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Private Client & Trust Tax Reform Advisory

December 21, 2017

On December 22, 2017, the President signed into law H.R. 1, informally known as the **"Tax Cuts and Jobs Act" (the "Act")**, implementing sweeping changes to United States income tax regimes for individuals and businesses and greatly expanding the existing exemptions from gift, estate and generation-skipping transfer taxes. Most of the provisions of the **Act will take effect as of January 1, 2018**. Many of the provisions relating to individuals are temporary and expire (or "sunset") after 2025 if not extended by future law. Highlights of the Act impacting individuals are discussed below.

Estate, Gift and Generation-Skipping Transfer Taxes

In 2018, the exemption amounts for estate, gift and generation-skipping transfers will double, from the scheduled amount of $5.6 million per individual taxpayer to $11.2 million, indexed for inflation. (Sunset after 2025)

Total lifetime gifts over the exemption amount, and estates over the exemption amount (when augmented by lifetime taxable gifts) will continue to be taxed at the current rate of 40%. Property included in a decedent's estate at death will continue to receive a step-up in basis to fair market value.

Individual Income Tax

Tax Brackets and Rates: The Act retains seven brackets but lowers the top marginal rate on income from 39.6% to 37% and modifies the other rates and breakpoints. In general, most rates are lowered and the brackets are adjusted with the effect that more income will be taxed at lower rates as compared to the prior tables. The new rates revert to 2017 levels after 2025.

Deductions and Exemptions: While income is generally taxed at lower rates, taxpayers who itemize their deductions will see some familiar deductions curtailed in favor of a higher standard deduction. Many taxpayers who previously itemized their deductions will fall under the standard deduction starting in 2018.

- **Standard Deduction and Personal Exemption:** For those who do not itemize deductions, the standard deduction has been approximately doubled for each filing status ($12,000 for individuals; $18,000 for heads of household and $24,000 for joint filers, indexed for inflation); however, the availability of personal exemptions has been largely suspended. (Both sunset after 2025)
- **State and Local Tax ("SALT") Deduction:** The Act caps the aggregate deduction for state and local property taxes and income (or sales) taxes at $10,000 ($5,000 for married taxpayers filing separately). (Sunset after 2025)

- **Home Mortgage Interest Deduction:** For debt incurred after December 15, 2017 for the purchase of a principal residence or second residence, the Act reduces the mortgage interest deduction to interest on an aggregate of $750,000 of acquisition indebtedness. A $1 million limitation remains in effect for existing acquisition indebtedness. (Sunset after 2025)
- **Home Equity Loans:** Commencing in 2018, the Act eliminates the deduction for interest on home equity loans. (Sunset after 2025)
- **Medical Expense Deduction:** The Act retains the medical expense deduction and reduces the floor from 10% to 7.5% of adjusted gross income for 2017 and 2018.
- **Miscellaneous Itemized Deduction:** The Act eliminates miscellaneous itemized deductions previously subject to the 2% floor of adjusted gross income. (Sunset in 2025)
- **Charitable Contributions:** The Act retains the charitable deduction and raises the annual limit on deductions that may be taken for cash contributions to a public charity from 50% to 60% of adjusted gross income. (Sunset after 2025)
- **Alimony Deduction:** The Act eliminates the deduction for payment of alimony (and the corresponding inclusion in income of the recipient), effective for divorce decrees and separation agreements entered into after December 31, 2018.
- **Repeal of "Pease Amendment":** The Act repeals the limitation on itemized deductions for high-income taxpayers. In 2017, the reduction began at income levels of $261,500 for a single taxpayer and $313,800 for married taxpayers. An affected taxpayer's deductions could be reduced by 3% of the taxpayer's adjusted gross income over these thresholds (but not more than 80% of the deductions).

Alternative Minimum Tax: The Act retained the Alternative Minimum Tax (the "AMT") for individuals, so taxpayers must continue to calculate their taxes under two regimes. However, the exemption amounts have been increased for 2018 ($70,300 for single filers and $109,400 for joint filers). The exemptions will begin to phase out for single filers at $500,000 of income and joint filers at $1 million of income. (Sunset after 2025)

Other Items of Interest

529 Plans: Funds held in 529 Plans may now be used to pay up to $10,000 of elementary or high school tuition per year.

Business Income Tax:

- **Corporate Tax Rate**: The income tax rate for corporations will be a flat 21%.
- **Pass-through Entities:** The Act introduces a deduction of 20% for qualified business income from a partnership, S corporation or sole proprietorship, subject to important limitations.
- **Carried Interest:** Generally, carried interests will need to be held for three years to qualify for long-term capital gain treatment.

Tax Planning

Year End Planning

Generally, given that the Act lowers rates and limits deductions in 2018, deferring income to 2018 and accelerating deductions into 2017 would seem to be advantageous. However, given the interplay of the adjustments to tax brackets and rates, the alternative minimum tax, the allowable deductions, and the repeal of the Pease Amendment, year-end planning must be analyzed based on each client's individual circumstances. Considerations include the following:

- **Prepayment of SALT.** Prepay any state and local taxes (SALT) due for tax year 2017 on or before December 31, 2017. Prepayment of 2018 state and local taxes may not be used to generate a deduction for 2017. Clients who are in the alternative minimum tax may not be able to use the deduction in 2017. However, the deduction may still be useful to offset a portion of the 3.8 percent tax on net investment income.
- **Charitable gifts.** With the increase in the standard deduction, some individuals may not be able to itemize deductions next year. Those individuals should make their gifts in 2017. Clients who are in the AMT this year but who will not be in it next year and who expect to itemize deductions may see an effective rise in rates such that their charitable deductions will be more valuable next year. The elimination of the Pease Amendment may also mean that more of the deduction can be used next year.

An individual's ability to deduct charitable gifts is limited to a percentage of the individual's adjusted gross income based on the type of charity to which the gift is made (i.e., public charity or private foundation) and the nature of the property given (e.g., cash or marketable securities). Individuals who make charitable gifts in excess of the limitations may carry forward their excess deductions for up to five years. A taxpayer who is considering making a charitable gift in 2017 in excess of the limitations and who is in part motivated by a charitable deduction should project his or her ability to use the carryforward in future years.

Planning Beginning in 2018:

The substantially increased federal gift and generation-skipping transfer tax exemptions, along with annual exclusion gifts already scheduled to increase to $15,000 per person, will present significant planning opportunities. We look forward to discussing these opportunities with our clients and other friends in the New Year.

For updated and additional advisories, please visit: **https://www.goulstonstorrs.com/private-client-trust/publications/**