Seven Pointers Regarding the Tax Cuts and Jobs Act of 2017

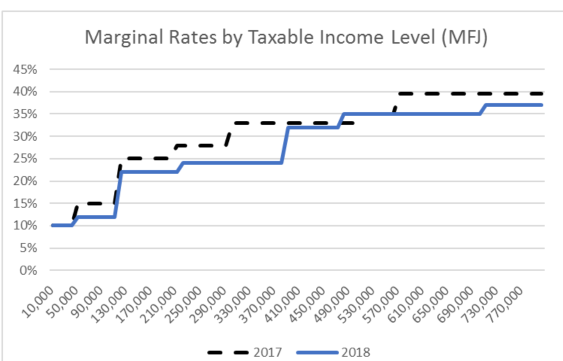
The Tax Cuts and Jobs Act of 2017 (TCJA) was signed into law on December 22, 2017. Consisting of more than 1,000 pages, it represents the largest overhaul of the U.S. tax code in more than 30 years. The new law embodies comprehensive tax reform, but with many expiration dates (most in 2025). It also calls for lowering individual and corporate tax rates while repealing many tax credits and deductions. It proffers "tax simplification," but for many, there will be "tax complication."

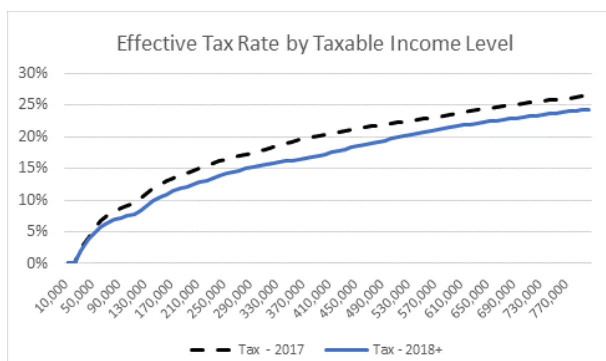
While it is beyond the scope of this informational memo to provide details on the many sections and provisions of the new law, the selected planning pointers that follow may be worthy of consideration.

1. Lower Individual Tax Rates & Increased Income Ranges

- **Old law**: 10%, 15%, 25%, 28%, 33%, 35% and 39.6%.

- **New Law:** 10%, 12%, 22%, 24%, 32%, 35% and 37%. **(Sunsets 2025)**





✓ **Planning Pointer**

TCJA does not repeal the Affordable Care Act's taxes, except for the penalty under the individual mandate. Note: TCJA retains the net investment income (NII) tax of 3.8% and the 0.9% Medicare tax on wage and employment income. These taxes apply to single filers making more than $200,000 and married joint filers making more than $250,000.

2. Standard Deduction, Personal Exemption and Itemization

• **Old law**: Standard Deduction: $13,000 (married); $9,550 (head of household); $6,500 (single).

• **New Law**: Standard Deduction: $24,000 (married); $18,000 (head of household); $12,000 (single). **(Sunsets 2025)**

✓ **Planning Pointer**

TCJA repealed the deduction for personal exemptions ($4,150) and essentially doubled the standard deduction. As a result, in order to itemize deductions, married taxpayers must now exceed the $24,000 standard deduction annually through: allowable mortgage interest; state income, local income/property taxes (up to $10,000); and charitable deductions. Getting beyond the standard deduction will be a challenge for many; however, since charitable deductions are not annually capped, it may make sense to employ a "bunching strategy" every other year in order to itemize.

By way of illustration, consider a married couple who are claiming the maximum state income, local income/property taxes (up to $10,000) and have mortgage interest of $6,000 annually. If they normally give $7,000 a year to charity, they will not break the needed threshold of $24,000 to itemize and will essentially lose their annual charitable deduction. If, however, they combine two years of charitable giving into one tax year ($14,000), they can itemize deductions in that year and take the standard deduction the next. Note also, there could be state specific ramifications for itemization. For example, in Georgia, the rule has been that if you use the standard deduction on your federal return, you must also use the standard deduction on your personal return. A simple illustration may help highlight the importance of breaking through the federal standard deduction, which has state itemization benefits. If a married couple in Georgia with $23,000 in deductions were to give $1,001 to charity, doing so would save $1,260 in Georgia taxes since they can now itemize for state income tax purposes.

3. State and Local Taxes

• **Old Law**: Deductible for taxpayers who itemize, with limits.

• **New Law**: Caps at $10,000 the amount that can be deducted. **(Sunsets 2025)**

✓ **Planning Pointer**

The new aggregate limit for state and local income or sales taxes and property taxes is $10,000. For 2018, taxpayers may deduct a combination of these taxes, but only up to $10,000. The "bunching strategy" discussed in the previous section to allow one to itemize no longer applies to the prepayment of state and local income taxes. It may, however, allow for the prepayment and bunching of property and sales taxes. An additional piece of good news is that the alternative minimum tax (AMT) now has higher exemptions and increased phase-out thresholds, so the AMT will be harder to trigger. Therefore, more people who were previously barred from taking "SALT" deductions altogether under the old AMT law will have now have a better shot at taking up to $10,000 in annual deductions. Finally, wealthier clients might explore the possibility of setting up irrevocable trusts (termed "incomplete non-grantor trusts") in other states such as Nevada and Delaware to avoid state income taxes.

4. <u>**Mortgage-Interest Deduction for Both Primary and Second Homes**</u>

• **Old Law**: Itemized deduction on loans up to $1 million.

• **New Law**: Itemized deduction on loans up to $750,000. **(Sunsets 2025)**

✓ **Planning Pointer**

Individuals are generally allowed an itemized deduction for interest on principal residence and second residence mortgages up to a combined $750,000. Pre 12/16/17 mortgages are grandfathered and new purchase money mortgages may be grandfathered if the purchase contract was dated before 12/16/17. Refinancing of grandfathered mortgages is grandfathered, but not beyond the original mortgage's term/amount (some exceptions apply for "balloon payment" mortgages). Query whether vacation homes may be turned into rental properties and thereby transform the deductibility of interest and taxes. Finally, interest on a home equity line of credit is no longer deductible so it may make sense to consider paying off these loans.

5. <u>**Estate Taxes and Planning**</u>

• **Old Law**: 40% on estate over $5.6 million per individual.

• **New Law**: 40% on estates over $11.2 million per individual. **(Sunsets 2025)**

✓ **Planning Pointer**

Many clients have transfer tax formulas embedded within their current estate planning documents. With the increased exemptions, however, unintended funding of bequests may occur per the documents. For example, the credit shelter/family trust could easily be fully funded with assets, while the marital trust for the surviving spouse remains unfunded altogether. Therefore, we recommend having your estate planning documents reviewed to ensure that they accomplish your disposition objectives and protect your family. Wealthier clients may also have a limited opportunity under the increased exemptions to gift significant amounts of wealth out of their estate on a tax favorable basis.

One popular vehicle to consider in gifting wealth is a Spousal Lifetime Access Trust (SLAT). For example, a husband in a stable marriage can, through a SLAT, benefit his wife as a beneficiary and fund the trust with his separate property for any amount up to his $11.2 million transfer exemption. During her lifetime, the wife can be the sole trustee of the trust or a co-trustee with a third party, and the trustee(s) can distribute income and principal to the wife or the husband's descendants in accordance with the provisions of the trust. As a result, the husband would effectively maintain indirect access to the trust's income and principal through his wife, and upon her death, the assets can pass estate tax-free to the husband's descendants.

6. **Choice of Business Entity**

• **Old Law**: “C” corporation’s top tax rate is 35%. Pass-through business taxes based on applicable individual income tax rates and brackets.

• **New Law**: “C” corporations now taxed at a flat 21% corporate tax rate. **(No expiration date)** Many pass-through business owners get a 20% deduction for pass-through income. **(Sunsets 2025)**

✓ **Planning Pointer**

Under TCJA the corporate tax rate for regular “C” corporations is reduced to 21% from 35%. There is also a new 20% deduction for qualified business income from pass-through businesses such as partnerships, LLCs, “S” corporations and sole proprietorships. Under the new law, a pass-through business will be entitled to a 20% deduction for the non-wage portion of pass-through income. Note: the deduction is limited to 50% of an entity’s W-2 wages for married filers with income over $315,000 and for single filers with income over $157,500. For many pass-through entities, this brings the top marginal tax rate down from 39.6% to 29.6%. Certain service providers in the fields of health, law, consulting, athletics, financial, or brokerage services are denied the deduction if their income is over $315,000.

In view of the above, business owners should consider evaluating their current business entity structure with their legal and tax professionals.

7. **529 Plans**

• **Old Law**: Proceeds from such tax-free accounts can be used for post-secondary education.

• **New Law**: Proceeds can be used for K-12 and for post-secondary education. **(No expiration date)**

✓ **Planning Pointer**

Now, in addition to post-secondary education, distributions from 529 plans of up to $10,000 per student per year can be used for tuition in connection with an enrollment or attendance at an elementary or secondary public, private or religious school, or for home-based education.

Undoubtedly, we will be experiencing the far-reaching effects and seeking to understand the ramifications of the Tax Cuts and Jobs Act of 2017 for some time to come. Eventually, matters regarding the new law will become clearer as the IRS issues regulations, tax cases are ruled upon, and tax professionals share their evolving insights. Presently, however, it is particularly important to consult your tax professional before engaging in any tax planning strategy and to understand the specifics of your tax situation under the new law.

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