The New Federal Tax Law: Wealth Planning Considerations

FIDUCIARY TRUST

Wealth Planning

The new Tax Cuts and Jobs Act introduces sweeping changes that will affect individuals, businesses, and non-profit organizations. Here are 10 key items that are likely to impact high-net-worth individuals:

1. **Tax Brackets Adjusted**
   Top bracket drops, and benefits vary depending upon income.
   Seven tax brackets remain, but the actual tax rate and at what income levels they apply have changed, with the top bracket dropping from 39.6% to 37%. The 37% bracket will apply to taxable income over $600,000 for married filing jointly (MFJ) and over $500,000 for individuals. Keep in mind that despite the lowering of the top bracket, wages and self-employment income over $250,000 (MFJ) and $200,000 (individual) are still subject to the 0.9% Medicare surcharge, and the 3.8% net investment income tax is in addition to the revised tax brackets.
   - *Estates and Trusts:* Estates and trusts will be subject to only four brackets, but the 37% bracket will be applied to taxable ordinary income in excess of $12,500.
2. **Itemized Deduction Opportunities Change**
   Breaks for state and local taxes and mortgage interest are reduced.
   Some of the most significant changes are in itemized deductions, where state and local taxes and mortgage interest deductions are taking hits. Standard deduction amounts have increased ($24,000 for MFJ, $18,000 for head-of-household, and $12,000 for individuals), but that will not affect high-income taxpayers whose itemized deductions exceed those levels.

Learn More:

For more information on Fiduciary Trust visit:

www.fiduciary-trust.com

or contact:

Jody R. King
jking@fiduciary-trust.com
617-574-3424

Under the new law, a child's net unearned income is taxed at rates used for trusts and estates without regard to their parents' tax situation

Here are some of the key adjustments to itemized deductions:

- *Limitations on Itemized Deductions:* Itemized deductions that were previously subject to a reduction based on an adjusted gross income (AGI) threshold are no longer subject to reduction.
- *Real Estate Taxes and State and Local Income Taxes:* The total allowable deduction for any combination of real estate taxes and state and local income taxes is now capped at $10,000 per year. If you were previously subject to the Alternative Minimum Tax (AMT) you may not see a significant impact as deductions taken for real estate and state and local taxes are added back for AMT calculations. Note that foreign real estate taxes are not deductible.
- *Medical Expense Deduction:* This deduction is subject to a floor percentage, where unreimbursed expenses must exceed a certain percentage before they can be itemized. For 2017 and 2018, the floor for the medical expense deduction is reduced to 7.5% of AGI, but it returns to 10% of AGI in 2019.
- *Mortgage Interest Deduction:* The interest deduction remains for up to $1 million of acquisition indebtedness incurred before December 15, 2017. For new loans established on or after that date, only the interest on $750,000 of acquisition indebtedness will be allowed. The $750,000 limit reverts back to $1,000,000 beginning in 2026. Refinancing will not affect which limit is applicable, as long as the new debt amount does not exceed the amount being refinanced. Home equity debt is no longer deductible regardless of when it was established, at least until 2026.
- *Charitable Gifts:* The Tax Cuts and Jobs Act makes changes in charitable giving rules that could affect your decisions.
  - AGI Limits: Good news here, as the deduction limit increases from 50% of AGI to 60% for cash gifts to qualified charitable organizations. As before, contributions in excess of the AGI limits can be carried forward for up to five years. But look closely at the alternatives: It still may be more tax efficient to use appreciated securities to satisfy the majority of charitable giving (subject to a 30% AGI limitation). Those over age 70½ should consider making up to $100,000 of charitable gifts directly from their individual retirement accounts (IRAs).
  - College Event Seating: Amounts contributed to gain access to seats at college athletic events are no longer deductible.
- *Miscellaneous Itemized Deductions:* The bill eliminated some miscellaneous itemized deductions, such as tax preparation fees, investment management fees, and home office expenses. For the most part, this will have no effect if you were previously subject to AMT.

3. 'Kiddie Tax' Receives Full Overhaul

Children's income will be taxed without regard to parents' rates.

A child's net unearned income is now taxed at rates used for trusts and estates, regardless of their parents' tax situation. This is a significant change from the old rules, which used a complicated formula to tax a portion of unearned income of minor children and full-time students under age 24 at their parents' marginal tax rate.

4. Child Tax Credit Could Come into Play
Credits increase.

Mostly a non-factor in the past, this credit is more likely to benefit higher-income households going forward because of increased phase-out levels. Under the new law, the credit is increased to $2,000 per qualifying child, defined as under age 17, with up to $1,400 of that being refundable. In addition, a $500 nonrefundable credit is available for qualifying dependents other than children. The phase-out now begins at AGIs of $400,000 (MFJ) and $200,000 (single taxpayers). Amounts are not indexed for inflation.

5. Good News on Education Savings Plans
New flexibility makes accounts more attractive.

The use of funds in a Section 529 plan has been permanently expanded to allow up to $10,000 per year for tuition costs associated with attending an elementary or secondary school. This expansion makes Section 529 plans more attractive, but irrevocable trusts may be more flexible, and therefore, more attractive than Section 529 plans for high-net-worth families.

- *ABLE Accounts:* ABLE accounts are a tax-advantaged way to provide some level of benefits for a disabled person. Under the new law, an ABLE account can be funded from a Section 529 plan that may exist for the disabled individual or their family member, subject to annual exclusion gift level contribution limitations.

6. AMT Impact Is Reduced
Exemption levels rise, and rules change.

Fewer taxpayers will be subject to AMT under the revised rules. The exemption amounts increase to $109,400 for MFJ and $70,300 for single individuals, and the phase-out thresholds rise to $1 million for MFJ and $500,000 for single individuals. Amounts will be indexed for inflation. AMT impact is further reduced by the elimination of some itemized deductions, which are now disallowed for base tax purposes. These include real estate taxes, state and local income taxes, miscellaneous itemized deductions, and home equity loan interest deductions.

Fewer taxpayers will be subject to the AMT under the revised rules

7. No More Roth Reversals
Once an IRA is converted, it cannot be recharacterized.

Going forward, once assets are converted from a traditional IRA to a Roth IRA, such conversion can no longer be reversed.

8. Alimony Payments Will No Longer Be Deductible
Payors and payees both face new rules.

For divorce or separation agreements executed after December 31, 2018, the payor will no longer be allowed to deduct the payment from income, and the payee will no longer be required to include the amount received in taxable income. Unless modified after December 31, 2018, and specifically agreed to be subject to the new rule in the process, agreements executed before that date will continue under the current rules, where taxability is shifted from the payor to the payee. The treatment of child support payments has not changed.

Author

Jody R. King, JD, CPA
Vice President and Director
of Client Services

Learn More:

For more information on Fiduciary Trust visit:

www.fiduciary-trust.com

or contact:

Jody R. King
jking@fiduciary-trust.com
617-574-3424

9. **Estate and Gift Tax Exemptions Rise**
   Exclusions increase to more than $11 million per person.
   The new law reduces the tax impact of transferring wealth by roughly doubling the federal estate and gift tax exemptions. This results in a 2018 federal estate and gift tax exclusion amount of approximately $11.2 million per individual (or $22.4 million per married couple). This will also apply to the generation-skipping transfer tax. All amounts will continue to be indexed for inflation.

10. **Inflation Factor Changes**
    IRS to use a different index with a lower rate of increase.
    One permanent change relates to the index that will be applied going forward to most items that are indexed for inflation in the tax code. The Chained Consumer Price Index for All Urban Consumers (C-CPI-U) replaces the Consumer Price Index for All Urban Consumers (CPI-U). The basic difference between these two indexes is that the C-CPI-U assumes that consumers will alter their buying choices when options exist for lower-priced alternatives, thus resulting in a lower inflation rate.

Please follow Fiduciary Trust or contact us for further wealth planning guidance. ■

Note: Unless otherwise commented, items discussed above will affect tax years beginning after December 31, 2017, and before January 1, 2026, which for most taxpayers translates to the years 2018 through 2025.

FIDUCIARY™ TRUST