SoundView Advisors

New Tax Law Highlights by Ben Jennings

Business Taxes

Let's start with the big headline: The corporate tax rate is reduced to a flat 21% from the previous 35%. Achieving a big cut in the corporate tax rate was perhaps the dominant focus for this legislation, and this change is made permanent by the law (as much as anything in tax law is "permanent").

Looking beyond the traditional C corporation, other business forms are also receiving major tax breaks. There is a new 20% deduction for "qualified business income" (QBI) from pass-through businesses such as partnerships, LLCs, S corporations, and sole proprietorships. There are significant limitations and restrictions, but this is a big deal for small business owners, who likely need to re-evaluate their business entity structure with their tax and legal professionals.

Estate & Gift Taxes

Though not eliminated strictly speaking, the doubling of federal state and gift tax exemptions - now $11.2 million for individuals and $22.4 million for married couples - means that very few families face the need to plan for estate taxes, at least on the federal level (one estimate pegs the number of estates subject to federal tax as under 5,000 per year in the entire country).

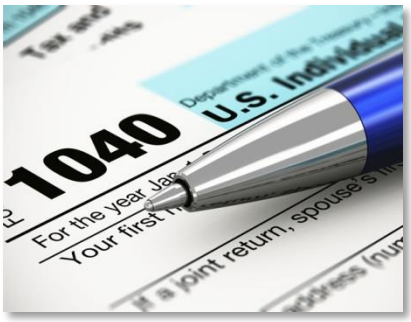
In contrast, state-level estate taxes are still in place in 15 states, and among these Washington has the highest maximum estate tax rate (20%) as well as a 2018 exemption of only about $2.2 million. Some states may see increased attempts to backstop their estate taxes with gift taxes to eliminate loss of tax revenue through "deathbed" gifts.

Personal Taxes

This is the area most newsletter readers are focused on, and there is big news here also. Before we highlight the key points, however, we note that nearly all of the individual tax changes are designed to be temporary, ending around 2025 under so-called "sunset" provisions. Many observers, however, note that the changes can become permanent as that time draws near (as the 2003 "Bush tax cuts" did) through the "fiscal cliff" scenario the law sets up.

Bracket Reductions. While the number of tax brackets remain at seven rather than early concepts with as few as three brackets, five of those see rate reductions of a few points as well as widening of the lower brackets. For example, household taxable income of $300,000 would have had some income taxed at up to 33% under former law, but will now face a top rate of 24%. Interestingly (!) the thresholds for capital gain and qualified dividend tax rates (rates which remain unchanged), which were formerly tied to limits aligned with individual tax brackets, were not changed under the new law.

Personal Exemption Elimination & Standard Deduction Increase. The new law eliminates personal exemptions, but more than makes up for it with an expanded standard deduction for married couples of $24,000 ($12,000 for individuals). If you are over 65, the extra $1,250 standard deduction continues to apply. The increased standard deduction means far fewer families will itemize.



Expanded Child Tax Credit. While some families would have lost under the "merging" of the personal exemption and standard deduction described above, this disadvantage is more than offset in most cases by an expansion of the child tax credit from $1,000 to $2,000 and increased income thresholds before the credits phase out.

Limitations on Itemized Deductions. Families who do have a possibility of itemizing deductions will face additional hurdles:

- A $10,000 cap on state and local taxes, whether income, sales, or property taxes.
- Mortgage interest no longer deductible for home equity loans and limited to balances under $750,000 for new acquisition debt incurred after 12/15/2017.
- Medical expenses retain the 10%-of-AGI threshold, though there is a temporary reduction to 7.5% for 2017 and 2018.
- Essentially all deductions that were "miscellaneous itemized deductions" subject to a 2%-of-AGI threshold are simply eliminated.

Reduced Impact of AMT. The Alternative Minimum Tax (AMT) now has both increased exemptions and a widened income range for phaseout of the exemptions. While AMT was not eliminated for individuals, when you take into account the reduced role for itemized deductions - many of which were key catalysts for taxpayers being subject to AMT - very few of us are going to be exposed to future AMT liability.

Goodbye to "Undoing" Roth Conversions. Finally, we note that one of the most flexible strategies for tax management in recent years has been the ability to recharacterize, or "undo," conversions from traditional IRA accounts to Roth IRA accounts. Beginning with conversions done in calendar 2018, this ability has been removed by the new tax law.