

Tax Cuts and Jobs Act: Itemized Deductions



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As we continue our analysis of the TCJA, this week's newsletter will focus on some of the more important individual tax changes, specifically those pertaining to itemized deductions.

Every deduction indicated on Schedule A of your individual income tax return has been modified to some extent under the TCJA. Accordingly, if you're a taxpayer that has historically itemized deductions, the changes discussed below will, to some degree, have an impact to your taxable income in the coming years.

Unless otherwise noted, these changes are in effect for tax years beginning after December 31, 2017 and before January 1, 2026.

Changes to deduction for medical and dental expenses

Under pre-TCJA tax law, the deduction for qualified medical expenses was allowed for qualified medical expenses exceeding 10% of adjusted gross income ("AGI"). This floor was reduced to 7.5% of AGI for taxpayers 65 and older, however that provision expired on December, 31, 2016.

Under TCJA tax law, for tax years beginning after December, 31, 2016 and before January 1, 2019, a taxpayer that itemizes may deduct qualified medical expenses, so long as they exceed 7.5% of AGI. As such, the new law extends the 7.5% through 2018 and retroactively makes it available to taxpayers that itemize, regardless of age, during this period.

Changes to state and local tax deduction

Under pre-TCJA tax law, taxpayers were entitled to a deduction equal to the state and local taxes ("SALT") paid during the year. The deduction consisted of the following types of taxes paid:

- State, local, and/or foreign real property taxes
- State and local personal property taxes (i.e. cars, boats) and
- State, local, and/or foreign income taxes

It is also worth noting that there were no caps or limitations on the amount of SALT deducted on Schedule A (unlike medical expenses).

Under the new tax law, no changes were made with regard to the types of taxes that a taxpayer may deduct, so long as they fall under one of the aforementioned tax types. However, the same cannot be said of the amount of deduction allowable on Schedule A. Unfortunately, the new tax law places a \$10,000 ceiling on the SALT deduction. Since this has traditionally been one of the largest itemized deductions, it is anticipated that it will have one of the greatest impacts to taxable income.

Changes to mortgage interest deduction

Under the TCJA, mortgage interest on loans used to acquire a principal residence and/or a second home remains deductible, but only on debt up to \$750,000. This represents an unfavorable increase of \$250,000 since the limitation was \$1 million under prior tax law. Taxpayers with existing acquisition debt, that is, debt acquired on or before December 15, 2017, would remain subject to the \$1 million limitation, as the new law is not applied retroactively.

Additionally, mortgage refinances after 2017 will be considered incurred on the date of the original mortgage so long as the refinanced debt does not exceed the original debt. This will afford taxpayers with existing debt the option to refinance without being encumbered by the new limitations.

Interest on home equity loans, regardless of when the debt was acquired, is no longer deductible under the TCJA. However, based on current guidance, it is not yet clear whether proceeds from home equity loans used for business purposes may be deductible elsewhere on a taxpayer's return (i.e. Sch. E in the case of a rental or Sch. A in the case of investment interest). It is anticipated that the IRS will provide further clarification on this in future guidance.

Changes to charitable contributions deductions

Under the TCJA, the limit for cash contributions has been extended from 50% to 60% of the contribution base, which is generally a taxpayer's adjusted gross income (AGI). However, payments made to a college or university in exchange for the right to purchase tickets to an athletic event are no longer deductible. This represents a divergence from pre-TCJA tax law, under which 80% of such payments were treated as deductible contributions.

Changes to miscellaneous itemized deductions

Under the new law, all miscellaneous itemized deductions that are subject to the 2% of AGI floor are no longer deductible. Such expenses include, but are not limited to, the following:

- Unreimbursed employee expenses
- Investment expenses (i.e. brokerage fees)
- Tax preparation fees
- Hobby expenses

Changes to personal casualty loss deduction

Under the TCJA, casualty and theft losses are generally only deductible to the extent they are attributable to a "federally declared disaster". There is a limited exception for taxpayers who have personal casualty gains, whereby losses not attributable to a disaster may be used to offset such gains, but not below zero. For the purposes of this provision, a "federally declared disaster" is one that has been determined by the President to warrant federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

Additionally, the TCJA retroactively provides relief to taxpayers who incurred a disaster loss in tax years 2016 and 2017 by raising the \$100-per-casualty limitation to \$500 and waiving the 10% of AGI floor.

Changes to the deduction for gambling losses

Historically, gambling losses have only been deductible to the extent of gambling winnings. However, a 2011 tax court ruling in *Mayo vs. Commissioner* (136 TC 181) allowed taxpayers engaged in the trade or business of gambling to exclude certain non-wagering expenses (i.e. travel, meals, entry fees, etc.) from "gambling losses" and report them on Schedule C.

Given that this has long been a point of contention by the IRS, it should come as no surprise that the TCJA, for purposes of the limitation, broadens the definition of "losses from wagering transactions" to include any and all non-wagering expenses. As such, it is no longer possible to create a loss from gambling, regardless of whether it is considered a trade or business of the taxpayer.

Changes to the overall limitation on itemized deductions

Under pre-TCJA tax law, this provision, also known as the "Pease limitation", was an overall limit on otherwise allowable itemized deductions of high income taxpayers. In an effort by congress to "simplify" the internal revenue code, this overall limitation has been completely repealed under the TCJA. It is unclear at this point whether taxpayers will really benefit from this change, since almost all itemized deductions have been limited or repealed individually (i.e. SALT, miscellaneous itemized deductions, et cetera).

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