2018 TAX REFORM

OVERVIEW OF THE NEW TAX LEGISLATION

JANUARY 2018

On **Wednesday, December 20, 2017**, both chambers of Congress passed the new tax reform bill, labeled by many as the "greatest" overhaul of the tax code in modern U.S. history. Depending on which news station you watch probably depends on your immediate reaction to the changes that come along with the tax reform efforts passed by Congress. So, what does the new tax reform really mean? Whether you agree with the new legislation or not we must be prepared to do what we always do; protect the interest of our clients who entrust us with their retirement, family, and legacy.

The tables and considerations found below and on subsequent pages will highlight key areas advisors need to be prepared to address with their clients.

SIDE-BY-SIDE COMPARISON

INDIVIDUAL TAXES

Provisions	Current Law			New Tax Reform		
	%	Single	Married / Joint	%	Single	Married / Joint
Income Tax Rates	10	$0-9,525	$0-18,650	10	$0-9,525	$0-19,050
	15	$9,525-38,700	$18,650-75,900	12	$9,525-38,700	$19,050-77,400
	25	$38,700-93,700	$75,900-153,100	22	$38,700-82,500	$77,400-165,000
	28	$93,700-195,450	$153,100-233,350	24	$82,500-157,500	$165,000-315,000
	33	$195,450-424,950	$233,350-416,700	32	$157,500-200,000	$315,000-400,000
	35	$424,950-426,700	$416,700-470,700	35	$200,000-500,000	$400,000-600,000
	39.6	over $426,700	over $470,700	37	over $500,000	over $600,000

Indicates change

INDIVIDUAL TAXES KEY PROVISIONS

Provisions	Current Law	New Tax Reform
Capital Gains	0%, 15%, 20%	no change
AMT	On income over certain thresholds ($54,300 single, $84,500 joint	Retained with increased exemptions ($70,300 single, $109,400 joint) and phase-outs ($500,000 single, $1,000,000 joint
Business Income from Pass-through entities	Taxed at the individual income tax rate	20% deduction for individuals, trusts and estates on domestic "qualified business income" from pass-through entities, subject to various restrictions.
Standard Deductions	$6,350 (single), $12,700 (joint)	$12,000 (single), $24,000 (joint)
Personal Exemptions	$4,050	$0
SALT Deduction	Allowed	Allowed for individual state and local taxes up to $10,000, but no 2017 deductions allowed for prepayment or 2018 state and local taxes
Mortgage Interest	Permitted on mortgages up to $1,000,000 first and/or second home and for interest on home equity lines up to $100,000	Allowed on total mortgages of up to $750,000 first and/or second home purchased under contracts dated after December 14, 2017. **No** deduction for interest on home equity lines, **whether new or existing**

The information provided herein is general in nature and should not be construed as legal or tax advice, as such opinions can be rendered only when related to specific situations.

Gains on the sale of Primary Residence	Exclusions allowed for gain of up to $250,000 (single), $500,000 (joint) if used as primary residence for 2 of last 5 years.	no change
Charitable Contributions	Cash contribution limit is 50% of adjusted gross income **(AGI)**	Increase AGI limit to 60%
Individual Mandate	Individuals must have health insurance coverage. If they don't they will incur a penalty	Eliminates the mandate for coverage and discontinues the penalty effective 2019

Indicates change

TRANSFER TAXES

Provisions	Current Law	New Tax Reform
Rates	40% top rate (flat for GST tax)	no change
Gift / Estate & GST Tax Exemptions	$5,000,000 basic exclusion amount ($5.49M in 2017, $5.6M in 2018) for the unified gift/estate and GST tax exemptions	Doubled the basic exclusion amount from $5M to $10M starting in 2018 ($11.2M w/ adjusted inflation) Expires 2026 and reverts to $5M adjusted for inflation from 2010 to 2026
Basis Step Up @ Death	YES	no change

Indicates change

CORPORATE TAXES

Provisions	Current Law	New Tax Reform
C Corp Rate	35% max rate (flat for personal service corporations PSCs)	**21% flat rate** (including for PSCs) effective in 2018 and **NOT** set to expire
Corporate AMT	Applied to C Corporations	**REPEALED** and **NOT** set to expire

Indicates change

CONSIDERATIONS

INDIVIDUAL TAXES AND INDIVIDUAL KEY PROVISIONS

- The new law retains seven tax brackets but reduces the lowest bracket while increasing the bracket thresholds.
- The top tier bracket will see a 2.6% decrease moving from 39.6% down to 37% for high-income earners, both single and married/joint filers.
- High-income earners will still be subject to AMT but see higher exemptions and phase-out amounts.
- The standard deduction is doubled under the new law, both single and joint, which on the surface is perceived as a positive however, when you consider the new law eliminates or significantly limits itemized deductions making the increased standard deduction not as impactful or favorable, to higher income earners, as it may appear. *Notable current deductions now eliminated or limited include:*

- SALT: The new Act caps the aggregate limit of SALT deductions at $10,000. This includes property taxes and state income or sales taxes. The impact of this provision is significant to individual filers living in high property tax areas of the country.
- Interest deductions for mortgages are now capped at $750,000 vs $1,000,000 today for both first or second homes under contract after December 14, 2017, unless closed on April 1, 2018, or before in which the transaction would be grandfathered under the current $1,000,000 cap.
- The Act eliminates completely, the deduction for interest on home equity lines of credit without any grandfathering and regardless of when the line of credit was established.
- The medical expense deduction is now moved to 7.5% vs. 10% under current law eliminating the minimum tax preference beginning after December 31, 2016, and ending before January 1, 2019.
- Charitable contribution AGI increase is moved from 50% up to 60% under the Act.
- Other impacted itemized deductions worth noting:
  - Misc. itemized deductions, moving expense deduction *except for Armed Forces members, and above-the-line deductions for alimony, divorce, or separation agreements modified on or after January 1, 2019 will see affect under the new law.

TRANSFER TAXES

- As shown above, the gift / estate and GST the thresholds for annual inflation adjustment and basic exclusion amounts are doubled under the new Act moving from $5,000,000 to $10,000,000 in 2018 with the inflation year base being 2010. *<u>This is set temporary and set to expire under the new Act in 2026.</u>*
- The Act does slow the inflation adjustments by a few tenths of a percent.
- Transfer tax rates remain the same (40% top rate for gift and estate taxes and a flat 40% for the GST).
- Under the new Act, estates continue to receive a step-up in basis in income tax to the fair market value upon decedent's passing.

CORPORATE TAXES

Pass Through Businesses:

- The Act allows a 20% deduction for "qualified business income" from a non-excluded trade or business conducted by a sole proprietorship or pass-through entity (partnership, LLC, or S corporation). The deduction will be limited on the amount of W-2 wages paid and depreciable assets owned by the business. If all income is eligible for the 20% deduction, an effective top tax rate of 29.6% would apply to the qualified business income, whether received by an active or passive partner. It's important to note that many taxpayers will not be eligible for the full 20% deduction, resulting in a top tax rate of greater than 29.6%.
  - This deduction is generally not allowed for specified businesses, defined as health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services.
  - The 20% deduction would be available to an owner of a personal services business whose entire taxable income is less than $157,500 (single) $315,000 (married, joint) but is phased out completely once the taxable income exceeds $207,500 (single) $415,000 (married joint).
- Several types of income are not eligible for the 20% deduction. Samples include:
  - reasonable compensation paid to a subchapter S shareholder of the business
  - guaranteed payments to a partner in the business
  - income from a business outside of the U.S. or Puerto Rico

  - net long-term capital gains
  - dividends (except REIT dividends)
  - interest from investment gains from trading commodities, foreign currency transactions, or notional principal contracts
  - amounts received from an annuity.
- Wage/Asset Limitations are being limited to the greater of: 50% of W-2 wages paid by the business, or 25% of W-2 wages plus 2.5% of the unadjusted basis of tangible depreciable assets ("TD assets") placed in service within the depreciable period for such assets, or, if greater, 10 years.
- Trusts & Estates. Trusts and estates who are owners in pass-through businesses may take advantage of the 20% deduction.

Executive Compensation and Retirement Plans

- The Act repeals the exceptions for commissions and performance-based compensation from the $1 million yearly limit on the deduction for compensation with respect to a covered employee* of a publicly traded corporation.

  **covered employee includes the CEO, CFO, and the three highest paid employees of the corporation.*
- The ability to recharacterize a traditional IRA conversion to a Roth IRA goes away after 2017.

THE IMPACT AND OPPORTUNITIES

ESTATE AND GIFT TAX IMPACT AND OPPORTUNITIES

- The federal estate tax increase will further limit the percentage of taxpayers, now significantly less than the top 1%.
  - While the increased estate tax threshold may be lead many to believe there need to create a formal legacy plan is no longer important, the reality is that legacy planning is important regardless of the estate tax minimum for most families. It's important to also note that there is nothing permanent about the increased thresholds. The new reform has the increased thresholds set to expire in 2026, and additionally, they are subject to change at least once between now and then under different administrations in Washington.
  - Planning is paramount. Successful legacy transfers require discipline and a long-term approach that adequately preserves insurability while hedging against life's unexpected. Advisors should not be discouraged by the new thresholds since, after all, clients that choose to wait will carry significant risk of exposure regardless of if the thresholds revert back or not.
  - The federal estate tax exemption increase does nothing for those who reside in decoupled states with lower estate tax exemptions or inheritance taxes. The importance of knowing the potential implications at the state level is critical as many clients will still face state tax exposure.
  - For those states that currently tie to the federal amount, it's possible, and likely, you will see many reconsider their provisions due to lost revenue from other implications of the new tax reform.
    - States with separate, state specific estate exemption levels as of January 1, 2018: Connecticut, D.C., Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, and Washington.
    - States with a current inheritance tax: Kentucky, Maryland, Nebraska, New Jersey, and Pennsylvania.

- It goes without saying that taxes alone have never been the only driver in legacy planning, after all legacy planning still addresses many items such as,
    - Unified wealth management for HNW families,
    - creditor protection,
    - control of assets to younger beneficiaries,
    - business succession and estate equalization, and
    - transfer across multiple generations
- **IMMEDIATE Opportunity:** Clients who are still affected by the federal estate tax can use the **increased gift and GST exemptions to implement accelerated lifetime planning over the next few years,** particularly dynasty trust, business succession planning (for clients with concentrated positions in closely-held businesses), and large gifts to fund life insurance.
- Since basis-step up is still available for assets held by a decedent, basis planning will remain critical.

The bottom line is that even with the new reform, life insurance is still one of the most beneficial tools available to accomplish many legacy planning objectives like;

- Personal cash value life insurance providing cash accumulation and retirement savings during life, and earnings replacement and family security in the event of an untimely death.
- Life insurance, especially trust-owned, is still the only tool that can; minimize family conflict, equalize an estate between heirs when a family business is involved, and provide long-term wealth and tax advantageous wealth transfer across generations.
- Life insurance during the insured's life and the death benefit upon the insured's passing is still not be subject to income or capital gains tax under the new reform.
- Policy owners are still able to access cash value within permanent life insurance policies, up to basis, without incurring income tax, assuming the policy is not a MEC.

INCOME TAX IMPACT AND OPPORTUNITIES

- Under the new tax reform, many individuals will no longer itemize deductions. **This will cause significant impact to the revenue of accounting and tax preparation professionals** requiring these individuals to seek out new ways to replace lost revenue and continue delivering value to their clients. We should be working with these professionals to educate them on our products and help them diversify their service offering to their clients.
- Although the new tax reform is touted as lower taxes for everyone, many Americans who own real property in high income and/or property tax states, may not see tax reductions, since new deduction limits have been imposed under the new reform. Those affected by these new limits will likely be interested in life insurance for asset allocation or deferred compensation purposes, since the tax treatment of life insurance remains unchanged.

CORPORATE TAX IMPACT AND OPPORTUNITIES

- High-income service professionals structured as pass-through entities (i.e. lawyers, doctors, accountants) may not see much benefit from the new deduction on pass-through entities. Therefore, life insurance should continue appealing to these professionals for both deferred compensation and retirement planning.

CLOSING COMMENTS

There is no question that the tax reform legislation will have significant, positive and negative, impact on individuals and businesses at all income levels for the foreseeable future. As with any legislation, it will take time before we fully understand the complete impact of this reform and analyze and quantify the impact on any single individual or entity. Over the upcoming weeks we encourage advisors to proactively speak with their clients about the tax reform, review the material changes with them, and work with them to outline and help them understand the impact this reform will have on them individually. For more information or specific questions regarding this overview on the new tax reform contact your local AIMCOR Group BGA. Our advanced planning teams are ready to assist.

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SOURCES

Act §11061, Act §§11061, 11002. Applicable sections of §11061, Act §11001, Act §12003, Act §11021, Act §11041, Act §11042, Act §11043, Act §11045, Act §11027, Act § 11051, Act §11027, Act §11023, Act §11011, Act §13520, Act §13521, Act §13522, Act §13601, Act §13611.

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