NAR ISSUE BRIEF

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

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NATIONAL ASSOCIATION *of* REALTORS®

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December 20, 2017

Introduction

The National Association of REALTORS® (NAR) worked throughout the tax reform process to preserve the existing tax benefits of homeownership and real estate investment, as well to ensure as many real estate professionals as possible would benefit from proposed tax cuts. Many of the changes reflected in the final bill were the result of the engagement of NAR and its members, not only in the last three months, but over several years.

While NAR remains concerned that the overall structure of the final bill diminishes the tax benefits of homeownership and will cause adverse impacts in some markets, the advocacy of NAR members, as well as consumers, helped NAR to gain some important improvements throughout the legislative process. The final legislation will benefit many homeowners, homebuyers, real estate investors, and NAR members as a result.

The final bill includes some big successes. NAR efforts helped save the exclusion for capital gains on the sale of a home and preserved the like-kind exchange for real property. Many agents and brokers who earn income as independent contractors or from pass-through businesses will see a significant deduction on that business income.

As a result of the changes made throughout the legislative process, NAR is now projecting slower growth in home prices of 1-3% in 2018 as low inventories continue to spur price gains. However, some local markets, particularly in high cost, higher tax areas, will likely see price declines as a result of the legislation's new restrictions on mortgage interest and state and local taxes.

The following is a summary of provisions of interest to NAR and its members. NAR will be providing ongoing updates and guidance to members in the coming weeks, as well as working with Congress and the Administration to address additional concerns through future legislation and rulemaking. Lawmakers have already signaled a desire to fine tune elements of The Tax Cuts and Jobs Act as well as address additional tax provisions not included in this legislation in 2018. REALTORS® will need to continue to be engaged in the process.

The examples provided are for illustrative purposes and based on a preliminary reading of the final legislation as of December 20, 2017. Individuals should consult a tax professional about their own personal situation.

All individual provisions are generally effective after December 31, 2017 for the 2018 tax filing year and expire on December 31, 2025 unless otherwise noted. The provisions do not affect tax filings for 2017 unless noted.

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Major Provisions Affecting Current and Prospective Homeowners

Tax Rate Reductions

- The new law provides generally lower tax rates for all individual tax filers. While this does not mean that every American will pay lower taxes under these changes, many will. The total size of the tax cut from the rate reductions equals more than $1.2 trillion over ten years.
- The tax rate schedule retains seven brackets with slightly lower marginal rates of 10%, 12%, 22%, 24%, 32%, 35%, and 37%.
- The final bill retains the current-law maximum rates on net capital gains (generally, 15% maximum rate but 20% for those in the highest tax bracket; 25% rate on "recapture" of depreciation from real property).

Tax Brackets for Ordinary Income Under Current Law and the Tax Cuts and Jobs Act (2018 Tax Year) Single Filer

Current Law		Tax Cuts and Jobs Act	
10%	$0 - $9,525	10%	$0 - $9,525
15%	$9,525 - $38,700	12%	$9,525 - $38,700
25%	$38,700 - $93,700	22%	$38,700 - $82,500
28%	$93,700 - $195,450	24%	$82,500 - $157,500
33%	$195,450 - $424,950	32%	$157,500 - $200,000
35%	$424,950 - $426,700	35%	$200,000 - $500,000
39.6%	$426,700+	37%	$500,000

Tax Brackets for Ordinary Income Under Current Law and the Tax Cuts and Jobs Act (2018 Tax Year) Married Filing Jointly

Current Law		Tax Cuts and Jobs Act	
10%	$0 - $19,050	10%	$0 - $19,050
15%	$19,050 - $77,400	12%	$19,050 - $77,400
25%	$77,400 - $156,150	22%	$77,400 - $165,000
28%	$156,150 - $237,950	24%	$165,000 - $315,000
33%	$237,950 - $424,950	32%	$315,000 - $400,000
35%	$424,950 - $480,050	35%	$400,000 - $600,000
39.6%	$480,050+	37%	$600,000+

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Exclusion of Gain on Sale of a Principal Residence

- The final bill retains current law. A significant victory in the final bill that NAR achieved.
- *The Senate-passed bill would have changed the amount of time a homeowner must live in their home to qualify for the capital gains exclusion from 2 out of the past 5 years to 5 out of the past 8 years. The House bill would have made this same change as well as phased out the exclusion for taxpayers with incomes above $250,000 single/$500,000 married.*

Mortgage Interest Deduction

- The final bill reduces the limit on deductible mortgage debt to $750,000 for new loans taken out after 12/14/17. Current loans of up to $1 million are grandfathered and are not subject to the new $750,000 cap. Neither limit is indexed for inflation.
- Homeowners may refinance mortgage debts existing on 12/14/17 up to $1 million and still deduct the interest, so long as the new loan does not exceed the amount of the mortgage being refinanced.
- The final bill repeals the deduction for interest paid on home equity debt through 12/31/25. Interest is still deductible on home equity loans (or second mortgages) if the proceeds are used to substantially improve the residence.
- Interest remains deductible on second homes, but subject to the $1 million / $750,000 limits.
- *The House-passed bill would have capped the mortgage interest limit at $500,000 and eliminated the deduction for second homes.*

Deduction for State and Local Taxes

- The final bill allows an itemized deduction of up to $10,000 for the total of state and local property taxes and income or sales taxes. This $10,000 limit applies for both single and married filers and is not indexed for inflation.
- The final bill also specifically precludes the deduction of 2018 state and local income taxes prepaid in 2017.
- *When House and Senate bills were first introduced, the deduction for state and local taxes would have been completely eliminated. The House and Senate passed bills would have allowed property taxes to be deducted up to $10,000. The final bill, while less beneficial than current law, represents a significant improvement over the original proposals.*

Standard Deduction

- The final bill provides a standard deduction of $12,000 for single individuals and $24,000 for joint returns. The new standard deduction is indexed for inflation.
- *By doubling the standard deduction, Congress has greatly reduced the value of the mortgage interest and property tax deductions as tax incentives for homeownership. Congressional estimates indicate that only 5-8% of filers will now be eligible to claim these deductions by itemizing, meaning there will be no tax differential between renting and owning for more than 90% of taxpayers.*

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Repeal of Personal Exemptions

- Under the prior law, tax filers could deduct $4,150 in 2018 for the filer and his or her spouse, if any, and for each dependent. These exemptions have been repealed in the new law.
- This change alone greatly mitigates (and in some cases entirely eliminates) the positive aspects of the higher standard deduction.

To illustrate how the above-listed changes can affect the tax incentives of owning a home for a first-time buyer and a middle-income family of five, please see the two examples in the Appendix 2 on pages 19-23.

Mortgage Credit Certificates (MCCs)

- The final bill retains current law.
- *The House-passed legislation would have repealed MCCs.*

Deduction for Medical Expenses

- The final bill retains the deduction for medical expenses (including decreasing the 10% floor to 7.5% floor for 2018).
- *The House bill would have eliminated the deduction for medical expenses.*

Child Credit

- The final bill increases the child tax credit to $2,000 from $1,000 and keeps the age limit at 16 and younger. The income phase-out to claim the child credit was increased significantly from ($55,000 single/$110,000 married) under current law to $500,000 for all filers in the final bill.

Student Loan Interest Deduction

- The final bill retains current law, allowing deductibility of student loan debt up to $2,500, subject to income phase-outs.
- *The House bill would have eliminated the deduction for interest on student loans.*

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Deduction for Casualty Losses

- The final bill provides a deduction only if a loss is attributable to a presidentially-declared disaster.
- *The House bill would have eliminated the deduction for casualty losses with limited exceptions.*

Moving Expenses

- The final bill repeals moving expense deduction and exclusion, except for members of the Armed Forces.
- *The House-introduced bill would have eliminated the moving expense deduction for all filers, including military.*

Major Provisions Affecting Commercial Real Estate

Like-Kind Exchanges

- The final bill retains the current Section 1031 Like Kind Exchange rules for real property. It repeals the use of Section 1031 for personal property, such as art work, auto fleets, heavy equipment, etc.
- *The exclusion of real estate from the repeal of 1031 like-kind exchanges is a major victory for real estate stakeholders, who had fought hard to preserve the provision for several years, and against long odds.*

Carried Interest

- The final bill includes the House and Senate language requiring a 3-year holding period to qualify for current-law (capital gains) treatment.
- *Again, real estate stakeholders prevailed against long odds to preserve the incentive of capital gains treatment for carried interests in the final legislation.*

Cost Recovery (Depreciation)

- The final bill retains the current recovery periods for nonresidential real property (39 years), residential rental property (27.5 years) and qualified improvements (15 years). The bill also replaces separate definitions for qualified Restaurant, Leasehold, and Retail improvements with one definition of "Qualified Improvement Property."

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Qualified Private Activity Bonds

- The final bill retains the deductibility of qualified private activity bonds used in constructing affordable housing, local transportation and infrastructure projects and for state and local mortgage bond programs.
- *The House bill would have eliminated the use of private activity bonds.*

Low Income Housing Tax Credit

- The final bill retains current law. However, a lower corporate rate will negatively impact the value of the credits in the future, and will result in less low-income housing being developed.

Rehabilitation Credit (Historic Tax Credit)

- The final bill repeals the current-law 10% credit for pre-1936 buildings, but retains the current 20% credit for certified historic structures (but modified so the credit is allowable over a 5-year period based on a ratable share (20%) each year).
- *The House bill would have entirely eliminated the Historic Rehabilitation Credit.*

Provisions Not Included in the Final Bill

Rental Income Subject to Self-Employment Tax

- The House-introduced bill would have subjected rental income to self-employment taxes. This provision was dropped from the House (and final) bill.

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Major Provisions Affecting Real Estate Professionals

Deduction for Qualified Business Income

Because the new tax bill greatly decreases the tax rate for corporations (from the prior law's 35% to just 21%), many Members of Congress believed that the business income earned by sole proprietors, such as independent contractors, as well as by pass-through businesses, such as partnerships, limited liability companies (LLCs), and S corporations, should also receive tax rate reductions. In addition to lower marginal tax rates, the final bill provides a significant up-front (above the line[1]) deduction of 20% for business income earned by many of these businesses, but with certain conditions.

Specifically, the bill limits the 20% deduction to non-personal service businesses. Essentially, a personal service business is one involving the performance of services in the following fields:

Health, Law, Consulting, Athletics, Financial Services, Brokerage Services, and "Any business where the main asset of the business is the reputation or skill of one or more of its employees or owners."

It seems clear that most real estate agents and brokers will be considered in a personal service business and would thus not normally qualify for the 20% deduction.

However, NAR was able to help secure a major exception (the personal service income exception) in the final bill that will make it possible for many real estate professionals to be able to take advantage of the deduction.

- This exception provides that if the business owner has taxable income of less than $157,500 (for single taxpayers) or $315,000 (for couples filing jointly), then the personal service restriction will not apply.
- Above this level of income, the benefit of the 20% deduction is phased out over an income range of $50,000 for singles and an income range of $100,000 for couples[2].
- For those with non-personal service income above these thresholds, the bill provides a second exception that may still allow a full or limited 20% deduction. This second exception (the wage and capital limit exception) places a limit on the deduction of the greater of:

[1] Meaning one does not have to itemize deductions in order to claim it.

[2] This means that for single individuals, the benefit of the deduction would be fully phased out for taxable income levels above $207,500 and for married couples filing joint returns, the benefit of the deduction would be fully phased out for taxable income levels above $415,000.

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- 50% of the W-2 wages paid by the business, or
- The total of 25% of the W-2 wages paid by the business plus 2.5% of the cost basis of the tangible depreciable property of the business at the end of the year.

Bottom Line: Independent contractors and pass-through business owners with personal service income, **including real estate agents and brokers**, with taxable income **below** the $157,500 or $315,000 thresholds may generally claim the full 20% deduction under the personal service income exception. Independent contractors and pass-through business owners with **non-personal service income** and total taxable income below these thresholds may also claim the full 20% qualified business income deduction. In addition, independent contractors (or other sole proprietors) with non-personal service incomes **above** these thresholds may also be able to claim a 20% deduction, but that deduction may be limited by the wage and capital limit exception.

The House and Senate started out with significantly different approaches to lowering the tax rate on qualified business income from sole proprietors and pass-through entities. The House bill featured a top rate approach while the Senate offered a deduction, which was set at 23% in the Senate bill. The House approach offered flexibility in allowing businesses with significant capital invested or wages paid. The final provision reflects a compromise between the different approaches. The provision generally follows the Senate proposal, but, at the request of the House, includes an additional factor related to the level of capital investment in the business.

The following examples (detailed in the Appendix 1 on pages 12-18) illustrate how these new changes would affect different real estate professionals based on how their income is earned, income they may claim from a spouse, and how their business is structured. NAR members should consult a tax professional about their own personal circumstances.

Example 1: Amy Agent, a single filer with sole income from real estate commissions

Example 2: Andy Agent, a married filer with children with income from his real estate business and W-2 income from his spouse

Example 3: Barry Broker, a single filer with income passed through his real estate LLC

Example 4: Bobbie Broker, a married filer with income passed through her real estate LLC and salary income from her spouse

Example 5: David Developer, a married filer with income from his development S corp, which also has wage employees and capital at risk

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Section 179 Expensing

- The final bill increases the amount of qualified property eligible for immediate expensing from $500,000 (current law) to $1 million. The phase-out limitations are increased from $2 million to $2.5 million.
- The final bill expands the definition of qualified real property eligible for section 179 expensing to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.
- The bill also significantly increases the amount of first-year depreciation that may be claimed on passenger automobiles used in business to $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period.

Denial of Deductibility of Entertainment Expenses

- The final bill provides that no deduction is allowed with respect to:
    - An activity generally considered to be entertainment, amusement, or recreation;
    - Membership dues with respect to any club organized for business, pleasure, recreation or other social purpose, or
    - A facility or portion of a facility used in connection with the above items.
- Thus, the provision repeals the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business.
- Taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel).

Provisions Considered But Not Included in the Final Bill

Additional Withholding Requirements for Independent Contractors

- Language in the Senate-introduced bill would have subjected Independent Contractors to an additional 5% withholding requirement. This provision was dropped from the Senate (and final) bills.

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Expansion of Unrelated Business Income Tax (UBIT) for Non-Profits

- The Senate introduced bill expanded UBIT treatment to include royalties derived from association licensing of trademarks or logos. This provision was dropped in the Senate (and final) bill. Additionally, tax writers considered subjecting certain exempt income (such as trade show or education revenue) to UBIT treatment but these provisions were not included.

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Appendix 1 – Examples of How the Deduction for Qualified Business Income May Affect Various Real Estate Professionals

Example 1. Amy Agent is single and for 2018 has commission income from her real estate sales activities of $55,000, net of her normal business expenses[3]. Amy has no dependent children and claims the standard deduction. Here is how Amy's tax situation would change under the new law:

Prior Law. Under the prior law, Amy would pay ordinary income tax rates on her net commission income. Assuming she had no other income, her federal income tax for 2018 would be computed as follows:

Net commission income	$55,000
Personal exemption	($ 4,150)
Standard deduction	($ 6,500)
Taxable income	$44,350
Tax	$ 6,741

Note: Amy is in the marginal tax rate bracket of 25% under the prior law.

New Law. The new tax law would provide a 20% deduction for Amy's net commission income so long as her total taxable income does not exceed $157,500, even though the income is derived from personal services (because of the personal service income exception). This deduction would reduce Amy's taxable income by $11,000 ($55,000 x 20%). Her tax under the new law would be computed as follows:

Net commission income	$55,000
Business income deduction (20%)	($11,000)
Standard deduction[4] $12,000	($12,000)
Taxable income	$32,000
Tax	$ 3,650

Tax Difference Under New Law. Amy's savings attributable to the new business income deduction would be $1,320 ($11,000 x 12%, since she is in the 12% marginal tax bracket).

Her total tax reduction compared with the prior law is $3,091 ($6,741 - $3,650).

[3] With the exception of some restrictions on the deductibility of entertainment expenses, the normal business expenses of real estate professionals were not changed by the bill.
[4] The new law provides single individuals with a $12,000 standard deduction.

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Example 2. Andy Agent is married to Emma Employee and they have two dependent children. For 2018, Andy earns $45,000 of net commission income while Emma earns a salary of $45,000. They have itemized deductions of $18,000, which are comprised of mortgage interest, state and local taxes, and charitable contributions.

Prior Law. Under the prior law, Andy and Emma would pay ordinary income tax rates on their total taxable income. Assuming they have no other income, their federal income tax for 2018 would be computed as follows:

Net commission income	$45,000
Salary income	$45,000
Personal exemptions (4 x $4,150)	($16,600)
Itemized deductions	($18,000)
Taxable income	$55,400
Tax	$ 7,358
Tax credit for children[5]	$ 2,000
Net tax after credits	$ 5,358

Note: Andy and Emma are in the marginal tax rate bracket of 15% under the prior law.

New Law. The new tax law would provide a 20% deduction for Andy's net commission income so long as his and Emma's total taxable income does not exceed $315,000, even though the business income is derived from personal services (because of the personal service income exception). This deduction would reduce Andy and Emma's taxable income by $9,000 ($45,000 x 20%). Their tax under the new law would be computed as follows:

Net commission income	$45,000
Salary income	$45,000
Business income deduction (20%)	($ 9,000)
Standard deduction[6]	($24,000)
Taxable income	$57,000
Tax	$ 6,459
Tax credit for children[7]	$ 4,000
Net tax after credits	$ 2,459

[5] The prior law provided a tax credit of $1,000 for each child.

[6] The new law increases the standard deduction for married taxpayers filing a joint return to $24,000. Since this is higher than Andy and Emma's itemized deductions, they will claim the higher standard deduction.

[7] The new law doubles the child tax credit to $2,000 per child.

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Tax Difference Under New Law. The business income deduction would save Andy and Emma $1,080 ($9,000 x 12%, since they are in the 12% marginal tax bracket).

Their total tax reduction compared with the prior law is $2,899 ($5,358 - $2,459).

Example 3. Barry Broker is single and is the sole owner of BB Properties, a limited liability company (LLC), which is taxed as a partnership. He has no dependents and claims the standard deduction. For 2018, Barry has net business income of $175,000 from his real estate brokerage business.

Prior Law. Under the prior law, Barry would pay tax on his net brokerage income at the ordinary income tax rates. Assuming he had no other income for the year, his 2018 income tax would be computed as follows:

Net brokerage income	$175,000
Personal exemption	($ 4,150)
Standard deduction	($ 6,500)
Taxable income	$164,350
Tax	$ 38,861

Note: Under prior law, Barry is in the marginal tax bracket of 28%.

New Law. Unlike Amy, Barry's taxable income (determined without regard to the deduction for qualified business income) is higher than the threshold for single individuals ($157,500). However, Barry's income does not exceed the upper threshold of the phase-out range ($207,500). Thus, Barry will receive a pro-rated deduction.

- The 20% deduction for Barry will be limited as follow:
  - Barry's taxable income under the new law will be $163,000 ($175,000 less standard deduction of $12,000).
  - $163,000 (taxable income) less $157,500 (income threshold for singles) = $5,500.
  - $5,500/$50,000 (income phase-out range) = 11% (percentage amount of deduction disallowed)
  - 20% x 89% (e.g. 1-.11) = 17.8% (deduction percentage)
  - $175,000 x 17.8% = $31,150 (deduction allowed)

Barry's tax liability under the new law would be computed as follows:

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Net brokerage income	$175,000
Business income deduction	($ 31,150)
Standard deduction	($ 12,000)
Taxable income	$131,850
Tax	$ 25,934

Tax Difference Under New Law: Barry's business income deduction would save him $7,476 ($31,150 x 24%) in taxes, as he is in the marginal tax bracket of 24%.

His total tax reduction compared with current law is $12,927 ($38,861 - $25,934).

Example 4. Bobbie Broker owns 100% of a successful real estate brokerage called Bobbie's Realty, which operates as a limited liability company (LLC). She is married to Emil Employee, who is a senior VP at a manufacturing company. For 2018, Bobbie has net business income of $175,000 from her business, while Emil earns a salary of $270,000. Bobbie and Emil have no dependents and claim itemized deductions of $28,000 from state taxes, mortgage interest, and charitable contributions.

Prior Law. Under the prior law, Bobbie and Emil would pay tax on her net brokerage income and his salary income at the ordinary income tax rates. Assuming they had no other income for the year, their 2018 income tax would be computed as follows:

Net brokerage income	$175,000
Salary income	$270,000
Personal exemptions[8]	($ – 0 –)
Itemized deductions[9]	($ 24,250)
Taxable income	$420,750
Tax	$113,573

Note: Under prior law, Bobbie and Emil are in the marginal tax bracket of 33%.

[8] At this income level, Bobbie and Emil's personal exemptions would be phased out.

[9] At this income level, Bobbie and Emil's itemized deductions are reduced by 3% of the excess of their AGI ($445,000) over the 2018 phaseout threshold of $320,000, or by $3,750. $28,000 - $3,750 = $24,250.

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New Law. Bobbie and Emil's taxable income (determined without regard to the deduction for qualified business income) is higher than the threshold for married couples filing a joint return ($315,000). Their taxable income is also higher than the upper phase-out threshold of $415,000. Therefore, since Bobbie's brokerage income is considered all personal services income, she and Emil will receive no business income deduction.

Bobbie and Emil's tax liability under the new law would be computed as follows:

Net brokerage income	$175,000
Salary income	$270,000
Business income deduction	($ – 0 –)
Itemized deductions[10]	($ 28,000)
Taxable income	$417,000
Tax	$ 97,329

Tax Difference Under New Law:

Their total tax reduction compared with current law is $16,244 ($113,573 - $97,329).

Example 5. David Developer is a successful real estate developer, and is married to Valerie Volunteer. For 2018, David earned net income of $370,000 from his solely-owned S corporation, Davco, after paying himself a salary of $80,000 and W-2 wages to a full-time assistant totaling $50,000. In addition, Davco owns the office building where it does business, which is worth $300,000 (net of the land value), and the business also has other depreciable assets that originally cost $50,000. Valerie earns no income and she and David have no dependents. Their itemized deductions total $35,000.[11]

Prior Law. Under the prior law, David would pay tax on his net income passed through from Davco, as well as on his Davco salary, at the ordinary income tax rates. His and Valerie's 2018 income tax under the prior law would be computed as follows:

[10] The new law repeals the itemized deduction phaseout (so-called "Pease" provision).

[11] These are made up of mortgage interest, state and local taxes, and charitable contributions.

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Salary from Davco	$ 80,000
Net income passed through	$370,000
Personal exemptions[12]	($ – 0 –)
Itemized deductions[13]	($ 31,100)
Taxable income	$418,900
Tax	$112,963

Note: Under prior law, David and his spouse are in the marginal tax bracket of 33%.

New Law. As with Barry Broker, David and Valerie's taxable income (determined without regard to the deduction for qualified business income) is higher than the threshold. For married couples filing jointly, this threshold is $315,000. Also, like Barry, David and Valerie are above the phase-out level of $415,000, so they cannot qualify for the unrestricted 20% business income deduction. However, assuming David's income is not personal services income, it may qualify for the wage and capital limit exception. This exception limits the deduction based on the greater of (1) 50% of the W-2 wages paid by the business, or (2) the total of 25% of the W-2 wages paid by the business plus 2.5% of the cost basis of the tangible depreciable property of the business at the end of the year.

- The deduction for David would be computed as follows:
  - 50% of wages paid = $65,000 ($130,000 x 50%), or
  - (2) 25% of wages paid = $32,500 ($130,000 x 25%) plus $8,750 (2.5% x $350,000) = $41,250
  - The unlimited deduction would be 20% of net income passed through = $74,000 ($370,000 x 20%). Since the greater of the two limitations is $65,000, Denny's business income deduction would be limited to $65,000.

David and Valerie's tax liability under the new law would be computed as follows:

Salary from Davco	$ 80,000
Net income passed through	$370,000
Business income deduction (see above)	($ 65,000)
Itemized deductions[14]	($ 35,000)
Taxable income	$350,000
Tax	$ 75,379

[12] At this income level, David and Valerie's personal exemptions would be phased out.

[13] At this income level, David and Valerie's itemized deductions are reduced by 3% of the excess of their AGI ($450,000) over the 2018 phaseout threshold of $320,000, or by $3,900. $35,000 - $3,900 = $31,100.

[14] The new law repeals the itemized deduction phaseout (so-called "Pease" provision).

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Tax Difference Under New Law: David's business income deduction would save him and Valerie almost $20,800 in taxes, as he is in the marginal tax bracket of 32% ($65,000 x 32%).

Their total tax reduction compared with current law is $37,584 ($112,963 - $75,379).

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Appendix 2 – Examples of How The New Law Will Affect the Tax Incentives of Owning a Home

Example 1 - First-Time Homebuyer. To illustrate how the changes to the standard deduction, repeal of personal exemptions, mortgage interest and state and local taxes might affect a first-time homebuyer, consider the example of Barbara Buyer. Barbara, an accountant making $58,000 per year, is single and currently rents an apartment. She also pays state income tax of $2,900 and makes charitable contributions of $2,088, but the total of these is lower than the standard deduction, so she claims the standard.

Barbara's tax liability for 2018 under the **prior law** is as follows:

Salary income	$58,000
Standard deduction	($ 6,500)
Personal exemption	($ 4,150)
Taxable income	$47,350
Tax	$ 7,491

Under the **new law**, Barbara would get a tax cut, computed as follows:

Salary income	$58,000
Standard deduction	($12,000)
Personal exemption	($ - 0 -)
Taxable income	$46,000
Tax	$ 6,060

Tax Difference Under New Law. Even though Barbara would not get the benefit of the personal exemption under the new law, her higher standard deduction would more than make up for the loss. In addition, the lower tax rates of the new law would help deliver the total tax cut of $1,431 ($7,491 - $6,060) as compared with the prior law.

However, let's take a look at what happens to Barbara if she were to purchase the condo that she likes costing $205,000. She takes out a 30-year fixed rate mortgage at 4% interest, putting down 3.5%. Assuming she buys early in 2018, her first-year mortgage interest would total $7,856 and she would pay real property taxes of $2,050.

As a first-time homeowner, her tax liability under the **prior law** would be computed as follows:

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Salary income		$58,000
Mortgage interest	$ 7,856	
Real property tax (1%)	$ 2,050	
State income tax (5%)	$ 2,900	
Charitable contributions (3.6% of income)	$ 2,088	
Total itemized deductions		($14,894)
Personal exemption		($ 4,150)
Taxable income		$38,956
Tax		$ 5,393

Note. Under the prior law, Barbara would lower her tax liability for 2018 by $2,098 ($7,491 - $5,393) by purchasing the condo. This is the financial effect of the prior law's tax benefits of buying a home. This amount effectively lowers her monthly mortgage payment by $175 per month.

Now, let's take a look at what her tax situation would be under the **new law** as a first-time homebuyer:

Salary income		$58,000
Mortgage interest	$ 7,856	
Real property tax (1%)	$ 2,050	
State income tax (5%)	$ 2,900	
Charitable contributions (3.6% of income)	$ 2,088	
Total itemized deductions		($14,894)
Personal exemption		($ - 0 -)
Taxable income		$43,106
Tax		$ 5,423

Tax Difference Under New Law. Even though Barbara would still be able to claim all of her itemized deductions under the new law, she would lose the benefit of her personal exemption. This would mean that her taxes would actually go up under the new law by $30 ($5,393 - $5,423). But far worse, look at the tax differential between renting and owning a home. This difference, which was $2,098 under the prior law, has now shrunk to just $637 ($6,060 - $5,423), or $53 per month. In other words, under the prior law, Barbara was given a strong incentive to move into the ranks of those who own their home. The new law still offers her an incentive, but it is a shadow of what it was, and is unlikely to be very compelling.

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Example 2 - Middle-Income Family of Five:

To illustrate how the changes to the standard deduction, repeal of personal exemptions, mortgage interest and state and local tax deductions, and increase in the child credit might affect middle-income family of five, consider the example of Steve and Melinda. Steve is a store manager making $55,000 per year, while Melinda is a school principal, earning $65,000. They have three children, ages 17, 14, and 9. Steve and Melinda recently relocated from another city, and while they are getting to know their new community, they are leasing a home. But they would like to purchase as soon as they identify which area is the best fit for their family. As renters, they pay state income tax on their salaries, totaling $6,000, and also make some charitable contributions equaling $3,120. Since these itemized deductions do not reach the level of the standard deduction, they do not itemize, but they expect to do so when they purchase their home.

Here is a look at Steve and Melinda's tax liability for 2018, computed under the **prior law:**

Salary income	$120,000
Standard deduction	($ 13,000)
Personal exemptions (5 x $4,150)	($ 20,750)
Taxable income	$ 86,250
Tax before credits	$ 12,870
Child tax credits (2 x $1,000 less $500 phase-out)	($ 1,500)
Net Tax	$ 11,370

Under the **new law**, Steve and Melinda, as renters, would get a tax cut, computed as follows:

Salary income	$120,000
Standard deduction	($ 24,000)
Personal exemption	($ - 0 -)
Taxable income	$ 96,000
Tax before credits	$ 12,999
Child tax credits (2 x $2,000)	($ 4,000)
Net Tax	$ 8,999

Tax Difference Under New Law As Renters. Steve and Melinda lose the big benefit of the personal and dependency exemptions for the two adults and three children. And the increase in the standard deduction is not enough to make up for this loss. However, the big increase in the child credit for the two younger children and the lower tax rate are enough to deliver them a tax cut of $2,371 ($11,370 - $8,999) as compared with the prior law.

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Let's now consider how Steve and Melinda's tax situation changes if they were homeowners, rather than renters. Assume they find an ideal home in a nice neighborhood that costs $425,000, and after offering a 10% down payment, Steve and Melinda take out a 30-year fixed mortgage at a 4% rate. Let's say that their real property tax for the year totals $4,250, which is just 1% of the home's value.

Here is how their 2018 tax liability would be computed as homeowners, under the prior law:

Salary income	$120,000
Mortgage interest	$ 15,189
Real property tax (1%)	$ 4,250
State income tax (5%)	$ 6,000
Charitable contributions (2.6% of income)	$ 3,120
Total itemized deductions	($ 28,559)
Personal exemptions (5 x $4,150)	($ 20,750)
Taxable income	$ 70,691
Tax before credits	$ 9,651
Child tax credits (2 x $1,000 less $500 phase-out)	($ 1,500)
Net Tax	$ 8,151

Note. Under the prior law, Steve and Melinda would lower their tax liability for 2018 by $3,219 ($11,370 - $8,151) by purchasing their home instead of renting. This is the financial effect of the prior law's tax benefits of buying a home. This amount effectively lowers their monthly mortgage payment by over $268 per month.

Now, let's take a look at what her tax situation would be under the new law as a home-owning family instead of renters:

Salary income	$120,000
Mortgage interest	$ 15,189
Real property tax (1%)	$ 4,250
State income tax (5%) (limited by $10,000 cap)	$ 5,750
Charitable contributions (2.6% of income)	$ 3,120
Total itemized deductions	($ 28,309)
Personal exemptions	($ - 0 -)
Taxable income	$ 91,691
Tax before credits	$ 12,051
Child tax credits (2 x $2,000)	($ 4,000)
Net Tax	$ 8,051

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Tax Difference Under New Law As Homeowners. For Steve and Melinda, most of their itemized deductions from the prior law are preserved by the new law. They are limited slightly ($250) by the $10,000 limit on the deduction of state and local taxes. However, they lose big by the repeal of the personal and dependency exemptions, which equal $20,750 for this family. Even so, Steve and Melinda receive a small tax cut of $100 ($8,151 - $8,050) under the new law, thanks to the much larger child credit and lower tax rate. But as renters, they received a tax cut of almost $2,400.
Thus, buying a home becomes a net tax change of almost $2,300.

What happened? What happened is that the new law is taking away most of the tax benefits of owning a home. Under the prior law, this benefit was $3,219 for Steve and Melinda. But under the new law, they enjoy only a benefit of $948 ($8,999 - $8,051). This gives them a benefit of just $79 per month, which is obviously a far weaker incentive to own.