INSURED

Health plans worry that fewer young, low-risk people will get insurance, forcing up premiums further. Some analysts counter that the mandate has never been aggressively enforced and has had little impact.

Some states have, or are considering, their own state-wide penalties and insurance coverage requirements.

In short, people who didn't have coverage during 2019 don't owe a federal penalty.

—*Stephanie Armour*

HOME-SELLERS' EXEMPTION

*Nothing changed, despite an initial effort
by House Republicans to reduce the benefit*

Despite proposed changes, the tax benefit for home sellers has remained.

Married couples filing jointly can exclude \$500,000 of profit on the sale of a primary home from taxes. For single filers, the exemption is \$250,000 of profit. These amounts aren't indexed for inflation.

\$250,000
Exemption for singles

\$500,000
Exemption for
married couples

For example, say that John and Jane bought a home many years ago for \$120,000 and later made improvements that added \$100,000 to its cost. This year, they sell the home for \$600,000.

The gain, or profit, on the sale is \$380,000. All of it would be exempt from capital-gains tax due to their \$500,000 exemption.

To be eligible for this benefit, the homeowner must have used the house

as a primary residence for two of the previous five years. In general, taxpayers aren't eligible for the full exemption if they excluded the gain from the sale of another home during the two years before the sale.

Other limits and exceptions apply, such as for certain military personnel. For more information, see IRS Publication 523, *Selling Your Home*.

—Laura Saunders

ESTATE AND GIFT TAX

Lawmakers didn't repeal the estate tax, but they doubled the exemption, reducing the number of liable estates

The overhaul doubled the estate-and gift-tax exemption, which is a combined amount that applies to an individual's gifts made during life and assets left at death.

For 2019, an inflation adjustment lifted it to \$11.4 million per individual and \$22.8 million per couple. For 2020, it's \$11.58 million per individual, and \$23.16 million per couple.

About
7,700
Number of estates
expected to owe
estate tax for 2017

About
2,700
Number of estates
expected to owe
estate tax for 2019

This increase in the exemption is set to lapse after 2025. In November 2018, the Treasury Department and the IRS issued proposed regulations that would allow individuals who make large gifts between 2018 and 2025 to retain the tax benefit of the higher exemption, even if it reverts to pre-2018 levels. These rules were made final in 2019.

Here is a simplified example. Say that John has assets of \$11 million, and he gave it to a trust for his heirs in 2019. The transfer is free of gift tax because exemption was \$11.4 million for 2019.

But after 2025 the exemption reverts to its 2017 level of \$5.49 million (plus an inflation adjustment), and John dies in 2026. Under the Treasury rules, John's estate wouldn't owe tax on the portion of his 2019 gift that's above the 2026 exemption.

The number of estates that owe tax is expected to drop sharply as a result of the overhaul's changes. About 2,700 estates, or 0.1% of people who died, are expected to owe estate tax for 2019, according to estimates by the Tax Policy Center. For 2017, when the exemption was \$5.49 million per person, 7,700 estates were expected to owe the tax.

ESTATE AND GIFT TAX

NO CHANGE ON CAPITAL GAINS AT DEATH

Assets held at death still aren't subject to capital-gains tax. This is known as the "step-up in basis."

For example, say that Robert dies owning shares of stock worth \$100 each that he bought for \$5, and he held them in a taxable account rather than a tax-favored retirement plan such as an IRA.

Because of the step-up provision, Robert's estate won't owe capital-gains tax on the \$95 of growth in each share of stock. Instead, the shares go into his estate at their full market value of \$100 each. Heirs who receive the shares then have a cost of \$100 each as a starting point for measuring taxable gain when they sell.

UNUSED PORTION OF EXEMPTION IS 'PORTABLE'

The tax overhaul also didn't change the rules on portability, a generous tax benefit for many married couples. It allows a surviving spouse to receive the unused portion of the federal exemption of the spouse who died.

If Linda died in 2019 leaving an estate of \$2 million to heirs other than her husband Jack, he could claim the \$9.4 million of Linda's unused exemption for his own use during life or after his death.

ANNUAL GIFTS

The law also allows any taxpayer to make annual gifts to anyone—relative, neighbor, friend or stranger—up to a certain amount free of federal gift tax. An inflation adjustment raised this exemption from \$14,000 to \$15,000 per recipient for 2018, and it will remain at that level for 2019 and 2020.

Above this exemption, taxable gifts are subtracted from an individual's lifetime estate- and gift-tax exemption, which is \$11.4 million per person for 2019 and \$11.58 million per person for 2020.

These annual gifts aren't deductible from income tax, but they do gradually remove assets from the giver's estate, and the amounts can add up—especially

ESTATE AND GIFT TAX

if the assets grow in value after the gift. A husband and wife with three married children and six grandchildren, for example, could shift \$360,000 a year to the 12 family members by using this benefit.

The annual exemption can be used to transfer complex assets, such as fractional shares of a business, but expert help is recommended.

BUNCHING GIFTS FOR COLLEGE

In an alternative strategy, givers can “bunch” five years of annual \$15,000 gifts to a 529 education-savings plan, typically for children or grandchildren.

No tax is due, but a gift-tax form should be filed, says Mark Kantrowitz, the publisher of savingforcollege.com.

—*Laura Saunders*

THE ‘KIDDIE TAX’

The overhaul simplified a special levy on a child’s ‘unearned’ income, but Congress repealed the revision in 2019 because of its unfavorable effects on children of lower earners

The overhaul made significant changes to the “Kiddie Tax,” a special levy on a child’s “unearned” income above \$2,200 for 2019 and the same for 2020. These changes greatly simplified the levy, but they also raised taxes significantly on lower-earning families—such as those with children of military service members who died on duty.

In 2019, the law came full circle when Congress repealed the overhaul’s changes to the Kiddie Tax and reinstated prior law. Affected taxpayers can choose either version of the law for their 2018 and 2019 returns. Those who want to claim refunds for 2018 need to file amended returns.

The Kiddie Tax typically applies to investment income such as dividends, interest, and capital gains, although it can also apply to taxable financial aid for education and certain other payouts, such as a taxable survivor’s benefit. It doesn’t apply to a young person’s earned income, such as from mowing lawns or designing websites.

Congress passed the Kiddie Tax in 1986 to prevent wealthy or affluent people from taking advantage of their children’s lower tax rates by shifting income-producing assets to them. Today, the Kiddie Tax applies to nearly all children under 18 and many who are under 24, if they are full-time students and aren’t self-supporting.

The overhaul simplified the Kiddie Tax by making a youngster’s unearned taxable income subject to trust-tax rates rather than the parents’ income-tax rate. An [unanticipated result of the change](#) was that, while the Kiddie Tax was often lower or the same for children of high-income parents, it rose for children of parents in lower tax brackets.

Here’s [an example](#). After a Navy chief petty officer died of a heart attack at age 39 in 2017, his 6-year-son received a survivor’s benefit that in 2018 came to about \$29,300.

THE 'KIDDIE TAX'

The pre-2018 Kiddie Tax rules taxed the son's income at his mother's tax rate, which was 12%. After the 2017 revision, the top rate on the son's income rose to 37%. Following the 2019 revision, the child's tax rate will again be linked to his mother's rate.

The reinstatement of prior law for 2020 and beyond means that generous parents, grandparents and others need to take yet another look at [the income-tax effects of making gifts to young people.](#)

—*Laura Saunders*

CRYPTOCURRENCY

The IRS is on the warpath about cryptocurrency tax compliance

In 2019, the IRS moved aggressively to [crack down on tax cheating involving cryptocurrencies](#) such as bitcoin after learning of potential widespread noncompliance.

In July and August, the agency [sent letters to more than 10,000 cryptocurrency holders](#) warning that they may have broken federal tax laws. The letter served notice that those not in compliance should come forward immediately.



CRYPTOCURRENCY

The IRS is now asking tax filers whether they have traded cryptocurrencies.

In October, the IRS added a new question to the tax returns: “At any time during 2019, did you sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?”

Cryptocurrency owners who fail to answer the question or are untruthful risk higher penalties.

The IRS released [new rules](#) on the tax treatment of cryptocurrency, including controversial guidance on certain splits known as forks.

The recent guidance follows the agency’s original notice, issued in 2014. It said that [bitcoin and its kin are property](#), not currencies like dollars or francs. Often they are investment property like stock shares or real estate. Sales proceeds are typically taxed as long- or short-term capital gains, and [losses can offset gains](#).

If cryptocurrencies are held for personal use, as a home is, rather than primarily as an investment, then profits are taxable but losses aren’t deductible. The IRS hasn’t issued guidance in this area.

—*Laura Saunders*

DEDUCTIONS

STATE AND LOCAL TAX DEDUCTIONS

The overhaul capped the deduction for state and local taxes at \$10,000 per return

In a landmark change, the tax overhaul put a cap on deductions for state and local taxes, known as SALT. Previously these deductions were unlimited for individuals, although many people who owed the alternative minimum tax lost the benefit of some or all of their SALT write-offs.

Now taxpayers can deduct property and income or sales taxes, but only up to \$10,000 per return. This change expires at the end of 2025.

For example, say that Dan is a single filer who owes \$6,000 of state income tax and \$6,000 of property tax on his home. For 2017, he could deduct the \$12,000 total of these taxes. But for tax years 2018-2025, the deduction is capped at \$10,000 per return, and it isn't indexed for inflation.

According to the Tax Foundation, this change is expected to hit hardest in the six states where SALT deductions are highest as a percentage of income: New York, New Jersey, Connecticut, California, Maryland and Oregon.

Since the overhaul, a number of wealthy people, including President [Donald Trump](#), have decided to leave high-tax northeastern states for Florida, [which doesn't have a state income tax](#). Some [other residents of high-priced areas](#) are pulling up stakes as well.



STATES MOST AFFECTED

- New York
- New Jersey
- Connecticut
- California
- Maryland
- Oregon

States where SALT deductions are highest as a percentage of income

STATE AND LOCAL TAX DEDUCTIONS

Lawmakers in some states have considered strategies to preserve the full deductibility of state and local taxes. One workaround would, in effect, have converted these levies to charitable contributions that could be deducted on the federal return.

In August 2018, the Treasury Department [moved to block attempts](#) by New York, New Jersey and Connecticut to enable their residents to take such write-offs. But Treasury's proposal also pinches tax-credit programs that benefit private schools and other programs in Georgia, Arizona and elsewhere, preventing donors from getting more money in tax breaks than they contribute.

Treasury's rule wouldn't affect New York's other major attempt to work around the cap—an [optional payroll tax](#) shifting SALT deductions from individuals who can no longer fully take them [to businesses that can](#). Businesses have been skeptical of this idea, and relatively few signed up for 2019 and 2020.

The new cap will affect many married couples more than singles, because the \$10,000 SALT limit is per return and not per person.

Some Wall Street Journal readers have asked whether two spouses can each file separately and claim two \$10,000 deductions. The answer is no. Although married couples can file separate returns, in this case each spouse would get a \$5,000 deduction for state and local taxes. To qualify for two \$10,000 deductions, the couple would have to divorce.



FILING SEPARATELY

Spouses cannot file separately as a strategy to claim two \$10,000 deductions. If married couples file separately, each spouse would get a \$5,000 deduction for state and local taxes. To qualify for two \$10,000 deductions, the couple would have to divorce.

—*Laura Saunders and Richard Rubin*

MORTGAGE-INTEREST DEDUCTION

Near-doubling of standard deduction, caps on eligible mortgages mean fewer will take popular write-off

The tax overhaul enacted new curbs on deductions for mortgage interest, both indirect and direct. These changes expire at the end of 2025.

As a result, the number of tax returns with a mortgage-interest deduction will drop to about 14 million for 2019 compared with 32 million for 2017, according to data from the Joint Committee on Taxation.

**32 million vs.
14 million**

Estimated number
of returns taking the
mortgage deduction
for 2017 vs. 2019

One reason for the change is that millions more filers will claim the expanded standard deduction rather than list write-offs separately on Schedule A.

For example, if a married couple's mortgage interest, state taxes and charitable contributions average about \$15,000 per year, they benefited from listing these deductions on Schedule A before the overhaul. But for 2019

they won't, because it is to their advantage to take the \$24,400 standard deduction instead.

NEW LIMIT ON ELIGIBLE MORTGAGE DEBT

Lawmakers also made [important changes](#) affecting some taxpayers who do take mortgage-interest deductions. The new law allows homeowners with existing mortgages to continue to deduct interest on a total of \$1 million of debt for a first and second home.

For new buyers, however, the \$1 million limit drops to a total of \$750,000 for a first and second home. These limits aren't indexed for inflation.

MORTGAGE-INTEREST DEDUCTION

For example, if John had a \$750,000 mortgage on a first home and a \$200,000 mortgage on a second home as of December 15, 2017, then he can continue to deduct the interest on both on Schedule A. But if he bought one home with a \$750,000 mortgage by that date, and then bought a second home using a \$200,000 mortgage in 2018, he can't deduct the interest on the second loan.

MORTGAGE REFINANCING

According to the National Association of Realtors, homeowners can refinance mortgage debt up to \$1 million that existed on Dec. 15, 2017 and still deduct the interest. But often the new loan can't exceed the amount of the mortgage being refinanced.

For example, if Linda has a \$1 million mortgage she has paid down to \$800,000, then she can refinance up to \$800,000 of debt and continue to deduct interest on it. If she refinances for \$900,000 and uses \$100,000 of cash to make substantial improvements to the home, she could also deduct the interest on \$900,000, according to the NAR.

But if Linda refinances for \$900,000 and simply pockets \$100,000 of cash, then she could deduct interest on only \$800,000 of the refinancing.

HOME-EQUITY LOANS AND LINES OF CREDIT (HELOCS)

The overhaul [prohibits interest deductions](#) for this debt unless the funds are used for certain types of home improvement. Under prior law, homeowners could deduct the interest on up to \$100,000 of home-equity debt used for any purpose.

To be deductible now, the borrowing must be used to “buy, build, or substantially improve” a first or second home. The debt must also be secured by the home it applies to, so a Heloc on a first home can't be used to buy or expand a second home.

For more information, see IRS Publication 936, which has been revised to reflect the new law.

—*Laura Saunders*

CHARITABLE-DONATION DEDUCTIONS

The overhaul didn't make major changes to these deductions, but the near doubling of the standard deduction means far fewer filers will choose to itemize

The number of tax returns claiming deductions for charitable contributions is expected to drop by more than 50% as a result of the overhaul, although charitable giving will not drop as much. For 2019, about 15 million filers are expected to take this write-off, compared with about 38 million for 2017, according to the Joint Committee on Taxation and the IRS.

38 Million
Returns deducting
charitable donations
for 2017

15 Million
Returns expected
to deduct charitable
donations for 2019

Here is why. The standard deduction for 2019 is nearly double the level for 2017, rising from \$6,350 to \$12,200 for single filers and from \$12,700 to \$24,400 for couples filing jointly. For 2020, it rises to \$12,400 for singles and \$24,800 for couples.

The standard deduction is the amount filers can subtract from income if they don't list "itemized" write-offs for mortgage interest, charitable donations, state taxes and the like on Schedule A.

As a result, a filer's itemized deductions for 2019 and 2020 will need to be greater than new standard-deduction amounts for the filer to benefit from itemizing.

Say that Jane and her husband, Robert, donate \$10,000 to charities each year, but their mortgage is paid off and their only other itemized deduction is \$10,000 of state and local taxes, for a total of \$20,000.

This couple itemized deductions on Schedule A for tax year 2017, because the \$20,000 total exceeded their \$12,700 standard deduction. But for tax year 2019, they will opt for the standard deduction of \$24,400, because it exceeds the \$20,000 total on Schedule A.

CHARITABLE-DONATION DEDUCTIONS

This means that Jane and Robert won't get a specific tax benefit for giving to charity on their 2019 return—a change that is worrying charities that rely on donations from filers who aren't wealthy.

For charitable donors who want a tax break, there are ways around this change. One is to “bunch” donations every few years to surmount the higher standard deduction.

If Jane and Robert donate \$20,000 every other year, they could itemize in those years and claim the standard deduction in the years they don't donate.



DONOR-ADVISED FUNDS

Donors can bunch smaller gifts into one larger deduction, but payments to charities can be made over several years. Meanwhile, the assets can be invested and grow tax free. These accounts save paperwork but have fees.

Givers should also consider so-called donor-advised funds. These popular accounts enable donors to bunch smaller gifts into one large amount and take a deduction in the year of the gift. The donor can then designate charities as recipients later. Meanwhile, the assets can be invested and grow tax-free, although the accounts have fees.

Donors who are 70½ or older have [another good strategy](#) if they have individual retirement accounts. Many can benefit from contributing up to \$100,000 of IRA assets directly to one or more charities.

—*Laura Saunders*

MEDICAL-EXPENSES DEDUCTION

After considering an end to this write-off, lawmakers retained it and made it slightly more generous

An attempt by the House of Representatives to end the deduction for medical expenses as part of the overhaul provoked an intense public reaction because it would have affected people in nursing homes and those with expensive chronic illnesses.

7.5%
Income threshold above
which medical expenses
are deductible for
2019 and 2020

In the end, lawmakers retained the deduction and made it slightly more generous. In 2019 they extended the lower rate, so taxpayers can deduct eligible medical expenses exceeding 7.5% of adjusted gross income for tax years 2017 through 2020.

Expenses that qualify include many out-of-pocket costs not typically covered by health insurance. Among them are nursing-home costs, insurance premiums paid with after-tax dollars, prostheses, eyeglasses, and even a wig if needed after chemotherapy, among others.

This deduction is only available to filers who itemize. For more details, see IRS Publication 502.

—*Laura Saunders*

ALIMONY

*Future alimony payments are expected
to shrink as a result of the overhaul*

The overhaul made a major change to the tax status of alimony payments. Payers can't deduct alimony on their tax returns for divorce and separation agreements signed after 2018.

At the same time, alimony recipients no longer have to report these payments as income, making the tax treatment of them similar to that for child support.

Deductions are still allowed for alimony paid as a result of agreements signed in 2018 and before, and such payments will still be taxable to recipients.

Divorce specialists say that in many cases, the overhaul's changes to alimony will be negative for both members of the couple because the payer and the payee often are in very different tax brackets.

The move "changes the economics of many divorces," says Madeline Marzano-Lesnevich, a New Jersey-based lawyer and national head of the American Academy of Matrimonial Lawyers. She said the payments to lower-earning spouses are likely to shrink as a result.

Alimony, also called maintenance, is typically used when one spouse of a divorcing couple earns far more than the other. Alimony payments continue for a period of years and help defray the expense of splitting one household into two.

—*Laura Saunders*

OTHER DEDUCTIONS

Many write-offs have been curtailed, including those for unreimbursed employee travel expenses

The tax overhaul suspended many other deductions or imposed new limits on them. These changes generally expire at the end of 2025.

On Schedule A, Congress eliminated deductions for miscellaneous expenses, a grab bag of items. The change removed deductions for unreimbursed employee expenses for travel, meals and entertainment; union dues; uniforms; subscriptions; safe-deposit box fees; and tax-preparation fees; among others.

Also gone is the deduction for investment-advisory fees. [This change affects investors](#) who pay fees for advice based on a percentage of their assets, including many with tax-efficient separately managed accounts. It also hits investors in hedge funds or other funds structured as partnerships, if they owe tax on profits before hefty fees are deducted.

Many taxpayers found the miscellaneous-expenses deduction hard to qualify for, because total eligible expenses had to exceed 2% of adjusted gross income.

Also on Schedule A, lawmakers curtailed the deduction for most casualty and theft losses other than from federally declared disasters. Some other itemized deductions are still allowed, such as for certain gambling losses. They are listed in the instructions for Schedule A.

Elsewhere on the return, Congress ended the deduction for moving expenses by taxpayers who aren't in the military. However, educators can still deduct up to \$250 of unreimbursed expenses for classroom supplies, even if they don't itemize.

—Laura Saunders

RETIREMENT AND EDUCATION

RETIREMENT SAVINGS

In 2019, the Secure Act legislation made important changes to retirement-savings provisions

In the final version of the 2017 overhaul, lawmakers backed off a controversial proposal to lower the amount Americans can contribute before taxes to 401(k) and similar retirement-savings plans.

But they did make other changes affecting savers who have these plans. Savers who leave a company with a 401(k) loan outstanding now have until the day they file their federal tax return to repay the loan. Under prior law, such employees typically had to repay such loans within 60 days of departure or pay income tax on the loan's balance and in some cases a 10% penalty.

CHANGE FOR ROTH IRAS

The legislation also ended the ability of savers to “undo” Roth IRA conversions and thus nullify tax bills they would owe.

With a traditional IRA, savers typically get a tax deduction for contributions and owe ordinary income tax on withdrawals. With a Roth IRA, there is no upfront tax deduction, but withdrawals are usually tax-free in retirement.

Savers can also convert all or part of a traditional IRA to a Roth IRA, but they owe income tax on the conversion. Future tax-free withdrawals from the Roth account won't push the saver into a higher tax bracket or trigger higher Medicare premiums.

Until the overhaul, savers could also undo a Roth conversion by “recharacterizing” it by the October tax-filing date of the year following the original conversion.

Reasons for undoing the conversion typically included a lower account balance than at the time of the switch, or a lack of cash to pay the tax bill. Roth conversions completed in or after 2018 can no longer be undone.

SECURE ACT CHANGES

The Secure Act, which lawmakers passed late in 2019, made [the most significant changes to the nation's retirement system](#) in more than a decade.

RETIREMENT SAVINGS

Beginning Jan. 1, 2020, there is no age cap for individuals contributing to traditional IRAs. Savers must still earn wages or self-employment income to be eligible to contribute to these accounts.

The law also now allows many savers with tax-deferred accounts to delay required minimum payouts until after age 72 rather than after age 70 ½. This delay applies to people born after June 30, 1949.

In addition, there are new rules for many people who inherit Roth and traditional IRAs or 401(k)s. Under prior law, younger heirs could often take required withdrawals over many decades, a technique known as the Stretch IRA.

Now, many heirs of people who die after Dec. 31, 2019 [will have to empty the accounts within 10 years](#), although annual payouts are not required during this period.

The new law exempts some heirs from this new requirement, including surviving spouses. They can continue to stretch required payouts—and taxes on them—over their lifetimes.

Another change makes it easier for employers to offer annuities within 401(k) plans. That gives workers access to an investment option that provides a steady lifetime income, although annuities often have high fees.

—Anne Tergesen and Laura Saunders

RETIREE TAX ISSUES

The overhaul didn't change the taxation of Social Security benefits or retirement-plan distributions, but the large increase in the standard deduction will benefit many retirees

A key change of the overhaul will be positive for many retirees: the near-doubling of the standard deduction. For individuals it is \$12,200 for 2019 and \$12,400 for 2020, while for married couples filing jointly it is \$24,400 for 2019 and \$24,800 for 2020.

The standard deduction is the amount taxpayers can deduct if they don't list write-offs for state taxes, charitable donations, mortgage interest and the like on Schedule A. Many retirees who have paid off their mortgages take the standard deduction.

The expanded standard deduction expires at the end of 2025.

The overhaul also retained the 'additional standard deduction' for people age 65 and older. It is \$1,650 for singles and \$1,300 for each eligible spouse in a married couple for both 2019 and 2020.

As a result of these changes, many retirees will see an after-tax income boost, even with the elimination of the personal exemption.



ADDITIONAL STANDARD DEDUCTION

People age 65 and older are eligible to take the additional standard deduction:

- \$1,650 for singles
- \$1,300 for each partner of a married couple

NO CHANGES TO IRA CHARITABLE TRANSFERS

Neither the 2017 overhaul nor the 2019 Secure Act changed charitable transfers from individual retirement accounts, or IRAs. This popular benefit allows retirees 70½ or older to donate IRA assets up to \$100,000 directly to one or more charities and have the donations count toward their required annual payout.

For IRA owners who give to charity, [this is often a tax-efficient move](#). Donors can still take the standard deduction and receive a tax break for their giving.

While there is no deduction for gifts of IRA assets, the withdrawal doesn't count as taxable income. This can help reduce Medicare premiums that rise with income and taxes on other investment income.

—Laura Saunders

529 EDUCATION-SAVINGS ACCOUNTS

These plans can now be used to pay up to \$10,000 of private school tuition and up to \$10,000 of student-loan debt, but clarifications are needed in some states

The overhaul made so-called 529 accounts more flexible—but there is also a downside. The Secure Act also added a key change.

Named after a section of the tax code enacted two decades ago, 529 accounts allow savers to contribute dollars after federal taxes have been paid on them. The assets are invested and can grow free of federal and state taxes.

Withdrawals from the accounts are tax-free if they are used to pay eligible education expenses such as college tuition, books, and often room and board.

These plans are popular with middle- and upper-income families. According to Mark Kantrowitz, publisher of savingforcollege.com, assets in 529 plans grew to \$352 billion in June 2019 from \$133 billion a decade earlier.

Most 529 plans are offered by states, and nearly all states have them. More than 30 states offer a tax break for contributions, says Mr. Kantrowitz. Savers dissatisfied with their own state's investment offerings or fees can go elsewhere, although investment options are limited in most states.

PAYING FOR K-12 EDUCATION

A big change in the tax overhaul allows 529 plan assets to be used for up to \$10,000 per year, per student, for private-school tuition for K-12.

This change provides savers who have a 529 plan with more flexibility.

But private schools will likely want to know about families' 529 savings and may take that information into account when making financial-aid decisions. Those who want to use this new break should also check carefully to make sure that these withdrawals are approved for their specific plan.

According to Mr. Kantrowitz, about [20 states](#) with income-tax breaks for 529 plans allow them for K-12 tuition. New York, California, Michigan and New Jersey are among those that don't allow tax-free 529 payouts to be used for K-12 tuition.

SECURE ACT CHANGES

Parents and others with 529 education savings accounts can now take tax-free

529 EDUCATION-SAVINGS ACCOUNTS

\$10,000
Amount from a
529 account that
may be used to pay
student-loan debt

withdrawals for repayments of some student loans. There's a lifetime limit of \$10,000 per borrower. It's not yet clear which states will conform with the new federal rules.

In addition, some costs for apprenticeships are now eligible for tax-free withdrawals from 529 accounts.

TRANSFERS TO '529 ABLE' ACCOUNTS

In another significant change, the overhaul also enabled savers to transfer funds from 529 plans to 529 ABLE accounts. ABLE accounts are for people who become blind or disabled before age 26, and they don't limit the person's access to Medicaid and Supplemental Security Income, or SSI, benefits.

Like 529 plans, 529 ABLE accounts allow assets to grow tax-free. Annual contributions are capped at \$15,000, and withdrawals can be tax-free if used to pay expenses such as housing, legal fees and employment training. Total assets in an account can reach \$100,000 without affecting SSI benefits.

The recent change allows transfers of up to \$15,000 a year from a regular 529 plan to a 529 ABLE account. The ability to make such transfers avoids a significant drawback. It is that after the disabled person's death, remaining funds in an ABLE account typically go to the state to repay benefits if the person was receiving Medicaid—as many are.

The assets of a regular 529 plan needn't go to the state at death, however. So under the new rules, someone could fund a 529 account for a disabled person and transfer money from it as needed to a 529 ABLE account, according to Mr. Kantrowitz. This arrangement offers tax-free growth and perhaps a state-tax deduction, without giving up ownership of assets.

Owners of 529 and 529 ABLE accounts who want to use this new benefit should check their state plans to make sure it is allowed.

—Laura Saunders and Anne Tergesen

OTHER EDUCATION BENEFITS

The House had planned a major shake-up—but in the overhaul, Congress passed very few changes. In 2019, the expired tuition and fees deduction was extended.

Many changes related to education, including tax-free tuition waivers and student-loan interest deduction, seemed to be on the horizon as the tax overhaul took shape in 2017. In the end, Congress didn't enact several that were approved by the House of Representatives.

In addition, Congress didn't enact the House Republicans' changes to the American Opportunity tax credit for college, Coverdell education savings accounts and the Lifetime Learning tax credit.

The overhaul did make an important change for people with student loans who die or become disabled: such forgiveness of debt due to death or disability is no longer taxable. This provision expires at the end of 2025.

Late in 2019, Congress retroactively extended the Tuition and Fees deduction, which expired at the end of 2017. Now it expires at the end of 2020. For many taxpayers, this write-off is not as beneficial as the American Opportunity tax credit or the Lifetime Learning credit.

For more information, see IRS Publication 970, Tax Benefits for Education.

—*Laura Saunders*

**FOR BUSINESS
OWNERS**

PASS-THROUGH INCOME

*Owners of pass-through businesses got a break—
but figuring out who is eligible can be challenging*

The overhaul created a new deduction of 20% for many pass-through business owners, making their top tax rate 29.6% instead of the 37% rate that applies to top earners' wages and other income. Lawmakers made the change as a way to assist firms that don't benefit from the cut in the top corporate rate to 21% from 35%.

A Pass-Through Primer

How different types of businesses are affected by the rules on 'pass-through' business income.

20% of pass-through income can be deducted; **up to 37%** top rate applies to rest, including any wage income

More than \$160,700 individual income
(or \$321,400 married)

Deduction is phased out for law, consulting and other service businesses. For other businesses, deduction is limited to greater of...

Up to \$160,700 individual income
(or \$321,400 married)

Eligible for **full deduction**

50% of wages paid

OR

25% of wages paid plus **2.5%** of business's tangible, depreciable property; benefits real estate investors

PASS-THROUGH INCOME

So-called pass-through businesses include millions of partnerships, limited liability companies, S corporations and sole proprietorships. Regular corporations pay corporate taxes and then individual shareholders pay a second layer of taxes on dividends. For pass-throughs, their net income flows directly to their owners' personal return and is only taxed once, at the owners' individual rates.

Pass-through businesses include large private companies as well as fast-food franchises, manufacturers, investment funds, law firms and mom-and-pop firms. Some of these businesses qualify for the new deduction, while others don't.

Pass-through owners can claim the 20% deduction for 2019 without restriction if their taxable income is under \$321,400 for joint filers or \$160,700 for singles. They calculate their business income, take 20% of it and subtract that from total income. It effectively operates like a rate cut on business income.

For 2020 an inflation adjustment lifts the taxable-income limits to \$163,300 for single filers and \$326,600 for married joint filers, according to the IRS.

Above those income levels, the law has important limits that are designed to reduce the measure's cost and prevent higher-earning pass-through owners from claiming a business tax break for what is really their own labor income.

High-earning doctors, lawyers, accountants, consultants and other owners of service businesses generally can't claim the 20% deduction. Separate restrictions are tied to the level of wages paid and capital investment.



INCOME LIMITS

Pass-through owners can often claim the full 20% deduction if their taxable income for 2019 is under:

- \$321,400 for joint filers
- \$160,700 for single filers

PASS-THROUGH INCOME

Phase-outs, exceptions and gray areas make this new tax break complex, and tax advisers have been struggling to figure it out, especially for service businesses.

In January of 2019, the Trump administration released [final rules for this new deduction](#) that provided more clarity for real-estate owners and service-industry businesses.

However, it rejected requests from real-estate settlement agents, Major League Baseball team owners, writers and physical therapists, who all wanted more favorable rules for their specific industries.

The guidance also established that for many landlords, [the new tax break comes with strings attached](#). Rental real estate owners who want to claim it for 2019 and later years will often have to send 1099 forms to service providers who charge \$600 or more that aren't corporations—and they must also send a copy to the IRS.

—*Richard Rubin*

INTEREST PAYMENTS

The overhaul put a cap on the amount of interest cost that most companies can deduct

Heavily indebted companies are facing new limits on their ability to deduct interest payments from their tax returns, a change that makes business debt less attractive.

Interest payments have long been deductible, but the tax law creates a cap on that break that will raise \$253 billion in tax revenue over a decade, according to the Joint Committee on Taxation. Under the new rule, companies will be able to deduct their net interest costs, but only up to 30% of earnings before interest, taxes, depreciation and amortization.



NO EXCEPTIONS

The law doesn't make any exceptions for debt issued before the law was enacted, so companies that borrowed in the past will be facing the stringent new limits immediately.

The law doesn't make any exceptions for debt issued before the law was enacted, so companies that borrowed in the past will be facing the stringent new limits immediately. And proposed Treasury regulations on the subject create a broad definition of interest that may pinch some companies. Final regulations are expected in early 2020.

Starting in 2022, unless Congress acts again, the restriction will get even tougher. At that point, the 30% limit will apply to a different measure of income: earnings before interest and taxes. The change would hit even more companies.

Small firms won't be affected. The limit applies only to businesses with average gross receipts of at least \$25 million for the preceding three years. Car dealers and other similar companies also will be exempt from the limit on the loans they use to get inventory on their showroom floors.

The legislation exempts many electric utilities from the limit and lets farmers and many real-estate firms opt out of the limit. Real-estate companies don't get the benefit of immediate write-offs for capital investments that tax policy experts view as the trade-off for the interest limits.

—Richard Rubin

DEPRECIATION

The overhaul allowed companies to immediately write off 100% of equipment purchases, an extraordinary—albeit temporary—perk

Businesses buying equipment are getting an extraordinary new benefit from the new tax law: the ability to deduct the entire cost of their equipment purchases in the first year.

That marked a major change in the income-tax system, replacing the prior framework that required companies to deduct those costs over several years according to depreciation schedules. Economists encouraged Republicans to try what is known as “full expensing” so that companies would have an incentive to make the kinds of investments that can improve productivity, output and wages.



EPHEMERAL BENEFIT

The 100% write-offs are available for items acquired and used after Sept. 27, 2017, and before 2023. After that, the amount eligible for the deduction declines each year until 2027. Then, regular depreciation schedules resume.

Business investments increased quickly in early 2018 but the pace of growth decelerated later in the year. Investment has declined in several recent quarters, in part due to the uncertainty caused by global trade tensions.

The 100% deductions are an expanded form of the “bonus depreciation” that has been in place for most of the past 20 years. The break is now available to businesses that buy used equipment, not just items that are placed into service for the first time.

There is a catch. The 100% write-offs are even more ephemeral than other tax cuts in the new law. They are available for items acquired and used after Sept. 27, 2017 and before 2023. After that, the amount eligible for the deduction declines each year until 2027, when the regular depreciation schedules resume. Some Republicans have been trying to make those breaks permanent, but that has become more difficult in divided government, and the outcome hinges on the 2020 election.

DEPRECIATION

Many small companies had already been getting 100% deductions for capital investments, under Section 179 of the tax code. The law retains and expands those rules.

The new rules don't apply to real-estate firms. Generally, they will continue to operate under the old system that includes depreciation deductions and the ability to fully deduct interest costs, which are now limited for most other firms.

—*Richard Rubin*

WHAT HAS THE TAX OVERHAUL DONE SO FAR?

Two years after Trump's tax cuts, a deep dive into what happened to jobs, tax revenue, corporate profits and investment

The Tax Cuts and Jobs Act is now more than two years old. So what did it do?

The tax cuts themselves are easy to see: Tax bills went down for most families and corporations. Domestic retailers and banks reaped some of the biggest savings.

How the law rippled through the economy is muddier. Employment, wages and other key indicators have improved, and the 2020 economy looks stronger than projected at the start of the Trump presidency.

But many of those metrics were already on the rise before the tax law was signed by President Trump, and most economic numbers don't show a sharp change that coincides with the tax law. Early growth in business investment seems to have faded; overall economic growth rose before pulling back again. Cross-border investment patterns have changed only modestly.

The bottom line: It seems clear the tax cuts contributed to economic growth—but not enough to pay for themselves, as many backers promised. And even some of the intended beneficiaries say the gains haven't been dramatic.

“On the whole it was positive, in that it helped the broader consumer, but on the effective tax rate for us it was a lot less than you'd think,” Whirlpool Corp. Chief Executive Marc Bitzer said in an interview in late 2019. He said the global appliance maker didn't see a meaningful change in its taxes or boost its U.S. hiring or capital investment as a result of the law.

For multinational corporations, the law lowered the U.S. federal rate to 21% from 35%, limited some tax breaks, made it easier to get foreign profits to shareholders and sought to make it harder for companies to benefit from very low foreign tax rates. How individual companies fared depended on their mix of foreign and domestic income, among other factors.

WHAT HAS THE TAX OVERHAUL DONE SO FAR?

Isolating the tax law's impact—to what extent it spurred investment at a time of general upswing in the U.S. economy—isn't easy. And it wasn't the only major economic policy change in the past few years. One of the biggest confounding factors was the trade fight that President Trump has been waging for much of his administration.

The tax law's authors hoped to build certainty for businesses, creating a stable platform for investing. But the climate around the creation of the tax law, which was written and adopted by Republican lawmakers without Democratic support, meant that its long-term future has looked vulnerable to political changes right from the start: Executives worry that major components of the tax law could be altered or repealed if Democrats regain control of the White House or Congress. The leading Democratic presidential candidates have all proposed trillions of dollars in new tax increases, including rolling back the 2017 law's tax cuts for corporations and high-income individuals.

The trade war scrambled what certainty was left, leaving businesses unsure about their costs and wary of investing for the long run.

“We are more competitive in the U.S. than we have been for many, many years on the tax front,” said Torsten Sløk, chief economist for Deutsche Bank Securities. So far, he said, the downside effects from trade tension have overshadowed the benefits for business investment from the tax cuts.

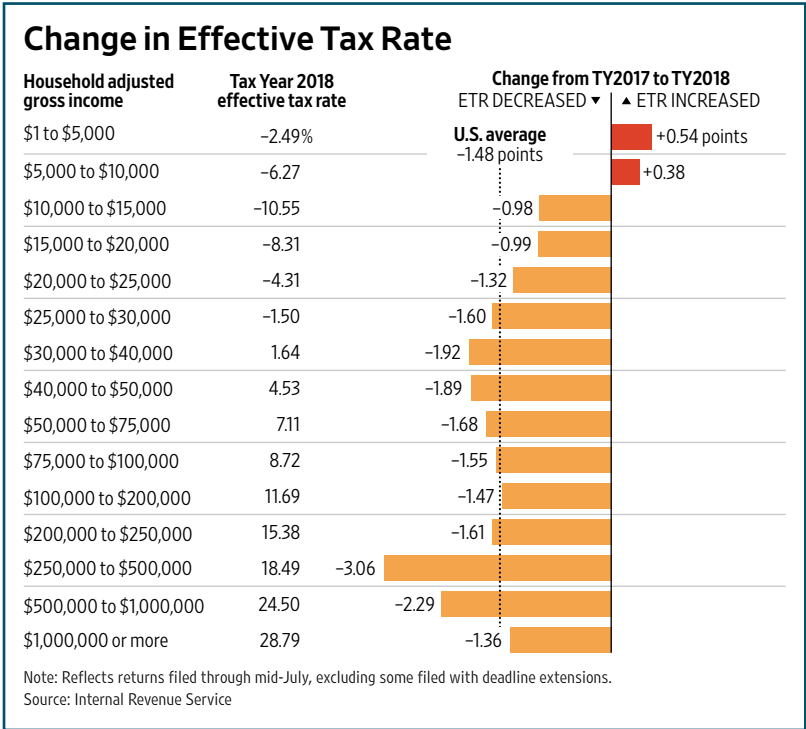
While Democrats say the tax law hasn't delivered what it promised, Republicans say it is a big reason the U.S. economy is as strong as it is today.

Here's what the data show:

INDIVIDUALS ARE PAYING LESS OF THEIR INCOME IN TAXES

For households, the law cut tax rates, increased tax credits for families with children, sharply narrowed the alternative minimum tax and expanded the standard deduction—the minimum amount someone can earn before income taxes kick in. Other changes partially offset these savings, such as a repeal of personal

WHAT HAS THE TAX OVERHAUL DONE SO FAR?

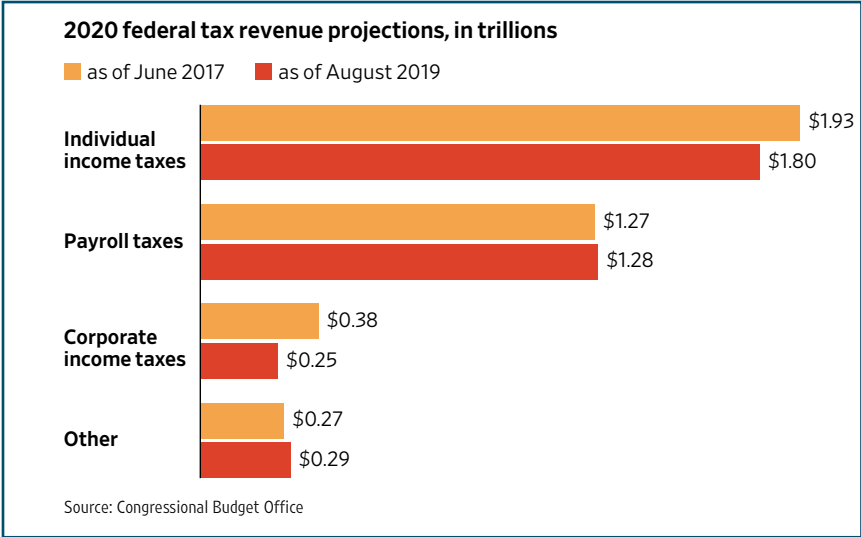


exemptions. The result, for almost every income group: lower taxes or bigger net refunds. Here, negative tax rates reflect tax refunds that exceed taxes.

The law also reshaped what factors determine each person’s tax bill. A bigger standard deduction means fewer people itemize their deductions, so fewer households have incentives for charitable contributions and mortgage-interest payments. The Internal

Revenue Service also changed how much it withheld from paychecks, which didn’t affect what people ultimately owed but meant that refunds tended to shrink slightly, compared with prior years.

THE CHANGE LOWERED TAX-REVENUE PROJECTIONS



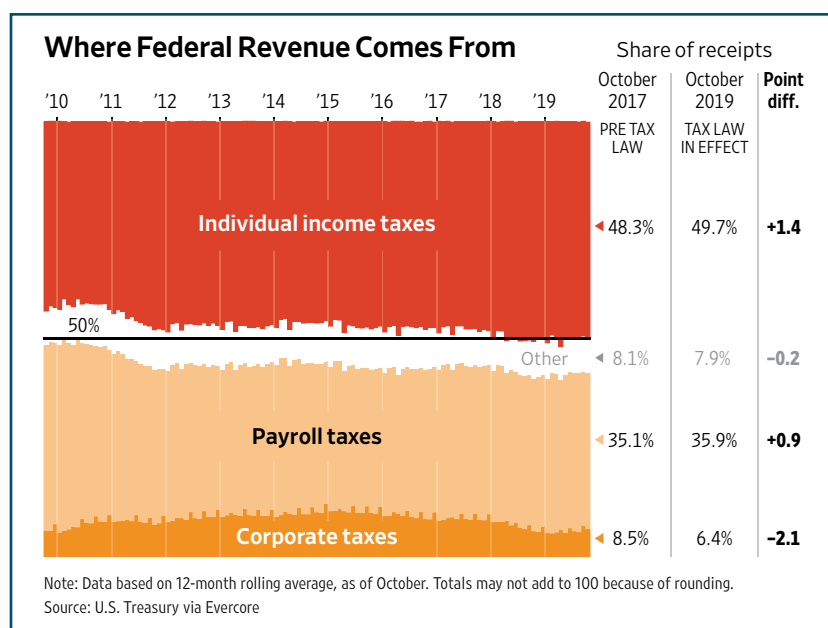
In mid-2017, before the tax law was drafted, the Congressional Budget Office projected that individual and corporate tax collections would keep growing along with the economy. By reducing tax rates for

WHAT HAS THE TAX OVERHAUL DONE SO FAR?

both groups, the law generally reduced revenue projections from what they would have been absent the tax overhaul.

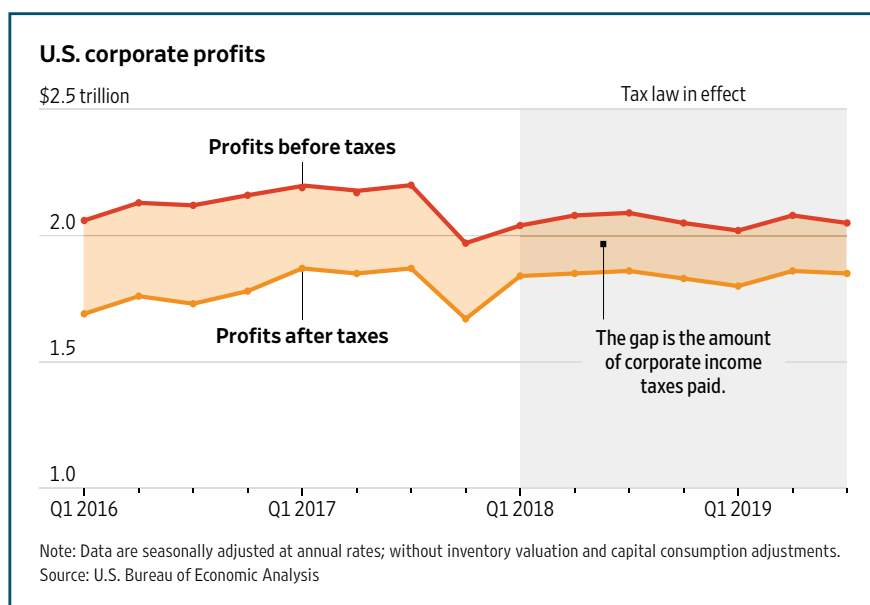
AND MORE REVENUE IS COMING FROM INDIVIDUALS

The result: Overall tax revenues as a share of the economy have fallen. Within that smaller revenue stream, more is coming from individuals, not companies.



LOWER TAX RATES PUSHED UP COMPANIES' AFTER TAX PROFITS

Overall, the U.S. tax-law change helped push global effective tax rates for S&P 500 companies down, to just under 19% from almost 26%—but energy and materials companies saw rates rise, and rates fell modestly for consumer-staples companies.



WHAT HAS THE TAX OVERHAUL DONE SO FAR?

BUT A PICKUP IN THEIR SPENDING DIDN'T LAST

Higher profits leave companies with more money to spend or return to shareholders. Proponents argued that companies would invest more in factories, property, vehicles and computers or other equipment. This capital spending, in

turn, would stoke production and economic activity at suppliers—a virtuous cycle.

Business investment grew faster at first, but not dramatically. In fourth-quarter 2018, a broad measure of business investment rose 5.9% over the same quarter in 2017—the growth rate the CBO said it had predicted when analyzing the tax legislation.

But growth soon returned to pre-overhaul levels, and all but stalled from the first through the third quarter of 2019.

“Anecdotes don’t show companies are spending a whole heck of a lot more on capex than they have in the past,” said Joseph LaVorgna, chief economist for the Americas at Natixis.

Administration officials argue that this isn’t surprising. They say the one-time bump in capital spending should pay dividends for years to come, as companies reap the benefits of new equipment and facilities.

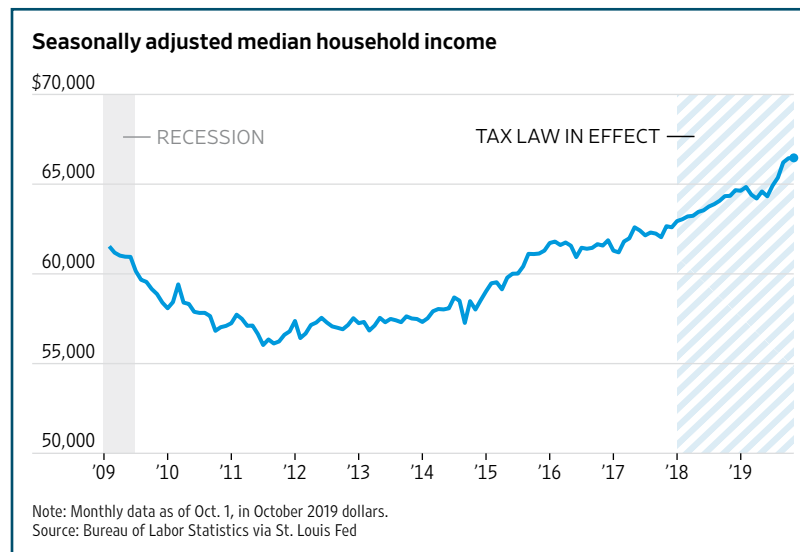
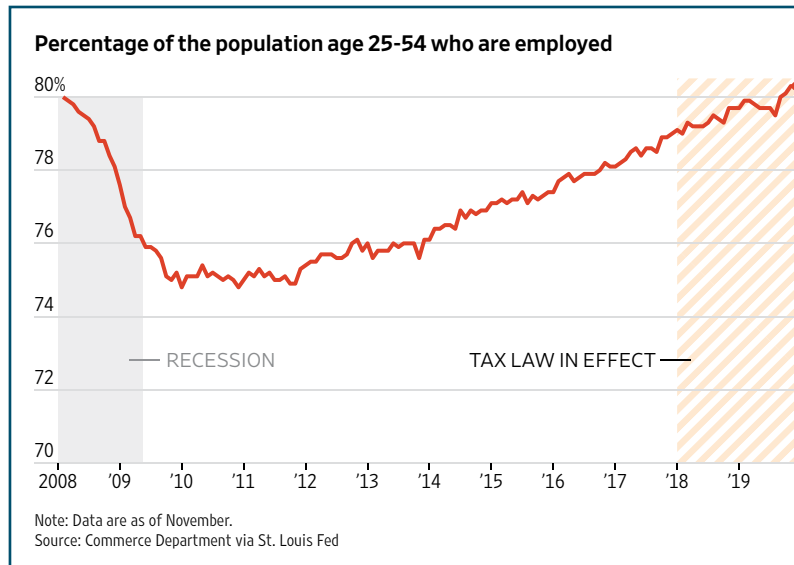
EMPLOYMENT AND WAGES ROSE

If companies were restrained in their capital investment, there’s little question that the job market improved, particularly for those of prime working age, driven at least in part by greater consumer spending.

Much the same was true of wages and household income, though minimum-wage increases may also be affecting pay.



WHAT HAS THE TAX OVERHAUL DONE SO FAR?



Still, one widely publicized feature of the 2017 tax law hasn't held up: The bonuses [many companies announced](#) for employees—often described as sharing the benefits of the corporate tax cut with workers—haven't been repeated, even as company tax savings persist.

WHAT HAS THE TAX OVERHAUL DONE SO FAR?

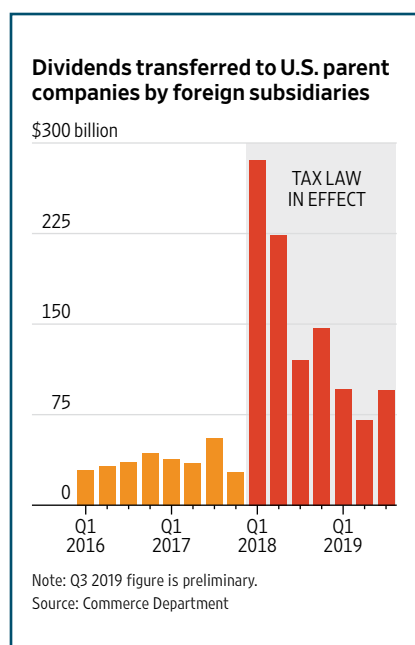
HOUSING PRICES ROSE MORE SLOWLY IN SOME AREAS

Some individual provisions of the tax overhaul appear to be leaving their marks as well. The \$10,000 cap on state and local tax deductions, for example, has been felt in some housing markets. Areas with more common use of the deduction have seen slower growth in home prices, according to data from Zillow, the real-estate firm.

U.S. COMPANIES BROUGHT CASH BACK FROM OVERSEAS

Another provision was intended to spur U.S. companies to bring foreign profits to the U.S., by ending a tax obligation previously triggered by such moves. In one sense, it worked: U.S. companies have shifted more than \$1 trillion from foreign subsidiaries to their U.S. parents. But [the sums are far lower](#) than President Trump predicted, and multinational companies already had plenty of capital even without those foreign profits.

Overall, companies are once again accumulating profits overseas.



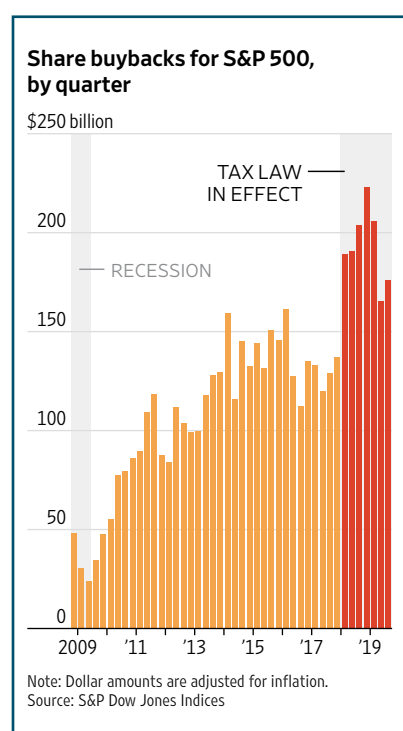
Most of what companies retrieved—\$500 billion of roughly \$775 billion in 2018—came from three low-tax countries: Bermuda, the Netherlands and Ireland, Brad Setser, a senior fellow at the Council on Foreign Relations, has observed. That underscores the degree to which big corporations—particularly those dependent on patents and other intellectual properties, such as big pharmaceutical and technology companies—had shifted past profits to these countries, Mr. Setser says.

Since 2018, the profits retrieved from overseas subsidiaries have, in aggregate, trailed the new profits these subsidiaries have generated abroad. In other words, the foreign-profit stockpile is growing again,

WHAT HAS THE TAX OVERHAUL DONE SO FAR?

not shrinking, albeit more slowly than it used to. That raises the question of how successfully the law is driving U.S. companies to shift more of their operations to the U.S.

MUCH OF WHAT THEY RETRIEVED WENT TO BUYBACKS

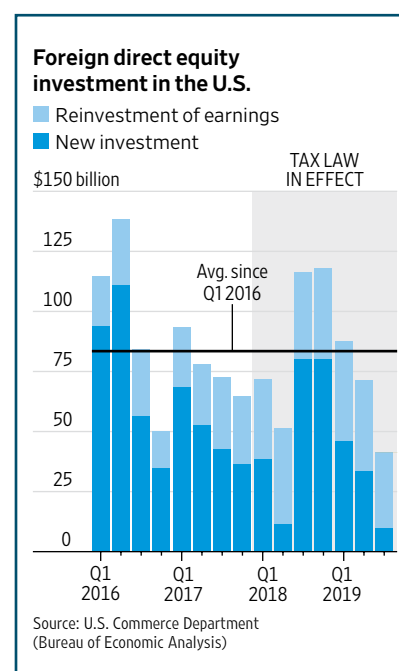


U.S. and foreign companies incentives to invest in the U.S. rather than overseas. So were a reduced tax rate for some U.S. production destined for export, and a complex new global minimum tax rate intended to make low-tax countries less attractive.

What happened to that trillion dollars of foreign-subsidary profits shifted to U.S. parents? Much of it has gone into share buybacks, which jumped to record levels after the tax law was passed, though that money may then get reinvested in other businesses. “It looks like the corporate tax cut went mainly to buybacks,” said Mr. Sløk at Deutsche Bank Securities.

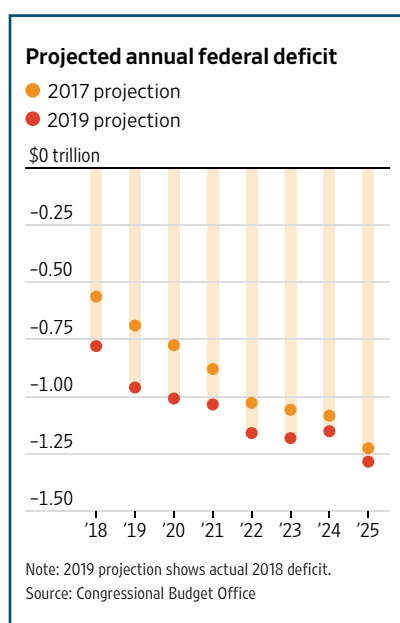
Much of the buybacks came from a small number of giant companies: About half of the total in recent periods comes from 20 companies, data from S&P Dow Jones Indices show, and Apple Inc. alone accounted for \$18 billion of the buybacks in the second and third quarters of 2019.

A lower domestic tax rate was part of the effort to give both



WHAT HAS THE TAX OVERHAUL DONE SO FAR?

So far, however, there has been only a modest—and temporary—increase in foreign investment in the U.S. The pace of new U.S. investment abroad picked up briefly, before settling down again. (A big dip in U.S. investment abroad in early 2018 reflected the transfer of past profits from foreign subsidiaries to U.S. parents.)



THE CUTS CAME AT A COST

There is, of course, a price tag for reducing taxes. Absent a similar reduction in spending, or robust economic growth, the federal deficit will rise.

Proponents of the tax law said it would pay for itself over the long run; so far, it has not generated the amount of growth that would make that possible.

—Richard Rubin and Theo Francis

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