CHAPTER 1

Tax Cuts and Jobs Act of 2017

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President Trump signed new tax legislation on December 19, 2017, that will significantly impact many Americans. The title of the new law was intended to be the Tax Cuts and Jobs Act. However, due to certain procedures involved in passing the new law, the short title was removed and the official title is "To provide for reconciliation pursuant to title II and V of the concurrent resolution on the budget for fiscal year 2018." Despite the issues surrounding the name, the new tax law is commonly known as the Tax Cuts and Jobs Act and will be referred to in this book as the TCJA.

The TCJA sets forth the most extensive changes to the tax law in more than 30 years, although many of the provisions are set to expire after 2025. The TCJA significantly impacted both individual and corporate taxpayers. Individual tax rates were reduced, and individual deductions were modified. Taxpayers operating businesses through flow-through entities, such as LLCs, S corporations, or sole proprietorships, received a favorable new deduction for certain types of income. The TCJA reduced corporate tax rates for corporations taxed as C corporations. In the estate and gift tax arena, the TCJA doubled the amount of wealth that may pass tax-free to nonspouse, noncharitable beneficiaries.

Although the TCJA made changes to many areas of the tax law, not all the provisions of the TCJA are permanent. Most provisions took effect on January 1, 2018. The TCJA included a sunset provision stating that many provisions will expire after 2025. For instance, the TCJA created provisions regarding individual tax reform that extend through 2025. However, the changes to business reform measures are generally permanent. Taxpayers should become familiar

with an overview of the TCJA and its effect on income tax provisions, business tax provisions, and estate and gift tax provisions.

Ordinary Income Tax Rates

The TCJA effectively changed individual income tax rates from 2018 to 2025 for all Americans other than those under the 10 percent tax bracket.

The TCJA shifted the marginal tax rates for Americans making more than $9,525. The marginal tax rates for middle-class Americans are subject to a progressive rate structure as income increases. The ordinary income tax rates under the new law are: 10 percent, 12 percent, 22 percent, 24 percent, 32 percent, 35 percent, and 37 percent. However, the TCJA dramatically altered the income brackets to which the tax rates are applied. For example, the marginal tax rate of 35 percent, which previously encompassed $424,950–$426,700, now encompasses an income bracket of $200,000–$500,000. See Table 1.1 for a complete review of the schedule for joint and single tax filers for 2018. The marginal brackets are indexed for inflation and set to increase beginning in 2018.

Capital Gains Tax Rates and Qualified Dividends

The TCJA maintained the favorable maximum capital gains rates of 15 percent for all Americans making less than $425,000 ($479,000 for married filing jointly), indexed for inflation. For wealthier Americans, the maximum capital gains rate will be 20 percent. Similarly, the 15 percent rate on qualified dividends will apply to taxpayers making less than $425,000 ($479,000 for married filing jointly), indexed for inflation. For taxpayers with incomes above those thresholds, dividends will be taxed at 20 percent.

Educational Provisions

Prior law introduced many tax benefits for implementing an educational savings plan. With respect to the TCJA, prior benefits were retained by extending the American Opportunity Tax Credit for Higher Education Expenses through 2025 as well as the addition of new benefits in some areas. Some of these benefits are highlighted below.

Education IRA

The TCJA continued the opportunity for taxpayers to contribute to a Coverdell Education Savings Account. Because of some of the restrictions outlined below

TABLE 1.1 Schedule of Individual Income Tax Rates

				Single Filers			
2018	10%	12%	22%	24%	32%	35%	37%
Year	**$0–$9,525**	**$9,256–$38,700**	**$38,701–$82,500**	**$82,501–$157,500**	**$157,501–$200,000**	**$200,001–$500,000**	**$500,001+**
				Joint Filers			
2018	10%	12%	22%	24%	32%	35%	37%
Year	**$0–$19,050**	**$19,051–$77,400**	**$77,401–$165,000**	**$165,001–$315,000**	**$315,001–$400,000**	**$400,001–$600,000**	**$600,001+**

and the enhanced features to 529 plans under the TCJA, most taxpayers will likely utilize the benefits of a 529 plan under the new law as opposed to Education Savings Accounts. Nonetheless, the features of these accounts under the TCJA include:

- Permanently increased the contribution limits from $500 per year to $2,000 per year.
- Distributions, when used to pay for qualified education expenses, are tax free.
- Allowed tax-free withdrawals for elementary (including kindergarten), secondary, and postsecondary school tuition and expenses.
- Included tuition, room and board, tutoring, uniforms, extended day program costs, computer technology hardware and software, Internet access, and special needs services for special needs beneficiaries as qualifying expenses.
- The age limit is waived for special needs beneficiaries.
- Contributions can be made until the donor's due date for their federal income tax return.
- For donors who are single tax filers with a modified adjusted gross income (MAGI) of between $95,000 and $110,000 ($110,000 and $220,000 for married taxpayers filing jointly), the contribution limits are (ratably) phased out. These MAGI thresholds are adjusted annually for inflation.

Tip

If you would like to make a contribution to an education IRA for your child but you do not qualify because your adjusted gross income (AGI) is too high, consider having your child contribute to his or her own account. Unlike other IRAs, a person does not have to have earned income to contribute to an education IRA, nor is there a minimum age requirement. Contributions cannot be made for beneficiaries who are 18 years of age or older.

Section 529 Plans

529 college savings plans were expanded through broadening the meaning of "qualified higher education expenses" to include tuition at public, private, or religious elementary or secondary schools, limited to $10,000 per student during the taxable year.

Business and Corporate Tax Relief

Under prior law, the business taxpayer was allowed to immediately deduct up to $500,000 of business property purchased during the calendar year. Prior law also allowed for 50 percent bonus depreciation for purchases of certain new property. The TCJA increased the deductible amount to $1 million with a phase-out threshold of $2.5 million. The TCJA expanded the bonus depreciation percentage from 50 percent to 100 percent for purchases of property acquired and in service after September 27, 2017, and before 2023 (2024 for "long production period" property and certain aircraft). For the latest updates regarding tax law changes, visit the Resource Center at www.welchgroup.com; click on "Helpful Links," then "ESTATE BOOK UPDATES."

Corporate Tax Rate Changes

Under prior law, the tax liability for corporations taxed as C corporations was determined by applying a certain set of progressive rates to brackets of taxable income. A rate of 35 percent as applied at the highest income levels ($18,333,333 in 2017).

Under the TCJA, the corporate tax regime is changed from a progressive rate structure to a flat rate of 21 percent. You will notice that this rate is significantly lower than the highest individual rate. However, corporations (again, taxed as C corporations) are still subject to the so-called double tax on income, meaning that income is first taxed at the corporate level, now at 21 percent but if it is distributed to shareholders as a dividend, the income is subject to a second level of tax at a top rate 20 percent.

Pass-Through Income Deduction Under § 199A

One of the biggest changes to the tax law under the TCJA is the new 20 percent deduction for business income derived from a pass-through entity. Note, in the discussion of the corporate tax above, we talked about the double tax. Income from a pass-through entity is subject to only one level of tax.

Under prior law, sole proprietorships, partnerships, LLCs, and S corporations were treated as pass-through entities subject to tax at the individual owner or shareholder level. The income earned by the owners or shareholders was reported on their individual tax returns and subject to ordinary income tax rates.

Under the TCJA, a 20 percent deduction is now available for taxpayers with domestic "qualified business income" from these types of businesses for tax years after December 31, 2017, and before January 1, 2026. The provisions

under new Section 199A are extremely nuanced and complicated, but limits on the deduction are imposed on certain types of income unless a taxpayer's income is below a threshold amount (taxable income under $315,000 for joint filers, $157,500 for single filers).

The deduction is available to noncorporate taxpayers such as trusts and estates. However, pass-through income from certain service businesses in the fields of health, law, accounting, performing arts, and other service businesses are not eligible for the deduction. However, engineers and architects are not subject to this restriction.

Many other limitations and complications to the new pass-through deduction exist, and many tax advisers are looking to the IRS to guide them through issues raised by the deduction.

Additionally, new regulations addressing the deduction were proposed on August 8, 2018. Taxpayers may rely on these rules until final regulations are published.

Estate, Gift, and Generation-Skipping Transfers

The TCJA retained the current transfer tax regime but made a significant change that gives taxpayers a tremendous planning opportunity. The tax rate is 40 percent on estates exceeding the exemption amount (i.e., the "taxable" estate). The previous exclusion amount enacted was $5 million indexed for inflation and under prior law was set to be $5,490,000 in 2018. Under the TCJA, the exemption amount doubled, meaning that each individual may transfer up to $11,180,000 (indexed for inflation) at death or by gift during life without paying transfer taxes. Because of portability, this effectively allowed spouses to transfer approximately $22 million to beneficiaries without estate gift taxes. The applicable exclusion amount is now the basic exclusion amount of $11,180,000 million (indexed for inflation) plus a deceased spouse's unused exclusion (DSUE) amount.

Following is a list of select provisions that could affect your estate planning:

- The TCJA maintained the maximum estate, gift, and generation-skipping rates at 40 percent. The TCJA also temporarily increased the exclusion amount to $11.18 million, indexed annually for inflation (see Table 1.2). This amount is set to return to pre-2018 levels at the end of 2025.
- Portability is still a feature of the estate tax system under the TCJA. A decedent's applicable exclusion amount is now the basic exclusion

TABLE 1.2 **2018 Tax Relief Act Applicable Exclusion Amount**

Year	Applicable Exclusion Amount	Maximum Estate Tax Rate (%)
2018	$11,180,000	40

amount of $11.18 million plus the DSUE amount. Congress intended that portability would simplify estate planning. Portability will continue to be an important component of the tax system.

- The TCJA retained the "annual exclusion" in which taxpayers may make gifts of assets (assuming the gift is of a present interest) to as many donees as they like without using their applicable exclusion amount. For spouses, the amount effectively doubles. In 2018, the annual exclusion amount is $15,000.

Estate-Planning Issues under the 2017 TCJA

Because of the unique opportunity provided by the TCJA, everyone should review their estate plan to take advantage of the new provisions through 2025. An approach we favor is for the client to contact one of their professional advisers on the estate-planning team, whether the estate-planning lawyer, financial planner, life insurance agent, accountant, or trust officer. Authorize that team member to assemble the team in a preliminary meeting to review the listing of the assets and liabilities (financial X-ray), review the current documents, and then meet with the client and the client's spouse to make team recommendations. This approach maximizes creative input and communication and often aids in identifying important new alternatives to consider. The financial X-ray would show what assets are titled in the name of each spouse; what, if any, assets are titled in joint names; and, ideally, what assets are in the children's names.

Understand that payment of estate or death taxes is largely elective. By making annual gifts during your lifetime, then transferring the maximum tax-free amount (applicable exclusion amount) to your children and grandchildren at death, and finally bequeathing your remaining estate to a family charitable foundation, your estate tax would be zero. For example, Raymond and Laura Gold have a $50 million net worth. Each year, they make maximum annual gifts to their two children and their spouses, plus maximum annual gifts to 529 plans for each of their grandchildren. Their wills direct the maximum to legacy trusts (Chapter 11) for the children, with the balance to a private

foundation (Chapter 12) where the children (and eventually grandchildren) will serve as trustees. If they died in 2018, the disposition of their estate would look as follows:

$50,000,000	Total estate
–22,360,000	Exemption amount (2018) to legacy trust
$27,640,000	Directed to private foundation
$ 0	Estate tax

So here's the question: Is $22,360,000 "enough" to leave to your children? If not, you can still achieve "zero" estate taxes by employing additional strategies outlined throughout this book.

Here are two areas to focus your attention on:

1. With the advent of portability, does the plan provide the most flexibility while simultaneously taking advantage of the permanently enacted favorable transfer tax provisions and achieving the best result from an income tax perspective?
2. As discussed later in this chapter, does the estate plan and overall tax plan adequately prepare for income tax issues that may be a function of increased exclusion amounts or the 3.8 percent tax on net investment income that began in 2013 under the Affordable Care and Patient Protection Act?

Planning with Portability Under the TCJA

Portability allows the second spouse to die to use the DSUE amount from the first spouse to die. For example, assuming a couple where the husband has $1 million of assets in his name while the wife has $14 million in her name (combined estate of $15 million). Assuming a $11.18 million exclusion amount, under prior law if the husband died with $1 million of assets titled in his name (and payable to wife), then $10.18 million of his exclusion was wasted. This is because at her subsequent death, her now $15 million estate would be eligible for only her $11.18 million exclusion amount. Thus her taxable estate would be approximately $4 million. Portability will now allow the surviving wife to use the $10.18 million DSUE amount of her deceased husband plus her own $11.18 million exclusion amount. Thus, she could transfer $22.38 million tax free at her death.

Dangers of Relying on Portability

The purpose of portability is to provide a level of simplicity to estate planning. For couples with a combined net worth of less than the exclusion amount this may be true, assuming the net worth does not grow faster than the inflation-adjusted exclusion amount. Couples with a combined estate of this size may rely on portability to minimize or eliminate estate taxes. For high-net-worth couples, relying on portability for tax planning is not the best option. Moreover, there are several tax and nontax advantages to incorporating a plan that uses traditional credit shelter and marital trust planning to be used in conjunction with portability. First, appreciation in the assets is protected from estate taxes on the death of the second spouse to die. Second, the use of trusts will protect the assets from potential creditors of the beneficiaries and safeguard the assets in the event the surviving spouse remarries.

Despite the advantages of portability, solely relying on portability is a recipe for disaster. The key to a solid estate plan is flexibility. Therefore, an ideal plan should build in the flexibility to defer the decision of whether to rely on portability or traditional credit shelter and marital trust planning until the death of the first spouse.

Planning Considerations Under the 2017 TCJA

With the opportunity provided by the TCJA, you have an opportunity to revisit your own estate plan in light of a recently passed estate tax law that offers many opportunities for business owners and wealthy families, as well as the "not yet wealthy." Here's a quick review of the major provisions of the law as well as several planning strategies worth considering:

- *Up to $11.18 million (inflation-adjusted annually) exempt from estate taxes*. **Planning point:** Many wills use a formula that states that the maximum amount allowed under law first goes to fill up the family trust, with the balance going either outright or in trust for the surviving spouse. With this higher limit, it means that in many cases all of the assets will go to the family trust and none to the surviving spouse, either outright or in the marital trust. For many families, this is an unintended consequence. So, the best course of action is to review your current planning documents to insure that even with the changes in the tax law that your assets will be transferred in a fashion that you desire.

- *Portability of exemption amount*. **Planning point:** Theoretically, the activity of equalizing the estates between spouses is no longer necessary since the surviving spouse now "inherits" the DSUE amount. However, if the surviving spouse remarries and that new spouse dies, the exemption of the first deceased spouse would be lost forever. Relying solely on portability is not an ideal strategy, and building a plan with flexibility is the best course of action. When you review your estate documents, determine the impact that portability will have on your plan in light of your personal circumstances.
- *Make gifts during your lifetime*. **Planning point:** If you are a small business owner who would like to make certain the business stays in the family, now may be an excellent time to gift some of your business ownership to children. And this is not just for business owners. If you have an estate that significantly exceeds the exemption amount, you may want to consider making tax-free gifts to family members, using assets that you believe will appreciate in value in the years ahead.
- *Heirs receive a new tax basis for transfers at death*. (This is not new but is a point worth making.) **Planning point:** You face a trade-off in deciding whether to make transfers during your lifetime versus transfers at death. The recipient of a gift during your lifetime gets your same tax basis so that a future sale would be potentially subject to capital gains taxes. With the exclusion amount now exceeding $11 million, the income tax consequences of receiving a step-up in basis may be a more important factor than the transfer tax consequences.

The 3.8 Percent Tax on Net Investment Income

The 3.8 percent tax on net investment income (NII) was enacted as a new Section 1411 to the Code in 2013. The purpose behind the tax was to tax "unearned" income, such as dividends, rents, royalties, gain on the sale of capital assets, and income from businesses in which the taxpayer did not "materially participate" to name a few.

The effect of the 3.8 percent surtax tax is that taxpayers in the highest income brackets (37 percent for ordinary income and 20 percent for net capital gains) may be subject to an additional 3.8 percent tax on income that meets the definition of NII.

Anytime that a client owns an interest in a business, there are numerous planning considerations involved. If the business interest is held in trust, then there is an additional layer of issues to work through to get the best result for the client.

Although the NII tax is harsh, there are some planning opportunities to minimize the tax. Individuals that own an interest in a trade or business should consult their tax professionals to ensure that the requirements of active participation are satisfied. Distributing NII from trusts will lower the amount of the NII tax imposed on trusts. However, there may be nontax reasons to not distribute the income to a beneficiary—for instance, to protect the distribution from creditors or provide incentive to the beneficiary.

If you feel your estate is not large enough to take advantage of any of these strategies, be clear that, at a minimum, you need at least a basic estate plan, which would include a will, durable power of attorney, and an advanced health care directive.

NOTICE

As we are sure you are aware, Congress frequently changes tax law that can significantly impact your estate, retirement, and tax planning. To stay apprised of the latest changes that affect you, visit the Resource Center at www.welchgroup.com; click on "Links," then "ESTATE BOOK UPDATES." Posted content will focus on tax law changes that affect this book's content as well as changes we believe are most important to our readers.

Limitations on Deductions

The TCJA made significant changes to income tax deductions for individual taxpayers. The biggest changes involve an increase in the standard deduction and the suspension or limitation on certain other deductions. As discussed below, the increase in the standard deduction may cause a taxpayer who previously itemized to utilize the more beneficial standard deduction. Taxpayers should consult their personal tax professionals to determine what is best for their particular circumstances, but many will change to a system in which they no longer deduct the interest on their mortgage or property taxes on their home.

Changes to Standard Deduction

Under the TCJA, the standard deduction is increased from $13,000 to $24,000 for married taxpayers that file a joint return. The TCJA also eliminates the personal exemption. Because of the increase in the standard deduction and the elimination or limitations imposed on other itemized deductions, many taxpayers who previously itemized will now use the standard deduction and may only itemize once every several years—for example if they have significant charitable contributions.

Mortgage Interest Deduction

The mortgage interest deduction—perhaps the most well-known itemized deduction—has been modified significantly by the TCJA. Under the TCJA, homeowners with mortgages that existed before the enactment of the new law may continue to deduct interest on a total of $1 million of debt for their first and second home. However, new buyers are limited to deduct the interest on $750,000.

Additionally, deductions are suspended for home-equity loans through 2025 unless the loan is used to make substantial improvements to the home and the combined total of the loan and the first mortgage does not exceed $750,000.

However, because of the substantially increased standard deduction, millions fewer taxpayers will likely opt to take the standard deduction rather than using the mortgage interest deduction.

Charitable Deductions

For tax years after 2017 and before 2026, the limitation on the deduction for cash contributions made to public charities, private operating foundations, and private distributing foundations is increased from 50 percent to 60 percent of AGI. The limitation on deductions for cash contributions to private nonoperating foundations remains at 30 percent of the AGI.

For tax years beginning after 2017, the 80 percent deduction for contributions made for university athletic seating rights is repealed. In other words, season ticket holders for college football (and other sports) may not deduct the contribution for the right to purchase season tickets under the new law.

Deduction for State and Local Taxes

Perhaps one of the most significant changes for individual taxpayers is the new limitation on the deductibility of state and local taxes. The new limitation applies to taxes such as property taxes and state/city income taxes.

Under the TCJA, taxpayers that continue to itemize deductions will be limited in deducting up to $10,000 (for married filing jointly) of state and local property taxes.

Alimony Payments Deduction

The TCJA eliminates the above-the-line deduction for alimony payments effective for divorces, separations, or modifications entered into after 2018. However, the TCJA does not require the alimony payee to include the payments as income.

Miscellaneous Itemized Deductions

Under the TCJA, all miscellaneous itemized deductions subject to the 2 percent floor, including expenses such as tax preparation fees, investment fees and expenses, the "home office" deduction, and other unreimbursed employee expenses, are suspended for tax years beginning after December 31, 2017, and before January 1, 2026.

Pease Limitation

The TCJA repealed the so-called Pease limitation until January 1, 2026. Under prior law, the Pease limitation provided additional restrictions on the ability of high-income taxpayers to take full advantage of itemized deductions, such as charitable deductions.

In this chapter, we have provided an overview of the current tax laws and how the changes to the tax law may impact you in the near future. In our next chapter, we will delve deeper into the importance of developing your estate plan and planning opportunities under the TCJA.