How to Benefit Financially from Tax Law Changes

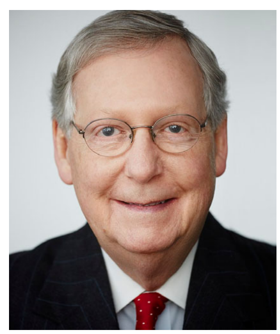
H.R. 1

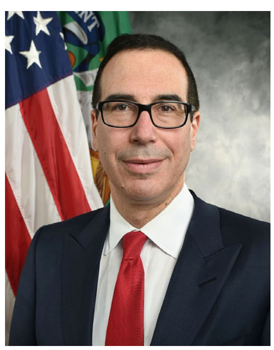
Plus oral commentary on the Senate summary

Robert S. Keebler, CPA/PFS, MST, AEP

The Big Six








Notable Changes

- Significantly **lower rates** for most individuals
- Repeals the **AMT**
- Nearly doubles the **standard deduction**
- Eliminates **personal exemptions**
- Reduces the **mortgage interest deduction** for acquisition indebtedness from $1,000,000 to $500,000 (existing debt is grandfathered)
- **SALT** deduction eliminated, except up to $10,000 for property taxes
- Additional credits for **families**
- Combines **education** tax benefits

Notable Changes

- **Estate & GST tax**
  - Doubles the exemption for 2018
  - Estate and GST tax repealed in six years (2024)
- **Business**
  - Lowers the corporate rate to 20%
  - Lowers the tax on certain pass-through business income to 25%
  - Increased expensing
  - Business interest deduction limited
  - NOL deduction modified
  - Like-kind exchanges limited to real property
  - Certain contributions of capital to corporations may be taxable
  - Technical termination of partnerships is eliminated

INDIVIDUAL INCOME TAXATION

Individual Income Tax Rates

2017

CURRENT TOP OF EACH BRACKET

	S	MFJ/QW	MFS	HOH	T&E
10.0%	$ 9,325	$ 18,650	$ 9,325	$ 13,350	
15.0%	$ 37,950	$ 75,900	$ 37,950	$ 50,800	$ 2,550
25.0%	$ 91,900	$ 153,100	$ 76,550	$ 131,200	$ 6,000
28.0%	$ 191,650	$ 233,350	$ 116,675	$ 212,500	$ 9,150
33.0%	$ 416,700	$ 416,700	$ 208,350	$ 416,700	$ 12,500
35.0%	$ 418,400	$ 470,700	$ 235,350	$ 444,500	
39.6%					

CAPITAL GAINS	0%	15%	20%

Individual Income Tax Rates

2018

PROPOSED TOP OF EACH ORDINARY INCOME BRACKET

	S	MFJ/QW	MFS	HOH	T&E
12.0%	$ 45,000	$ 90,000	$ 45,000	$ 67,500	$ 2,550
25.0%	$ 200,000	$ 260,000	$ 130,000	$ 200,000	$ 9,150
35.0%	$ 500,000	$ 1,000,000	$ 500,000	$ 500,000	$ 12,500
39.6%					

*Benefit of the 12% bracket phased-out after $1,200,000 (joint) or $1,000,000 (all others); (Does not apply to estates and trusts)

PROPOSED TOP OF EACH CAPITAL GAINS BRACKET

	S	MFJ/QW	MFS	HOH	T&E
0.0%	$ 45,000	$ 77,200	$ 38,600	$ 51,700	$ 2,600
15.0%	$ 425,800	$ 479,000	$ 239,500	$ 452,400	$ 12,700
20.0%					

Standard Deduction

2017

CURRENT STANDARD DEDUCTION

S	MFJ/QW	MFS	HOH
$ 6,350	$ 12,700	$ 6,350	$ 9,350

2018

CURRENT STANDARD DEDUCTION

S	MFJ/QW	MFS	HOH
$ 12,200	$ 24,400	$ 12,200	$ 18,300

Exemptions

- Personal exemptions completely repealed at the end of 2017
  - Consolidated into the standard deduction
  - Expanded child tax credit and a new family tax credit designed to offset the loss for families

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Child and Family Tax Credits

- Credits after 2017
  - Child tax credit increased from $1,000 to $1,600
    [Note: 15% x $4,050 = $607.5]
  - Additional $300 credit for non-child dependents
  - New family flexibility credit - $300 credit for those who are neither children or non-children dependents
  - $300 credits phase-out in 2022
- Phase-out increased after 2017
  - Phase-out to increase from $110,000 to $230,000 for joint filers ($75,000 to $115,000 for single) [Note: 25% x $4,050 = $1,012]
- Refundability after 2017
  - The refundable portion to increase from $1,000 to $1,600
  - Neither $300 credit is refundable

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Education Provisions

- Deductions and exclusions repealed after 2017
  - Student loan interest deduction
  - Tuition and fee deduction
  - Exclusion of interest on Series EE and Series I U.S. Savings Bonds issued after 1989
  - Qualified tuition reduction (for employees, spouses and dependents of employees of education institutions)
  - Employer-provided education assistance
- Coverdell Education Savings Accounts (ESAs)
  - Contributions to ESAs would be prohibited after 2017
  - Taxpayers may roll over ESAs tax-free to Section 529 plans
- Section 529 Plans
  - Distributions of up to $10,000 may be used for "qualified expenses" for elementary school and high school
  - "Qualified expenses" would be expanded to include expenses associated with apprenticeship programs
  - Unborn children (in utero) may be named as designated beneficiaries

Education Provisions

- Credits
  - Hope Scholarship Credit (HSC) – Repealed after 2017
  - Lifetime Learning Credit (LLC) – Repealed after 2017
  - American Opportunity Tax Credit (AOTC)
    - Most provisions of the current AOTC kept intact
      - 100% credit for first $2,000 of "qualified higher education expenses"
      - 25% credit for next $2,000 of "qualified higher education expenses"
      - $1,000 of the credit is refundable
      - Phases out once AGI is above $160,000 for married taxpayers and above $80,000 for other taxpayers
      - Available for first four years of post-secondary education in a degree or certificate program
      - Covers tuition, fees and course materials
    - Expanded in 2018
      - Now includes fifth year of post-secondary education
      - Credit in fifth year is half of the AOTC for the first four years (i.e. $1,250 maximum credit)
      - $500 of credit is refundable
- Student loan forgiveness
  - Starting in 2018, forgiveness of student loan debt will not be taxable income to the student on account of the student's death or total disability

Simplification of Deductions

- Deductions <u>repealed</u> after 2017
  - State and local income taxes (not paid in a trade or business)
  - State and local sales taxes
  - Personal casualty losses (except for special disaster relief)
  - Medical expenses
  - Tax preparation fees
  - Unreimbursed employee expenses
  - Alimony paid (income not included by payee; effective for agreements executed after 2017)
  - Moving expenses
  - MSA contributions (HSAs to remain)

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Simplification of Deductions

- Deductions modified
  - State and local property taxes <u>limited to $10,000</u> after 2017
  - The mortgage interest deduction limited to interest on up to <u>$500,000 of acquisition indebtedness</u> after 2017
  - Charitable contribution AGI limitation <u>increased to 60% from 50%</u> after 2017
  - Wagering losses and expenses limited to wagering winnings after 2017
- The 3% "Pease limitation" is also eliminated

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Exclusions to Income

- Exclusions for a variety of employment benefits repealed or limited after 2017:
  - Employer provided housing
  - Employee achievement awards
  - Dependent care assistance programs
  - Qualified moving expense reimbursement
  - Adoption assistance programs

Exclusions to Income

- **Exclusion on gain from sale of a personal residence after 2017**
  - Currently, a taxpayer merely needs to live in a home for two out of the previous five years. <u>The proposal increases this limit to five out of the eight previous years.</u>
  - Currently, a taxpayer can generally claim the exclusion once every two years. T<u>he proposal increases this limit to five years.</u>
  - Currently, high-income taxpayers can benefit from the exclusion. <u>The proposal phases out the exclusion as AGI exceeds $500,000 (MFJ).</u>

Retirement Plans

- Repeal of the Roth IRA recharacterization rules after 2017
- Reduction of minimum age for in-service distributions after 2017
- Modification of hardship distributions after 2017
- Extended rollover period for plan loan offset amounts after 2017
  - Currently plan loans must be repaid within 60-days of separating from the employer
  - The proposal moves the deadline to the due date of the employee's income tax return
- Modification of non-discrimination rules to protect older, longer service participants after 2017

AMT Repeal

- Beginning with the 2018 tax year, the Alternative Minimum Tax (AMT) provisions of IRC Sections 55 through 59 will no longer apply
- Despite the AMT being repealed as of 2018, the bill does allow for any unused AMT credit carryforward to be claimed as either a "non-refundable credit" or a "refundable credit" in future tax years
  - 50% of the unused AMT credit (as of the beginning of 2019) may be used as a "refundable credit" in 2019
  - 50% of the remaining unused AMT credit (after taking into consideration the AMT credit used in 2019) may be used as a "refundable credit" in 2020
  - 50% of the remaining unused AMT credit (after taking into consideration the AMT credit used in 2019 and 2020) may be used as a "refundable credit" in 2021
  - 100% of the remaining unused AMT credit after taking into consideration the AMT credit used in 2019, 2020 and 2021) may be used as a "refundable credit" in 2022

AMT Repeal

AMT Refundable Credit Example

- Assumptions
  - Regular tax
    - 2018 - $30,000
    - 2019 - $30,000
    - 2020 - $30,000
    - 2021 - $30,000
    - 2022 - $30,000
  - Non-refundable credits (e.g. foreign tax credit, child tax credit, AOTC)
    - 2018 - $5,000
    - 2019 - $5,000
    - 2020 - $5,000
    - 2021 - $5,000
    - 2022 - $5,000
  - AMT credit carryover (as of end of 2017) - $500,000

AMT Repeal

AMT Refundable Credit Example (cont)

- AMT credit used and carryover
  - 2018
    - Non-refundable portion - $25,000 ($30,000 - $5,000)
    - Refundable portion - $0
    - Carryover to 2019 - $475,000 ($500,000 - $25,000)
  - 2019
    - Non-refundable portion - $25,000 ($30,000 - $5,000)
    - Refundable portion - $225,000 ({$475,000 - $25,000} x 50%)
    - Carryover to 2020 - $225,000 ($475,000 - $250,000)
  - 2020
    - Non-refundable portion - $25,000 ($30,000 - $5,000)
    - Refundable portion - $100,000 ({$225,000 - $25,000} x 50%)
    - Carryover to 2021 - $100,000 ($225,000 - $125,000)
  - 2021
    - Non-refundable portion - $25,000 ($30,000 - $5,000)
    - Refundable portion - $37,500 ({$100,000 - $25,000} x 50%)
    - Carryover to 2022 - $37,500 ($100,000 - $62,500)
  - 2022
    - Non-refundable portion - $25,000 ($30,000 - $5,000)
    - Refundable portion - $12,500 ({$37,500 - $25,000} x 100%)
    - Carryover to 2023 - $0

Energy Credits

- The residential energy-efficient property tax credit would be modified
  - The current credit would be extended through 2022
    - Subject to a reduced rate of 26% for property placed in service during 2020
    - Subject to a reduced rate of 21% for property placed in service during 2021

Other Tax Credits to be Repealed at the end of 2017

- Disability retirement credit
- Adoption credit
- Mortgage interest credit
- Electric vehicle credit

Basic Planning

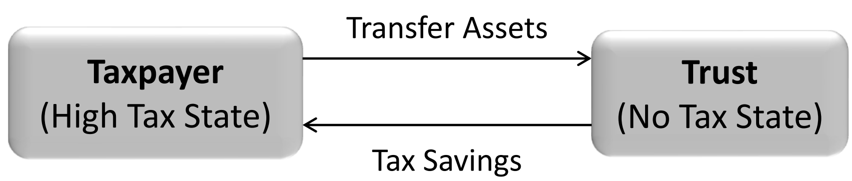
- Accelerate losses
- Defer gains
- Choice of fiscal year for estates & trusts
- Timing of bequest funding
- Timing of sale of securities (and other capital assets)

Basic Planning

- Carefully consider traditional or Roth retirement account contributions
- Time business expenses
- Accelerate itemized deductions

NINGs, SINGs and DINGs

- Without a state and local income tax deduction, forming an incomplete nongrantor (ING) trust to save state income taxes is even more viable



NINGs, SINGs and DINGs

- Strategy:
  - The trust must be created in a state that does not tax trust income
  - The income from the trust must not be taxable by the grantor's home state
  - The trust must allow discretionary distributions to the settlor without making the trust a grantor trust
  - Transfers to the trust must be incomplete gifts for federal gift tax purposes without making the trust a grantor trust
    - However, the permanent increase in the applicable exclusion amount and emergence of DAPTs may allow for completed gifts

NINGs, SINGs and DINGs

Overview

- PLR 201310002 confirmed that a gift to a Nevada Incomplete Non-Grantor (NING) trust met all the requirements listed above for creating a trust that avoids state income tax.

		Current	No SALT Deduction	W/ING
Income		$ 100	$ 100	$ 100
State Tax	5%	(5)	(5)	
Federal Tax	35%	(33)	(35)	(35)
		$ 62	$ 60	$ 65

ESTATE & GST TAX

Estate & GST Taxes

- Immediate changes
  - Double the Basic Exclusion Amount and GST exemption in 2018 ($10,000,000 in 2011 dollars)
  - Decrease the gift tax rate to 35% beginning in 2024
  - Retain the current gift tax exclusion ($10,000,000 in 2011 dollars)
  - Retain the annual exclusion ($14,000 in 2017 dollars)
  - No portability beginning in 2024

- The proposal repeals the estate and GST tax in 2024 (and beyond) while maintaining the basis step-up under IRC § 1014

Estate & GST Taxes

Six Years to Repeal

- The "Byrd Rule" allows Senators during the reconciliation process to block legislation if it possibly would <u>increase significantly the federal deficit beyond a ten-year term</u> or is otherwise an "extraneous matter" as set forth in the Budget Act.

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Estate & GST Taxes

Six Years to Repeal

- Tax-free gifts to use higher exemptions
- Six-year SCIN or private annuity
  - Term set to expire after repeal
  - Hedge risk of death before full repeal
  - Excluded from estate if death occurs after sunset
- GST grandfathered trusts/GST exempt trusts
- Portability elections
- GRATs
- “Springing” SLATs (i.e. SLAT with contingent GPOA provision)

BUSINESS TAXATION

Corporate Tax Rates

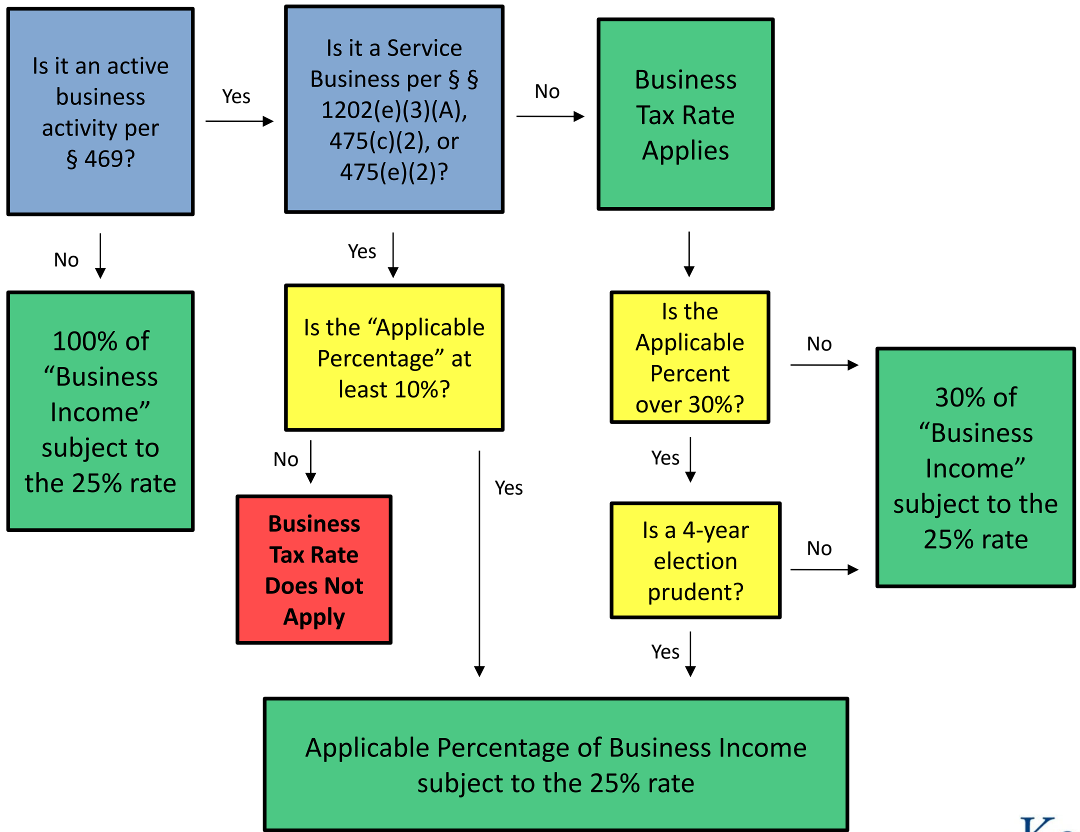
Current

Taxable income:	Tax rate:
$0-$50,000	15 percent
$50,001-$75,000	25 percent
$75,001-$10,000,000	34 percent
Over $10,000,000	35 percent

- Proposal beginning in 2018:
  - 20% flat rate
  - 25% flat rate for personal service corporations

Maximum Business Pass-through Rate

- Income passed-through to an owner, partner/member or shareholder is treated as "business income" and subject to a maximum rate of 25%
- General limit
  - 30% of the pass-through income deemed to be from active business activities (IRC § 469 rules apply) would be subject to this rate
  - The remaining 70% would be deemed to be subject to ordinary individual income tax rates
- Personal service businesses
  - Default "capital percentage" of 0%
- Alternate factors
  - Allows a determination of greater than 30% (or 0%)
  - Fact-and-circumstances based formula



Business Entity (Re)classification

Pass-through

"Capital" Pass-through Income		$ 30
Business pass-through tax	25%	(7.50)
Normal Pass-through Income		$ 70
Pass-through tax	39.6%	(27.72)
Income		$ 100
Business pass-through tax		(7.50)
Normal pass-through tax		(27.75)
Net to Business Owner		$ 64.75
Tax Rate		**35.25%**

C-Corp

Corporate Income		$ 100
Corporate Income Tax	20%	(20)
Net to Corporation		$ 80
Dividend		$ 80
Shareholder Income Tax	20%	(16)
Net to Shareholder		**$ 64**
Tax Rate		**36%**

Service Business (Re)classification

Pass-through

Income		$ 100
Normal pass-through tax	39.6%	(39.60)
Net to Business Owner		$ 60.40
Tax Rate		**39.60%**

C-Corp

Corporate Income		$ 100
Corporate Income Tax	25%	(25)
Net to Corporation		$ 75
Dividend		$ 75
Shareholder Income Tax	20%	(15)
Net to Shareholder		**$ 60**
Tax Rate		**40%**

Cost Recovery

- Increased expensing
  - The proposal would allow a deduction of 100% of the cost of “qualified property”
  - Includes property placed in service after September 27, 2017 and before January 1, 2023
  - Eliminates the current bonus-depreciation new property requirement

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Cost Recovery

- IRC §179 Expansion
  - Currently, a taxpayer may expense (under IRC § 179) up to $500,000 of property. However, this is phased out if a business places over $2,000,000 of property in service during the tax year
  - The proposal, increases the expensing limit to $5,000,000 and the phase-out to $20,000,000

Business Interest Deduction

- The proposal would disallow interest expense in excess of 30% of a business's "adjusted taxable income"
- Determined at the tax-filer level (e.g. the **partnership** not the partners would be subject to testing)
- "Adjusted taxable income" is computed without regard to interest income, net operating losses, depreciation, amortization, and depletion
- Any interest disallowed would be carried forward five years
- Businesses with average gross receipts of $25,000,000 or less are exempt

NOL Deduction

- Under current law, NOLs can generally be carried forward twenty years and back two. The AMT rules provide that a NOL deduction cannot exceed AMTI by more than 90%
- The legislation limits a NOL carryover or carryback deduction to offset 90% of taxable income (conforming to the AMT rule)
- The legislation would also eliminate almost all carrybacks
- NOLs can be carried forward indefinitely

Like-Kind Exchanges

- The bill proposes to limit like-kind exchanges to real property
- However, the bill would allow transactions open at the end of 2017 to be completed tax-free

Contributions to Capital

- Currently, capital contributions to a corporation are generally not included in its gross income. This includes contributions which are not made in exchange for stock.
- The proposal would require the inclusion of contributions as income which exceed the fair market value of stock exchanged.

Partnership Technical Terminations

- Currently, a partnership is subject to the technical termination rule when 50% or more of the partnership interest ownership changes within 12 months
- The bill would repeal the technical termination rule and new elections would not be required or permitted

Energy Credits

- Investment tax credit is modified
  - The 30% ITC for solar energy, fiber-optic solar energy, qualified fuel cell, and qualified small wind energy property is available for property where construction begins before 2020 (and is then phased out for property where construction begins before 2022)
  - The 10% ITC for qualified microturbine, combined heat and power system, and thermal energy property is made available for property where construction begins before 2022.
  - The 10% ITC available for solar energy and geothermal energy property are eliminated for property where construction begins after 2027

Additional Business Changes

- Repeal of deductions for local lobbying expense
- Repeal of the deduction for income attributable to domestic production activities (DPAD)
- Repeal of deductions for entertainment, amusement or recreation
- A new 50% limitation on the deductibility of qualifying business meals
- UBTI for certain fringe benefits provided to employees of nonprofits
- Limitation on the deductibility of FDIC premiums
- Repeal of rollover of Publicly Traded Securities Gain into SSBICs

Additional Business Changes

- Income from a self-created patent, invention, model or design, or secret formula or process would be ordinary income
- The election to treat copyrighted work as a capital asset would be repealed
- Income from the sale or exchange of an uncommercialized patent would be ordinary
- Repeal of credit for clinical testing expenses for certain drugs for rare diseases or conditions
- Repeal of employer-provided child care credit

Additional Business Changes

- Repeal of rehabilitation credit
- Repeal of work opportunity tax credit
- Repeal of deduction for certain unused business credits
- Termination of new market tax credit
- Repeal of credit for expenditures to provide access to disabled individuals
- Modification of credit for portion of employer social security taxes paid with respect to employee tips

Additional Changes

- Bond Reform
- Insurance taxation
- Compensation
- Foreign income & persons
- Exemption organizations

IRAs & the Potential "5-Year Rule"

5-Year Rule

Current Law

	Death Before Required Beginning Date	Death On or After Required Beginning Date
Designated Beneficiary	*Life Expectancy Rule*	*Life Expectancy Rule*
Non-Designated Beneficiary	*Five-Year Rule*	*Owner's "Ghost" Life Expectancy Rule*

5-Year Rule

Expected in the Senate proposal

- *Retirement Enhancement and Savings Act of 2016*
  - **Sponsored by Orrin Hatch**
  - **Aggregate balances of defined contribution plans over $450,000 at the death of the employee must be paid out over five years**
  - Individual retirement arrangements would be subject to the same treatment
  - Exceptions for minor, disabled, and chronically ill beneficiaries
  - Exceptions for beneficiaries not more than 10 years younger than the employee
  - Exceptions for spouse

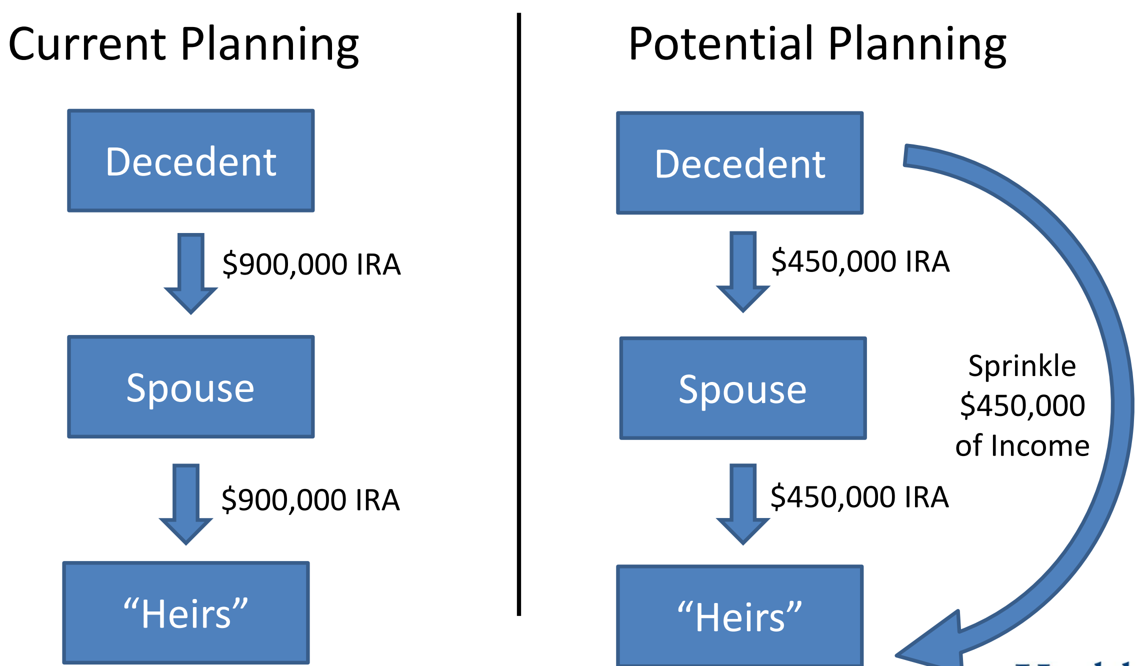
5-Year Rule

Solutions

- Few clients will have a suitable beneficiary eligible for an exemption at the second death
- **Naming a charitable reminder trust as the designated beneficiary would provide a similar tax-deferred series of payments**
- Naming many separate taxpayers as beneficiaries could mitigate "bracket spike"
- Draw down IRAs during life to spread out income
  - Roth conversions
  - Buy life insurance
  - Other reinvestment

5-Year Rule

The New Spousal Rollover Trap – a $900,000 example



Picking a Year-End for Estates

Picking a Year-End for Estates

- The date of death is the end of the individual taxpayer's last tax year
- However, the estate may choose it's first reporting period provided it is twelve months or less and ends on the last day of the month
- The § 645 election allows a QRT to be taxed as if it's part of the estate thereby avoiding that the trust have a 12/31 year-end
- The end of the reporting period determines the applicable law

Picking a Year-End for Estates

- Considerations
  - Estate and trust tax rates: 39.6% v. 35%
  - Business tax rates : 39.6% v. 25%
  - Itemized deductions: vanishing?

Picking a Year-End for Estates

- *Example.*
  - Joe died 4/25/2017
  - His final reporting period is 1/1/2017 – 4/25/2017
  - The start of Joe's estate's tax year is 4/26/2017
  - The estate can choose it's first tax year to end between 4/30/2017 and 3/31/2018
  - Joe's executor will decide whether a 645 election is prudent
  - Joe's executor will intentionally choose a year end so the more favorable tax laws apply to the estate (and QRT)

Estate Tax Repeal, Planning & Portability

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Overview

- Prior to portability, a trust was needed to preserve the first-to-die's exemption
- Portability simplifies planning and even can allow a second basis adjustment
- 10-year repeal of the estate tax may be a trap for some families; a trust could preserve the exemption

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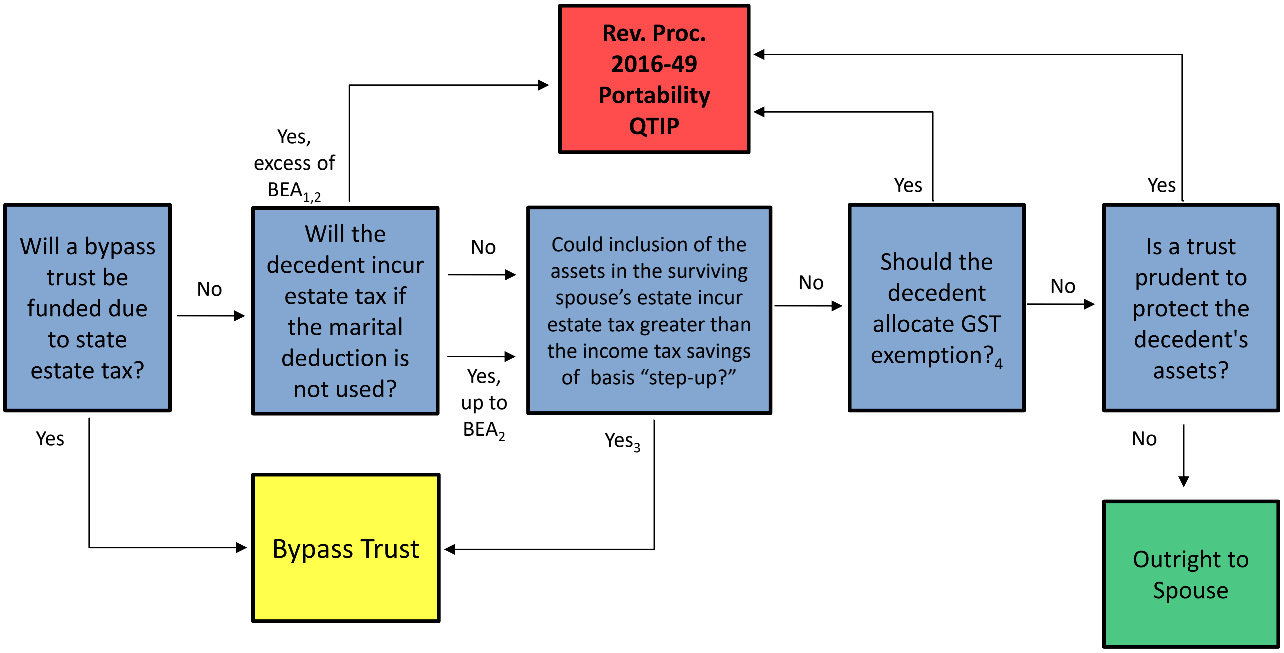
Current Testamentary Planning



1. Basic Exclusion Amount (BEA)
2. Assumes asset protection is desirable.
3. May be prudent to elect portability, give assets to the surviving spouse and then fund the trust in order to allow for a grantor trust.
4. Note that the GST exemption cannot "port" to the surviving spouse, however a "reverse-QTIP" election is available.

Planning

- A late 2017 exemption gift could shelter the assets from transfer taxes should reinstatement occur:
  - Preserve current (and perhaps larger) Basic Exclusion Amount (BEA) and GST Exemption
  - Use Deceased Spousal Unused Exclusion Amount (DSUE)
- Many elderly clients may have "I love you" type wills and updating documents will need to happen quickly

Planning

- GST repeal would change the generally prudent and commercialized common estate tax planning structure
- Gift tax could remain in place
- A periodic deemed capital gain recognition event could be added (Canadian system)
- Possible that there may be significant opportunity for certain wealthy individuals

Questions

Thank you for joining us today!