WELLS FARGO Advisors

Any Questions? Call (949) 862-1233

WELLS FARGO Advisors

Key Provisions of 2017 Tax Reform

The final provisions of the 2017 tax reform bill are finally here. The goal of this publication is to briefly highlight some of the key changes and planning issues of this complex bill that are important to individual investors and business owners. The impact on individuals will vary depending on your particular situation. Also, many aspects of this bill raise more questions and will need clarification. As time passes, we expect additional guidance to develop.

The provisions listed here are effective starting in 2018 unless stated otherwise. The items in (red) will expire on December 31, 2025. Therefore, any planning ideas should be evaluated in light of the fact that these particular changes are scheduled to revert back to pre-2018 tax law within a relatively short time frame. The remaining provisions are not scheduled to expire unless otherwise noted.

Summary of new tax law changes

Individual, trust, and estate tax rates and brackets

Changes

- For individuals, the new law provides for the same number of tax brackets, but with lower rates and different income thresholds. See the following charts for income thresholds associated with each bracket.
- The tax rates for trusts and estates have also decreased and now consist of only four brackets. New rates: 10%, 24%, 35%, and 37%. Old rates: 15%, 25%, 28%, 33%, and 39.6%.

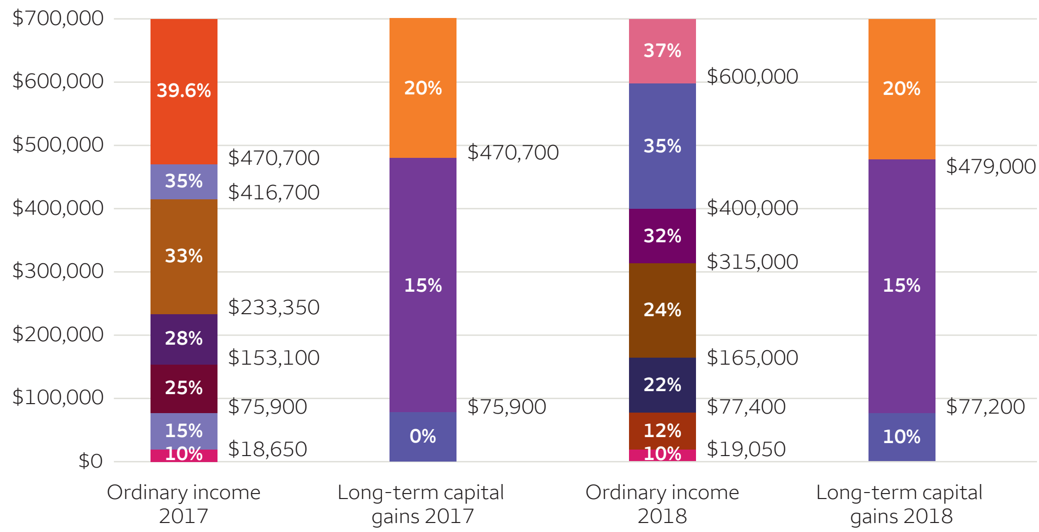
Impact

- Rates for qualified dividends and long-term capital gains are unchanged. The income thresholds for the capital gain brackets are no longer tied to the ordinary income brackets. See the following charts for a comparison of the capital gain and ordinary income brackets.
- Congress did not repeal existing Medicare taxes (the 0.9% additional payroll tax, or the 3.8% tax on net investment income) that apply to higher-income taxpayers. These apply when adjusted gross income (AGI) exceeds $250,000 (joint) or $200,000 (single).

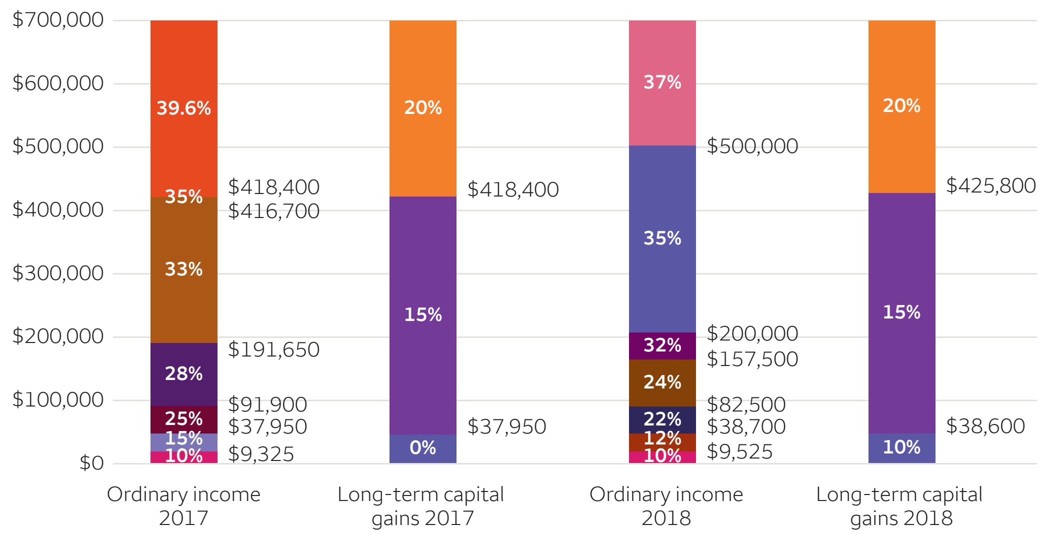
Planning considerations

Since taxable income is determined after applying your deductions, it will be important to evaluate how the loss of deductions may offset the benefit of lower rates.

Married filing jointly



Single



Deductions, exemptions, and the child tax credit

Changes

- The standard deduction is nearly doubled to $24,000 for married filers and $12,000 for single filers.
- The additional standard deduction for individuals who are age 65 or older, or blind, is retained.
- Personal and dependent exemptions (currently $4,050 per person) are eliminated.
- The deduction for state and local taxes is significantly changed. This deduction will be capped at $10,000 for the sum of state and local property taxes and income taxes (or sales tax in lieu of income tax). Property taxes paid in carrying on a trade or business will not be subject to this $10,000 cap.

- Mortgage interest deduction limit on qualified acquisition debt is reduced from $1,000,000 to $750,000. This means interest is deductible on loan balances up to $750,000 used to buy, build, or improve your primary home or one second home. This reduction applies only to debt incurred after December 15, 2017.
- Mortgage interest deduction is eliminated for interest paid on home equity debt. This is debt used for something other than to buy, build, or improve your home.
- Cash contributions to charitable organizations may now offset up to 60% of your AGI (up from 50%).
- Deductions for investment expenses, tax prep fees, and unreimbursed employee expenses are eliminated.
- Medical expenses exceeding 7.5% of your AGI are deductible (down from 10%). This reduced limit applies only for 2017 and 2018.
- Casualty losses are limited to those attributable to a federally-declared disaster area.
- The phase-out of itemized deductions for higher-income taxpayers is eliminated.
- The child credit increases from $1,000 to $2,000. The income level at which the credit begins to phase out also increases allowing more taxpayers to benefit.
- Alimony payments for divorce agreements entered into and/or modified after December 31, 2018, will no longer be deductible by the payer and will not be considered income to the recipient.
- The Alternative Minimum Tax exemption is increased allowing more taxpayers to escape AMT.

Impact

How these changes affect you is dependent on the specifics of your personal tax situation.

- For those who don't itemize currently, a larger standard deduction will be a welcome benefit.
- The repeal of many itemized deductions could mean that some taxpayers, who previously itemized, could find themselves limited to a standard deduction that is smaller than the amount they used to get under itemization.
- The repeal of personal exemptions may be mitigated or offset by the increased standard deduction and/or child credit.

Planning considerations

- For taxpayers who are charitably inclined and over age 70½, it will be important to evaluate whether it is more beneficial to make a contribution of cash, stock, or a qualified distribution from your IRA. The best strategy will not be the same for everyone.
- Some taxpayers may want to consider "bunching" charitable contributions into alternate years, with a view to qualifying for itemization at least some of the time. Bunched gifts to donor-advised funds might be another way to accomplish this goal. However, the cash flow impact of these ideas on the taxpayer and the charity should be considered.

IRA contributions and conversions

Changes

- The rule allowing a contribution to one type of IRA to be recharacterized as if made to another type of IRA is modified to exclude Roth IRA conversions. Normal IRA contributions may still be recharacterized.

Impact

- Taxpayers who want to convert their Traditional IRA to a Roth IRA will need to carefully consider the consequences since they no longer have a period of time to undo it if they change their mind.

Planning considerations

- A Roth conversion can still be a useful tax strategy in years where you have a decrease in income or a market decline in your retirement plan assets.

Education tax benefits and ABLE accounts

Changes

- Qualified distributions from a 529 plan now include up to $10,000 annually for elementary and secondary tuition.
- ABLE accounts may accept tax-free rollovers from 529 plans, up to the annual contribution limit for ABLE accounts.
- Contributions to ABLE accounts are eligible for the saver's credit.
- Contributions to ABLE accounts are increased by amount of beneficiary's earned income (up to federal poverty line).

Impact

Both 529 college savings plans and ABLE accounts (designed for disabled beneficiaries) become more attractive tools for meeting savings goals.

Planning considerations

- Consider additional funding for a 529 plan since the funds may now be used for tuition for grades K-12.
- Work with your tax advisor to determine the best way to make ABLE account contributions that qualify for the saver's credit. The credit could equal up to 50% of your contribution (maximum credit is $1,000).

Taxation of a child's investment income

Changes

Investment income of a child will be taxed at trust income tax rates rather than individual income tax rates.

Impact

For children under age 24 who are full-time students, investment income is no longer taxed at their parent's rate but at trust rates. The top trust income tax rate is the same as the top rate for an individual. However, the top trust rate applies at a much lower level of income likely resulting in a higher tax bill under this new rule.

Planning considerations

- Review your goals for gifting to a minor along with the various vehicles available for holding funds in a child's name.
- For minors, a trust and a custodial account may now have similar tax implications, but they still differ when it comes to distribution requirements and control of assets.
- If gifts are intended for education, the tax rules for 529 plans are considerably more attractive than other options.
- For other gifts, investment choices will be important in order to control the amount and character of income generated while the child is subject to these rules.

Estate, gift, and generation-skipping taxes

Changes

- The new law doubles the "applicable exclusion" to $11,180,000 per person, effective in 2018.
- This exclusion will continue to be inflation-adjusted in future years.

Impact

- The "portability" election, which permits a deceased spouse to transfer unused exclusion amounts to a surviving spouse, is unchanged.
- The rules providing a "step-up" in cost basis at death for capital assets are unchanged.
- A married couple, with basic planning, should be able to transfer up to $22,360,000 with no federal estate tax.

Planning considerations

- Existing estate plans for married couples often call for automatic, maximum funding of a "credit shelter" trust at the first spouse's death.
  - That could result in less-than-optimal use of the deceased spouse's exclusion, and sacrifice the opportunity for a "step-up" in cost basis at the surviving spouse's death.
  - Estate plans created before 2013 should definitely be reviewed, and even recently created plans may need to be reconsidered in light of dramatically higher exclusions.
- Higher exclusions may tempt some individuals to overlook estate tax planning, resulting in missed opportunities. It could be a mistake to over-simplify your estate plan in reaction to the new law.
  - Instead of doing less estate planning, these higher thresholds could be viewed as a historic opportunity to do more.
  - In particular, higher generation-skipping exclusions provide a huge opportunity for multi-generational wealth preservation planning.
- Individuals with charitable planning goals may benefit from adjustments to strategies and timing. For example, if you don't owe estate tax, a charitable bequest does not result in any tax reduction. Perhaps lifetime giving strategies—which could provide an income tax deduction if you itemize—should be evaluated as an option. Alternatively, consider naming a charity to receive some funds from IRAs, qualified retirement plans, or deferred annuities—distributions from these assets would result in taxable income to individual beneficiaries, but can be distributed to charities with no income tax.

Business income and deductions

Changes

- The tax rate for C Corporations is reduced to a flat rate of 21%.
- Corporate AMT is eliminated.
- There is now a new deduction for 20% of qualified business income of S corporations, partnerships, and sole proprietorships.
  - Generally speaking, this special deduction is allowed against business profits, and does not apply to wages earned by the business owner.
  - The amount of the deduction generally cannot exceed 50% of wages paid by the business: however, capital-intensive businesses may qualify for an alternative limitation based on the value of capital assets.
  - This deduction is not available for businesses that provide services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, investment or brokerage services, or any business where the principal asset is the reputation or skill of one or more of its employees.
  - However, owners with taxable income below $315,000 (if married filing jointly) or $157,500 (if single) are still permitted to take this deduction, without regard to the limit for wages or specified services businesses.
- Taxpayers are also able to deduct 20% of income received as qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income.
- 100% expensing of qualified business property is allowed for five years then gradually phases out.
- Increased limits for expensing are allowed under Section 179 and certain real property improvements are added as qualifying property.

Impact

- Your current business entity choice may no longer be the best choice for tax purposes.
- Significant tax benefits are now available to businesses which have been waiting to invest in capital expenditures.

Planning considerations

- Many questions remain about the details of how the deduction for pass-through entities will apply.
- The type of business activity you conduct may have a significant impact on whether you benefit from the new pass-through deduction. Business owners will want to evaluate whether it is beneficial (and practical) to segregate “favored” and “unfavored” business activities into different entities.
- When considering a change of business structure or entity type, evaluate how the expiration of these new rules will impact the value of any particular strategy.
- Meet with your tax advisor and attorney to carefully weigh any decisions related to choice of business entity.

State and local taxes

Changes

Some state tax provisions are tied to federal tax provisions. Upon enactment of this federal law each state will have to decide whether or not to go along with the federal changes. Many states typically update their laws to conform to some, usually not all, of the federal changes.

Impact

- Differences in state and federal laws lead to additional complexity, record keeping, and tax prep costs.
- Some states use federal taxable income as the starting point of their tax calculation. If your federal taxable income increases due to the loss of several federal deductions, your state tax bill could increase even without any state law change.

Planning considerations

Income tax

- Any tax strategies considered for federal tax planning purposes should also take into account the state tax impact.
- Consider the impact of the new law when determining your estimated tax payments for 2018.

Estate/Gift/GST tax

- The thresholds for state estate tax are often considerably lower than the federal applicable exclusion.
- A few states have "tied" their exemptions to the federal exclusion. It will be important to monitor whether these states continue that link, or choose to "decouple."
- It's not sufficient just to plan for the laws of the state where you live. To preserve family wealth effectively, it's increasingly important to consider the potential impact of state taxes in the places where your heirs and beneficiaries live.

The individual provisions listed each represent a significant change to current law. In combination, the overall effects will vary widely among taxpayers. As time passes, we will have more clarity on the details and more planning strategies to share. Now is the time to gather your advisor team. Your financial advisor, estate attorney, and tax advisor will be instrumental in determining what action steps are best for you in the short-term and the long-term.

Wells Fargo Advisors is not a tax or legal advisor. Although this summary is not intended to replace discussions with your tax advisor, it may help you to comprehend the tax implications of your investments and plan efficiently going forward. This summary was originally released in 2017 and has not been updated for inflation adjustments or subsequent legislation.