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Wealth & Succession Planning Group

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KEEPING OUR CLIENTS INFORMED ON WEALTH AND SUCCESSION PLANNING ISSUES

For any questions or comments you might have regarding this newsletter or any other wealth and succession planning concerns, please feel free to contact::

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Tax Cuts and Jobs Act - Legal Alert

On November 2, 2017, the House Ways and Means Committee Chairman released the "Tax Cuts and Jobs Act," which would drastically alter the way we prepare our individual income tax returns. Below, I have: (i) highlighted significant individual income tax and estate and gift tax changes as part of the proposed new law; and (ii) illustrated the impact of the changes to an example income tax return, comparing a sample client's 2016 tax figures and tax liability to that of the same tax figures with an estimated tax liability under the new law.

<u>Significant Changes to Individual Income Tax Returns</u>

- Tax brackets (for 2017 joint filers) under existing law:
  10% from $0 to $18,650;
  15% from $18,651 to $75,900;
  25% from $75,901 to $153,100;
  28% from $153,101 to $233,350;
  33% from $233,351 to $416,700;
  35% from $416,701 to $470,700; and
  39.6% above $470,700.
- Tax brackets (for 2017 joint filers) under proposed new law:
  12% from $0 to $90,000;
  25% from $90,001 to $260,000;
  35% from $260,001 to $1,000,000; and
  39.6% above $1,000,000.
- The Personal Exemption would be repealed
- The Standard Deduction would be nearly doubled from $6,350 to $12,200 (for single filers) and from $12,700 to $24,400 (for joint filers)
- The limitation on itemized deductions would be repealed; however, itemized deductions would be substantially altered:
  - the deduction for state and local taxes would be repealed
  - the property tax deduction would be limited to $10,000
  - the mortgage interest deduction cap would be reduced from $1,000,000 to $500,000, and this deduction would only be available for mortgages on principal residences and NOT for second homes or home equity lines of credit
  - the 50% AGI limitation for charitable contributions would be increased to 60%
  - the deductions for medical expenses, casualty losses, tax preparation fees, alimony payments, moving expenses, and Archer Medical Savings Account contributions would be repealed

- The child tax credit would increase from $1,000 to $1,600, and a new $300 credit would be available for tax years before 2023 for non-child dependents and taxpayers themselves (each spouse in the case of a joint return)
- The exclusion for employer provided housing would be limited to $50,000 and would phase out for taxpayers with wages more than $120,000
- The ownership requirements for the capital gain exclusion on the sale of a principal residence is extended from 2 out of the previous 5 years to 5 out of the previous 8 years, and the exclusion would only be available once every 5 years and would phase out for single filers with AGI over $250,000 and joint filers with AGI over $500,000
- The exclusion for employer-provided dependence care assistance programs, moving expense reimbursement programs, and adoption assistance programs would be repealed
- The American Opportunity Tax Credit, the Hoper Scholarship Credit and the Lifetime Learning Credit would be merged into a single modified American Opportunity Tax Credit, which would provide a 100% credit for the first $2,000 of education expenses and a 25% credit for the next $2,000 of expenses for the first four years of education
- New contributions to Coverdell education savings accounts would be disallowed and Section 529 plans would be expanded to allow for expenses of apprenticeship programs and up to $10,000 of elementary and high school expenses
- Above-the-line deductions for interest payments on qualified education loans would be repealed
- Above-the-line deduction for qualified tuition and related expenses would be repealed
- Exclusion from income of interest on US savings bonds used for qualified tuition and related expenses would be repealed
- Exclusion from income of qualified tuition reduction provided by educational institutions to their employees, spouses or dependents would be repealed
- Exclusion from income of employer-provided education assistance would be repealed

Estate Tax Changes

- The federal estate tax life-time exclusion amount would be increased from a base of $5,000,000 to $10,000,000 indexed for inflation
- The federal estate tax would be scheduled for repeal as of 2023
- Upon repeal, the assets held by a decedent at his or her death would continue to receive a stepped up basis as of the date of death, despite the fact that the federal estate tax system would be repealed

Illustration of Tax Return for Comparative Purposes

For purposes of illustrating some of the changes to the federal income tax, let's assume the following figures (for both 2016 and 2017) for a married couple filing jointly with two (2) children:

- Adjusted Gross Income is $275,849
- Itemized deductions included:
    - State income taxes of $10,343
    - Property taxes of $11,676
    - Home mortgage interest of $13,385 (on a mortgage of $800,000, assume $8,366 allocable to mortgage below $500,000)

Tax Comparison

Tax Figures and Liability	2016	2017
Line 37, Adjusted Gross Income	$275,849	$275,849
Line 40, Standard or Itemized Deductions	$ 37,665	$ 24,400
Line 42, Personal Exemption	$ 16,200	$ 0
Line 43, Taxable Income	$221,984	$251,449
Line 44, Tax	$ 49,141	$ 51,162
Line 45, Alternative Minimum Tax	$ 3,561	$ 0
Line 63, Total Tax	$ 52,702	$ 51,162
Tax Bracket	28%	25%

Conclusions

For the sample tax return above, although the actual dollar figures did not substantially change from 2016 to 2017, the method of obtaining the total tax liability is materially different. The sample client's deductions went down substantially given that numerous itemized deductions have been repealed or limited and the sample client had no personal exemptions for 2017 due to repeal. Yet, the client's 2017 taxes still were slightly down, because the Alternative Minimum Tax would be repealed and the taxpayer would be in a lower tax bracket.

Taxpayers should expect to see their itemized deductions significantly reduced, especially for those taxpayers who have recurring medical expenses, pay substantial amounts of state income tax, have multiple residences or property tax in excess of $10,000 on an annual basis, and who have mortgages in excess of $500,000. Coupled with the loss of personal exemptions, this could be a significant change to one's tax status.

Yet, with the repeal of the Alternative Minimum Tax, taxpayers who were either repeatedly hit with the same or were not originally intended to be the target of the Alternative Minimum Tax would see tax savings.

Finally, with the expansion of tax brackets, taxpayers who may have previously been at the top of a tax bracket and would be moved down to a lower tax bracket could see tax savings. The biggest change for tax brackets impacts those (joint filers) making between roughly $471,000 and $100,000. Instead of being in the 39.6% tax bracket in 2016, these taxpayers would now realize a tax break by being moved down to the 35% tax bracket.

Each taxpayers situation is different and the impact this new law would have on your tax situation would be unique to your individual facts and circumstances. Please feel free to contact KTJ to discuss any questions you have in this regard.