

TAX PLANNING DEVELOPMENTS & OPPORTUNITIES UNDER TCJA

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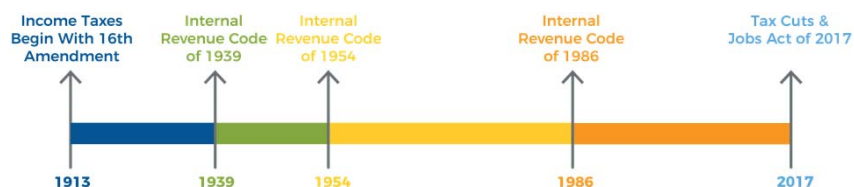
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THE EVOLUTION OF THE TAX CODE

- 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

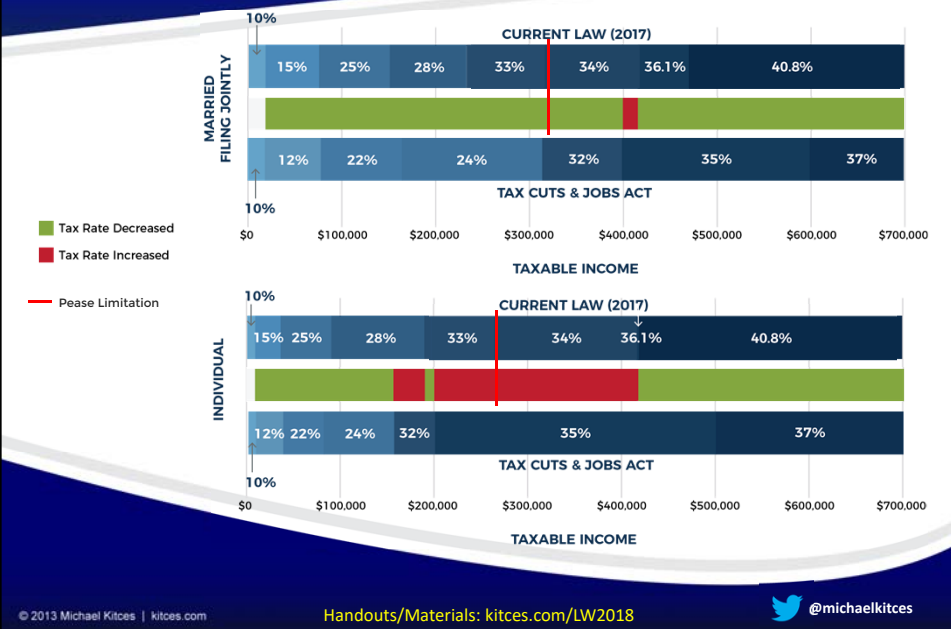
Individuals		Married Couples
Taxable Income	Tax Bracket	Taxable Income
Up to \$9,525	10%	Up to \$19,050
Over \$9,525 and up to \$38,700	12%	Over \$19,050 and up to \$77,400
Over \$38,700 and up to \$82,500	22%	Over \$77,400 and up to \$165,000
Over \$82,500 and up to \$157,500	24%	Over \$165,000 and 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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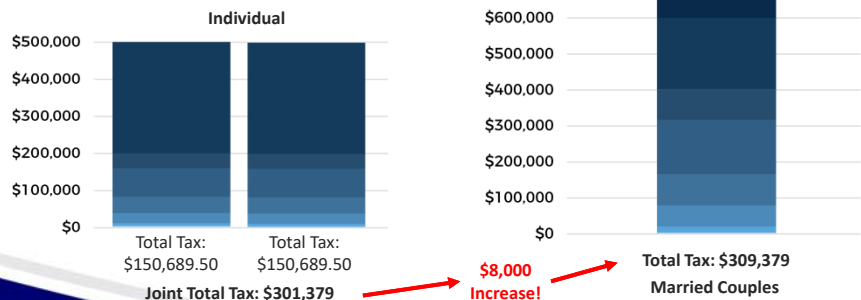
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FINAL TCJA TAX BRACKETS



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 above \$2,100...

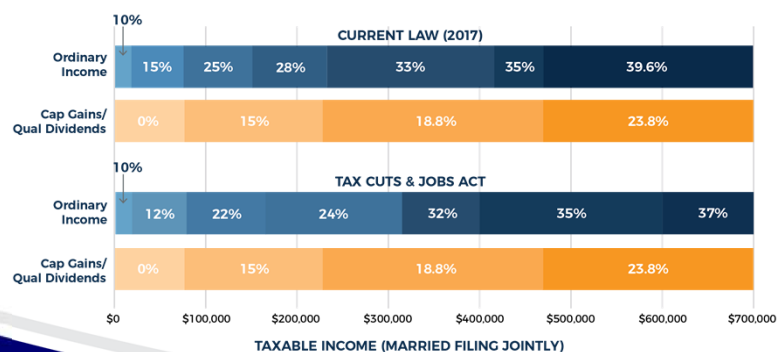
- Limited impact for high-income families?

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%

CAPITAL GAINS TAX BRACKETS

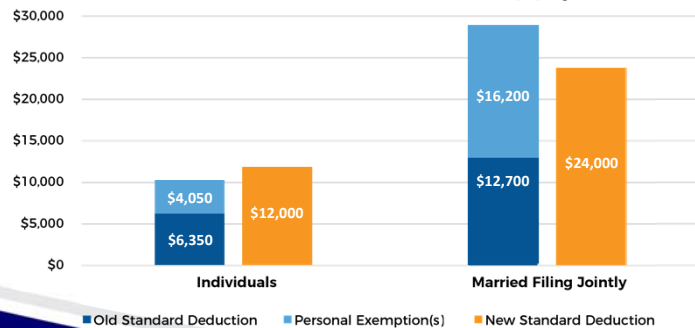
- Capital Gains/Qualified Dividend Brackets Remain

- But are still anchored to the "old" tax brackets!



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!

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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	

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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*

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
 - **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
 - 529 college savings plans may now be used for private elementary or secondary school
 - But option for homeschooling expenses was eliminated
 - 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)

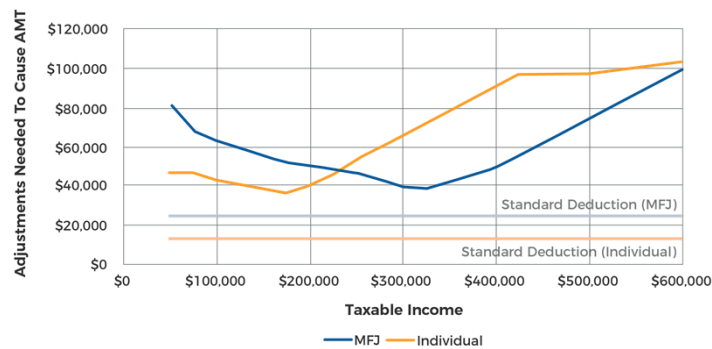
ALTERNATIVE MINIMUM TAX

- 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

ALTERNATIVE MINIMUM TAX

- AMT Exposure Is Drastically Limited Now!



- Huge capital gains... or ISOs?

GIFT & ESTATE TAXES

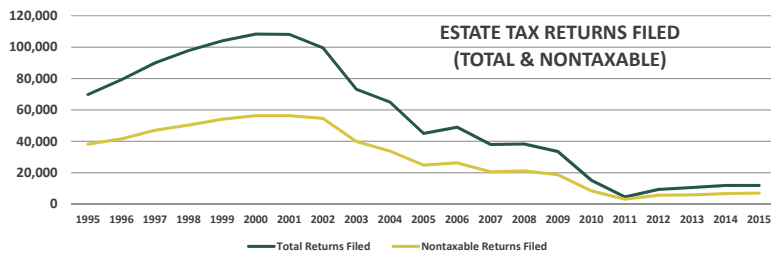
- Unified Gift & Estate Tax Exemption is *doubled*
 - From \$5.6M in 2018 to \$11.2M instead
 - \$22.4M for married couples!
 - Portability remains
 - Repeal *not* included in final legislation!
 - Step-up in basis remains
 - 40% top rate remains
 - Annual gift tax exclusion remains

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PLANNING IMPLICATIONS OF TCJA

- Estate Planning Under TCJA
 - Estate taxes really *are* “for the 1%” now
- 
- | Year | Total Returns Filed | Nontaxable Returns Filed |
|------|---------------------|--------------------------|
| 1995 | 70,000 | 40,000 |
| 1996 | 80,000 | 45,000 |
| 1997 | 90,000 | 50,000 |
| 1998 | 100,000 | 55,000 |
| 1999 | 105,000 | 55,000 |
| 2000 | 110,000 | 55,000 |
| 2001 | 110,000 | 55,000 |
| 2002 | 100,000 | 55,000 |
| 2003 | 80,000 | 45,000 |
| 2004 | 65,000 | 35,000 |
| 2005 | 45,000 | 25,000 |
| 2006 | 50,000 | 25,000 |
| 2007 | 40,000 | 20,000 |
| 2008 | 35,000 | 20,000 |
| 2009 | 30,000 | 15,000 |
| 2010 | 15,000 | 10,000 |
| 2011 | 10,000 | 5,000 |
| 2012 | 10,000 | 5,000 |
| 2013 | 10,000 | 5,000 |
| 2014 | 10,000 | 5,000 |
| 2015 | 10,000 | 5,000 |
- HNW strategies remain relevant, but more likely than ever to be targeted more aggressively?
 - Watch out for FLPs, GRATs, etc.?

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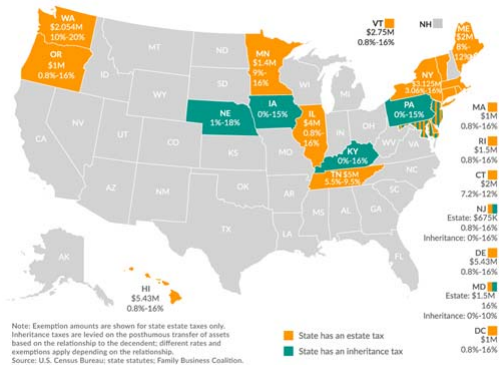
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PLANNING IMPLICATIONS OF TCJA

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

State Estate and Inheritance Tax Rates and Exemptions in 2015



TAX FOUNDATION

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Source: Tax Foundation

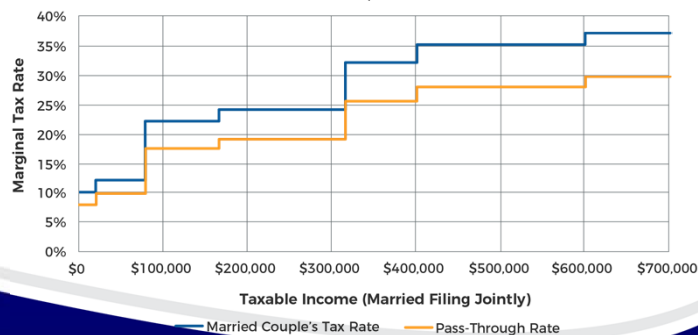
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DEDUCTION FOR PASS-THRU BUSINESS

- 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 cannot exceed 20% of taxable income!
 - But is claimed on the *personal* tax return
 - Below-the-line deduction, *not* itemized, but *after* AGI

The screenshot shows Form 1040 (2018) Page 2. Key lines are highlighted with arrows and text:

- Line 38:** Amount from line 37 (adjusted gross income). An arrow points to this line with the text "AGI from Page 1".
- Line 40:** Itemized deductions (from Schedule A) or your standard deduction (see left margin). An arrow points to this line with the text "Standard Or Itemized".
- Line 41:** Subtract line 40 from line 38.
- Line 42:** Taxable income. A red circle is drawn around this line with the text "New QBI Deduction Here???" pointing to it.
- Line 43:** Tax (see instructions). Check if any from: a ☐ Form(s) 9814 b ☐ Form 4972 c ☐

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 \$300,000 profits last year.
Andy’s QBI: \$150,000
 - Other portfolio income: \$17,000

Qualified Business Income	\$150,000
Total Income	\$167,000
Standard Deduction	\$12,000
QBI Deduction	\$30,000
Tentative Taxable Income	\$155,000
Actual QBI Deduction	\$30,000

DEDUCTION FOR PASS-THRU BUSINESS

- Limitations On 199A “Pass-Thru” Business Deduction
 - Specified Service Business test + 20%-of-income limit
 - Andy is a 50% partner in an advisory firm with \$300,000 profits last year.
Andy’s QBI: \$150,000
 - Other portfolio income: None

Qualified Business Income	\$150,000
Total Income	\$150,000
Standard Deduction	\$12,000
QBI Deduction	\$30,000
Tentative Taxable Income	\$138,000
Actual QBI Deduction	\$27,600

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

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?

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?

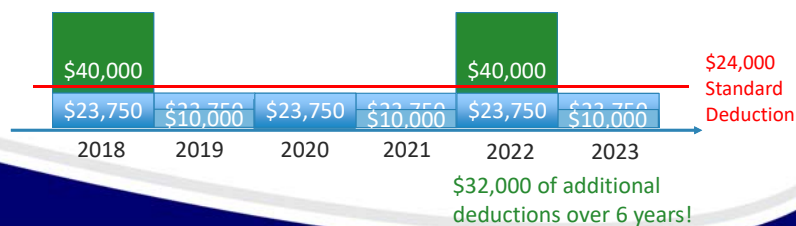
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PLANNING IMPLICATIONS OF TCJA

- 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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MARGINAL TAX RATES: MOVING TARGET

- Tax rates exposed to numerous factors
 - Tax brackets
 - Phaseout of exemptions & deductions
 - Long-term capital gains & qualified dividends
 - AMT tax rates
 - AMT exemption phaseout
 - 3.8% Medicare tax
 - Income-related Medicare adjustments to Part B & Part D
 - Taxability of Social Security benefits

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MARGINAL TAX RATES: MOVING TARGET

Determining The Marginal Tax Rate For Various Types Of Income In 2018

Individual income above...	Couple's income above...	Income "type"	Ordinary Income	L/T gains & qual. dividends	Pass-Thru Business Deduction	Wage earned income	Self-employed earned income	Net inv. income	AMT rate	AMT exemption phaseout
\$0	\$0	Taxable	10%	0%	-2%					
\$9,525	\$19,050	Taxable	12%		-2.4%	7.65%	15.30%			
\$38,600	\$77,200	Taxable								
\$38,700	\$77,400	Taxable	22%		-4.4%					
N/A	\$128,400	Earned				7.65% / 1.45%	15.3% / 2.9%	0%	26%	
\$82,500	\$165,000	Taxable	24%		-4.8%					
\$128,400	N/A	Earned								
\$157,500	N/A	Taxable				1.45%	2.90%			
\$191,500	\$191,500	AMTI	32% / 24%	15%	Up to 29% / -4.8%					0%
\$200,000	\$250,000	Earned								
\$200,000	\$250,000	AGI								
\$200,000	N/A	Taxable	35% / 24%							
\$207,500	N/A	Taxable	35% / 32%		0% / Up to 29%					
N/A	\$315,000	Taxable								
N/A	\$400,000	Taxable								
N/A	\$415,000	Taxable	35%			2.35%	3.80%	3.80%	28%	
\$425,800	\$479,000	Taxable								
\$500,000	N/A	AMTI		20%	0%					7% / 0%
\$500,000	\$600,000	Taxable								0%
\$781,200	N/A	AMTI	37.0%							0% / 7%
N/A	\$1,000,000	AMTI								
N/A	\$1,437,600	AMTI								

Income thresholds based on estimated 2018 inflation adjustments (where applicable).
Where two rates are shown, the first applies to individuals, the second to married couple:

© 2018 Chart originally created by Michael Kitces for the November/December 2012 issue of The Kitces Report.

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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 repeal & 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...?

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