MEMORANDUM

DATE: January 5, 2018

TO: Members of the House of Representatives

FROM: Jim Stansell, Senior Economist

RE: Tax Cut and Jobs Act of 2017

The recently enacted Tax Cut and Jobs Act of 2017 (TCJA) represents the most extensive overhaul of the federal tax code since the Tax Reform Act of 1986, and makes a number of changes to the individual income tax, the corporate income tax, and the estate tax beginning with the 2018 tax year (TY 2018). Many of the provisions amending the individual income tax sunset after 2025 in an effort to reduce the overall revenue loss, which, after accounting for potential economic growth, the Joint Committee on Taxation estimates at just over $1.1 trillion over the period from 2018-2027. This memo identifies a number of the more significant changes contained in the TCJA, and provides brief explanations of those changes.

Individual Income Tax

The TCJA revises the individual income tax as follows:

- Maintains seven income brackets, but revises the income thresholds for many of the brackets, and in most cases reduces the marginal tax rate relative to current law. A comparison of the brackets and tax rates is shown below:

Single Filers				Joint Filers			
TY 2017		TCJA		TY 2017		TCJA	
Rate	Taxable Income	Rate	Taxable Income	Rate	Taxable Income	Rate	Taxable Income
10%	$0 - $9,525	10%	$0 - $9,525	10%	$0 - $19,050	10%	$0 - $19,050
15%	$9,525 - $38,700	12%	$9,525 - $38,700	15%	$19,050 - $77,400	12%	$19,050 - $77,400
25%	$38,700 - $93,700	22%	$38,700 - $82,500	25%	$77,400 - $156,150	22%	$77,400 - $165,000
28%	$93,700 - $195,450	24%	$82,500 - $157,500	28%	$156,150 - $237,950	24%	$165,000 - $315,000
33%	$195,450 - $424,950	32%	$157,500 - $200,000	33%	$237,950 - $424,950	32%	$315,000 - $400,000
35%	$424,950 - $426,700	35%	$200,000 - $500,000	35%	$424,950 - $480,050	35%	$400,000 - $600,000
39.6%	Over $426,700	37%	Over $500,000	39.6%	Over $480,050	37%	Over $600,000

- Reduces the personal/dependent exemption from a projected TY 2018 amount of $4,150 to $0.

- To offset the loss of the personal/dependent exemptions, increases the standard deduction (for those taxpayers that do not itemize deductions) from $6,500 to $12,000 for single filers and from $13,000 to $24,000 for joint filers.

- Doubles the child tax credit from $1,000 per qualifying child (under the age of 17) to $2,000, although the credit phases out for single taxpayers with adjusted gross incomes (AGI) in excess of $200,000 ($400,000 for joint filers).

- Eliminates the individual mandate for purchasing health insurance for all practical purposes by virtue of eliminating the penalty amount, effective January 1, 2019.

- Increases the Alternative Minimum Tax exemption for joint filers from $86,200 to $109,400 and increases the phase-out threshold to $1.0 million.

- Revises the following for those taxpayers that itemize:

    - Caps the deduction for state and local taxes paid at $10,000 (whether for single or joint filers).
    - Reduces the deduction for mortgage interest from $1.1 million of debt (including $100,000 of home equity debt) to $750,000 for home purchases after December 15, 2017.
    - Expands the deduction for out-of-pocket medical expenses for TY 2018 and TY 2019 from current threshold of expenses in excess of 10% of AGI to those in excess of 7.5% of AGI.
    - Eliminates deductions for investment advisory fees, tax preparation fees, the home office deduction, and other employee business expenses.

- Eliminates the deduction for job-related moving expenses.

- Changes the inflation index used for tax brackets and other provisions of the individual income tax from the more commonly reported CPI-U, the consumer price index for all urban consumers, to the chained consumer price index (C-CPI-U). The C-CPI-U is thought to provide a more accurate measure of inflation, although by its nature it tends to increase more slowly. As a result, to the extent that incomes increase faster than inflation, taxpayers will be subjected to higher marginal tax rates sooner than they would have under the previous inflation measure.

- Makes the shift to the C-CPI-U and the elimination of the individual mandate penalty permanent facets of the individual income tax; Sunsets most of the other provisions after 2025.

Overall, the changes at the federal level to the individual income tax are not expected to have significant revenue impacts in Michigan. The starting point for Michigan's individual income tax is federal AGI, and the majority of the changes discussed will affect only deductions and credits which factor in after federal AGI has been calculated.

The one notable exception that would potentially have a revenue impact is the reduction of the personal/dependent exemption to $0, which will likely eliminate the $4,000 personal/dependent on Michigan's individual income tax. Because Michigan's exemption is based on the number of exemptions claimed on a taxpayer's federal tax return, if those exemptions are no longer reported (which is reasonable since they would have a value of $0), a Michigan taxpayer would see a tax increase of $170 for each exemption lost on a Michigan tax return. Because this represents a collective $1.4 billion income tax increase in Michigan, it is anticipated the issue will be addressed statutorily to prevent any unintended consequences.

Corporate Income Tax

The TCJA revises the corporate income tax as follows:

- Most notably, reduces the top corporate income tax rate from 35% to 21%.

- Makes qualified business income (i.e., pass-through income from business entities such as sole proprietorships, partnerships, LLCs, and S corporations) eligible for a 20% deduction. Because pass-through income is taxed on the recipient's individual income tax, the deduction is an attempt to provide this type of business income with preferential tax treatment similar to the rate reduction that applies to corporate income. The deduction is limited to the lesser of 20% of the qualified business income or 50% of the total wages paid to employees, and the deduction does not apply to "specified service" businesses, including those providing health care, legal, accounting, consulting, or financial services.

- Allows short-lived capital investments to be immediately expensed for a 5-year period, and doubles the section 179 expensing cap (which is generally intended to provide assistance for small businesses) from $500,000 to $1,000,000.

- Eliminates the corporate Alternative Minimum Tax.

- Provides a one-time preferential treatment for repatriating foreign assets by subjecting deferred foreign profits to a 15.5% tax rate and taxing reinvested foreign earnings at an 8% rate. The extent to which this will encourage foreign assets to be repatriated is unknown since tax treatment is less generous with a 21% top corporate income tax rate as opposed to the prior top rate of 35%.

Because of the complexity of corporate tax structures and a lack of data due to confidentially constraints, it's not possible to estimate the potential revenue impacts in Michigan of the federal corporate income tax changes. To the extent that foreign assets are repatriated by multinational firms and become taxable in Michigan, there would be an increase in Michigan corporate income tax revenue, but the magnitude cannot be determined.

Estate Tax

The TCJA revises the estate tax as follows:

- Doubles the estate tax exemption from $5.6 million ($11.2 million for married couples) to $11.2 million ($22.4 million for couples). Sunsets the increased exemptions after 2025.

Although Michigan technically has an estate tax, it is a pickup tax in that it is tied directly to the credit allowed for state estate taxes paid on the federal estate tax. However, the Economic Growth and Tax Relief Reconciliation Act of 2001 phased the state credit out over a 4-year period, and by 2005 when the credit fell to $0, Michigan's estate tax was effectively eliminated. The Taxpayer Relief Act of 2012 made the repeal of the state estate tax credit permanent.

As previously indicated, this memo highlights only the more significant provisions, and this by no means represents the full extent of the TCJA. If you have any questions, please feel free to contact me at your convenience.