



District of Columbia

# **Summary of the Effects of Major Provisions of the “Tax Cuts and Jobs Act” on District Residents and Businesses**

February 27, 2018



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# Tax Changes Under the TCJA

- ❑ The Tax Cuts and Jobs Act (TCJA) is the most significant revision to the federal tax system since 1986
- ❑ TCJA makes substantial changes to the Internal Revenue Code that impact both the federal and District tax liabilities of District taxpayers
  - *An estimated **83%** of District taxpayers will **experience a decrease or experience no change** in their combined net federal and District income taxes*
  - *An estimated **17%** of District taxpayers will **experience an increase** in their combined net federal and District income taxes*
- ❑ The changes to individual income tax and estate tax are temporary and will expire after December 31, 2025
- ❑ The changes to the corporate income tax are permanent



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# Major Provisions



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## Major Changes Impacting the District

This presentation will focus on the following changes that may significantly impact District revenues and/or District taxpayers:

- Federal Tax Rates
- Standard Deduction
- Personal Exemption
- Child Tax Credit
- State and Local Tax (SALT) Deduction
- Estate Tax Exclusion
- 20% Qualified Business Income Deduction
- Immediate Expensing/Interest Deduction Limitation for Businesses



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## Federal Rate and AMT Changes

### ***Federal Individual and Corporate tax rates reduced and AMT Adjusted***

- Individual income tax rates were reduced for most federal income tax brackets (See attached appendix)
  - Alternative minimum tax (AMT) exemption and phaseout levels were substantially increased
  - Corporate income tax rates were changed from a graduated structure to a flat 21%
- ❑ **Federal Effect:**
- Reduces federal tax liability for most individual taxpayers and corporations
  - Offsets, at least in part, the limitation of SALT deduction for individuals and elimination of other deductions
- ❑ **District Effect:**
- No impact on District revenues
  - No impact on District taxpayers' District income or franchise tax liability



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## Standard Deduction

### ***Federal standard deduction almost doubled***

***(2018 - Married: \$24,000, Single: \$12,000, Head-of-Household: \$18,000)***

- ❑ **Federal Effect:** Reduces federal taxable income for taxpayers who:
  - Currently claim the standard deduction
  - Previously claimed itemized deductions less than the new higher standard deduction
  
- ❑ **District Effect:** Reduces District taxable income for taxpayers who:
  - Currently claim the standard deduction (*59% of all District taxpayers*)
  - Previously claimed itemized deductions that are less than the new higher standard deduction (*13% of all District taxpayers*)



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## Personal Exemption

### ***Personal Exemption Suspended***

***(\$4,150 per exemption before TCJA)***

#### ❑ **Federal Effect:**

- Increases federal taxable income for some District taxpayers (especially those with dependents)
- Largely offset by increase to the standard deduction and federal child tax credit

#### ❑ **District Effect:**

- Increases District taxable income for some District taxpayers (especially those with dependents)



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## Changes to DC Standard Deduction and Personal Exemption

	2016	2017	2018 pre-TCJA	2018 TCJA
Standard Deduction				
Single	\$5,200	\$5,650	\$6,500	\$12,000
Married	\$8,350	\$10,275	\$13,000	\$24,000
Head of Household	\$6,500	\$7,800	\$9,350	\$18,000
Personal exemption	\$1,775	\$1,775	\$4,150	\$0





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## Child Tax Credit

### ***The Federal Child Tax Credit Increased***

- \$2,000 per child
- Partial credit for certain non-child dependents
- Income thresholds increased
- \$1,400 is refundable

#### **□ Federal Effect:**

- Decreases federal tax liability for eligible taxpayers
- Partially offsets suspension of the personal exemption for eligible taxpayers with dependents

#### **□ District Effect:**

- The District does not have a child tax credit
- District taxpayers with dependents will not be able to reduce their District taxable income with a child credit or a personal exemption



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## SALT Deduction Limitation

***Federal deduction for state and local taxes, including property tax, is limited to \$10,000***

### ❑ **Federal Effect:**

- No impact on federal taxable income for taxpayers who claim the standard deduction
- Increases federal taxable income of taxpayers who itemize deductions and pay more than \$10,000 in state and local taxes. For 3% of taxpayers, the SALT limitation increases federal tax despite other offsetting tax code changes.

### ❑ **District Effect:**

- No impact on District taxpayers who claim the standard deduction
- No impact on District taxable income for District taxpayers who itemize deductions:
  - District income taxes are not deductible from District taxable income
  - The federal deduction limitation to property taxes does not apply to District taxes (District tax form will be modified to ensure full deduction)



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## Estate Tax Basic Exclusion Amount Increased

***Increases the Estate Tax Basic Exclusion Amount from \$5 million to \$10 million (adjusted for inflation to \$5.6 million and to \$11.2 million for 2018)***

### ❑ **Federal Effect:**

- Reduces the number of estates required to file a federal estate tax return
- Eliminates the federal estate tax liability for taxable estates up to \$11.2 million
- Decreases the federal estate tax liability for taxable estates over \$11.2 million

### ❑ **District Effect:**

- Reduces the number of estates required to file a District estate tax return
- Eliminates the District estate tax liability for taxable estates up to \$11.2 million
- Decreases the District estate tax liability for taxable estates over \$11.2 million



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## Summary of Individual Changes

Provision	Federal Effect	District Effect	Slide
<b>Federal Rate Changes</b>	<ul style="list-style-type: none"> <li>Reduces federal tax liability for 65% of District taxpayers</li> </ul>	<ul style="list-style-type: none"> <li>No impact on District revenues</li> <li>No impact on District taxpayers' District income or franchise tax liability</li> </ul>	P. 5
<b>Increase in Standard Deduction</b>	<ul style="list-style-type: none"> <li>Reduces federal taxable income for 52% of District taxpayers</li> </ul>	<ul style="list-style-type: none"> <li>Reduces District taxable income for 64% of taxpayers</li> </ul>	P. 6
<b>Personal Exemption Suspended</b>	<ul style="list-style-type: none"> <li>Increases federal taxable income for 83% of District taxpayers (especially those with dependents)</li> </ul>	<ul style="list-style-type: none"> <li>Increases District taxable income for 93% District taxpayers (especially those with dependents)</li> </ul>	P. 7
<b>Child Tax Credit</b>	<ul style="list-style-type: none"> <li>Decreases federal tax liability for eligible taxpayers</li> </ul>	<ul style="list-style-type: none"> <li>The District does not have a child tax credit</li> </ul>	P. 9
<b>SALT Deduction Limitation</b>	<ul style="list-style-type: none"> <li>Increases federal taxable income of taxpayers who itemize deductions and pay more than \$10,000 in state and local taxes</li> </ul>	<ul style="list-style-type: none"> <li>No District impact on District taxpayers</li> </ul>	P. 10
<b>Estate Tax Exclusion Increased</b>	<ul style="list-style-type: none"> <li>Reduces the number of estates required to file a federal estate tax return and reduces tax due</li> </ul>	<ul style="list-style-type: none"> <li>Reduces the number of estates required to file a District estate tax return</li> </ul>	P. 12



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## BUSINESS TAX CHANGES

- Federal corporate tax decrease for District businesses of an estimated \$460 million in 2019, mostly from federal rate reduction and repeal of corporate alternative minimum tax (AMT)
  - Corporate rate reductions do not change District taxes
  - District does not conform to federal AMT so no impact
- Passthrough (sole proprietor and partnerships) business income deduction reduces federal taxable individual income.
- Business expensing provisions that allow the immediate deduction of investment costs will reduce federal tax revenue in 2018 and 2019. The District does not conform to the federal change in expensing.
- Most of positive fiscal impact offset after 2022 is from expanding the taxable income base
  - Limitation on use of net operating losses
  - Limitation on deduction of interest expense
- Tax on foreign income increases federal revenue by \$146 million in 2019 on District taxpayers, offsetting some of the federal corporate tax reduction and will increase the amount of funds available for investment and dividends in the District.



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## 20% Deduction for Qualified Business Income

***Creates a new deduction for business owners for 20% of income received from certain qualified businesses and passthrough entities***

❑ **Federal Effect:**

- Allows taxpayers to deduct 20% of “qualified business income” on their individual income tax returns
- Intended to provide business owners a benefit similar to the lowering of corporate rate

❑ **District Effect:**

- ORA assumes District taxable income not affected when calculating fiscal impact



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## Immediate Expensing/Interest Deduction Limitation

### Immediate Expensing Deduction Allowed

*Allows businesses to immediately deduct the purchase of an asset as an expense instead of depreciating the asset over time*

#### □ **Federal Effect:**

- Accelerates tax benefit to businesses that purchase assets
- Decreases federal tax liability

#### □ **District Effect:**

- The District previously decoupled from this provision
- No impact on District tax liability

### Interest Deduction Limited

*Limits the deduction for interest paid by businesses*

#### □ **Federal Effect:**

- Limits ability of businesses to deduct interest
- Increases federal tax liability
- Intended to offset the effect of immediate expensing deduction

#### □ **District Effect:**

- The District is coupled with federal law regarding the deductibility of interest and, therefore, will follow this new limitation
- Increases District tax liability



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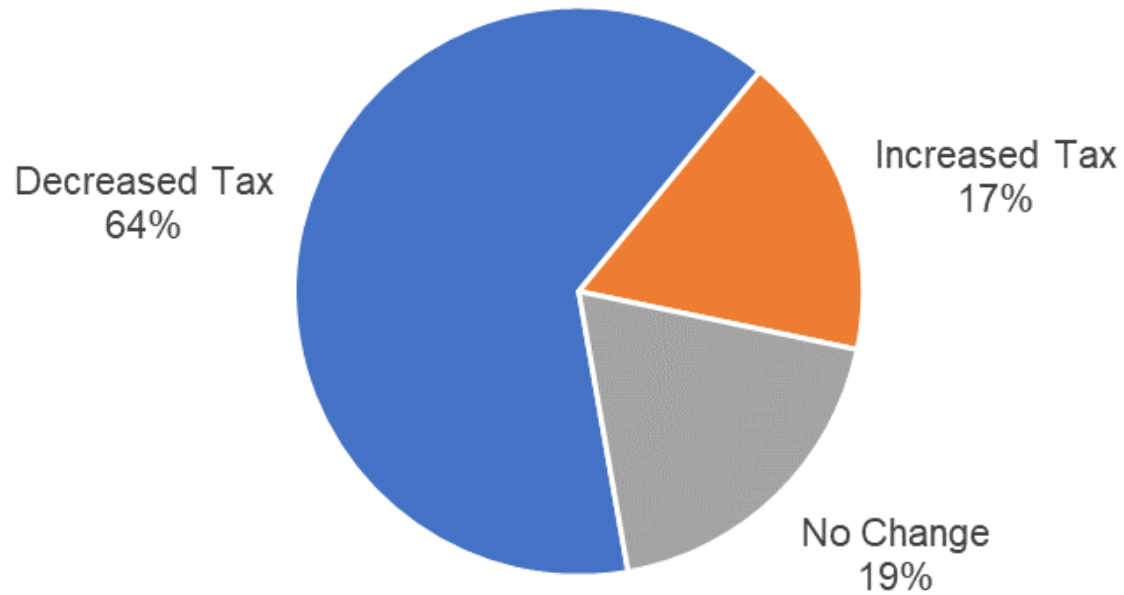
# Individual Income Tax Effects





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## Combined Federal and DC Tax Impact



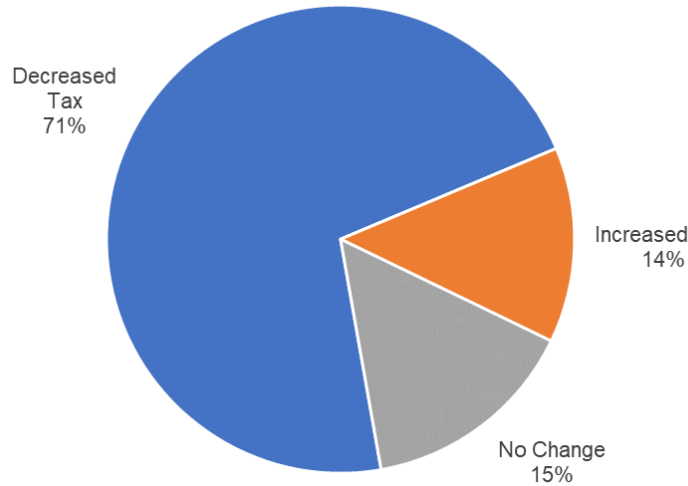
Combined Federal & DC Impact				
	Increase	Decrease	No Change	Total
% of returns with change	17%	64%	19%	100%
Change (\$M)	\$139.9 M	-\$670.6 M		-\$530.7 M
Median change	\$929	-\$1,159		



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# Federal and DC Tax Impact

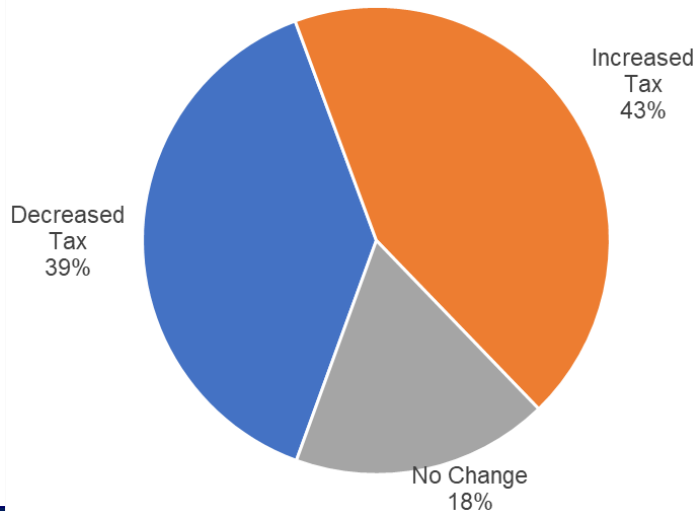
## Federal Tax Impact



- Federal tax revenue decrease \$617.3 million

	Federal			Net
	Increase	Decrease	No Change	
% of returns with change	14%	71%	15%	100%
Federal Change (millions)	\$109.1 M	-\$726.4 M		-\$617.3 M
Median change (dollars per return)	\$815	-\$1,206		

## DC Tax Impact



- DC tax revenue increase \$56.4 million

	DC			Net
	Increase	Decrease	No Change	
% of returns with change	43%	39%	18%	100%
District Change (millions)	\$82.3 M	-\$25.9 M		\$56.4 M
Median change	\$336	-\$88		

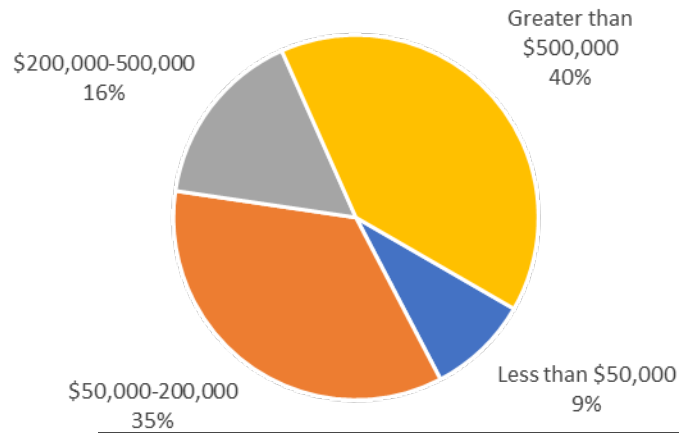


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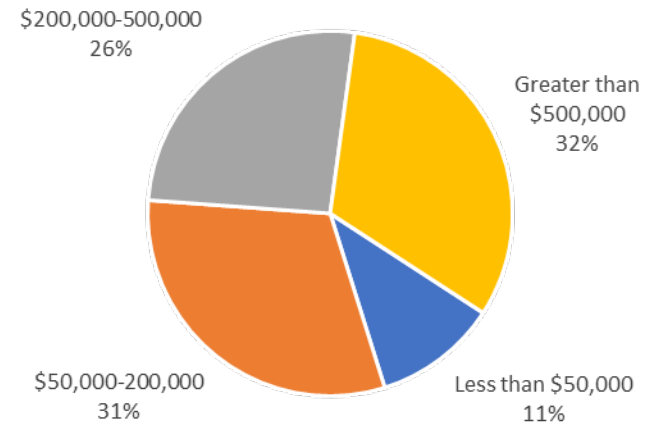
## Share of tax change by income group

Net Federal Change = \$617 Million decrease

Federal Decrease

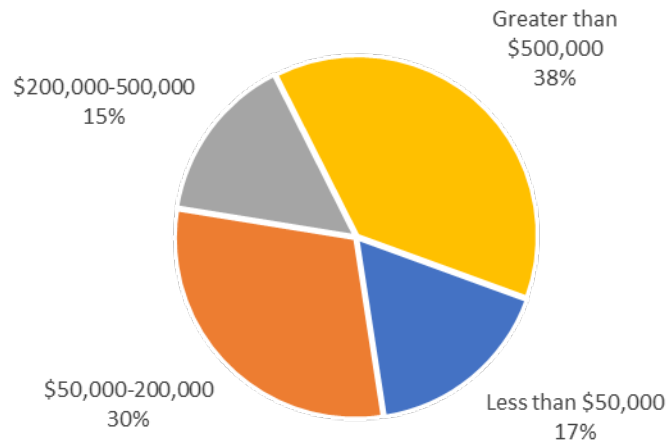


Federal Increase

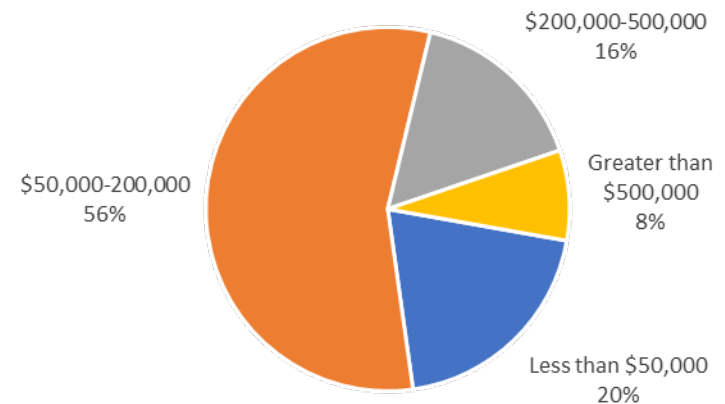


Net DC Change = \$56 Million increase

DC Decrease





















DC Increase





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## Increase in DC Effective Tax Rate Before and After TCJA

	PRIOR TO TCJA		AFTER TCJA		Change in Effective Rate
	Average Tax	Effective rate	Average Tax	Effective Rate	
\$ 0 to \$ 10,000	-\$341	No Liability	-\$344	No Liability	
\$ 10,000 to \$ 25,000	-794	No Liability	-777	No Liability	
\$ 25,000 to \$ 50,000	712 	<b>1.70%</b>	867 	<b>2.10%</b>	0.4%
\$ 50,000 to \$ 75,000	2,363 	<b>3.50%</b>	2,536 	<b>3.70%</b>	0.2%
\$ 75,000 to \$ 100,000	3,964 	<b>4.10%</b>	4,199 	<b>4.40%</b>	0.3%
\$ 100,000 to \$ 200,000	7,389 	<b>4.90%</b>	7,777 	<b>5.10%</b>	0.2%
\$ 200,000 to \$ 350,000	16,068 	<b>5.70%</b>	16,465 	<b>5.80%</b>	0.1%
\$ 350,000 to \$ 500,000	28,301 	<b>6.20%</b>	28,479 	<b>6.30%</b>	0.1%
\$ 500,000 to \$ 1 M.	47,722 	<b>6.40%</b>	47,673 	<b>6.40%</b>	0.0%
Greater than \$ 1 M.	221,654 	<b>6.30%</b>	220,398 	<b>6.30%</b>	0.0%
Total, All Taxpayers	\$5,667 	<b>4.80%</b>	\$5,833 	<b>4.90%</b>	0.1%



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## Why Certain Taxpayers are Impacted

Low (< \$50,000) and middle income (\$50,000-\$200,000) taxpayers may see increased DC tax if:

- The new standard deduction does not offset prior combination of standard deduction and personal exemption
  - *For federal taxpayers, the suspension of the personal exemption may be offset by rate reductions or the expanded child credit. DC tax rates do not change and DC does not have a child tax credit*
- They itemize deductions but no longer receive additional deduction from personal exemption

High income taxpayers may see increased DC tax if:

- They have significant miscellaneous deductions such as investment broker fees which are no longer deductible
- Their business/partnership losses greater than \$250,000 (single) or \$500,000 (married) which are now limited.



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# FISCAL IMPACT



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## Impact On District Financial Plan

### Fiscal Impact of Federal Tax Reform

(\$ millions)

	FY18	FY19	FY20	FY21	FY22
1. Individual Income Tax	33.8	56.4	58.9	61.4	64.1
2. Corporate tax	0.5	1.0	1.0	1.1	1.1
3. Unincorporated tax	0.5	1.0	1.0	1.1	1.1
4. Estate tax		(6.5)	(6.6)	(6.9)	(7.2)
<b>Net Impact</b>	<b>34.8</b>	<b>51.9</b>	<b>54.3</b>	<b>56.7</b>	<b>59.2</b>



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# Two Options Considered by Other States to Address State and Local Tax Deduction Limitation



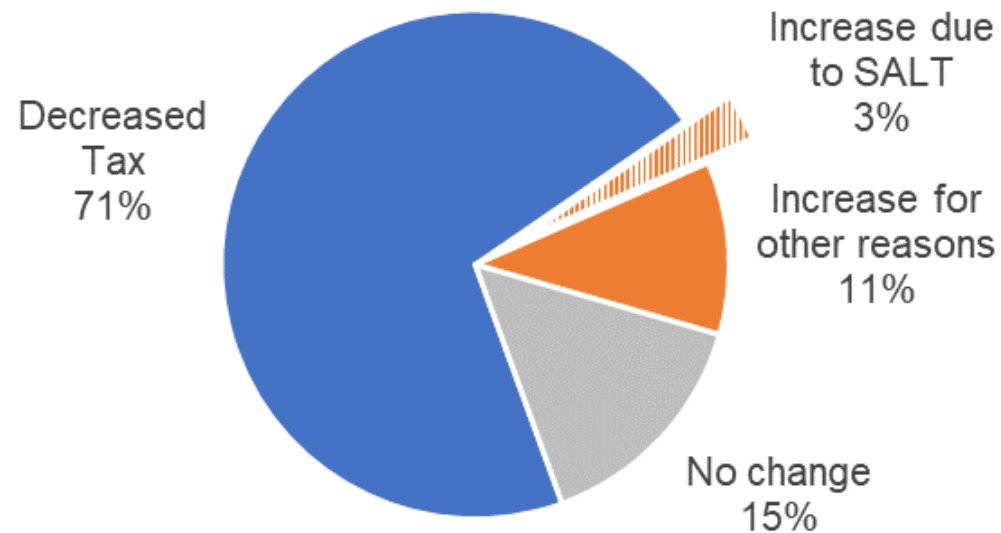


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## Who is affected by SALT Limitation

- 3% (11,310) of taxpayers with federal tax increase because the SALT limitation not offset by other tax changes.

### Federal Tax Change





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## Charitable Contributions in Exchange for State Tax Credits

### **Proposal:**

- Taxpayers donate money to a state-created fund in exchange for state tax credits
- Taxpayers could be allowed a charitable contribution deduction on their federal return
- Charitable contributions are not subject to a \$10,000 cap
- Taxpayers claim the credit to reduce their state tax liability

### **Goals:**

- Allow taxpayers to avoid the \$10,000 cap on state and local tax deductions on their federal returns

### **Risks:**

- Administrative complexity and likely budget costs for the District
- The IRS or Congress may disallow the deductions
- Federal government may disallow District legislation as part of oversight role



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## Substituting Employer Payroll Taxes for Income Taxes

### Proposal:

- States will lower the personal income tax rate and increase the payroll tax, paid by employers
- Private employers will be able to deduct the payroll tax from corporate/business income

### Goals:

- Maintain overall federal deductibility to mitigate loss of individual state and local tax deductions on their federal returns

### Risks:

- Payroll tax cannot be levied on federal government, which is responsible for about 15% of wages in the District
- Federal government may disallow District legislation as part of oversight role
- Non-profits employers would be subject to the tax, but would receive no benefit from the deduction
- Difficult for some employers to lower an employee's wages due to existing contracts
- Lowering wages would reduce employees' future Social Security benefits



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# SUMMARY



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## Major Uncertainties

### Repatriation

- Unknown revenue impact
- Foreign income is not taxed in the District
- Federal analysis assume a significant amount of the repatriated income will flow to individuals as capital gains or dividend.

### Implementation and regulation

- IRS operating with strained resources
- Many items still unclear and need to be defined



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## Summary of Tax Impacts of TCJA

### Federal

- Federal individual taxes decrease by \$617 million; businesses by \$460 million
- Most DC Residents' federal tax reduced
  - 83% tax reduction or no change
  - Median federal income tax cut \$1,206
- Some see increased federal tax
  - 17% tax increase
  - Lower tax rate and higher standard deduction do not offset limited itemized deductions and suspension of personal exemption for this group

### DC

- DC taxes for businesses and individuals increase by \$51.9 million
- Many DC residents see DC tax increase
  - 57% tax decrease or no change
  - 43% tax increase
    - Mostly taxpayers with income between \$50,000 and \$200,000
    - Suspension of personal exemption is not offset by child tax credit or lower rates as with federal tax
    - Median increase \$336



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## Summary of Impact of TCJA on DC Income Taxes

- ❑ Effective tax rate increases from 4.8% to 4.9% (tax as share of income)
  - ❑ Higher effective tax rate impact for lower and middle income taxpayers
- ❑ Federal tax changes will result in \$51.9 million additional DC tax revenue in FY 2019
  - ❑ \$56.4 million individual income tax revenue
  - ❑ \$2 million business franchise tax revenue
  - ❑ Doubling of estate tax threshold reduces DC revenue by \$6.5 million
- ❑ Major uncertainties remain
  - ❑ Repatriated income impact on District economy and finances unclear



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# APPENDIX





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## Federal Tax Rates Before and After Tax Bill

TCJA RATES			
Rate	Single Filers	Joint Filers	Head of Household Filers
10.0%	\$0 - \$9,525	\$0 - \$19,050	\$0 - \$13,600
12.0%	\$9,525 - \$38,700	\$19,050 - \$77,400	\$13,600 - \$51,800
22.0%	\$38,700 - \$82,500	\$77,400 - \$165,000	\$51,800 - \$82,500
24.0%	\$82,500 - \$157,500	\$165,000 - \$315,000	\$82,500 - \$157,500
32.0%	\$157,500 - \$200,000	\$315,000 - \$400,000	\$157,500 - \$200,000
35.0%	\$200,000 - \$500,000	\$400,000 - \$600,000	\$200,000 - \$500,000
37.0%	\$500,000 and Over	\$600,000 and Over	\$500,000 and Over
Pre TCJA RATES			
Rate	Single Filers	Joint Filers	Head of Household Filers
10.0%	\$0 - \$9,525	\$0 - \$19,050	\$0 - \$13,600
15.0%	\$9,525 - \$38,700	\$19,050 - \$77,400	\$13,600 - \$51,800
25.0%	\$38,700 - \$93,700	\$77,400 - \$156,000	\$51,800 - \$133,850
28.0%	\$93,700 - \$194,450	\$156,000 - \$237,950	\$133,850 - \$216,700
33.0%	\$194,450 - \$424,950	\$237,950 - \$424,950	\$216,700 - \$424,950
35.0%	\$424,950 - \$426,700	\$424,950 - \$480,050	\$424,950 - \$453,350
39.6%	\$426,700 and Over	\$480,050 and Over	\$453,350 and Over