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TAXOLUTIONS

ideas on taxes

## How the Marriage Penalty Has Changed uner the TCJA

Because of certain provisions of the tax code, an unmarried couple who file separately can have a lower combined income tax liability than a married couple filing jointly, especially if the partners have similar wage incomes and dependent children. This disadvantage is sometimes referred to as a "marriage tax penalty." In some cases, however, married couples filing jointly may enjoy a "marriage tax bonus," particularly if one spouse has significantly higher income than the other. Through changes to the tax rate brackets, the child tax credit, and other provisions, the Tax Cuts and Jobs Act of 2017 (TCJA) alleviated the effects of the marriage penalty starting in 2018. However, the TCJA left other tax code provisions that contribute to a marriage tax penalty untouched, and certain changes under the new law have exacerbated the penalty for some married filers.

In 2017, a married couple filing jointly could incur a marriage penalty starting with the 28% tax bracket. Under the TCJA, by contrast, all of the tax brackets for married couples filing jointly are precisely double the single brackets up to the 35% bracket, which in 2019 begins for married couples filing jointly at $408,200 and at $204,100 for singles. However, whereas single filers do not enter the 37% bracket until they earn $510,300, the 35% bracket ends at $612,350 for married couples—or far below twice the single-income threshold. Nonetheless, it is clear that the impact of the tax bracket-based marriage penalty is reduced under the TCJA as more couples are finding that filing jointly moves some of their income into lower tax brackets.

Yet the tax bracket disparity is not the only reason the marriage tax penalty can arise, as tax provisions that phase in or out with income also generate marriage penalties or bonuses. The TCJA removed the potential marriage penalty that can result from differences in the phaseout threshold for claiming the child tax credit: whereas in 2017 the credit started phasing out at $75,000 of AGI for singles and $110,000 for married couples, the child tax credit now phases out beginning at $400,000 for married filers, or double the $200,000 start of the phaseout for single filers.

In some parts of the tax code, however, the TCJA either failed to alleviate the marriage penalty, or even increased the risk of married filers facing a higher tax liability. In particular, the TCJA capped the itemized tax deduction for property, state, and local taxes (SALT) at $10,000 for every tax filer, regardless of whether the filer is single or a married couple filing a joint return. Thus, an unmarried couple can claim $20,000 in SALT deductions on two separate returns, but a married couple is limited to deducting $10,000 on a single return.

In addition, the 0.9% Additional Medicare tax, as well as the Net Investment Income Tax (NIIT), remains unchanged under the TCJA, as these taxes still apply to single taxpayers with modified AGI of $200,000 for single taxpayers and of $250,000 for married filing jointly. Similarly, a large marriage penalty persists for capital gains tax rates: in 2019, the thresholds at which long-term capital gains are taxed at 20% are $434,550 for singles and $488,850 for married filing jointly.

The alternative minimum tax (AMT) continues to impose a marriage penalty on some taxpayers. However, since the TCJA increased both the AMT exemption and the income levels at which it phases out, the AMT is likely to affect far fewer taxpayers than it did in the past. Under the TCJA, the exemption amounts have been raised, and are currently at $71,700 for single filers and $111,700 for married couples filing jointly. Meanwhile, the marriage penalty for the phaseout thresholds for these exemptions has been removed. In 2019, these thresholds are $510,300 for singles and $1,020,600 for married filing jointly.

Retired couples also continue to face a marriage penalty, as couples who receive Social Security benefits still experience a disadvantage when filing jointly. Following the TCJA, the taxable thresholds for Social Security benefits remain unchanged: for single filers, 50% of Social Security benefits become taxable at a modified AGI of $25,000 and 85% of benefits become taxable at $34,000; while for married couples, 50% of Social Security benefits become taxable at $32,000, and 85% of benefits become taxable at $44,000.

Moreover, lower-income married couples can be greatly disadvantaged if combining their incomes disqualifies them from claiming the earned income tax credit (EITC). For 2019, the maximum AGI a family with two qualifying children can earn and still claim the EITC is $46,703 for a single filer, and $52,493 for a married couple filing jointly.

While tax planning is usually not the main consideration when couples are considering whether to get married, being aware of these potential marriage penalties and bonuses should help couples and their tax advisers make more informed personal and financial decisions. As many of these TCJA provisions are currently set to expire in 2025, future changes to the tax code may again alter the tax penalties and bonuses associated with marriage.

## Congress Moves to Enact Major Changes to Retirement Savings Plans

On May 23, the House of Representatives voted 417-3 to pass H.R. 1994, Setting Every Community Up for Retirement Enhancement (SECURE) Act, which makes substantial changes to retirement plans, including provisions that incentivize small businesses to sponsor workplace retirement plans, remove barriers to offering annuities in 401(k) plans, and place limits on "stretch IRAs".

The bill contains many of the same provisions as S. 972, the Retirement Enhancement and Savings Act (RESA), which is currently being considered in the Senate, and also has strong bipartisan support. As both chambers are actively working on the issue of retirement reform, the SECURE Act or a similar bill could be signed into law in the near future. If approved, the bill would represent the largest legislative change to the retirement system in more than a decade, since the passage of the Pension Protection Act of 2006.

The SECURE Act makes 29 updates to the retirement system, including the following:

**Raises the age for required minimum distributions (RMDs):** Currently, defined contribution plan participants are required to start taking distributions from their retirement savings accounts at age 70.5. The SECURE Act raises that minimum age to 72, while the RESA pushes the age even higher, to 75.

**Repeals the maximum age for making traditional IRA contributions:** Under current law, taxpayers can contribute to a Roth IRA after reaching age 70.5, but not a traditional IRA. The SECURE Act removes this prohibition.

**Imposes a 10-year deadline on distributions for most non-spouse heirs of 401(k) or IRA balances:** This revenue-generating provision changes the required minimum distribution rules for inherited defined contribution plan and IRA balances. Under the SECURE Act, distributions to most heirs other than the surviving spouse or a minor child of the deceased account owner must be completed by the end of the 10th calendar year following the year of the owner's death. Thus, the legislation would eliminate the so-called "stretch IRA" option, which currently allows account beneficiaries to delay taxation by withdrawing the assets from the account over their expected lifetime. The RESA bill, by contrast, eliminates the stretch provision only for larger inherited IRAs over $400,000, and imposes a five-year payout period for these inherited IRAs.

**Extends 401(k) plan participation to more part-time workers:** Under current law, employers are permitted to exclude their part-time employees from eligibility to participate in a 401(k) plan if they do not complete at least 1,000 hours of service in a year. But under the SECURE Act, an employer must allow workers to participate in its defined contribution plan if they work at least 500 hours per year and have been with the employer for at least three consecutive years.

**Creates a safe harbor for offering annuities in 401(k) plans:** The bill provides a safe harbor provision for plan sponsors to select providers to offer lifetime income annuities as investment options inside of a 401(k) plan. Currently, most 401(k) sponsors avoid offering annuities due to liability concerns. Under the bill, fiduciaries are afforded an optional safe harbor to satisfy the prudence requirement with respect to the selection of annuity insurers, and are protected from liability for any losses that may result to the participant or beneficiary if the insurer fails in the future to satisfy its financial obligations under the terms of the contract.

**Requires 401(k) statements to include lifetime income stream disclosure:** The new retirement bill would require that benefit statements include a disclosure illustrating the monthly payments the participant would receive if the total account balance were used to provide a lifetime income stream, including through a qualified annuity.

**Allows for adoption or child birth cost distributions:** The bill permits in-service withdrawals from elective deferral contribution accounts of up to $5,000 for new parents to cover qualified costs associated with a new birth or adoption, provided the distribution is made within a year.

**Permits multi-employer 401(k) plans for small businesses:** The SECURE Act would expand the ability of unrelated employers to join forces to offer a common 401(k) plan to employees. The new plans, referred to as "pooled employer plans," would be treated as a single plan under the Employee Retirement Income Security Act (ERISA) of 1974. The bill also proposes tax credits to incentivize small employers to join these plans.

**Raises the automatic enrollment safe harbor cap:** The legislation increases the cap on the default rate for contributions under a qualified automatic contribution arrangement to 15% of compensation, from 10% currently.

**Creates a new small employer automatic enrollment tax credit:** The legislation creates a new tax credit of up to $500 per year to employers to defray startup costs for new 401(k) plans and SIMPLE IRA plans that include automatic enrollment.

**Increases the small employer plan start-up credit:** The SECURE Act would increase this credit from $500 currently or the lesser of $250 multiplied by the number of non-highly-compensated employees of the eligible employer who are eligible to participate in the plan, or $5,000. The credit applies for up to three years.

## Claiming Federal Tax Credits for Electric and Hybrid Plug-in Vehicles

As the market for electric vehicles grows, increasing numbers of U.S. taxpayers are eligible to claim the tax credit of up to $7,500 that is currently available for the purchase of most models of all-electric vehicles and plug-in electric-gas hybrid vehicles. But as these incentives are starting to phase out for certain manufacturers, bipartisan legislation that would expand electric vehicle and hydrogen fuel cell tax credits has been introduced in the Senate.

Section 30D of the Internal Revenue Code provides a credit of between $2,500 and $7,500 for qualified plug-in electric drive motor vehicles—defined as a car or truck with at least four wheels and a gross vehicle weight of less than 14,000 pounds that draws energy from a battery with at least four kilowatt hours and that can be recharged from an external source—purchased after December 31, 2009. The size of the credit depends on the vehicle's size and battery capacity: the base credit is equal to $2,500, plus $417 for a vehicle that draws propulsion energy from a battery with at least five kilowatt hours of capacity, plus an additional $417 for each kilowatt hour of battery capacity in excess of five kilowatt hours. The total amount of the credit allowed for a vehicle is limited to $7,500.

The IRS website provides a list of qualified plug-in electric vehicles, and the amount of the qualifying credit. It reports, for example, that the 2019 Kia Soul Electric is eligible for the full $7,500 credit, while the 2019 Ford Fusion Energi is eligible for a credit of $4,609.

The dollar-for-dollar tax credit is non-refundable, and must be claimed in the year when the vehicle was purchased by filing Form 8936 together with the owner's tax return. Thus, taxpayers with a tax liability below the refund amount will not be able claim the unused portion of the credit on their return for the following year. The credit can only be claimed by the original registered owner of the new vehicle, and not by a taxpayer who is leasing the car or who purchased it from the original owner. It should also be noted that conventional hybrid vehicles that do not plug into the power grid no longer qualify for a Federal tax break. There are, however, a wide range of state, local, and regional tax incentives for purchasing or driving plug-in and alternative fuel vehicles.

Moreover, it is important to keep in mind that the full Federal tax break is only available until 200,000 qualified vehicles have been sold in the U.S. by each automaker. The value of the credit to purchasers of vehicles for this manufacturer then decreases to 50% for the next six months, and to 25% over the subsequent six months, before being phased out entirely. The lifetime cap is based on the assumption that the high initial cost of adding new technology to a vehicle should decline as economies of scale improve with increased sales, and that subsidies will therefore no longer be needed.

The expiration date is separate for each manufacturer, and is not set until an automaker sells 200,000 qualified vehicles. Tesla hit this threshold first in July 2018. As a result, Federal credits for Tesla vehicles are currently phasing out, and will no longer available after December 31, 2019. GM became the second carmaker to reach the 200,000 sales mark in the last quarter of 2018. Tax credits for the purchase of GM's plug-in vehicles will no longer be available after March 31, 2020.

To expand this credit as well as tax incentives for the purchase hydrogen fuel cell vehicles, a bipartisan coalition of U.S. Senators introduced the Driving America Forward Act on April 10. The proposed legislation raises the current 200,000 cap to allow purchasers of an additional 400,000 vehicles per manufacturer to be eligible for a maximum tax credit of $7,000. The value of the credit to consumers from this automaker then decreases to 50% before being phased out entirely after six months. The bill maintains the $7,500 tax credit for the first 200,000 units sold. The legislation also extends the recently expired hydrogen fuel cell credit for 10 years, through 2028.

"Ten years ago there were no mass produced electric cars on U.S. highways, and today, there are about one million and automakers are planning to make millions more," said Senator Lamar Alexander (R-TN), one of the bill's co-sponsors. "Investing in American research and technology for better electric vehicles is one way to help our country and the world deal with climate change."

In addition to having bipartisan backing, the Driving America Forward Act is supported by 60 industry and environmental organizations, including the leading car manufacturers. However, President Trump proposed eliminating the electric vehicle tax credit entirely in his 2019 budget, and some Republican legislators have recently introduced bills that would limit the credit or impose fees on electric vehicle users to make up for lost fuel tax revenues.

# News & Notes

## IRS Issues Proposed Rules on Insurance Contract Reporting Requirements

On March 25, the IRS issued proposed regulations on the new information reporting requirements for certain life insurance contract transactions under the Tax Cuts and

Jobs Act (TCJA). As enacted, the new reporting requirements under Internal Revenue Code 6050Y apply to reportable policy sales, transfers of life insurance contracts to foreign persons, and payments of reportable death benefits made after December 31, 2017.


The IRS stated that, consistent with guidance issued last April in Notice 2018-41, the proposed regulations contain transitional guidance delaying any reporting until final regulations are issued. Moreover, the proposed regulations provide taxpayers additional time to satisfy any reporting obligations for sales or payments made prior to the publication of the final regulations.

A "reportable policy sale" is generally defined as the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship to the insured; while a "reportable death benefit" is defined as an amount paid at the death of the insured under a life insurance contract that was transferred in a reportable policy sale.

According to the IRS, these reporting requirements are intended to help sellers of life insurance contracts properly report any gain from that sale, as each person who acquires a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale during the taxable year must file a return with the IRS. For reporting the sale, IRS has released Form 1099-LS and Form 1099-SB, as well as specific instructions on the reporting requirements.

In addition, the proposed regulations provide guidance on new reporting requirements applicable to each person who makes a payment of reportable death benefits, and on how to determine the amount of death benefits excluded from gross income following a reportable policy sale.