Tax Cuts and Job Act of 2017

Prepared by Office of Legislative Council and Joint Fiscal Office

- Enacted December 22, 2017.
- Makes major changes to three federal taxes: Personal Income, Corporate Income, and Gift/Estate taxes.
- Two types of impact in Vermont:
    - Will affect how much individual taxpayers pay (to both the State and Federal Governments), given their particular situation.
    - Will affect State revenues.
- How does the federal bill affect State revenues? Vermont is linked to each of these federal taxes through shared definitions of the tax base; to the extent the federal act changes the tax base, absent State statutory intervention, some changes will fall through to the State tax, and affect State revenues.
- In descending order, the biggest potential for a revenue impact to the State come from changes in the federal tax bases for Personal Income, Corporate Income, and Estate taxes. These numbers are from FY2018.
    - Vermont Personal Income = $795 million
    - Vermont Corporate Income = $87 million
    - Vermont Estate Tax = $19 million
- Legislative and Executive staff have been working to understand the impact of the federal changes on State revenues.

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- Federal personal income taxes (as of 1/1/18):
    - GI (minus certain above the line deductions) =
    - AGI (minus either the standard deduction or itemized deductions) =
    - TI → (multiplied by a rate) = Liability (minus credits)
- Vermont personal income taxes (as of 1/1/18):
    - AGI (minus) federal personal exemption (minus) either federal standard deduction or certain itemized deductions
    - In Vermont, you can take:
        - all of your medical and charitable itemized deductions;
        - none of your state income tax deduction;
        - and all your remaining federal itemized deductions are limited to 2.5 times the standard deduction.
- The biggest personal income tax changes are elimination of personal exemptions, doubling of the standard deduction, and the alteration of numerous itemized deductions.
- The biggest corporate tax change is the move from a modified worldwide system to a territorial system, with the simultaneous repatriation of profits.
- The biggest estate change is the doubling of the unified gift/estate tax credit from $5 million/$10 million to $10 million/$20 million, adjusted for inflation to 2011.

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					Large= Greater than $25 million impact Medium=Between $10 and $25 million Small= Less than $10 million
INDIVIDUAL INCOME TAX CHANGES					
Personal Exemptions	TPs can deduct $4150 for each personal exemption.	Eliminates personal exemptions.	VTI = AGI with several additions and subtractions. One subtraction is the amount of personal exemptions taken at federal level.	Changes would fall through. If the amount of personal exemptions allowed at the federal level were zero, changes would increase VTI.	**Large, upward effect on VT revenues in FY19 and beyond** Explanation: Removal of the deduction of personal exemptions increases taxable income in FY19 and beyond.
Standard Deduction	TPs can deduct a standard deduction of $6,500 for single filers and $13,000 for married couples; helps create a de facto 0 percent bracket.	Standard deduction is increased to $12,000 for individuals and $24,000 for joint filers.	VTI = AGI with several additions and subtractions. One subtraction is the amount of the standard deduction taken at federal level. A different subtraction caps certain itemized deductions at 2.5 times the federal standard deduction amount.	Changes would fall through, lowering VTI, and likely reducing the number of itemizers. Would increase itemized deduction cap.	**Large, downward effect on VT revenues** Explanation: A larger standard deduction reduces taxable income for those who do not itemize. A larger standard deduction may also cause itemizers who had less than $12,000 (single) or $24,000 (joint) to take the larger standard deduction, further reducing taxable income.

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Pass through income	Income earned through a partnership (including LLCs), S Corp, or sole proprietorship is taxed to the individual owner as ordinary income, at the TP's marginal rate.	Allows a deduction of 20% of the amount of "qualified business income", which is generally defined as income earned through a pass through. There are limits based on business types and allocable wages, which start when the pass through income exceeds $315,000 for joint and $157,500 for individuals. The deduction is structured in such a way to be available to both itemizers and non-itemizers.	No preferential treatment for pass though income, but reduces VTI by certain itemized deductions, up to 2.5 times the federal standard deduction.	Changes would not fall through for non-itemizers because there is no allowance for the pass through deduction in 32 V.S.A. § 5811(21). If the pass through deduction is not considered an itemized deduction, it would not fall through for itemizers.	**POTENTIAL downward effect on VT revenues.** Explanation: The deduction will not fall through for non-itemizers. If the deduction is not an itemized deduction, then the deduction would not flow through to VT taxable income and therefore have no effect. However, there are also behavioral impacts that could affect this estimate long-term. If individuals can "game" the rules and establish themselves as pass-through businesses, there may be a greater downward effect on VT revenues.
Child credit	Child tax credit of $1000 per qualifying child. Phased out a $75,000 for an	Increase the amount of the child tax credit to $2,000 per qualifying child.	Vermont is not linked to this credit.		**No direct impact on VT revenues**

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	individual filers, $110,000 for joint filers. Refundable up to 15% of earned income over $3,000.	Maximum refundable amount would be $1,400. Create a new nonrefundable $500 credit for qualifying dependents who are not qualifying children. Phased out at $200,000 for single filers, $400,000 for joint return.			
Overall limit on itemized deductions	Total allowed itemized deductions are reduced by 3% of the amount that the TP is over the threshold (in 2017, thresholds were $261,500 for individual filers and $313,800 for joint filers).	Suspends limit for tax years 2018 to 2025.	No specific law on point in Vermont, but the effect of the limitation would fall through, in the sense that some high itemizers may have fewer deductions to claim.	To the extent suspending the limitation increases the amount of itemized deductions taken at the federal level, it may decrease VTI, unless the 2.5 times cap already applies to the TP.	**Small, downward effect on VT revenues** Explanation: If individuals over the previous income thresholds no longer have their itemized deductions limited, then their aggregate deductions may be increased under the new bill. This leads to a decrease in taxable income.
Home mortgage interest	Itemizers can deduct interest on	Reduces the limit on acquisition	Allows TP to reduce VTI by	Changes would fall through, and possibly	**Small, upward effect on VT revenues** Explanation: Individuals with new

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	up to $1,000,000 in indebtedness for up to two homes.	indebtedness to $750,000, for new mortgages after December 15, 2017.	amount of the federal deduction, subject to the 2.5 times cap.	increase VTI, but only to the extent that people with over $750,000 in indebtedness are currently not capped.	mortgages over $750,000 would be unable to deduct interest from that mortgage. This lowers the amount of the deduction in aggregate and increases taxable income.
State and local taxes	Itemizers can deduct state and local property taxes and either state and local income taxes or sales taxes.	Itemizers can deduct up to $10,000 of the aggregate of state and local property tax and state and local income taxes.	The federal deduction for state and local income taxes is disallowed, and added back into the calculation of VTI. The federal deduction for state and local property taxes falls through to the calculation of VTI, but is subject to the itemized deduction cap.	Change may result in fewer itemizers. May result in less deducted from AGI, which would mean an increase in VTI. If nothing is changed, there may be an incentive for filers to use all of their property tax first to fill the $10,000 limit, because they would need to add back any state and local income taxes used.	**Small, upward effect on VT revenues** Explanation: Because VT requires the addback of State and local income taxes, individuals are incented to use the $10,000 cap on their property taxes first, then the residual on income taxes. As a result, Federal Taxable Income would increase under this cap (because individuals can deduct less than they could before) but Vermont would see less in state and local income taxes added back, reducing Vermont taxable income. Therefore, the revenue impact is small.
Casualty losses	TPs can deduct losses not compensated by insurance, if they exceed 10% of AGI.	Limits casualty losses to losses incurred during a federally declared emergency.	Allows TP to reduce VTI by amount of the federal deduction, subject to the 2.5 times cap.	To the extent the change reduces itemized deductions for casualty losses, it may increase VTI.	**Small, upward effect on VT revenues** Explanation: Repeal of the deduction (for most cases) increases Vermont taxable income.
Charitable	Itemizers can	The bill would	Allows TP to	To the extent the	**Small, downward effect on VT revenues**

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contributions	generally deduct charitable contributions up to 50% of -their AGI.	increase the income-based percentage limit for charitable contributions of cash to public charities to 60%. It would also deny a charitable deduction for payments made for college athletic event seating rights.	reduce VTI by amount of the federal deduction.	change incentivizes more charitable giving, it could result in more federal deductions, and less VTI.	Explanation: JFO, when modeling, assumed that only individuals who gave 50% of their AGI in contributions under current law would increase their giving to 60% of AGI. This increases the aggregate amount of the deduction, lowering taxable income. It should be noted that with fewer taxpayers itemizing deductions, there will be a reduced benefit to charitable giving, which may reduce such giving.
Miscellaneous itemized deductions	TPs may deduct certain miscellaneous deductions, as long as they exceed, in the aggregate, 2% of AGI.	Suspends all miscellaneous deductions subject to the 2% floor from tax year 2018 to tax year 2025.	Allows TP to reduce VTI by amount of the federal deduction, subject to the 2.5 times cap.	To the extent the change reduces itemized deductions for miscellaneous itemized deductions, it should increase VTI.	**Small, upward effect on VT revenues** Explanation: Suspension of the deduction would increase Vermont taxable income.
Medical expenses	Itemizers may deduct unreimbursed medical expenses to the extent they exceed 10% of AGI.	Lowers threshold to 7.5% of AGI.	Allows TP to reduce VTI by amount of the federal deduction.	To the extent the change increases the amount of itemized deductions claimed at the federal level, it may decrease VTI.	**Small, downward effect on VT revenues** Explanation: Increases the aggregate amount of itemized deductions, reducing taxable income.
Moving expenses	TPs are permitted an above the line	Generally repeals the deduction for	Since the deduction is taken	Should increase federal AGI, and	**Small, upward effect on VT revenues** Explanation: Repeal of the deduction

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	deduction for work related moving expenses that meet certain requirement of distance and employment status. Qualified moving expense reimbursements from an employer are excluded from the TP's gross income, within limits.	expenses paid by an individual or reimbursed by an employer, except for members of the military who move.	about before AGI is calculated, the deduction is automatically incorporated into the calculation of VTI.	therefore VTI, to the extent non-military people claimed the deduction in Vermont.	increases AGI, and therefore VTI. Note: this is an above-the-line deduction. It is a deduction from gross income, before AGI.
Alternative Minimum Tax	Provides a separate minimum tax calculation for TPs who utilize specific tax preferences and adjustments.	Temporarily increases the exemption amount and exemption amount phaseout thresholds for the AMT, from tax year 2018 to tax year 2026. Basically, raises the thresholds to which the AMT would apply, such that fewer TPs at	Vermont is not linked to the individual AMT. Vermont has a separate type of alternative minimum tax based on AGI, not on the federal AMT.	Since the AMT is an alternative calculation of the tax due, it does not fall through to the Vermont calculation of VTI.	**No direct impact on Vermont revenues.**

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		the lower end are subject to the AMT.			
BUSINESS PROVISIONS					
Corporate Rates	The top corporate rate of 35 percent now applies to taxable income over $10 million a year. There are three other corporate tax brackets — 15 percent, 25 percent and 34 percent.	Sets a single corporate tax rate at 21 percent, starting in 2018, up from 20 percent proposed in the House and Senate bills.	8.5 percent for C Corps with more than $25,000 in net income attributable to Vermont; 7% between $10,000 and $25,000; 6% under $10,000. Minimum taxes ranging from $75 to $750 for different categories.	Vermont rates are not linked to federal changes.	**No direct impact on VT revenues, although there may be indirect effects.** Explanation: Although Vermont's corporate tax rates are not linked to the Federal, this provision may affect corporate valuations which would flow through to capital gains. Capital gains would flow through to VTI on the personal income side.
Corporate Alternative Minimum Tax	Provides a separate minimum tax calculation for TPs who utilize specific tax preferences and adjustments.	Repeals corporate AMT.	Vermont is not linked to the federal corporate alternative minimum tax.	Since Vermont is not linked to the federal corporate AMT, there should be little effect on Vermont revenues.	**No direct impact on VT revenues.**

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Bonus depreciation	TPs must capitalize the cost of property used in a trade or business or for the production of income through depreciation or amortization. Federal law allows a 50% bonus depreciation in the first year property is put into service.	Increases bonus depreciation to 100% for most property.	Vermont decoupled from the earlier federal decision to allow 50% bonus depreciation. Current law would also be decoupled from the 100% bonus depreciation in the new bill.	Without any changes to Vermont law, the 100% bonus depreciation would not fall through to the State on either the individual or corporate taxes.	**No direct impact on VT revenues.**
Luxury Automobiles	26 U.S.C. 280F limits the amount that can be depreciated for luxury and personal use automobiles.	The act increases the amount of the limits under 26 U.S.C. 280F, allowing more business expense to be claimed for luxury and personal use automobiles.	Changes would fall through to VNI, or VTI if depreciated on a business schedule.	To the extent the raised limits lead to increased amounts of depreciation, there may be less VTI, for both individual based business and corporate filers.	**Small, downward effect on VT revenue**
Depreciation changes	Businesses must depreciate property over time according to schedules designed by property type and	The act reduces the period required to depreciate certain farm equipment and real estate.	No specific decoupling -- likely falls through to VTI and VNI.	Quicker depreciation typically means less income in the years the depreciation is claimed.	**Unknown downward effect on VT revenue.** Explanation: Quicker depreciation could lead to lower VNI and VTI.

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	class. Most depreciation schedules span 3 to 50 years.				
Expensing	TPs may elect to expense in one year, rather than capitalize over time, certain types of property. TPs may expense up to $500,000 for items placed in service, but this amount is reduced by the amount by which total items placed into service exceed $2,000,000.	The act raises the dollar limits for expensing to $1,000,000 and $2,500,000.	No specific decoupling -- likely falls through to VNI, or VTI on a business schedule.	The ability to use more expensing, rather than capitalization, typically means less income in the years the expense is claimed.	**Unclear revenue impact on VT** Explanation: Will largely depend on if and when businesses make investments. If a large amount of businesses invest and expense in any single year, it would lead to lower VNI in that year, but potentially higher VNI in future years.
Interest	Business related interest for borrowing is generally deductible under 26 U.S.C. 163.	Limits the deductibility of business interest generally to (1) the amount of business interest income, or (2) 30% of adjusted taxable income.	Allowed to fall through as an itemized deduction for individuals or as a deduction before VNI for corporate filers.	To the extent the limitation reduces the amount of interest deducted, it may increase VTI or VNI for both individuals and corporations.	**Unclear revenue impact on VT** Explanation: Limits the amount of aggregate amount of deductions for both businesses and individuals, increasing VTI or VNI. However, the interaction between this provision and others (expensing, for example) may change borrowing decisions for businesses.

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Net operating losses	A net operating loss is the amount by which business losses exceed taxable income. Business and individuals can deduct operating losses, and can typically carry those losses forward 20 years or back 2 years, although there are numerous exceptions. A net operating loss can be claimed on either a corporate return, or on an individual return, as a subtraction from income on a business schedule.	The act limits net operating losses to 80% of taxable income, and eliminates the 2 year carryback. But it allows carryforwards indefinitely.	Vermont had decoupled from federal net operating losses for corporations, and allows a deduction of an apportioned amount of net operating losses. 32 V.S.A. § 5811(18), 32 V.S.A. § 5888. Since a net operating loss on an individual return is subtracted in the calculation of income, individual net operating losses can fall through.	The limitations may reduce the losses claimed by some individuals, which would increase gross income, and could theoretically increase VTI. Since Vermont is decoupled from the federal corporate net operating loss provisions, the changes will not fall through to VNI.	**No direct impact on VT revenues.**
Deduction for qualified production activities	26 U.S.C. 199 allows a deduction for certain qualified production activities, up to 9% of the expense, or	The act repeals this deduction.	Vermont has never decoupled from this deduction, which was passed in 2004, and it falls	The repeal of this deduction should increase VTI and VNI.	**Small, upward impact on VT revenues** Explanation: Repeal of the deduction increases AGI, which increases VTI. Note: this is an above-the line deduction

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	9% of taxable income. Originally designed to incentivize manufacturing, the deduction has been claimed by many businesses tangentially to manufacturing.		through on both the individual and corporate sides. To the extent the deduction is claim by an individual, it is an above the line deduction, and reduces federal AGI, and therefore VTI. To the extent it is taken by a corporation, it reduces federal taxable income, and therefore VNI.		
Carried Interest	Carried interest is the share of the profits from an investment fund that is paid to fund managers. Under current law, it is taxed at the preferential capital gains rate, rather than ordinary income.	The act creates a three year holding period, so that carried interest composed of gains held less than three years is taxed as ordinary income, and carried interest composed of gains held more than	Vermont has not decoupled from 26 U.S.C. 83, which contains the rules for carried interest. Since carried interest is determined at the gross income level, any change would fall through.	Since the limitation would arguably increase federal gross income, the changes would fall through to increase federal AGI and VTI.	**Small, upward effect on VT revenues** Explanation: The provision could increase gross income, which would then increase AGI and VTI, all other provisions held constant.

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		three years would get the capital gains rate.			
Employer credit for family or medical leave	No credit for family or medical leave payments.	Creates a credit for employers of 12.5% of the amount of wages paid to a qualifying employee during any period in which the employee is on family and medical leave if the rate of payment under the program is 50% of the wages normally paid to the employee. Applies to tax year 2018 and 2019 only.	Vermont has not decoupled.	Since it applies as a credit against a liability, the effect would likely not fall directly through to Vermont revenues.	**No direct effect on VT revenues**
TAXATION OF FOREIGN INCOME					
Dividends received deduction	The US has a modified "worldwide" taxing	At a very high level, allows US Corporations to	Vermont is based on VNI, which used federal	Since most foreign profits have been offshored, and not	**No direct effect on VT revenues**

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	system, where all worldwide income earned by a corporation is considered taxable, but the tax is deferred until the foreign earned profits are brought back to the US.	deduct the foreign-source portion of dividends paid by certain foreign corporations to US corporate shareholders owning at least 10% of the foreign corporation. In other words, most foreign earned profits are no longer considered taxable, moving the US to a modified "territorial" system.	corporate taxable income as a base.	taxed immediately, under the current US worldwide system, it is not obvious that the ability to deduct these profits will significantly change VNI.	
Repatriation of foreign profits	Under current law, foreign profits are not taxed until they are paid back to a domestic corporation or shareholder.	A transitional rule imposes a one-time tax on US shareholders of certain foreign corporations. The tax is assessed on the US shareholder's	VNI is based on federal corporate taxable income, which is calculated as gross income, minus allowable deductions.	The structure of this provision -- requiring the inclusion of repatriated profits in gross income with an allowance for a partial deduction -- will could result in an increase in VNI on a	**Unknown upward effect on VT revenues.** Explanation: Will largely depend on the extent to which businesses take advantage of the provision, and whether these businesses have a presence in VT. Because of Vermont's water's edge unitary taxation, VNI would increase if any business with a VT presence repatriates profits.

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		share of the foreign corporation's accumulated foreign earnings that have not previously been taxed under the US's system of deferred worldwide taxation. The provision generally requires that, for the last taxable year beginning before January 1, 2018, any U.S. shareholder of a specified foreign corporation must include in gross income its pro rata share of the accumulated post-1986 deferred foreign income of the corporation. A deduction is then		one time basis. However, there may be apportionment issues, timing issues, and tax avoidance strategies, which may limit the increase.	

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		allowed on that income at different rates, depending on whether the repatriated profits are cash or asset based. The result is that earnings in the form of cash and cash equivalents will be taxed at a rate of 15.5%; all other earnings will be taxed as 8%. The tax can be paid in installments over 8 years. The tax applies whether the profits are actually returned to the US or not.			
Base erosion minimum tax	No provision in current law.	Applicable corporations will be subject to a new tax equal to their "base erosion minimum tax	There is not corresponding Vermont provision.	The base erosion minimum tax is structured as a separate excise tax, outside of the normal federal corporate	**No direct effect on VT revenues**

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		amount." The formula for determining this tax is complex, but at a high level, is equal to 10% of the US corporation's modified taxable income (modified by adding back deductible payments to related foreign persons), minus the US corporation's regular tax liability (where the income base is reduced by deductible payments to related foreign persons, and the tax liability itself is reduced by certain credits). This provision is intended to apply		income tax calculation; therefore, the effects of the tax will likely not directly fall through to Vermont.	

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		to US corporations that reduce their US tax liability by making deductible payments to related foreign persons (e.g., interest on intercompany loans; royalties to affiliated entities).			
Minimum tax on passive/mobile undistributed income of CFCs	No current provision.	Under a new provision, US shareholders of a controlled foreign corporation (a CFC) will be taxed currently on their shares of "global intangible low-taxed income" (GILTI). Very generally, GILTI is (i) the US shareholder's pro rata share of the CFC's aggregate net income, minus (ii) a deemed 10%	There is no corresponding Vermont provision.	The structure of this provision -- attributing foreign income to a US shareholder and providing a partial deduction -- would seem likely to fall through to either VTI or VNI. These rules are intended to discourage US corporations from holding or moving low-basis business assets in low-tax jurisdictions. However, they do not	**Unclear effect on VT revenues.**

Key: TP = taxpayer, AGI = federal adjusted gross income, VTI = Vermont taxable income used to calculated personal income taxes (32 V.S.A. § 5811(21)), VNI = Vermont net income used to calculate corporate income taxes (32 V.S.A. § 5811(18))

Version as of January 5, 2018. Will be updated as appropriate.	**Current federal law**	**Tax Cuts and Jobs Act**	**Current Vermont law**	**Comments/Impact**	**Preliminary JFO Effect on VT Revenues (Note: these are in isolation; final estimate could be different than sum of individual provisions)**
		return on the CFC's aggregate basis in depreciable tangible property. Certain income (e.g., subpart F income) is excluded from the determination of (i) in the above formula.		appear to take away the incentive for a US company to move high-basis assets to such a jurisdiction (e.g., factories, equipment, etc.)	
		ESTATE TAX PROVISIONS			
Exclusion amount	There is a unified estate tax and gift tax at the federal level on estates passed on at death, or gifts made during a lifetime. Excluded from this tax is the first $5 million of the estate or lifetime gifts for an individual, or $10 million for a married couple.	Doubles the unified estate/gift tax exclusion amount to the first $10 million for individuals or $20 million for married couples. Retains the indexing for inflation to 2011, so under the bill, the amounts in 2017 would have been $10.98	Vermont uses the federal definitions for base amounts, but has a decoupled exclusion amount of $2.75 million.	Although the gap between Vermont's exclusion amount ($2.75 million) and the federal exclusion amount (roughly $11 million and $22 million) will increase, it seems unlikely that the increase in the gap would lead to an increase or decrease in State revenues.	**Unknown effects on VT revenues**

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	This amount is indexed for inflation beginning in 2011, and in 2017, these base amounts were $5.49 million and $10.98 million.	million for an individual or $21.96 million for a married couple.			

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