

TAX PLANNING DEVELOPMENTS & OPPORTUNITIES UNDER TCJA

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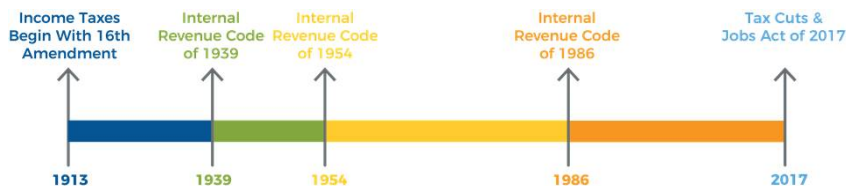
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Handouts/Additional Materials at: kitces.com/FPAKC18

THE EVOLUTION OF THE TAX CODE

- Tax legislation goes through cycles of growing complexity, followed by simplification



TAX REFORM MINI-CYCLES

- Tax Cuts & Jobs Act of 2017
 - Passed by the House on Nov 16th
 - Passed by the Senate on Dec 2nd
 - Conference Agreement filed Dec 15th
 - Largely followed the Senate version
 - Signed into law by President Trump on Dec 22nd
 - Corporate Tax Reform
 - Individual... stepping stone to actual reform?
- (Mostly) sunsets after 2025!

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INDIVIDUAL INCOME TAXES

- TCJA cut most tax brackets by 1% - 4%
 - Proposed (simplified) 3-bracket structure did not pass

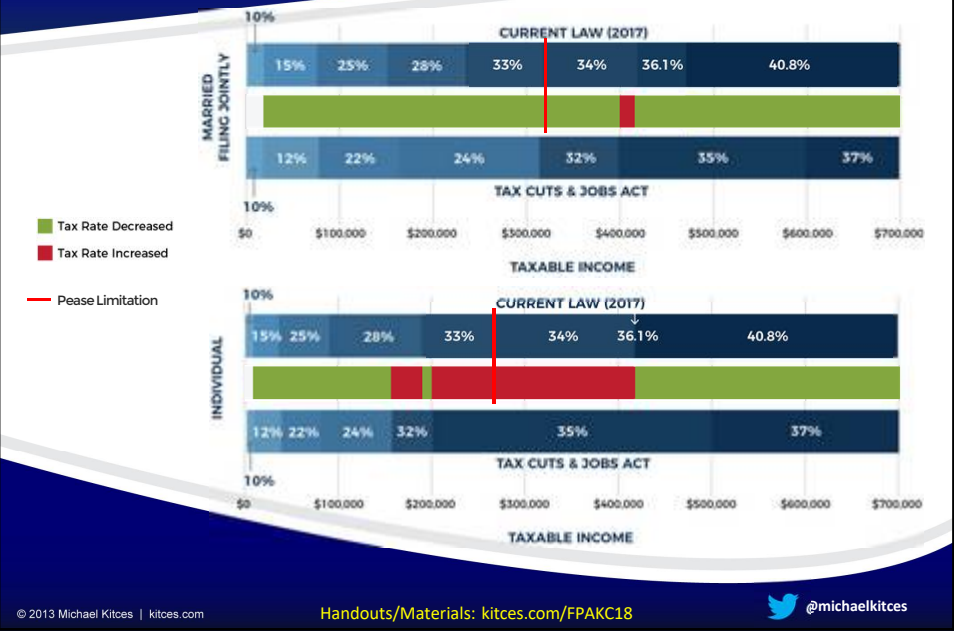
| Individuals | | Married Couples |
|------------------------------------|-------------|------------------------------------|
| Taxable Income | Tax Bracket | Taxable Income |
| Up to \$9,525 | 10% | Up to \$19,050 |
| Over \$9,525 and up to \$38,700 | 12% | Over \$19,050 and up to \$77,400 |
| Over \$38,700 and up to \$82,500 | 22% | Over \$77,400 and up to \$165,000 |
| Over \$82,500 and up to \$157,500 | 24% | Over \$165,000 and up to \$315,000 |
| Over \$157,500 and up to \$200,000 | 32% | Over \$315,000 and up to \$400,000 |
| Over \$200,000 and up to \$500,000 | 35% | Over \$400,000 and up to \$600,000 |
| More than \$500,000 | 37% | More than \$600,000 |

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FINAL TCJA TAX BRACKETS



INDIVIDUAL INCOME TAXES

- “Marriage Penalty”
 - All MFJ brackets are twice individuals, except...



INDIVIDUAL INCOME TAXES

- New Kiddie Tax Rules

- Child's *unearned* income now subject to trust tax rates!
 - First \$1,050 offset by standard deduction
 - Next \$1,050 at child's tax rates

• But the excess...

| Trusts & Estates | |
|---------------------------------|-------------|
| Taxable Income | Tax Bracket |
| Up to \$2,550 | 10% |
| Over \$2,550 and up to \$9,150 | 24% |
| Over \$9,150 and up to \$12,500 | 35% |
| Over \$12,500 | 37% |

• Limited impact for high-income families?

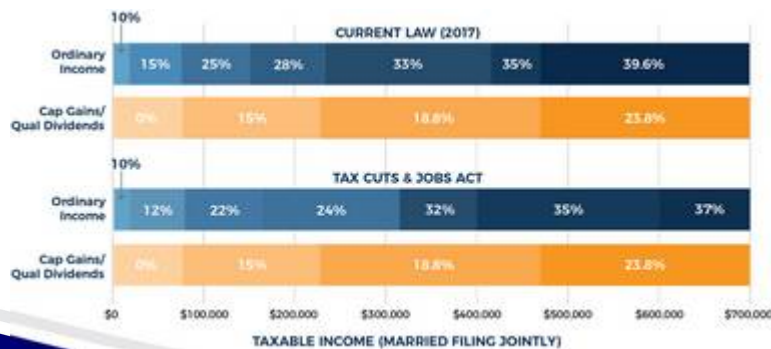
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CAPITAL GAINS TAX BRACKETS

- Capital Gains/Qualified Dividend Brackets Remain
 - But are still anchored to the "old" tax brackets!



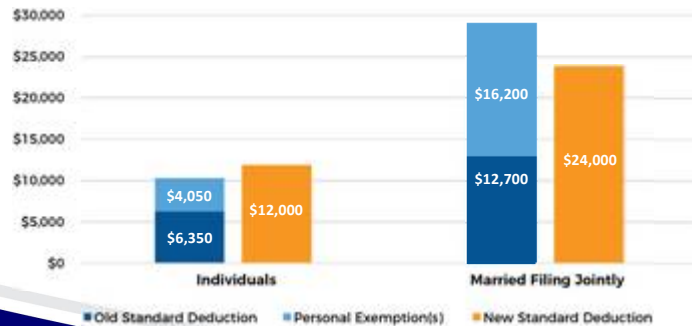
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INDIVIDUAL TAX DEDUCTIONS

- Standard Deduction Expanded...
 - But Personal Exemptions eliminated
 - “Additional” standard deductions still apply



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EXPANDED CHILD TAX CREDIT

- Child Tax Credit Increased from \$1,000 to \$2,000
 - Phaseout thresholds dramatically expanded...
 - From \$75,000 to \$200,000 for individuals
 - From \$110,000 to \$400,000 for married couples
(Not indexed for inflation)
 - New \$500 (nonrefundable) credit for other dependents
 - College-aged children?
 - Dependent parents?

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TCJA IMPACT ON FAMILIES

- Raymond & Debra have two children, and joint income of \$150,000...

| Old Rules | | New Rules | |
|---------------------------|------------|---------------------|------------------------------|
| Standard Deduction | \$12,700 | Standard Deduction | \$24,000 |
| Personal Exemptions | \$16,200 | Personal Exemptions | \$0 |
| Total Deductions | \$28,900 | Total Deductions | \$24,000 |
| Child Tax Credit | Phased Out | Child Tax Credit | \$4,000 |
| Tax Savings @ 25% Bracket | \$7,225 | Tax Savings | \$6,000 + \$4,000 = \$10,000 |
| | | Net Savings | \$2,775 Savings! |

- Upper income families were already subject to PEP!

LIMITATIONS ON DEDUCTIONS

- Original GOP Tax Reform Plan would have removed nearly all deductions (except charitable & mortgage)

SIMPLE, FAIR "POSTCARD" TAX FILING

| | | | |
|----|---|----|--|
| 1 | Wage and compensation income | 1 | |
| 2 | Add 1/2 of investment income | 2 | |
| 3 | Subtract contributions to specified savings plans | 3 | |
| 4 | Subtract standard deduction OR | 4 | |
| 5 | Subtract mortgage interest deduction | 5 | |
| 6 | Subtract charitable contribution deduction | 6 | |
| 7 | Taxable income | 7 | |
| 8 | Preliminary tax (from tax table) | 8 | |
| 9 | Subtract child credit | 9 | |
| 10 | Subtract earned income credit | 10 | |
| 11 | Subtract higher education credit | 11 | |
| 12 | Total tax | 12 | |
| 13 | Subtract taxes withheld | 13 | |
| 14 | Refund due / taxes owed | 14 | |

LIMITATIONS ON DEDUCTIONS

- Final version did not eliminate itemized deductions, but it did substantially curtail them...
 - State And Local Taxes (SALT) capped at \$10,000
 - Includes income *and* property taxes
 - Same cap for individuals & couples
 - Mortgage interest deduction curtailed
 - Acquisition indebtedness cap down to \$750k
 - Grandfathering for existing mortgages
 - Home equity indebtedness deduction eliminated!
 - Based on how the loan proceeds are *used*

LIMITATIONS ON DEDUCTIONS

- Final version did not eliminate itemized deductions, but it did substantially curtail them...
 - Casualty losses limited to Federal disaster areas
 - 2%-of-AGI Miscellaneous itemized deductions repealed!
 - Tax preparer expenses
 - Unreimbursed employee business expenses
 - Variable annuity losses
 - **Investment Advisory fees!**
 - Deductions *not* subject to 2%-of-AGI floor remain
 - Income in respect of a decedent

LIMITATIONS ON DEDUCTIONS

- Some deductions slightly expanded
 - Public charity limit for cash donations up to 60% of AGI
- Medical expense deduction threshold down to 7.5% of AGI for 2017 & 2018

OTHER MISCELLANEOUS CHANGES

- Other Notable Changes...
 - Individual mandate for health insurance repealed (2019)
 - Alimony treatment reversed starting in 2019
 - Alimony becomes non-deductible & not income
 - Existing agreements grandfathered unless changed
 - 1031 exchanges limited to real estate now
 - Moving expense deductions & exclusions repealed
 - Increased depreciation for business cars

OTHER MISCELLANEOUS CHANGES

- Other Notable Changes...
 - Crackdown on business entertainment expenses
 - Only for food & beverage (with 50% limitation)
 - New employer tax credit for paid FMLA
 - 12.5%-25% for 50%-100% of wages paid (up to 12 weeks)
 - More flexibility to roll over 401(k) loans after termination
 - New crackdowns on Deferred Compensation
 - Sexual harassment settlements not deductible if subject to an NDA!

OTHER MISCELLANEOUS CHANGES

- Other Notable Changes...
 - Life settlement tax treatment reverts to prior rules
 - Basis is based on premiums paid, *not* reduced by cost of insurance charges
 - New reporting requirements will apply to future sales
 - **Recharacterizations of Roth conversions *repealed***
 - Though recharacterizations of *contributions* remains
 - Leaves backdoor Roth open, but ends proactive recharacterization strategies in 2018 and beyond

EDUCATION TAX INCENTIVES

- (Only) Slight Reforms to Education Tax Incentives
 - Discharged student loan debt at death or disability is no longer taxable
 - But it is if discharged purchased to IBR, PAYE, REPAYE
 - 529 college savings plans may now be used for private elementary or secondary school
 - But option for homeschooling expenses was eliminated
 - Repeal of Hope Scholarship & Lifetime Learning Credits, student loan interest deduction, *not included in final*
 - Nor consolidation of Coverdell education savings accounts

529A ABLE ACCOUNT REFORMS

- 529A (ABLE) Accounts For Disabled Beneficiaries
 - Rollovers from a 529 plan to a 529A plan now permitted
 - Must be the same beneficiary
 - Still subject to the overall ABLE contribution limit (annual gift tax exclusion amount)
 - Beneficiaries may make an additional annual contribution of their own earned income from employment
 - *Lesser* of 100% of compensation or Federal poverty line
 - *Cannot* also contribute to an employer retirement plan
 - Eligible for Saver's Credit

ALTERNATIVE MINIMUM TAX

- AMT Exemptions & Phaseout Increased

| | Old Law | | TCJA | |
|--------------------|-----------|-----------|-----------|-------------|
| | Single | Married | Single | Married |
| AMT Exemption | \$55,400 | \$86,200 | \$70,300 | \$109,400 |
| Phaseout Threshold | \$123,100 | \$164,100 | \$500,000 | \$1,000,000 |
| Phaseout Ends | \$344,700 | \$508,900 | \$781,200 | \$1,437,600 |

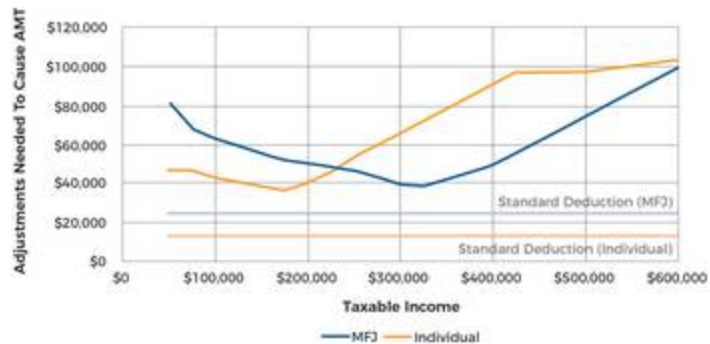
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ALTERNATIVE MINIMUM TAX

- AMT Exposure Is Drastically Limited Now!



- *Huge capital gains... or ISOs?*

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GIFT & ESTATE TAXES

- Unified Gift & Estate Tax Exemption is *doubled*
 - From \$5.6M in 2018 to \$11.2M instead
 - \$22.4M for married couples!
 - Portability remains
 - Repeal *not* included in final legislation!
 - Step-up in basis remains
 - 40% top rate remains
 - Annual gift tax exclusion remains

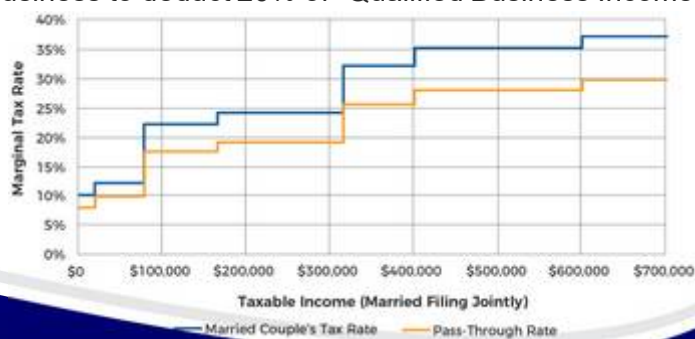
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DEDUCTION FOR PASS-THRU BUSINESS

- New Section 199A Deduction for “Pass-Thru” Business
 - Applies to any “non-C-corp” business
 - Partnership, LLC, S corporation, *and sole proprietor*
 - Allows business to deduct 20% of “Qualified Business Income”



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DEDUCTION FOR PASS-THRU BUSINESS

- New Section 199A Deduction for “Pass-Thru” Business
 - Deduction is 20% of QBI
 - But is claimed on the *personal* tax return
 - Below-the-line deduction, *not* itemized, but *after* AGI

The image shows a portion of Form 1040 (2016) Page 2, specifically the 'Tax and Credits' section. The form is annotated with arrows and text:

- A blue arrow points to line 38, labeled 'AGI from Page 1'.
- Two blue arrows point to lines 40 and 41, labeled 'Standard Or Itemized'.
- A green arrow points to line 42, labeled 'New QBI Deduction Here???'.
- A red circle highlights line 42, with a red line extending from the annotation to the line number.
- A blue circle highlights line 43, labeled 'Taxable income'.

| Line | Description | Amount |
|------|---|--------|
| 38 | Amount from line 37 (adjusted gross income) | |
| 39a | Check <input type="checkbox"/> You were born before January 2, 1952; <input type="checkbox"/> Spouse was born before January 2, 1952; <input type="checkbox"/> Blind; <input type="checkbox"/> Blind. Total boxes checked ▶ 39a | |
| 40 | Itemized deductions (from Schedule A) or your standard deduction (see left margin) | |
| 41 | Subtract line 40 from line 38 | |
| 42 | Exemptions: If the 20 is \$120,000 or less, multiply \$4,000 by the number on line 42. Otherwise, see instructions | |
| 43 | Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0- | |
| 44 | Tax (see instructions). Check if any from: a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972 c <input type="checkbox"/> | |

DEDUCTION FOR PASS-THRU BUSINESS

- Limitations On 199A “Pass-Thru” Business Deduction
 - Specified Service Business test
 - Wage or Qualified Property tests
 - Tests apply upon reaching the 32% tax bracket...
 - \$157,500 for individuals, \$315,000 for married couples
 - Phase-out of \$50,000 & \$100,000, respectively

DEDUCTION FOR PASS-THRU BUSINESS

- Limitations On 199A “Pass-Thru” Business Deduction
 - Specified Service Business test
 - Not *all* service businesses, just “specified” ones...

Any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees... IRC Section 1202(e)(3)

- Engineers & Architects explicitly excluded!
- Only applies if *taxable income* exceeds the threshold!

DEDUCTION FOR PASS-THRU BUSINESS

- Limitations On 199A “Pass-Thru” Business Deduction
 - Specified Service Business test
 - Andy is a 50% partner in an advisory firm with \$350,000 profits last year.
Andy’s QBI: \$175,000

| Qualified Business Income | \$175,000 |
|---------------------------|-----------------|
| Total Income | \$175,000 |
| Standard Deduction | \$12,000 |
| QBI Deduction | \$35,000 |
| Tentative Taxable Income | \$163,000 |
| Actual QBI Deduction | \$35,000 |

DEDUCTION FOR PASS-THRU BUSINESS

- Limitations On 199A “Pass-Thru” Business Deduction

- Specified Service Business test

- Charles is a financial advisor who earned \$275,000 last year as a sole proprietor, and his wife is a lawyer who earned \$170,000 as an employee...

| Qualified Business Income | \$275,000 |
|---------------------------|-----------|
| Total Income | \$445,000 |
| Standard Deduction | \$24,000 |
| QBI Deduction | \$55,000 |
| Tentative Taxable Income | \$421,000 |
| Actual QBI Deduction | \$0 |

DEDUCTION FOR PASS-THRU BUSINESS

- Limitations On 199A “Pass-Thru” Business Deduction

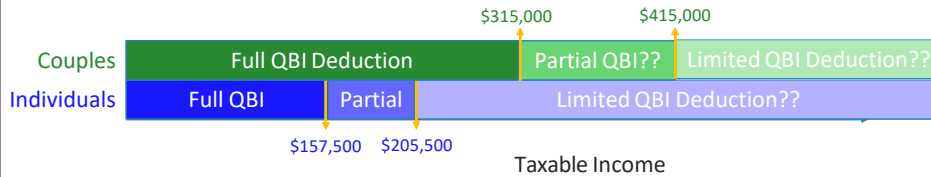
- Wage or Property Test – QBI deduction limited to:

- 50% of *total* wages (for the entire business)
 - Effectively requires at least 40% in staff overhead
- 25% of wages + 2.5% of the unadjusted basis of depreciable property
 - Useful for real estate and certain manufacturing businesses?

- Again, potential limit *only* applies to business owners whose income exceeds the phase-out thresholds

DEDUCTION FOR PASS-THRU BUSINESS

- Limitations On 199A “Pass-Thru” Business Deduction
 - QBI is *calculated* at the business level
 - But the tests apply at the *individual* level!



- QBI deduction still *unlimited* if not a *specified* service business, and able to clear the wage (or property) test!

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PLANNING IMPLICATIONS OF TCJA

- 199A “Pass-Thru” Business Deduction
 - Most pass-through businesses simply get a boon
 - In large service businesses, some partners may keep the QBI deduction while others do not
 - Converting to corporate taxation *may* be appealing
 - 21% + 23.8% not necessarily better than 37%?
 - Though C corp allows for deferral, & SALT deductions?
 - Service businesses may want to manage income
 - Employee-light businesses to switch ICs to employees?

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PLANNING IMPLICATIONS OF TCJA

- 199A “Pass-Thru” Business Deduction
 - Makes it appealing to “switch” from employee to independent contractor instead? (If below phaseout!)
 - Most IC “consultants” will be below income phaseouts?
 - But ½ of FICA taxes offsets QBI deduction anyway?
 - And IRS still has rules about IC classifications!

PLANNING IMPLICATIONS OF TCJA

- Itemized Deduction Planning
 - *Most* people will now claim the standard deduction!
 - Especially married couples
 - Estimated at 90%+ of all taxpayers
 - Large deductions that can still trigger itemizing
 - (Big) Medical expenses
 - Mortgage interest (up to \$750k of debt principal)
 - Charitable contributions

PLANNING IMPLICATIONS OF TCJA

- Itemized Deduction Planning
 - Deduction Lumping and Charitable Clumping
 - Focus itemized deductions into single years to clear
 - SALT deductions if below the \$10k cap
 - Medical expenses (if applicable)
 - Likely only relevant for singles, or stacking *on top* of mortgage?
 - Clump charitable contributions into a single year
 - Makes Donor-Advised Funds (DAFs) more appealing?

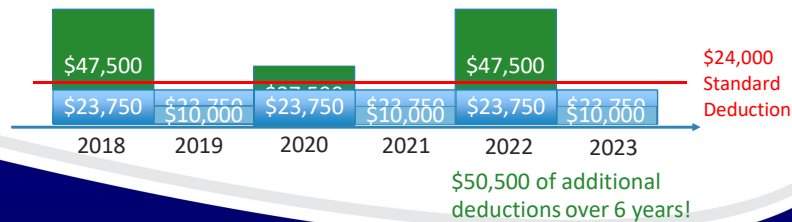
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PLANNING IMPLICATIONS OF TCJA

- Itemized Deduction Planning
 - Bradley and Angela earn \$180,000/year & live in Texas
 - Own a \$350,000 home with a 2.5% property tax (\$8,750)
 - Pay ~\$10,000/year in mortgage interest
 - Donate \$5,000/year to their various charities
 - 2-year property tax lumping & 4-year charitable clumping



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PLANNING IMPLICATIONS OF TCJA

- Itemized Deduction Planning
 - Re-evaluate where you bill advisory fees from!
 - IRAs can still pay *their own* fees pre-tax (Section 212 exp)
 - But *only* their own advisory fees!
 - And “*only*” for investment management!
 - Pro-rata billing from IRAs?
 - *Don't* bill Roth IRAs though!
 - Or package into a proprietary mutual fund or ETF?
 - Commissions subtracted from returns are implicitly pre-tax!

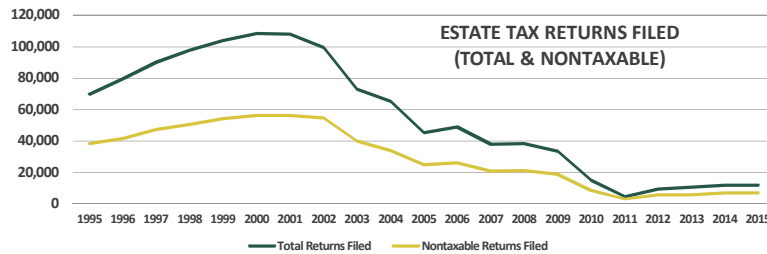
PLANNING IMPLICATIONS OF TCJA

- Other Planning Strategies
 - Qualified Charitable Distributions from IRAs look better
 - Especially for those who can't (fully) itemize the deduction!
 - No more AMT for most...
 - And some may release their MTC carryforwards?
 - Claim *whatever* you can for your business (Schedule C)
 - Pro-rata allocations of home office expenses?

PLANNING IMPLICATIONS OF TCJA

- Estate Planning Under TCJA

- Estate taxes really are “for the 1%” now

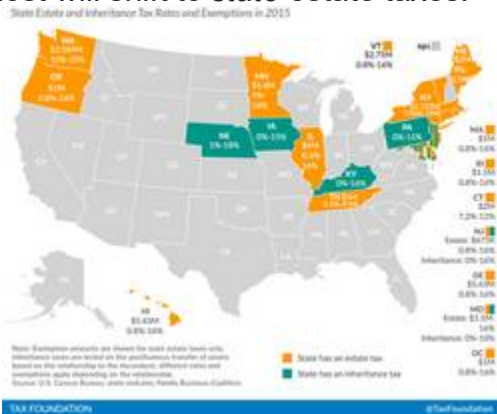


- HNW strategies remain relevant, but more likely than ever to be targeted more aggressively?
 - Watch out for FLPs, GRATs, etc.?

PLANNING IMPLICATIONS OF TCJA

- Estate Planning Under TCJA

- Primary focus for most will shift to *state* estate taxes!
- Will recouped states move in line to \$11.2M?
- More pressure to repeal or recouple for the rest?



Source: Tax Foundation

PLANNING IN 2018 (AND BEYOND)

- Ultimately, TCJA is only “temporary”
 - Individual tax law changes are scheduled to sunset after the year 2025
 - Only the individual mandate repeat & chained-CPI inflation indexing remain permanent
 - Republicans hope/expect the law will eventually be made permanent (as w/ most Bush tax cuts)
 - But lack of “permanence” leaves individual reform on the table after 2020 or 2024 elections...?

QUESTIONS?

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