IMPACT OF THE TAX CUTS AND JOBS ACT ON
WAGE EARNERS

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For better or for worse, the tax code was simplified for wage earners through the enactment of the Tax Cuts & Jobs Act. Taxpayers who work as employees escaped the more complicated business provisions and confront a code with fewer deductions. Under the new law, personal exemptions and certain popular deductions gave way to reduced tax rates, a more favorable alternative minimum tax, an expanded child tax credit, and an expanded standard deduction, among other changes.

Though many taxpayers will experience a tax cut, the size of the tax decrease will vary depending on the age of their children, their family size, where they reside, their income range, and the extent that they benefited from various itemized deductions under the old law. Simultaneously, there will be pockets of unlucky taxpayers who do worse and experience a tax increase. (In many cases, this will be irrelevant to income.)

Ultimately, the new legislation, which encompasses the most drastic changes to the tax code since 1986, will provoke taxpayers to ask: what does this mean, and where do I fall? Without doing the math, tax professionals may struggle to provide an accurate answer; however, general guidance can be provided by understanding the major changes impacting individuals and families working as employees across the country.

This article analyzes and explores the following:

- Reduced tax rates and elimination of the marriage tax penalty;
- Elimination of the alimony deduction;
- Suspension of personal exemptions;
- Expanded standard deduction;
- Expansion of child tax credit and new family credit;
- Revisions to itemized deductions;
- A more favorable alternative minimum tax;
- Expansion of 529 plans; and
- Elimination of the health care mandate.

REDUCED TAX RATES & ELIMINATION OF MARRIAGE TAX PENALTY

For tax years 2018 through 2025, most income levels (apart from some of those in the 10 percent marginal tax rate and 33 percent marginal tax rate under the old law) will be taxed at a lower rate. Marginal tax rates for lower and moderate-income individuals were reduced by approximately three percent whereas rates for most upper middle class individuals were reduced by approximately four percent. Once an individual taxpayer makes more than $157,500 in taxable income, there is less of a reduction in marginal rates between the old and new law and, as he or she approaches $200,000, some may even be subject to a higher marginal rate. However, once the individual taxpayer reaches the highest tax brackets, he or she will again see a reduction of two percent to 4.6 percent depending on where he or she falls.

These marginal tax rates will dictate the calculation of the more consequential effective tax rates, which, for the most part, will be lower overall. Again, there will be exceptions where there is absolutely no impact or the individual taxpayer will owe more. For example, an individual with $9,000 in taxable income will still incur $900 in tax if solely looking at the tax rates (without credits...
or additions to tax) whereas an individual approaching taxable income of $400,000 will incur approximately $300 more in tax. Somewhere around $435,000 in taxable income, the individual will again do better under the new law, and as they become the top income earners in the country, they will see more of a tax benefit. For example, someone earning $1 million in taxable income would incur about $16,000 less in tax under the new law if solely looking at the tax rate.

The reduction in tax rates will have a more significant impact on certain married couples due to elimination of the “marriage penalty” in most of the current tax brackets. Under the old law, single taxpayers earning a certain level of income would be taxed at a lower rate than some married couples whose total taxable income was twice that of a single taxpayer. For example, a married couple filing jointly with $200,000 in taxable income would incur approximately $600 more in tax than two single individual taxpayers reporting $100,000 each in taxable income. Now, the tax of a married couple filing jointly with $200,000 in taxable income will be equivalent to the combined tax of two single individual taxpayers with $100,000 each in taxable income.

Though largely eliminated, the marriage penalty continues to exist for some very wealthy taxpayers. Married couples filing jointly who have taxable income between $600,000 and $1 million will still experience somewhat of a marriage penalty—the new marginal tax rates jump to 37 percent for couples making over $600,000 whereas single taxpayers with $300,000 to $500,000 in taxable income will still be subject to the 35 percent marginal tax rate.

**Elimination of an Alimony Deduction for Those Who Divorce After December 31, 2018**

One detrimental impact of the new law involves taxpayers who divorce after December 31, 2018 and have significant alimony payments. Financially fragile, divorcing taxpayers frequently go through difficult times when ending their marriage. As the new tax law eliminates the alimony deduction for any divorce or separation instrument executed after December 31, 2018, these taxpayers may now have fewer funds to be shared between them.

Under the old law, divorced taxpayers required to pay alimony took an above-the-line deduction for the total payment while recipients of alimony were required to report it as other income. Typically, the divorced taxpayer paying the alimony was the higher-income earner; therefore, the above-the-line alimony deduction drastically reduced his or her taxable income, often placing him or her in a lower tax bracket. In contrast, the recipient, who earned less or nothing at all, was already in a lower tax bracket. Ultimately, the transfer of income was reported at an overall lower tax bracket, more money was kept in the family unit, and less was paid towards taxes.

Now, by not being able to deduct alimony under the new law, the alimony payer will have less after-tax income, which may indirectly reduce the amount of alimony required to be paid to the recipient. In sum, divorcing taxpayers who are financially struggling and must pay alimony will be negatively impacted by this new law; those currently divorcing will be encouraged to so before the end of this year to avoid the elimination of the alimony deduction.

**Suspension of Personal Exemptions**

Under the old law, most taxpayers were entitled to deduct $4,050 as a personal exemption for each dependent, which applies to qualifying children and relatives in their household. The personal exemption is an additional deduction on top of the standard deduction and itemized deductions, which reduces taxable income. Under the new law, personal exemptions have been suspended from January 1, 2018 through December 31, 2025, and taxpayers will solely be able to deduct an expanded standard deduction or reduced itemized deductions. In order to determine if this will negatively impact a taxpayer, the tax professional will have to examine any benefits associated with the reduced tax rates, expanded standard deduction, and expanded child tax credit. Without further exploring these provisions, taxpayers with multiple college age children or older dependents may appear to be immediately worse off. In contrast, higher-income earners whose personal exemptions were subject to a phase-out or completely eliminated under the old law will be less affected or not affected at all by this new provision.

**Expanded Standard Deduction**

The new law temporarily increases the standard deduction to $12,000 for single taxpayers and married couples filing separately, $18,000 for head of household taxpayers, and $24,000 for married taxpayers.
filing jointly for tax years 2018 through 2025. While the additional deduction for the blind and elderly remains the same, surviving spouses may actually see a slight decrease in their deduction. While the new law explicitly details the new deduction amounts for head of household taxpayers and married taxpayers filing jointly, it fails to mention surviving spouses and only states that all “other taxpayers” will receive a deduction of $12,000. If this is truly the case, surviving spouses may fall under the “other” category and see a decrease in the standard deduction from $12,700 to $12,000.

As for those who did not itemize under the old law, the temporary expansion of the standard deduction will be a welcome surprise. Taxpayers whose past itemized deductions are lower than the expanded standard deduction may feel a sense of relief that they do not have to itemize and worry about substantiating itemized expenses in a potential tax audit. However, the impact of the standard deduction will be reduced by the elimination of the personal exemption and, as discussed in more detail later, larger families with older children or dependents who do not qualify for the expanded child tax credit will have less of a tax benefit. For example, the new $500 dependent credit for non-qualifying children may not offset the loss of the $4,050 personal exemption for taxpayers with higher tax rates. In contrast, some higher-income earners will be grateful for the expanded standard deduction if they did not itemize nor benefit from the personal exemption deduction under the old law due to phase-out thresholds.

**EXPANSION OF CHILD TAX CREDIT & NEW FAMILY CREDIT**

One of the most beneficial aspects of the new law for families involves the doubling of the child tax credit from $1,000 per child to $2,000. Given their low effective tax rate, lower-income taxpayers would perhaps receive a $400 tax benefit from the inclusion of the personal exemption under the old tax law. Now, in lieu of the personal exemption, these taxpayers will receive an additional $1,000 for each child, potentially a $600 tax savings depending on where they fall.

The expansion of this credit is not only important to low- and moderate-income families with children under the age of 17, but upper middle class and wealthier families will also greatly benefit. Under the old law, married taxpayers filing jointly did not get any credit if their income exceeded $130,000 whereas single or head of households did not see the credit once their income exceeded $95,000. Under new law, the credit does not even begin to phase out until married taxpayers filing jointly exceed $400,000 in adjusted gross income and other taxpayers (single, head of household, surviving spouse, etc.) exceed $200,000 in adjusted gross income. Consequently, higher-income families who once received a $0 child tax credit will now be provided with a $2,000 credit. Therefore, the loss of their personal exemption for a child is more than offset by this credit since their highest marginal tax rate under the old law was 35 percent. This is especially beneficial to married taxpayers whose adjusted gross income falls somewhere between $300,000 to $400,000, subjecting them to the gradual phase out of personal exemptions under old law.

In addition to the $2,000 child tax credit, the new law embraces a $500 new family credit for other dependents, who are not qualifying children. Many families, particularly those with a lower tax rate (less than 12 percent), will be happy about the new $500 credit in lieu of the personal exemption. However, families with higher tax rates and children over 17 may not be as satisfied. While the expansion of the child tax credit will certainly offset the negative impact of losing the personal exemption for families with young children, families with children in college or other dependents may potentially be negatively affected with the replacement of a $500 family credit instead of the $4,050 personal exemption. For example, under the old law, a family with $200,000 in adjusted gross income and two children in college would typically receive a $4,050 personal exemption for each child, which would reduce their taxable income. Now, a family with $200,000 in adjusted gross income whose marginal tax rate is 24 percent, will solely receive $500 per child instead of a tax deduction of $972 ($4,050 * 24 percent).

But luckily, any detrimental impact associated with the loss of the personal exemptions will also be softened by reduced tax rates, the elimination of the marriage penalty, and the expanded standard deductions. However, for those who typically itemize and reside in high taxed rates, it may be a different story...