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Tax Cuts and Jobs Act of 2017

Tax Reform - What Changed

There are a number of provisions in the Tax Cuts and Jobs Act of 2017 touching on investments and financial planning. Anytime changes occur in the tax code, individuals and businesses should review their unique financial situations through the altered lens. The current tax changes hold both challenges and benefits. Bear in mind, though, this Tax Act does not affect 2017 tax preparation (the taxes filed this year). The changes to the tax code highlighted below are for 2018 and beyond. This report is narrow in scope dealing with financial planning topics, not tax-preparation and accounting.

New Tax Brackets for Individual Filers

Single Filers

Current Tax Rates	Current Thresholds	New Tax Rates	New Thresholds
10%	$0 to $9,325	**10%**	**$0 to $9,525**
15%	$9,326 to $37,950	**12%**	**$9,526 to $38,700**
25%	$37,951 to $91,900	**22%**	**$38,701 to $82,500**
28%	$91,901 to $191,650	**24%**	**$82,501 to $157,500**
33%	$191,651 to $416,700	**32%**	**$157,501 to $200,000**
35%	$416,701 to 418,400	**35%**	**$200,001 to $500,000**
39.6%	More than $418,400	**37%**	**More than $500,000**

Married Joint Filers

Current Tax Rates	Current Thresholds	New Tax Rates	New Thresholds
10%	$0 to $18,650	**10%**	**$0 to $19,050**
15%	$18,651 to $75,900	**12%**	**$19,051 to $77,400**
25%	$75,901 to $153,100	**22%**	**$77,401 to $165,000**
28%	$153,101 to $233,350	**24%**	**$165,001 to $315,000**
33%	$233,351 to $416,700	**32%**	**$315,001 to $400,000**
35%	$416,701 to $470,700	**35%**	**$400,001 to $600,000**
39.6%	More than $470,700	**37%**	**More than $600,000**

Alternative Minimum Tax Exemptions Increased

The bill also eases the burden of the individual alternative minimum tax (AMT) by raising the income exempted from $54,300 (adjusted for inflation) to $70,300 for single taxpayers and $84,500 (adjusted for inflation) to $109,400 for married, joint filers. Fewer taxpayers will have to pay this tax.

Increased Standard Deduction and Child Tax Credit

The new tax law nearly doubles the standard deduction amount for all individual filers. This means that fewer taxpayers will have to itemize. The Child Tax Credit has also doubled with an increase to the amount that is refundable. The bill adds a new, non-refundable credit of $500 for dependents other than children. The income threshold at which these benefits phase out went from $110,000 to $400,000 for a married couple.

Changes in Deductions

The bill limits the amount of state and local property, income, and sales taxes that can be deducted to $10,000. In the past, these taxes were generally fully tax deductible. The bill also caps the amount of mortgage indebtedness on new home purchases on which interest can be deducted at $750,000 (down from $1 million). The bill eliminates the tax penalty for not having health insurance after the end of 2018. For 2017 and 2018, the floor above which out-of-pocket medical expenses can be deducted has been lowered to 7.5%.

Self-Employed and Small Businesses

The biggest changes for business include a reduction in the top corporate rate to 21%, a new 20% deduction for incomes from certain type of "pass-through" entities (partnerships, S Corps, sole proprietorships), limits on expensing of interest from borrowing, almost doubling the amount small businesses can expense from Section 179 to $1 million, and the elimination of the corporate alternative minimum tax.

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Changes to the Federal Estate and Gift Tax

The main estate tax provision highlighted by the Press has been the increase to the federal estate and gift tax unified credit to $11 million ($10 million with inflation adjustments from 2011). This provision is effective for decedents and gifts after 2017. The amounts are indexed for inflation using a "chain" method that will mute increases. Although the House Bill called for a repeal of the estate tax in 2024, the final bill does not provide for this repeal. Beneficiaries will continue to receive a stepped-up basis in estate property. These changes to the estate tax expire at the end of 2025 but amounts continue to be indexed for inflation using chained-CPI in subsequent years.

Trust Income Tax Brackets

Tax Rate	Threshold
10%	Trust income up to $2,550
24%	Trust income $2,551 to $9,150
35%	Trust income $9,151 to $12,500
37%	Trust income above $12,500

Gift and Generation-Skipping Transfer (GST) tax provisions are increased with the estate tax amounts noted above. It may be advisable to take advantage of the increased gift tax and GST exemptions when considering gifting and allocation of assets in dynasty trusts before the legislation sunsets at the end of 2025.

<u>Special planning consideration</u>: Normally, wealthy elders seek ways to give assets from their estate to a younger generation to avoid estate tax. With the increase to the estate tax and gift tax exemption, there is an avenue here for a wealthier, younger generation to pass highly appreciated assets up to an older generation to receive a step-up in basis at death. The conditions where this strategy makes sense are narrow… but notable.

Retirement Assets

The Act repeals the special rule that allowed traditional IRA contributions converted to a Roth IRA to be recharacterized as a contribution to the traditional IRA. Investors should be very cautious when considering a Roth IRA conversion as the conversion may no longer be undone.

One welcome qualified plan change is the extension of the period within which a participant may pay the amount of an "offset" of an outstanding plan loan to another qualifying plan or IRA to accomplish a tax-free rollover of the loan offset amount. Normally, plan participants have 60 days in which to roll over the offset. Now, the deadline is the filing due date (including extensions). The change in this tax law means that the loan offset period could be as long as 21 months when the loan offset occurs early in the calendar year.

Education Savings

For the first time, 529 Plan accounts can be used for primary and secondary education up to $10,000 per year per student. All of the other rules still apply (contribute $15,000 per person per student per year with the ability to front-load 5 years of contributions) making 529 Plans an even more effective tool for transferring wealth between generations. Although Coverdell Education Accounts remain available (despite speculation they might be curtailed), their usefulness has been reduced considering their disadvantages to 529 Plans (such as lower contribution limits).

The new legislation also allows for a tax-free rollover of a 529 account to an Achieving a Better Life Experience (ABLE) account. The rollover would need to take place prior to January 1, 2026, as this provision will expire. ABLE accounts were created in 2014 to give individuals with disabilities and their families the opportunity to save for the future without limiting access to needed income. Rollovers are subject to the annual contribution limit of $15,000 (in 2018).

Bottom Line

Tax reform has the potential to provide an overall economic boost to help investor net worth. However, the benefits won't be uniform across asset classes, companies, or individuals. This is an ideal environment for active managers to benefit from company by company research. Investors should review plans and assets to ensure they are compatible with the new environment created by the tax reform legislation.