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Tax Reform

Issue:

Tax reform is expected to consume the attention of Congress next year as most of the individual tax cuts of 2017's Tax Cuts and Jobs Act (the "TCJA" or the "Act") are scheduled to expire at the end of 2025. The tax-writing committees are already gearing up for consideration of these expiring provisions, even though November's Presidential and Congressional elections will determine which direction this consideration ends up taking. NAIFA and the American families and businesses we serve have a huge stake in the outcome of the tax reform deliberations. Thus, it is imperative that we communicate the ongoing need for a stable tax system that continues to encourage Americans to plan and save for their future. The tax rules governing life, health, disability, long-term care, and retirement savings insurance products reflect sound tax policy and are important to middle-America's ability to protect families and businesses.

Background:

The TCJA made significant changes to individual income taxes and the estate tax, as well as providing a new tax rule on passthrough business income. It was the biggest rewrite of the tax code since the 1986 Tax Reform Act.

The Act changed the structure of several major itemized deductions. Most are of considerable significance to individuals and a summary of those appears below. Some are insurance/financial planning specific. These include the preferential tax rates on long-term capital gains and qualified dividends and the 3.8 percent net investment income tax (NIIT). The NIIT applies to interest, dividends, short- and long-term capital gains, rents and royalties, and passive business income. The TCJA retained the individual AMT but raised the exemption levels and the income threshold at which the AMT exemption phases out, which significantly reduced the number of taxpayers subject to the AMT. The exemption amounts and phaseout thresholds continue to be indexed for inflation.

The TCJA doubled the estate tax exemption to $11.2 million for single filers and to $22.4 million for couples and continued to index the exemption levels for inflation. The top estate tax rate remains at 40 percent.

The Act also made significant changes to the corporate income tax and taxes on passthrough businesses. While the individual income tax provisions and passthrough provisions expire after 2025, many of the other business tax provisions are permanent. The TCJA permanently reduced the federal top corporate income tax rate from 35 percent to 21 percent.

Unlike C corporations, passthrough firms such as sole proprietorships, partnerships, and S corporations are not subject to the corporate income tax. Instead, the owners include their share of profits as taxable income under the

individual income tax. The TCJA also included changes specific to passthrough businesses. Those are scheduled to expire after 2025 along with other individual income tax changes implemented by the TCJA.

The Act provided a deduction for passthrough businesses that allows joint tax filers with taxable income below $315,000 ($157,500 for single filers) in 2018 to deduct 20 percent of their qualified business income (QBI). The income amounts are adjusted for inflation each year: for tax year 2024, they are $383,900/$191,950. The 20 percent deduction lowers the effective top individual income tax rate on business income from 37 to 29.6 percent. Certain specified businesses, generally service businesses, including financial services, are limited in their ability to fully utilize the deduction. The deduction phases out for these types of businesses when taxable income ranges from $157,500 to $207,500 ($315,000 to $415,000 in the case of a joint return). A taxpayer whose taxable income exceeds the top of that range is not entitled to any deduction with respect to a specified service trade or business.

Importantly, the Act reduced statutory tax rates at most levels of taxable income and shifted the thresholds for several income tax brackets. It repealed the personal and dependent exemptions. In their place, the law increased the standard deduction and the child tax credit (CTC) and created a new $500 tax credit for dependents not eligible for the child tax credit. It expanded the CTC in several ways. It doubled the maximum per child credit amount from $1,000 to $2,000 starting in 2018. It also increased the refundable portion of the credit but limited the maximum refundable credit to $1,400 per child in 2018. The TCJA extended the CTC to higher-income families by substantially increasing the income thresholds at which the credit phases out. As under prior law, the income phaseout thresholds are not indexed for inflation.

Under prior law, itemizers could claim deductions for all state and local property taxes and the greater of their state and local income or sales taxes (subject to overall limits on itemized deductions). It limited the itemized deduction for total state and local taxes to $10,000 annually, for both single and joint filers, and did not index that limit for inflation. As under prior law, taxpayers cannot claim a deduction for state and local taxes against the alternative minimum tax (AMT).

Under prior law, taxpayers could deduct interest on mortgage payments associated with the first $1 million of principal paid on debt incurred to purchase (or substantially renovate) a primary and secondary residence, plus the first $100,000 in home equity debt. For taxpayers taking new mortgages after the effective date, the TCJA limited the deductibility to the interest on the first $750,000 of loan principal and eliminated the deductibility of interest for home equity debt unless used to buy, build, or substantially improve the taxpayer's home.

Previously, taxpayers could deduct out-of-pocket medical expenses (including costs for health insurance) that exceeded 10 percent of their adjusted gross income (AGI). For 2017 and 2018, the Act allowed deductions for out-of-pocket medical expenses above 7.5 percent of AGI. Congress later extended the lower 7.5 percent of AGI floor and made it permanent.

The TCJA repealed the phase-down of the amount of allowable itemized deductions. This limitation had applied to AGI at or above $266,700 for single filers and $320,000 for taxpayers filing joint returns.

Almost all these provisions expire after 2025. Thus, individual tax rates across tax brackets would rise, the child tax credit would return to $1,000, the standard deduction would be cut by 50 percent, as would the estate and gift tax exemption. The income tax deduction for passthrough businesses would disappear. A straight extension of the expiring TCJA provisions is estimated by the Congressional Budget Office and Joint Committee on Taxation to cost $4.6 trillion over 10 years.

NAIFA Position:
We support a comprehensive and inclusive Congressional discussion of the benefits and burdens of the TCJA's expiring tax provisions as well as other related tax provisions, including revenue offsets. We look forward to participating in that discussion to ensure that our members and the American families and businesses they serve can continue to plan and save to attain a secure financial future under current tax rules that reflect sound tax policy, fairness, and equitable treatment of business income whether it is in the form of corporate income or passthrough income. American families are able to protect themselves through the current tax treatment of cash value life insurance; the incentives to establish and participate in individual and employer-sponsored retirement plans; the savings vehicles for education and emergencies; paid leave, long-term care disability insurance, and employer-provided health insurance. In addition, financial security requires reasonable transfer taxes at death, and equitable income tax treatment of passthrough small business income through Code section 199A, as that is the form of business many of our members utilize to provide the advice and products American families need.

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