2017 TAX CUTS & JOBS ACT: WHAT YOU SHOULD KNOW

INDIVIDUAL TAX REFORM

February 6, 2018

Dorsey & Whitney Speakers

Ben Lindblad
Tessa Mielke
Katina Peterson
Mary Streitz

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Speaker Biographies

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Ben is a Partner in Dorsey's Tax, Trusts and Estates group. Ben advises publicly and privately held companies on a wide range of tax matters, emphasizing on mergers, acquisitions and divestitures, corporate and partnership restructurings, and joint ventures. He also advises emerging companies on formation, equity, governance and structuring issues. Ben advises employers and individuals on issues related to executive compensation and inbound and outbound U.S. international taxation.

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Tessa is a Partner in Dorsey's Tax, Trusts and Estates group. Tessa has a broad tax and estate planning practice. She helps clients plan for and manage tax-efficient transfers of wealth to future generations by designing comprehensive estate plans that meet each client's unique goals, and by implementing those plans through advice regarding lifetime gifts and estate and trust administration. Tessa also advises clients regarding income tax and retirement planning, and represents taxpayers in federal and state income, gift, and estate tax controversies. Finally, Tessa regularly advises charitable organizations and individuals with charitable goals with respect to the formation and administration of public charities, private foundations, and charitable trusts.

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Katina is a Partner in the Tax, Trusts and Estates group and is Co-Chair of the Tax Controversy and Litigation practice group. She has broad substantive and procedural tax experience and represents all types of clients in all aspects of federal and state tax controversies, including audits, administrative appeals, litigation, and collection actions. Katina also provides federal, state, and local tax advice and planning to all types of taxpayers.

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Mary is a Partner and Co-Chair of Dorsey's Indian and Gaming practice group. She represents Indian tribes, tribal entities, tribal members, and entities doing business with tribes in all types of federal, state, and tribal tax matters, involving advice regarding available tax exemptions, business and investment tax planning, representation in tax controversies in the IRS, in the state taxing agencies, and in the courts, legislative and administrative lobbying on tax policy matters, and compliance with applicable federal and state tax laws involving employment taxes, income taxes, property taxes, sales and use taxes, and other excise and transaction taxes. Mary also is Co-Chair of the Tax Controversy and Litigation practice group. She represents all types of clients in tax controversies within the IRS and the Minnesota Department of Revenue and in the federal and state courts. Mary also provides federal and state tax advice and planning for business and nonprofit corporations, other business entities, and individuals.

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Introduction

- **Session 1**
  - Individual income tax rates
  - Individual deductions and credits
  - Pass-through deduction
  - Estate and gift tax changes
  - Other provisions of interest
  - Impact on taxpayers
  - Policy and political implications
  - Questions
- **Session 2 – February 21**
  - Business and international tax reform

Individual Income Tax Rates

Married filing Jointly			
Original 2018 Tax Brackets and Rates		New 2018 Tax Brackets and Rates	
Not over $19,050	10%	Not over $19,050	10%
From $19,050 up to $77,400	15%	From $19,050 up to $77,400	12%
From $77,400 up to $156,150	25%	From $77,400 up to $165,000	22%
From $156,150 up to $237,950	28%	From $165,000 up to $315,000	24%
From $237,950 up to $424,950	33%	From $315,000 up to $400,000	32%
From $424,950 up to $480,050	35%	From $400,000 up to $600,000	35%
Over $480,050	39.6%	Over $600,000	37%

Individual Income Tax Rates

Single Individuals			
Original 2018 Tax Brackets and Rates		New 2018 Tax Brackets and Rates	
Not over $9,525	10%	Not over $9,525	10%
From $9,525 up to $38,700	15%	From $9,525 up to $38,700	12%
From $38,700 up to $93,700	25%	From $38,700 up to $82,500	22%
From $93,700 up to $195,450	28%	From $82,500 up to $157,500	24%
From $195,450 up to $424,950	33%	From $157,500 up to $200,000	32%
From $424,950 up to $426,700	35%	From $200,000 up to $500,000	35%
Over $426,700	39.6%	Over $500,000	37%

Individual Income Tax Rates

Heads of Households			
Original 2018 Tax Brackets and Rates		New 2018 Tax Brackets and Rates	
Not over $13,600	10%	Not over $13,600	10%
From $13,600 up to $51,850	15%	From $13,600 up to $51,800	12%
From $51,850 up to $133,850	25%	From $51,800 up to $82,500	22%
From $133,850 up to $216,700	28%	From $82,500 up to $157,500	24%
From $216,700 up to $424,950	33%	From $157,500 up to $200,000	32%
From $424,950 up to $453,350	35%	From $200,000 up to $500,000	35%
Over $453,350	39.6%	Over $500,000	37%

Individual Income Tax Rates

- **Changes to individual income tax rates, like most individual income tax changes under TCJA, sunset on December 31, 2025**

Individual Income Tax Rates

- New Inflation Rate Measure
  - Use of Consumer Price Index for urban consumers to adjust tax bracket thresholds replaced with Chained CPI
  - Chained CPI reflects consumer product substitution behavior and is considered more accurate, but will rise more slowly than traditional CPI
- Results:
  - Slower pace of inflation
  - Slower bracket breakpoint adjustments
  - Higher income taxes over period of time
  - Change permanent

Individual Income Tax Rates

- Changes to Alternative Minimum Tax ("AMT")
  - AMT exemption amounts increased for individuals
  - Substantial increase to exemption phase-out thresholds
  - Complex calculation unchanged
- Result
  - Vastly reduces the number of households subject to AMT
  - For those still subject to AMT, liability will likely be less

Filing Status	2017 AMT Exemption	2018 AMT Exemption	2017 AMT Threshold	2018 AMT Threshold
Single or Head of Household	$54,300	$70,300	$120,700	$500,000
Married Filing Jointly or Qualified Widow(er)	$84,500	$109,400	$160,900	$1,000,000

Individual Income Tax Rates

- **Kiddie Tax**
  - **Applies to unearned income of children under 19 and full-time students under 24**
  - **Old rule: child's unearned income in excess of $2,100 was subject to tax at the parent's tax rate**
  - **New rule: child's unearned income will be subject to tax using estate and trust brackets and rates**

2018 Kiddie Tax Brackets & Rates	
Not over $2,550	10%
From $2,550 up to $9,150	24%
From $9,150 up to $12,500	35%
Over $12,700	37%

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Individual Income Tax Rates

- **No Changes to Rates or Thresholds for:**
  - **Long Term Capital Gains**
  - **Qualified Dividends**
  - **3.8% Net Investment Income Tax**

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Individual Deductions & Credits

- **Standard Deduction Increased**

2017 Standard Deduction		2018 Standard Deduction	
Unmarried Individuals	$6,350	Unmarried Individuals	$12,000
Married Individuals Filing Jointly	$12,700	Married Individuals Filing Jointly	$24,000
Head of Household	$9,350	Head of Household	$18,000

- **Personal Exemption Eliminated**
  - **Valued at $4,050 per taxpayer, spouse, or dependent in 2017**

Individual Deductions & Credits

- **Increased Child Tax Credit**
  - **Raised Child Tax Credit from $1,000 to $2,000**
  - **Up to $1,400 of the tax credit is refundable**
  - **Significantly raises the AGI threshold for claiming the full credit, making it available to higher earners**

2017 Child Tax Credit Threshold		New Threshold	
Single, Head of Household, and Qualifying Widow(er)	$75,000	Single, Head of Household, and Qualifying Widow(er)	$200,000
Married Individuals Filing Jointly	$110,000	Married Individuals Filing Jointly	$400,000

- **New $500 non-refundable credit for non-child dependents**

Individual Deductions & Credits

- State and Local Taxes ("SALT") Deduction
  - Individuals may deduct only up to $10,000 for the aggregate of state and local property and income taxes
  - May deduct state and local taxes over $10,000 only if incurred in connection with a trade or business

Individual Deductions & Credits

- Mortgage Interest Deduction Limited
  - Deduction for home mortgage interest available only for interest paid on first $750,000 of acquisition indebtedness
  - For mortgages effective before December 15, 2017, individuals can continue to deduct interest on first $1,000,000 of acquisition indebtedness
- Home Equity Deduction Suspended
  - Deduction for interest paid on home equity indebtedness suspended, including existing home equity lines of credit
- Moving Expenses Deduction Suspended
  - Exclusion for moving expense reimbursements also suspended
  - Exception for certain members of the Armed Forces

Individual Deductions & Credits

- **Alimony Deduction Eliminated**
  - No deduction for alimony paid pursuant to divorce agreements executed after December 31, 2018
  - Recipient spouse no longer includes alimony as income
  - No change to treatment of existing alimony agreements
  - Permanent change
- **Charitable Contribution Deduction**
  - Maximum deduction for cash donations to in cash is now 60% of adjusted gross income (up from 50%)
  - Donors prohibited from deducting amounts paid for right to purchase tickets to college athletic events
- **Lower Floor for Deduction of Medical Expenses**
  - In 2017 and 2018 only, taxpayers can deduct qualifying medical expenses exceeding 7.5% (instead of 10%) of AGI

Individual Deductions & Credits

- **Repeal of Miscellaneous Deductions Previously Subject to 2% Floor**
  - Including:
    - Unreimbursed employee expenses
    - Investment expenses
    - Tax preparation expenses
    - Home office expenses
- **Repeal of Overall Limit on Itemized Deductions**
  - The "Pease Amendment" imposed an overall limit on itemized deductions for taxpayers earning over $261,500 for single filers or $311,300 for joint filers in 2017

Individual Deductions & Credits

- Almost all changes to individual deductions and credits sunset on December 31, 2025, including the following:
  - Adjustments to the standard deduction
  - Elimination of personal exemptions
  - Changes to the child tax credit
  - Limitation of state and local tax deduction
  - Most other itemized deduction changes
  - Addition of the new pass-through deduction

Pass-Through Deduction

- New deduction of 20% of qualified business income under new Section 199A
  - Available to non-corporate taxpayers
  - QBI: "ordinary" income -- less ordinary deductions -- you earn from a sole-proprietorship, S corporation, or partnership
    - Does not include wages, guaranteed payments, or capital gains
  - Income must be earned in a “Trade or Business”
    - Definition of “Trade or Business” for this purpose is unclear
  - Limited to 20% of taxable income less net capital gains

Pass-Through Deduction

- **Wage limitation phased-in for taxpayers with taxable income in excess of threshold**

	No Wage Limit	Wage Limit Phase-In	Full Wage Limit
Joint filers with TI of...	Up to $315,000	$315,000 - $415,000	$415,000 +
Others with TI of...	Up to $157,500	$157,500 - $207,500	$207,500 +

- **Limited to lesser of:**
  - **50% of taxpayer's allocable share of W-2 Wages; or**
  - **25% of the taxpayer's allocable share of W-2 Wages plus 2.5% of depreciable property in service**

Pass-Through Deduction

- **For specified service trades or businesses, an additional "applicable percentage" limitation applies to taxpayers with income above the same thresholds**
- **Specified service limitation results in complete phase-out of deduction for taxpayers with taxable income in excess of $415,000 / $207,500**
- **Specified service trades or businesses include: accounting, health, law, consulting, athletics, financial services, brokerage services, investment management, actuary services, or any business where the principal asset of the business is the reputation or skill of one or more of its employees or owners**
- **The Section 199A deduction will be discussed in more detail in Session 2**

Estate & Gift Tax

- **Doubled Estate, Gift, and Generation-Skipping Transfer Tax Exemption**

2017		2018 Exemption	
Individuals	$5.49M	Individuals	$11.18M*
Married Couples	$10.98M	Married Couples	$22.36M*

* IRS has not yet released official exemption amount for 2018. Amounts shown are projected.

- **Sunsets after December 31, 2025**

Estate & Gift Tax

- **Revisit wills and trusts drafted with formula clauses to ensure they still produce desired results**
  - **In Minnesota, state estate tax changes over the last five years also suggest revisiting estate plans**
- **Federal estate tax applies to fewer estates**
- **State estate tax planning, income tax planning, and non-tax planning continue to be important for individuals below the federal estate tax levels**
  - **Minnesota estate tax exemption is $2.4M per person in 2018, scheduled increases each year until $3M in 2020**
  - **Many states, including Minnesota, require planning to use both spouses' exemptions (no portability)**

Estate & Gift Tax

- **Planning ideas**
  - **Lifetime gifts**
  - **Allocation of increased GST exemption to prior gifts**
  - **Modify existing trusts (or distribute assets) to cause estate tax inclusion and obtain step-up in basis**
    - **Consider income tax, state estate tax, and non-tax consequences**
- **Sunset of increased exemption**
  - **Estate tax exemption has never decreased – effect unclear**
    - **Clawback of exemption used for lifetime gifts?**
    - **Does exemption passed to spouse via portability survive the sunset?**
    - **GST exemption likely more difficult to "claw back"**

Estate & Trust Income Tax Rates

Estates and Trusts			
Original 2018 Tax Brackets and Rates		New 2018 Tax Brackets and Rates	
Not over $2,600	15%	Not over $2,550	10%
From $2,600 up to $6,100	25%	From $2,550 up to $9,150	24%
From $6,100 up to $9,300	28%	From $9,150 up to $12,500	35%
From $9,300 up to $12,700	33%	Over $12,700	37%
Over $12,700	39.6%		

- **Deduction of expenses**
  - **Suspension of miscellaneous expense deduction impacts many estates and trusts**
    - **No deduction for investment advisor fees**
  - **Trustee fees and attorney fees still deductible**

Other Provisions of Interest

- Sexual Harassment Settlements
  - New IRC Section 162(q): No deduction "under this chapter" for (1) "any settlement or payment related to sexual harassment or sexual abuse" or (2) "attorney's fees related to such a settlement of payment" IF such settlement or payment is subject to a nondisclosure agreement.
  - Applies to payments made on or after December 22, 2017

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Other Provisions of Interest

- Sexual Harassment Settlements, cont.
  - Broad and undefined language creates significant uncertainties
    - Central terms left undefined
    - Scope of deduction limitation unclear
    - Unintended consequences to claimant
    - Commentators predict future technical corrections bill would address this provision

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Other Provisions of Interest

- Affordable Care Act
  - Individual mandate for acquiring health insurance was effectively repealed by setting the penalty tax for failure to do so at $0
    - Effective in 2019
    - May reduce the number of young, healthy people who purchase insurance, which would increase premiums
    - Full impact uncertain
  - Other provisions of Affordable Care Act remain intact

Other Provisions of Interest

- 529 Plan Changes
  - Payments of up to $10,000 per student per year may be made from 529 savings plans for elementary and secondary school tuition
    - Includes public, private, and religious schools (planned provision to include costs of homeschooling was removed)
  - Permanent provision

Impact on Taxpayers

- **Impact for 2017**
  - Acceleration of deductible payments for taxpayers who will no longer itemize
    - Charitable donations
    - Mortgage and home equity payments
  - Property tax prepayment stampede
    - Section 164(b)(6) provides that prepayment of a 2018 or later state or local income tax is treated as paid on the last day of the year for which it is imposed; no mention of property taxes
    - Hennepin County collected over $122 million in prepaid 2018 property taxes in 2017 (vs. $6 million in prior year)
    - IRS advised that prepayments are deductible only if property tax was assessed before paid

Impact on Taxpayers

- **Federal Tax Impact for 2018 through 2025**
  - 2018 Expectations
    - About 80% of individual taxpayers federal tax decrease
    - About 15% stay the same
    - About 5% see an increase
  - Most likely to see a tax increase in 2018
    - High-earning single taxpayers and heads of households with income from wages or specified service businesses who live in high tax states
      - May see increase with AGI of around $200,000 or more
      - Similarly, married taxpayers in high tax states with very high AGI from wages or specified service businesses ($500,000 or more) may also see a tax increase, but less likely
    - Low-to-middle income taxpayers that currently take very large itemized deductions (e.g. 30%+ of income)

Impact on Taxpayers

- **Federal Tax Impact for 2018 through 2025, cont.**
  - Over time, even before individual tax changes sunset, fewer individuals see a tax decrease and more see an increase compared to pre-TCJA law
    - Primarily because of new inflation measure
    - For families with children, the replacement of a personal exemption with a higher child tax credit becomes less valuable over time since the personal exemption was indexed to inflation and the child tax credit is not.

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Impact on Taxpayers

- **State Tax Impact for 2018 through 2025**
  - Base-broadening provisions of TCJA flow through to states that conform and use federal AGI or federal taxable income as base (includes Minnesota); corresponding rate reductions do not flow through
  - No child tax credit offset in Minnesota (and in most other states)
  - Result is that state income tax will increase for many filers
  - Most state tax increases will be offset by federal tax cuts

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Impact on Taxpayers

Filer Type/Income	Federal/ State	Baseline Tax	Tax Under TCJA	Change ($)	Change (%)
Married-Joint/$50K	Federal	($251)	($609)	($358)	-142.6%
	State	$912	$1,136	$224	24.6%
Total		**$661**	**$527**	**($134)**	**-20.3%**
Married-Joint/$150K	Federal	$17,743	$13,826	($3,917)	-22.1%
	State	$7,102	$7,390	$288	4.1%
Total		**$24,845**	**$21,216**	**($3,629)**	**-14.6%**
Married-Joint/$250K	Federal	$38,720	$33,775	($4,945)	-12.8%
	State	$13,449	$14,395	$946	7.0%
Total		**$52,169**	**$48,170**	**($3,999)**	**-7.7%**
Married-Joint/$500K	Federal	$119,808	$100,831	($18,977)	-15.8%
	State	$36,816	$35,940	($876)	-2.4%
Total		**$156,624**	**$136,771**	**($19,853)**	**-12.7%**
Married-Joint/$1 million	Federal	$293,438	$275,887	($17,551)	-6.0%
	State	$86,313	$82,531	($3,782)	-4.4%
Total		**$379,751**	**$358,418**	**($21,333)**	**-5.6%**
Single/$100K	Federal	$15,098	$13,756	($1,342)	-8.9%
	State	$5,395	$5,328	($67)	-1.2%
Total		**$20,493**	**$19,084**	**($1,409)**	**-6.9%**
Head of Household/$50K	Federal	$2,995	$1,322	($1,673)	-55.9%
	State	$1,664	$1,602	($62)	-3.7%
Total		**$4,659**	**$2,924**	**($1,735)**	**-37.2%**

*Data based on a number of assumptions described in MCFE's full article "Impacts of the TCJA on Minnesota Individual Income Filers," a copy of which is included with the CLE materials.

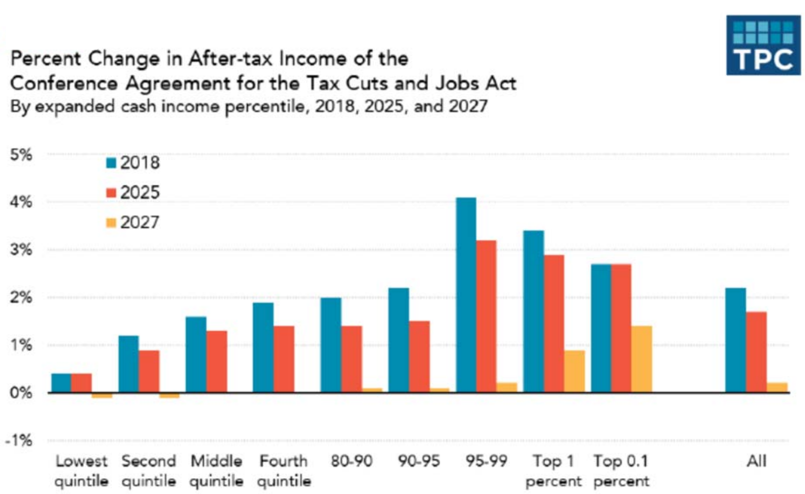
Impact on Taxpayers

- **Other Potential Effects in 2018 through 2025**
  - **Fewer Taxpayers Itemize Deductions**
    - **Expected reduction from 37 million to 16 million**
  - **Decline in Charitable Giving**
    - **Fewer itemizers and lower tax rates decrease value of charitable deduction**
    - **Estimates range from 4 to 7 percent decline in annual giving**
    - **Higher estate tax exemption may discourage giving at death**
  - **High Tax State Residency**
    - **Limitations on the SALT deduction may increase the exodus of taxpayers from high tax states**
  - **Increase in IRS Budget**
    - **Significant resources needed to implement TCJA changes.**
    - **IRS budget declined 18% and IRS lost 20% of its workforce from 2010 to 2017.**

Impact on Taxpayers

- **Potential Impacts in 2026 and Beyond**
  - **After individual changes sunset, remaining changes most relevant to individuals will be:**
    - **Inflation adjustment**
    - **Corporate rate reductions**
  - **Lower and middle income taxpayers will see little change to tax compared to pre-TCJA tax**
    - **Impact of slower inflation adjustment has most significant effect on lowest income taxpayers**
  - **Highest income taxpayers (top 1%) see continued, but significantly smaller, tax cuts**
    - **Primarily as a result of corporate tax changes**

Impact on Taxpayers



Policy and Political Implications

- **Federal Budget Impact**
  - Consensus appears to be that TCJA will increase the federal debt over $1 trillion over the next ten years.
    - For comparison, during the eight years of the Obama administration, the federal debt increased over $9 trillion.
  - Most of the TCJA estimates assume that TCJA will have relatively little effect on GDP (increases of less than 0.1% added to GDP).
  - Because TCJA includes fundamental changes to corporate taxation, however, estimates of the effect on GDP are more uncertain than usual and will need to be revisited in the months and years to come.

Policy and Political Implications

- **Federal Conformity Impact on State Budget**
  - Nearly all states with an income tax connect to federal tax code through state income definition
  - A handful of states (including Minnesota) use federal taxable income as starting point
  - Net effect of TCJA individual changes is to increase federal taxable income
    - Expanded tax base projected to increase Minnesota tax revenue by roughly $400 million in 2019
    - Repeal of personal exemption and no child tax credit at state level most significant
    - Estimated Minnesota revenue increase above $700 million in 2019 through 2021 when both individual and corporate changes considered

Policy and Political Implications

- **Minnesota Potential Responses to TCJA**
  - Conformity/federal update not automatic
    - Static versus rolling conformity
    - Multiple interests, including state budget, efficient tax administration and compliance, tax burden distribution
    - Short session could pose challenges
  - Conformity just the beginning
    - Partial conformity
    - Return to federal AGI as starting point
    - State child tax credit
    - Others

Policy and Political Implications

- **State Responses to SALT Deduction Limitation**
  - High tax states considering various ideas for altering their state tax structure to make state taxes deductible beyond the $10,000 limit
  - Charitable Contribution Credit
    - Give taxpayers a credit against state income tax for contributions to state charities
    - Validity of charitable deduction uncertain
      - IRS has previously ruled in non-precedential CCAs that a credit of less than 100% qualify for a charitable deduction
      - Treasury has suggested that a one-to-one credit makes it unlikely that a contribution is a valid charitable donation
      - If donors have some power to direct how the donation is used, looks more like a true charitable donation (but states may not like donors' decisions)

Policy and Political Implications

- **State Responses to SALT Deduction Limitation, cont.**
  - **Payroll Tax Increase**
    - **Employers withhold what amount to state income taxes as payroll taxes**
    - **Increases taxes on employers who can be expected to reduce wages, but state would offer a wage credit to employees to make them whole**
    - **Probably too complicated, reminiscent of old idea of border adjustment tax**
    - **Possible interference with minimum wage laws?**

Policy and Political Implications

- **To what extent will TCJA be an issue in upcoming elections and in this and the next Congressional session?**
  - **2018 election**
    - **2018 returns not yet filed**
    - **Impact potentially greater in high tax states**
    - **There may be shift in party control in one or both houses of Congress, but not in White House**
  - **2020 election**
    - **Impact of TCJA more clear**
    - **Presidential campaign year**
- **Similar to the situation at the end of 2012, individual tax change expiration at the end of 2025 likely to lead to new legislation**

Session 2 – February 21

- Corporate tax rate cut
- Pass-through deduction (in more detail)
- Business structuring and choice of entity
- Executive compensation and employee benefits
- International tax

January 17, 2018

Employers Beware: Tax Law Change Eliminates Tax Deductions Relating to Certain Settlements

Melissa Raphan and Katina Peterson

The #MeToo movement has had far-reaching implications and appears to have influenced the new federal tax law. The legislation contains a provision that has received little attention but that may have serious, unintended consequences for employers. New Internal Revenue Code Section 162(q) will require employers whose settlements of sexual harassment claims include nondisclosure provisions to navigate carefully to preserve the deductibility of settlement related payments. Although transparency has been a hallmark of the #MeToo movement, this provision may prove challenging for employers and employees who wish to maintain the confidentiality of certain settlements.

With certain exceptions, Section 162 of the Internal Revenue Code allows employers to deduct ordinary and necessary expenses paid or incurred in carrying on a trade or business. Under this provision, employers have historically been allowed to deduct payments made and costs incurred in settling employment-related claims, including claims relating to sexual harassment. The recently enacted tax legislation will significantly change these rules.

Public Law No. 115-97, originally titled the Tax Cuts and Jobs Act of 2017 (actual title "an Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018") (the "Tax Act") includes a provision that denies a tax deduction for expenses relating to certain settlements.

Section 13307 of the Tax Act states:

"No deduction shall be allowed under this chapter for (1) any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or (2) attorney's fees related to such a settlement or payment."

As summarized in the conference committee report, "Under the provision, no deduction is allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement."

The provision applies to amounts paid or incurred after December 22, 2017, the date of enactment.

The provision's broad language creates a number of troubling uncertainties and potential problems for both employers and claimants. Significantly, the statutory language fails to define any portion of the all-important phrase "any settlement or payment related to sexual harassment or sexual abuse." How will "sexual harassment" and "sexual abuse" be defined? If a sexual harassment claim is part of a multi-claim suit, are any settlement payments made to resolve the case "related to" a sexual harassment claim? What if release and confidentiality language included in the settlement agreement apply to claims of sexual harassment and abuse even if such claims have not actually been made? What if the parties are subject to a court order containing nondisclosure requirements? All of these questions are open issues and will need to be carefully evaluated by employers and their advisors.

It is also concerning that the provision explicitly applies to deductions "under this chapter," which in effect refers to all of the income tax provisions in the Internal Revenue Code. Read literally, the provision would deny a deduction for attorney's fees that claimants could otherwise potentially be entitled to under other applicable income tax provisions of the Code. Even if this is not the provision's intent, it is difficult to read the statutory language any other way and the conference committee report is unhelpful.

Takeaways for now:

1. In light of this provision (which will be codified as new Section 162(q) of the Internal Revenue Code), careful analysis, planning, and drafting relating to any settlements that could potentially fall under its terms will be imperative in order for employers to realize anticipated tax benefits.

2. Such planning will include carefully defining claims, making clear allocations of payments in the settlement agreement, and considering multiple settlement agreements for multi-claim matters.

3. Employers should pay close attention to this provision given that clarification could be forthcoming.

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Impacts of the TCJA on Minnesota Individual Income Filers

With the signing of the Federal Tax Cut and Jobs Act (TCJA), attention now turns to St. Paul and state policymakers' response in the forthcoming legislative session. The Minnesota Department of Revenue's (DOR) preliminary estimate of state budget impacts stemming from its passage has grabbed the headlines, prompting questions about possible tax burden impacts, shifting, and potential "winners and losers" under this reform.

As we have done previously, our modeling examines how the TCJA would impact Minnesota taxpayers if the state conformed to it. Our estimates are based on household profiles that DOR provided for our latest *Multistate Individual Income Tax Comparison Study* (tax year 2014). These profiles let us model federal and state income taxes on an "average Minnesota taxpayer" for different filer types at various incomes under the TCJA. The findings from our multistate study are the comparative baseline we use to determine the impact of the reform.

Our usual caveats once again apply:

- We assume federal taxable income remains the starting point for Minnesota returns and that Minnesota conforms to the new calculations of federal taxable income.

- We model first year effects (many individual income tax features are phased out in later years.)

- Since the taxpayer information we have is specific to tax year 2014, our analysis assumes that changes effective for the 2018 tax year were instead effective for 2014. This creates slightly larger differences between the baseline standard deduction and personal exemption amounts and the new standard deduction, and therefore slightly overstates the size of tax cuts.

- Any particular taxpayer at these income levels can have a very different tax burden than the "average" taxpayer we model. The most important factors in any variations include 1) the number of dependents claimed, 2) whether the filer itemizes deductions or claims the standard deduction, 3) the total amount of itemized deductions a filer claims if itemizing, and 4) the use of any "above the line" deductions (i.e. income subtracted in the calculation of federal adjusted gross income) that were eliminated in the TCJA. Our modeling assumes married-joint filers have two children and head of household filers have one child.

And one new one based on the details of the final bill:

- For married-joint filers at $150,000; $250,000; $500,000; and $1 million of household income we assume that any taxable income they have that is not assigned to wages, investments, or retirement is pass-through business income. We further assume that this business income is eligible for the 20% deduction (i.e., it is not earned in the variety of ineligible occupations). The TCJA imposes limits on the 20% deduction for our $500,000 and $1 million filers. However, since we cannot determine from the taxpayer profile data how to model the limitation, we simply assume that half of such income for those filers is eligible for the deduction (an assumption offering the smallest possible error).

Impact on Minnesota Taxable Income for Different Filers*

Filer Type/Income	Minnesota Taxable Income			
	Baseline	Under TCJA	Change ($)	Change (%)
Married-Joint/$50K	$19,622	$23,822	$4,200	21.4%
Married-Joint/$100K	$65,846	$68,934	$3,088	4.7%
Married-Joint/$150K	$112,652	$116,420	$3,768	3.3%
Married-Joint/$250K	$196,017	$205,842	$9,825	5.0%
Married-Joint/$500K	$443,467	$434,362	($9,105)	-2.1%
Married-Joint/$1 million	$949,795	$916,445	($33,350)	-3.5%
Single/$100K	$82,363	$81,482	($881)	-1.1%
Head of Household/$50K	$30,951	$29,951	($1,000)	-3.2%

* Note that per the DOR profile data, all households have a certain amount of nontaxable income that does not factor into these calculations.

The DOR analysis offers perspective on the sources and magnitude of state revenue increases resulting from applying Minnesota's existing tax rates to the now-expanded tax base. The following table offers a more detailed look at how Minnesota taxable income changes for various filer types at different income levels.

A couple of observations/explanations

- The larger dollar increase and disproportionate percentage change in taxable income for our $50,000 married filer reflects the interaction of the larger standard deduction and the elimination of personal exemptions compared to the baseline for taxpayers taking the standard deduction under both the old law and the TCJA. Put simply, personal exemptions are worth a lot more to lower income filers.

- The decline in taxable income in the married joint $500k and $1 million filers is due to 1) the new 20% pass through deduction for qualified business income, and 2) the elimination of limitations of allowable itemized deductions (a.k.a. “Pease limitations”). For federal tax purposes, the additional deductions these high income filers are allowed with the elimination of deduction limitations are offset by the higher taxable income resulting from the partial elimination of state and local tax deductibility. However, since Minnesotans who itemize have already been adding state income taxes back when calculating Minnesota taxable income, the full value of this elimination of deduction limits now flows through to the state tax return. Each of these two factors contributes to about half of the lower Minnesota taxable income these filers see under the TCJA.

- The decline in Minnesota taxable income for our single and head of household filers represents “sweet spots” in the new tax structure. For both of these filers, the additional standard deduction ($5,800 for the single filer; $8,900 for the head of household filer) is worth more than the value of the personal exemptions that the TCJA repealed.

Impact on Income Taxes Paid

Filer Type/Income	Federal/ State	Baseline Tax	Tax Under TCJA	Change ($)	Change (%)
Married-Joint/$50K	Federal	($251)	($609)	($358)	-142.6%
	State	$912	$1,136	$224	24.6%
Total		**$661**	**$527**	**($134)**	**-20.3%**
Married-Joint/$100K	Federal	$6,649	$4,025	($2,624)	-39.5%
	State	$3,803	$4,149	$346	9.1%
Total		**$10,452**	**$8,174**	**($2,278)**	**-21.8%**
Married-Joint/$150K	Federal	$17,743	$13,826	($3,917)	-22.1%
	State	$7,102	$7,390	$288	4.1%
Total		**$24,845**	**$21,216**	**($3,629)**	**-14.6%**
Married-Joint/$250K	Federal	$38,720	$33,775	($4,945)	-12.8%
	State	$13,449	$14,395	$946	7.0%
Total		**$52,169**	**$48,170**	**($3,999)**	**-7.7%**
Married-Joint/$500K	Federal	$119,808	$100,831	($18,977)	-15.8%
	State	$36,816	$35,940	($876)	-2.4%
Total		**$156,624**	**$136,771**	**($19,853)**	**-12.7%**
Married-Joint/$1 million	Federal	$293,438	$275,887	($17,551)	-6.0%
	State	$86,313	$82,531	($3,782)	-4.4%
Total		**$379,751**	**$358,418**	**($21,333)**	**-5.6%**
Single/$100K	Federal	$15,098	$13,756	($1,342)	-8.9%
	State	$5,395	$5,328	($67)	-1.2%
Total		**$20,493**	**$19,084**	**($1,409)**	**-6.9%**
Head of Household/$50K	Federal	$2,995	$1,322	($1,673)	-55.9%
	State	$1,664	$1,602	($62)	-3.7%
Total		**$4,659**	**$2,924**	**($1,735)**	**-37.2%**

As the table shows, all our average filer types realize net income tax relief – including our lowest income married joint filers – thanks to the expanded, partially refundable child credit included in the final bill. However, the influence of higher state taxes on the amount of net tax relief varies significantly across filer types. Increased state taxes offset only 7.3% of the federal tax relief provided to the $150k married-joint household but over 62% to the $50k married-joint household. Meanwhile, higher income earners and single filers are able to take additional advantage from their declines in Minnesota taxable income.

How will such distributional consequences affect the state debate over responding to the TJCA? Will tax fairness once again be the dominant rallying cry for public policy at it was several years ago? Or will the prospect of some portion of a billion-plus in revenue for new spending and investments – more regressively raised but less felt and largely hidden from view – temper these calls? These questions, and many more like them, promise to make the 2018 legislative session one to remember.