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Why Your 2018 Tax Bill Went Up or Down

Kathleen Pender April 13, 2019 Updated: April 14, 2019 12:18 p.m.

The sweeping federal tax law that took effect last year, the biggest in more than three decades, left many people shocked, angry and befuddled.

Many taxpayers found themselves writing bigger checks to Uncle Sam, or getting smaller refunds, than last year, even though they actually owed less for the entire year. That's because a change in withholding tables early last year reduced the federal tax withheld from employee paychecks, unless they filed a new W-4 with their employer. And some people, a vocal minority, actually did owe more.

Many readers I've heard from are not clear why their taxes went up or down. So last week I asked some Bay Area tax preparers, when they came up for air, to summarize how the changes affected their clients.

The law lowered federal tax rates across the board, which benefited everyone who paid taxes. But it also took away some deductions and credits and created new ones. Whether any person came out ahead or behind depended on their unique circumstances. A family with two toddlers might have paid less but if the kids were in college they could have paid more.

To generalize, here are some common themes that emerged. Remember that when I say someone paid less or came out ahead, I mean they paid less for the entire year, not when they filed their return.

People who took the standard deduction in 2017 and 2018 were generally winners: The law almost doubled the standard deduction, to $12,000 for singles and $24,000 for married filing jointly. But it also eliminated the personal exemption. This was a deduction you could claim for each person, including dependents of any age, on your tax return. In 2017, it reduced your income (not your tax bill) by $4,050 per person.

If you were in the 25 percent bracket, each exemption reduced your taxes by about $1,000. If you were in a lower tax bracket it saved you less and if you were in a higher bracket it saved you more, although it phased out at higher income levels.

A married couple with no children lost $8,100 in personal exemptions, but their standard deduction went up almost $12,000, so they generally were better off, especially when you factor in the tax-rate cut.

A couple with two kids, however, would have lost $16,200 in personal exemptions, more than the $12,000 standard deduction increase. Ouch.

Kids could help or hurt you: To ease the pain, Congress doubled the child tax credit to $2,000 per kid. Parents can claim this credit for each child younger than 17 at the end of the year. But in 2017, it started phasing out at $75,000 in modified adjusted gross income for singles and $110,000 for married filing jointly. The tax law raised the phase-out, by a lot — to $200,000 and $400,000, respectively.

A credit is more valuable than a deduction or personal exemption because it reduces your tax bill (not your income) dollar for dollar, no matter what tax bracket you're in.

In 2017, it reduced your tax bill by $1,000 per child under 17. In 2018, it cut your taxes by $2,000 per kid.

If you were in the 24 percent tax bracket in 2018, that extra $1,000 almost perfectly offset the loss of the personal exemption, leaving you essentially even with last year.

If you were in a higher tax bracket, losing the personal exemption might have cost you more than $1,000. However, many people in higher brackets couldn't claim the credit last year, but now with the higher phaseout, they can. In some cases, the extra $2,000 put them ahead of last year, despite losing the personal exemption for kids under 17.

Parents with dependents 17 and older, including college kids they're supporting, took a hit. They lost the personal exemption they previously got for those dependents, and can't take the child tax credit.

To throw them a bone, Congress created a new "other dependent credit" for dependents 17 and older, but it's only $500 and subject to the same income limits as the child credit. For that reason, we'll put them in the losing category.

The same goes for parents of kids without a Social Security number. Before 2018, "the child tax credit was available for undocumented children so long as they had an Individual Taxpayer Identification Number. Now they need a Social Security number" to get the $2,000 child tax credit, said Jay Wiedwald, a volunteer tax preparer with the free Tax-Aide program.

Parents may be able to claim the $500 other dependent credit for a child who has a tax identification number but no Social Security number.

People with “qualified business income” were generally winners: This is income from a partnership, sole proprietorship (self-employment) or S corporation. These are called pass-through entities because income is not taxed at the corporate level. Instead it flows through to the owners or partners and is taxed at their personal tax rate.

Starting in 2018, taxpayers can deduct up to 20 percent of pass-through income, unless they are in a “specified service trade or business” and their income exceeds a certain amount. These specified professions include health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investment management and any other trade or business “where the principal asset is the reputation” of the owners or employees, the IRS says.

People with pass-through income from any other trade or businesses — whether it’s real estate, manufacturing, agriculture or running a Jiffy Lube — can deduct up to 20 percent of it regardless of their income. “If you are actively engaged in the real estate industry you possibly got up to a 20 percent deduction out of the air,” said Sandy Murray, a CPA with San Francisco accounting firm BPM.

People with large state income and property taxes deductions generally did worse: The law capped the previously unlimited deduction for state and local taxes — SALT — at $10,000. In California, it’s not hard to exceed that cap if you have a job and own a home. Some people who lost SALT deductions still came out ahead thanks to the standard deduction increase and rate cut. But some did not.

Murray said that only 5% of his clients, who generally make $1 million and up, came out ahead because the loss of SALT deductions overwhelmed other benefits. Most are employees, so they didn’t qualify for the business income deduction. If they had qualified, they could have come out ahead.

“If you work for Facebook and you are bringing down $3 million in a W-2, you got hammered,” he said.

If the same person worked in a state with no income tax, like Texas or Washington, they probably would have been winners.

Those who avoided AMT generally fared well: Many people with large SALT deductions got little or no benefit from them before 2018 because they were subject to the alternative minimum tax. AMT is a separate tax system with different tax rates and deductions. People are supposed to calculate their tax under the regular tax system and AMT and pay whichever is higher. The difference shows up as an additional tax on their returns.

State and local taxes are not deductible under the AMT, and it previously fell hardest on households making $200,000 to $500,000 in high-tax states. In 2016, more than a third of all people who paid AMT came from California, New York and New Jersey.

The law, however, reduced the number of people subject to AMT from roughly 5 million to an estimated 200,000.

"In the past, most of my clients were in AMT," said San Francisco CPA Richard Pon. In 2018, none was.

Since AMT filers got little or no benefit from state and local taxes in the past, most people who made less than $600,000 or $700,000 and no longer have to pay AMT came out ahead because their tax rates dropped, said Jeff Pera, Northern California managing partner for accounting firm Marcum.

Pon said his clients who dropped out of AMT saved $600 on average.

People who bought an expensive home last year took a hit: Before 2018, homeowners could deduct interest on up to $1.1 million in mortgage debt on a first and second home, combined. For homes purchased in 2018 or later, that limit was cut to $750,000. Plus these buyers will be unable to deduct some or all of their property tax.

On state income taxes, most Californians came out even: Because California did not comply with any part of the federal law, most people owed roughly the same tax as last year, assuming their income or circumstances didn't change much.