Update on New Tax Legislation

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Earlier this week, the House and Senate reconciled their tax bills and passed the Tax Cuts and Jobs Act (the "Bill"). Today, the President signed the Bill, officially making it law. The Bill features major changes in the tax rates and rules for individuals and businesses. In order to adhere to the Senate budget reconciliation rules, many of the tax provisions for individuals are temporary and will expire at the end of 2025 while most of the corporate tax provisions are permanent.

With the changes to itemized deductions and the introduction of new deductions on "qualified business income," an individual's state of residence and type of income will play a substantial role in determining whether he or she will save money under the new Bill. Below is a summary of some of the key tax changes to be aware of for year-end planning. This is not a complete list of changes in the Bill, and some of the provisions will affect taxpayers differently based on their state of residence. As always, please speak with your financial counselor to discuss your own unique tax circumstances.

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New Income Tax Rates; New AMT Thresholds

Under the new Bill, federal income tax rates will be 10, 12, 22, 24, 32, 35, and 37%. The 0.9% Medicare tax on wages in excess of $250,000 and the 3.8% Medicare tax on investment income are unchanged. The alternative minimum tax (AMT) phase-out levels have increased to $500,000 for individuals and $1,000,000 for married couples.

Perhaps the most significant change is a reduction in the top rate from 39.6% to 37%. While the AMT changes are also significant, the changes to itemized deductions mean fewer taxpayers would have been subject to the AMT. Taxpayers with incentive stock options ("ISOs") should contact their financial counselors. Waiting to exercise ISOs until 2018 could result in tax savings.

Reduced Itemized Deductions and Increased Standard Deductions

Taxpayers are allowed to take either the standard deduction or itemized deductions, whichever is greater. The standard deduction has been increased to \$24,000 for married couples filing jointly and \$12,000 for single taxpayers, while personal exemptions have been eliminated. Many itemized deductions have been capped or eliminated under the new Bill, so fewer taxpayers will benefit from itemizing. Here are some of the major adjustments:

- Effective in 2018, the state and local tax deduction will be limited to a maximum of \$10,000 combined for income, sales, and real estate taxes that are not business-related.
- Mortgage Interest will be limited to \$750,000 in principal value for loans originated after 2017. Previously, taxpayers could deduct mortgage interest on up to \$1,000,000 in principal value and an additional \$100,000 for a home-equity line of credit. As part of the new Bill, the interest deduction for home equity lines has been suspended and will no longer be available after 2017.
- The new Bill suspends all 2% itemized deductions, including tax preparation fees, investment management fees, unreimbursed employee expenses, safe deposit box expenses, union and professional dues, and professional subscriptions.

The impact of these changes will vary significantly from taxpayer to taxpayer. The general rule of tax planning is to defer income and accelerate deductions. For some taxpayers, however, particularly those in high tax states (e.g., New York and California), it may make sense to do the opposite and accelerate income into 2017. The interaction between itemized deductions and the AMT means that in certain circumstances there is minimal benefit to accelerating deductions. By accelerating income, taxpayers may be able to receive the full benefit of their state tax deductions in 2017, whereas in future years they will be capped at \$10,000. Each situation is unique and requires a tax projection to determine the correct course of action. If you have the option to increase your income before the end of the year by accelerating a bonus or exercising options, please contact your counselor to see if it makes sense for your situation.

Many taxpayers will now be using the standard deduction rather than itemizing their deductions. One consequence of this is that there may be a "gap" where there is no tax benefit for making charitable contributions. For example, married taxpayers with real estate and state taxes exceeding \$10,000 and \$6,000 of mortgage interest will be sitting on only \$16,000 of itemized deductions, well below the \$24,000 standard deduction. If they wish to make a charitable contribution, the first \$8,000 given to charity will have no tax benefit. Taxpayers in these circumstances should consider bunching multiple years' worth of charitable contributions into the same tax year. Additionally, for taxpayers in the highest bracket there is likely a greater benefit to making the contribution in 2017, as the top tax rate is 39.6% vs. 37% in future years.

New Deduction for Pass-throughs

The Bill introduced a new 20% deduction for qualified business income from pass-through entities. There are a number of complex limitations, and it is likely that the IRS will issue significant guidance surrounding the new rules.

Under these new provisions, taxpayers may deduct 20% of domestic qualified business income from a partnership, S corporation, or sole proprietorship.

- Trusts and estates that own business interests also qualify for the deduction.
- The deduction is a post-AGI item, similar to the standard deduction or itemized deductions. Even taxpayers who do not itemize can still qualify for this deduction.
- The deduction is subject to several W-2 wage and business capital limitations for taxpayers with taxable income greater than \$315,000 if married filing jointly or \$157,500 for others.
- For taxpayers in the highest bracket, this reduces the rate on qualified business income to 29.6%.
- A taxpayer earning income from a specified service trade or business in the field of accounting, health, law, consulting, athletics, financial services, or brokerage services is only entitled to the deduction if the taxpayer's taxable income is less than \$315,000 if married filing jointly or \$157,500 for another filing status.

Under the new rules, dividends, capital gains, and other preferential income are not considered qualified business income and will continue to be taxed at preferential rates. Taxpayers with substantial income from pass-throughs should see significant tax savings as long as they avoid the various limitations. If you are an owner of a pass-through business please contact your financial counselor to see if you should be looking to defer income or accelerate expenses. We will closely monitor the guidance surrounding these rules, as they may enable new tax saving strategies.

Section 529 Plan Flexibility

Historically, Section 529 plans have been a way for parents to save money to cover costs for college. The new Bill expands the utility of 529 plans by allowing withdrawals for public, private, and religious K-12 schools. Originally, withdrawals for home-schooling expenses would also be allowed, but this was stripped from the Bill at the last minute. The new K-12 withdrawals are limited to $10,000 a year, unlike the college expenses which generally are uncapped. The deadline for contributions varies from state to state, but for most it is December 31. Contributions to a child's 529 plan are subject to the gift tax rules. For 2017, the annual gift exclusion is $14,000. A husband and wife generally can each make $14,000 gifts to each of their children without being subject to gift tax.

New 2018 Tax Rates

Single Taxpayers

Income Level	Rate
$0 - $9,525	10%
$9,526 - $38,700	12%
$38,701 - $82,500	22%
$82,501 - $157,500	24%
$157,501 - $200,000	32%
$200,001 - $500,000	35%
> $500,000	37%

Married Taxpayers & Surviving Spouses:

Income Level	Rate
$0 - $19,050	10%
$19,051 - $77,400	12%
$77,401 - $165,000	22%
$165,001 - $315,000	24%
$315,001 - $400,000	32%
$400,001 - $600,000	35%
> $600,000	37%

This letter is general and educational in nature. Individuals should seek advice for their particular circumstances from their financial counselors or other tax advisors before undertaking actions in response to the matters discussed.