Tax Impact

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Tax Tips

The Tax Cuts and Jobs Act

How will it affect your tax bill?

At the end of 2017, the most sweeping tax reform legislation in decades was signed into law. Let's take a look at the highlights of the Tax Cuts and Jobs Act (TCJA) that affect individuals and businesses. Most of the changes go into effect this year.

Individual taxes

As under previous law, there are seven individual tax brackets, but the tax rates have been adjusted to 10%, 12%, 22%, 24%, 32%, 35% and 37%. The previous rates were 10%, 15%, 25%, 28%, 33%, 35% and 39.6%. (Long-term capital gains rates haven't changed and remain at 0%, 15% and 20%.)

The TCJA also adjusts the income thresholds for each bracket. For example, the top rate of 37% applies to 2018 taxable income over $500,000 for single filers and $600,000 for married couples filing jointly. For 2017, the 39.6% rate kicked in at income levels of $418,400 and $470,700, respectively.

Most taxpayers will enjoy a tax cut under the new law, but not everyone. For example, a married couple filing jointly with $500,000 in taxable income will see their marginal rate drop from 39.6% to 35%. On the other hand, the marginal rate for a single filer with $180,000 in taxable income will increase from 28% to 32%.

The TCJA also makes many changes that affect taxable income, including:

- Nearly doubling the standard deduction to $12,000 for single filers and $24,000 for joint filers,
- Eliminating personal exemptions,
- Boosting the child tax credit, and
- Generally reducing itemized deductions by:
  - Capping the deduction for state and local taxes (on a combined basis for property tax and either income or sales tax) at $10,000,
  - Limiting the deduction for home mortgage interest to indebtedness up to $750,000 for new mortgages,
  - Generally eliminating the deduction for interest on home equity debt,
  - Eliminating the deduction for casualty and theft losses except for losses due to an event officially declared a disaster by the President, and
  - Eliminating the miscellaneous itemized deduction for expenses such as investment expenses, certain professional fees and unreimbursed employee business expenses.

The TCJA does enhance a couple of deductions. It increases the adjusted gross income (AGI) limit on the deduction for cash charitable contributions from 50% to 60%. And it reduces the AGI

TCJA provisions that affect estate planning

The Tax Cuts and Jobs Act doubles the combined gift and estate tax exemption and the generation-skipping transfer (GST) tax exemption from $5 million to $10 million (adjusted for inflation) for deaths and gifts after 2017 and before 2026. The inflation-adjusted exemption amounts for 2018 are expected to be $11.2 million ($22.4 million for married couples if they plan properly).

This creates an excellent opportunity to "lock in" the higher exemption amounts by accelerating lifetime gifts and creating dynasty trusts.

threshold for medical expense deductions to 7.5% for 2017 and 2018, reverting to 10% in 2019.

A key consideration for 2018 tax planning is whether to itemize or take the standard deduction. Many taxpayers who've typically itemized in the past will find they're better off taking the standard deduction because their itemized deductions will be lower than that amount.

One potential strategy is to "bunch" your charitable contributions. Say you file a joint return and your itemized deductions consist of $10,000 in state and local taxes and $10,000 in charitable contributions. Because your itemized deductions are less than $24,000, it makes sense to take the standard deduction. You can increase your deductions, however, by contributing $20,000 to charity every other year, allowing you to deduct $30,000 in those years and $24,000 in the off years.

Keep in mind that most of the TCJA's individual tax changes are temporary — they're scheduled to expire at the end of 2025.

Business taxes

The TCJA *permanently* reduces the corporate income tax to a flat 21% rate. Previously, C corporations were subject to graduated tax rates ranging from 15% to 39%, with a 35% marginal rate for the highest income tax bracket. In addition, the new law eliminates the corporate alternative minimum tax (AMT).

The TCJA also provides relief to pass-through entities — S corporations, partnerships, limited liability companies and sole proprietorships — by allowing them to deduct 20% of their qualified business income (for an effective top marginal rate of 29.6%). Note, however, that the deduction may be reduced or eliminated for pass-through owners whose taxable income exceeds $157,500 for single filers or $315,000 for joint filers. Above those thresholds, the deduction becomes unavailable to certain service businesses and is subject to limits based on a business's W-2 wages and depreciable assets.

Depending on their circumstances, some businesses may benefit by converting from pass-through to C corporation status, or vice versa. However, be aware that the pass-through entity deduction is scheduled to expire after 2025.

Review your plan

The TCJA will have an impact on nearly every individual and business, and we've just scratched the surface of the wide-ranging changes the act makes. For example, the new law also increases the AMT exemption for individuals and makes significant changes to various business tax breaks, enhancing some and reducing or eliminating others. Contact your tax advisor to discuss what the TCJA will mean for your tax bill and how you can take advantage of planning opportunities. ■

Breathe new life into a trust by "decanting" it

The term "decanting" typically is associated with wine — pouring it from one bottle into another container to remove sediment and allow it to breathe. In regard to an irrevocable trust, decanting allows a trustee to use his or her distribution powers to "pour" funds from one trust into another with different terms. Doing so provides the trustee with additional flexibility in light of changing tax laws or family circumstances.

Depending on the language of the trust and applicable state law, decanting may enable the trustee to correct errors, take advantage of new tax laws, eliminate or add a beneficiary, extend the trust term, modify the trust's distribution standard, and add spendthrift language to protect the trust assets from creditors' claims.

If you're in the process of planning your estate, consider including trust provisions that specifically authorize your trustee to decant the trust. Even for an existing irrevocable trust, however, your trustee may be able to take advantage of decanting laws to change its terms.

Questions to consider

Differences in state law complicate the decanting process. A detailed discussion of the various decanting laws is beyond the scope of this article, but here are several issues that you and your advisor should consider:

Q: If your trust is in a state without a decanting law, can you take advantage of another state's law?

A: Generally, the answer is "yes," but to avoid any potential complaints by beneficiaries it's a good idea to move the trust to a state whose law specifically addresses this issue. In some cases, it's simply a matter of transferring the existing trust's governing jurisdiction to the new state or arranging for it to be administered in that state.

Decanting laws generally don't require beneficiaries to consent to a trust decanting and several don't even require that beneficiaries be notified.

Q: Will the trustee need to notify beneficiaries or obtain their consent?

A: Decanting laws generally don't require beneficiaries to consent to a trust decanting and several don't even require that beneficiaries be notified. Where notice is required, the specific requirements are all over the map: Some laws require notice to current beneficiaries while others also include contingent or remainder beneficiaries. Even if notice isn't required, notifying beneficiaries may help stave off potential disputes down the road.

Q: What is the trustee's authority?

A: When exploring decanting options, trustees should consider which states offer them the greatest flexibility to achieve their goals. Generally, decanting authority is derived from a trustee's power to make discretionary distributions. In other words, if the trustee is empowered to distribute the trust's funds among the beneficiaries, he or she should also have the power to distribute them to another trust. But state decanting laws may restrict this power.

Don't try this at home

Before "popping the cork" (in other words, taking action), contact your estate planning advisor. Because of the complexities of decanting a trust, it's best to leave this to the experts. ■

Identity theft and your tax returns: How to protect yourself

Tax returns are a prime target for identity thieves. After all, the IRS processes more than $300 billion in tax refunds every year, and criminals follow the money. A thief needs little more than your name and Social Security number (SSN) in order to file a fraudulent tax return and pocket the refund. Then, when you attempt to file *your* return, the IRS or state tax authority informs you that you're attempting to file a duplicate return. It can take months to resolve the matter, cause unwelcome headaches and delay any legitimate refunds you expect.

Increasingly, identity thieves also target entities — including corporations, partnerships, estates and trusts — and use stolen information to file phony tax returns.

IRS cracks down on ID theft

In recent years, tax-related identity theft has substantially declined, due in large part to actions taken by the IRS. For example, the IRS has improved filters in its computer systems, enabling it to flag potentially fraudulent returns. The system looks for anomalies, such as dramatic differences in a taxpayer's returns from one year to the next or wage information that doesn't match information provided by employers.

In addition, online tax preparers and software companies have beefed up their security and implemented measures to confirm their customers' identities. For example, many providers use multifactor authentication — such as a password plus a code sent by text — to verify a user's identity. On the business side, the IRS now requires tax preparers to furnish additional information to verify that a return is legitimate.

These efforts have been effective, but tax-related identity theft remains a major threat. So it's important for individuals and businesses to take steps to protect themselves.

Preventive measures

For individuals, one of the keys to preventing tax-related (and other forms of) identity theft is to keep your SSN private. Don't carry your Social Security card with you and don't provide your SSN to others unless absolutely necessary (and never provide it via email).

Beware of phishing emails. These are official-looking emails designed to look like they're from the IRS, a financial institution or an executive at your company, but are actually from criminals attempting to steal your SSN, bank account numbers or passwords. Never click on links or attachments in emails unless you're positive they're legitimate. And remember that the IRS, banks and most other legitimate businesses will never ask you for financial or personal information via email.

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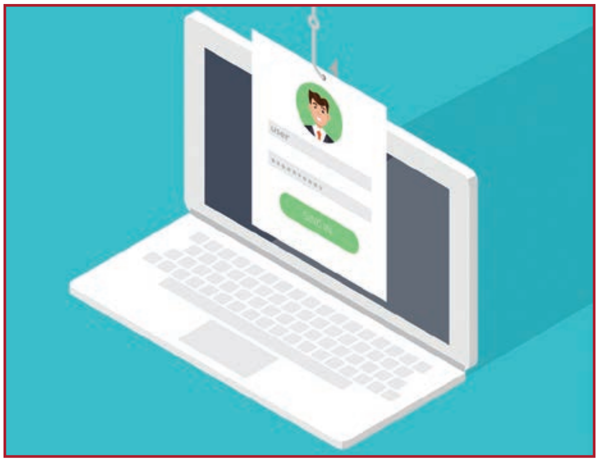
Other steps you should take to protect yourself include:

- Using strong passwords for computers, mobile devices and financial websites, and changing them periodically,
- Using antispam and antivirus software on your computers and installing all security updates,
- Reconciling bank and brokerage statements and reviewing them for suspicious activity,
- Storing bank statements and tax documents in a secure location and shredding them when no longer needed,
- Reviewing your credit report periodically for suspicious activity,
- Locking your mailbox, retrieving mail daily and shredding credit card solicitations and other mail thieves can use to obtain your SSN or other personal information, and
- Exercising caution when using public wi-fi networks. Use a virtual private network (VPN) service to encrypt any information you transmit over these networks.



Finally, file your return as early as possible. In the event identity thieves do obtain your SSN or other information, filing first will prevent them from claiming a refund in your name.

Businesses should take steps to protect their own information as well as that of their employees. They would be wise to provide training to accounting, human resources and other employees to educate them on the latest tax fraud schemes and how to spot phishing emails; using secure methods to send W-2 forms to employees; and implementing risk management strategies designed to flag suspicious communications.

Responding to a theft

If you become a victim of tax-related identity theft:

- File a complaint with the Federal Trade Commission (identitytheft.gov) and local law enforcement,
- Contact the three major credit bureaus to place a "fraud alert" on your credit records, the IRS and your tax advisor, and
- Submit an Identity Theft Affidavit (Form 14039) to the IRS. You'll receive a six-digit Identity Protection Personal Identification Number (IP PIN) for use in filing electronic or paper returns.

You should also contact your financial institutions and close any accounts that have been compromised or opened fraudulently. ■

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Giving to charity? Consider a donor-advised fund

If charitable giving is an important part of your financial and estate plans, a donor-advised fund (DAF) is one of the most tax-efficient vehicles available. Similar in many respects to a private foundation (but at a fraction of the cost), a DAF allows you to take an immediate charitable income tax deduction for your contributions, while retaining the flexibility to identify the charitable recipients down the road. However, keep in mind that, unlike a foundation, a DAF doesn't give you the final word on how your charitable dollars will be spent. But in most cases, the fund sponsor will follow your recommendations. ■

Tax break for solar panels

Thinking about installing solar panels in your home to generate electricity or hot water? Not only can such an investment make your home more energy-efficient, but it can also generate significant tax benefits. Qualified solar property is eligible for a 30% tax credit. The credit is nonrefundable, which means it can't exceed your tax liability for the year. But you can carry forward the excess to the following year. A similar credit is available for businesses (so long as the solar equipment isn't used to heat a swimming pool).

What if you own residential rental properties? Can you claim a tax credit for installing solar panels in your rental units? There's a common misconception that you cannot. That's because Section 25D of the tax code, which authorizes the residential energy credit, states that it's unavailable for investment property (such as rental property) that's not also used as your residence. However, Sec. 48 provides a tax break for solar panels as part of the general business credit, which can be used by rental property owners if certain requirements are met. ■

Calendar tax year or fiscal tax year?

Many businesses use the calendar year for tax-filing purposes, but in some cases a fiscal year — such as October 1 to September 30 — may be advantageous. For example, if most companies in your industry use a fiscal year, adopting a matching year makes it easier to benchmark your performance against that of your competitors.

Seasonal businesses also stand to benefit. A farming business, for example, might incur most of its expenses in the fall and reap most of its income the following spring. A fiscal year that encompasses both periods produces more accurate matching of income and expenses.

For existing businesses, switching to a fiscal year requires IRS permission. Keep in mind that fiscal year reporting is unavailable to some businesses, including sole proprietorships and certain pass-through entities. If you adopt a fiscal tax year, you must use the same year for financial reporting purposes. ■