An Overview of the
"Tax Cuts and Jobs Act"

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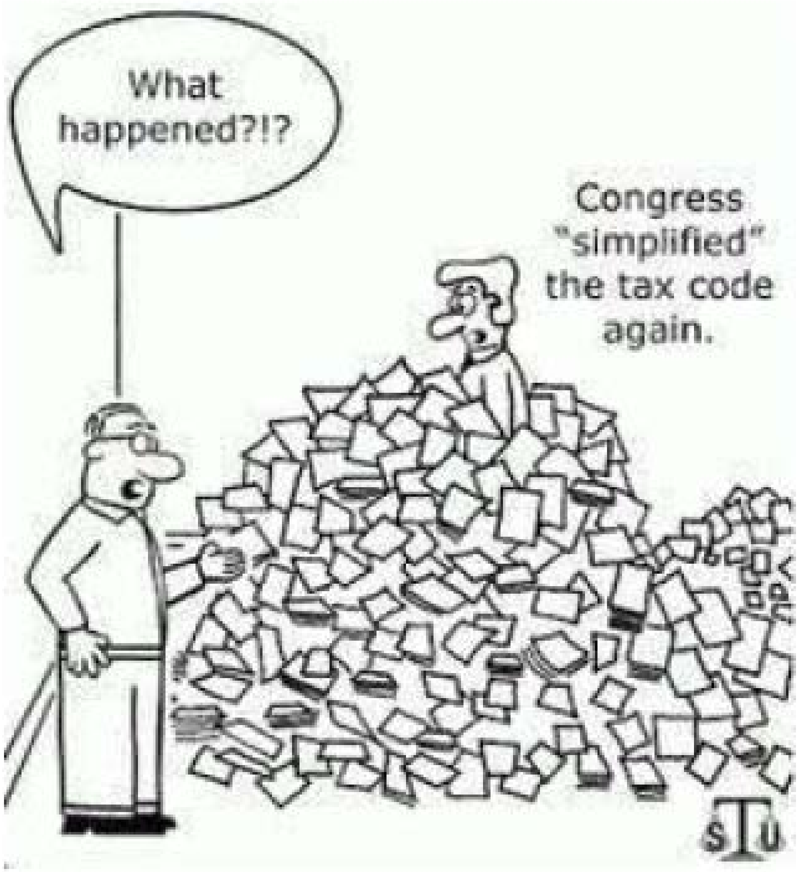
Tax Cuts and Jobs Act

- Most Significant Tax Legislation since 1986
  - 503 pages of Legislation, generally effective 2018
- Rate Reductions
  - ➢ Individual rates
  - ➢ C Corporation 21% rates
  - ➢ New “QBI” 20% Flow Through Deduction
    - Should we change our Business Structures?
- Individual & Corporate Tax Reform
- International Tax Reform
- Miscellaneous Pension, Exempt Organizations & Other Reforms

The New Tax Law



Legislative Process

- Signed on 12/22/17

- Speed at which the law was written will result in unintended consequences
- Expect a Large Amount of IRS Interpretations on how to apply and calculate the impact of the Act (especially IRC 199A)
- Accountants and Tax Lawyers should be Happy

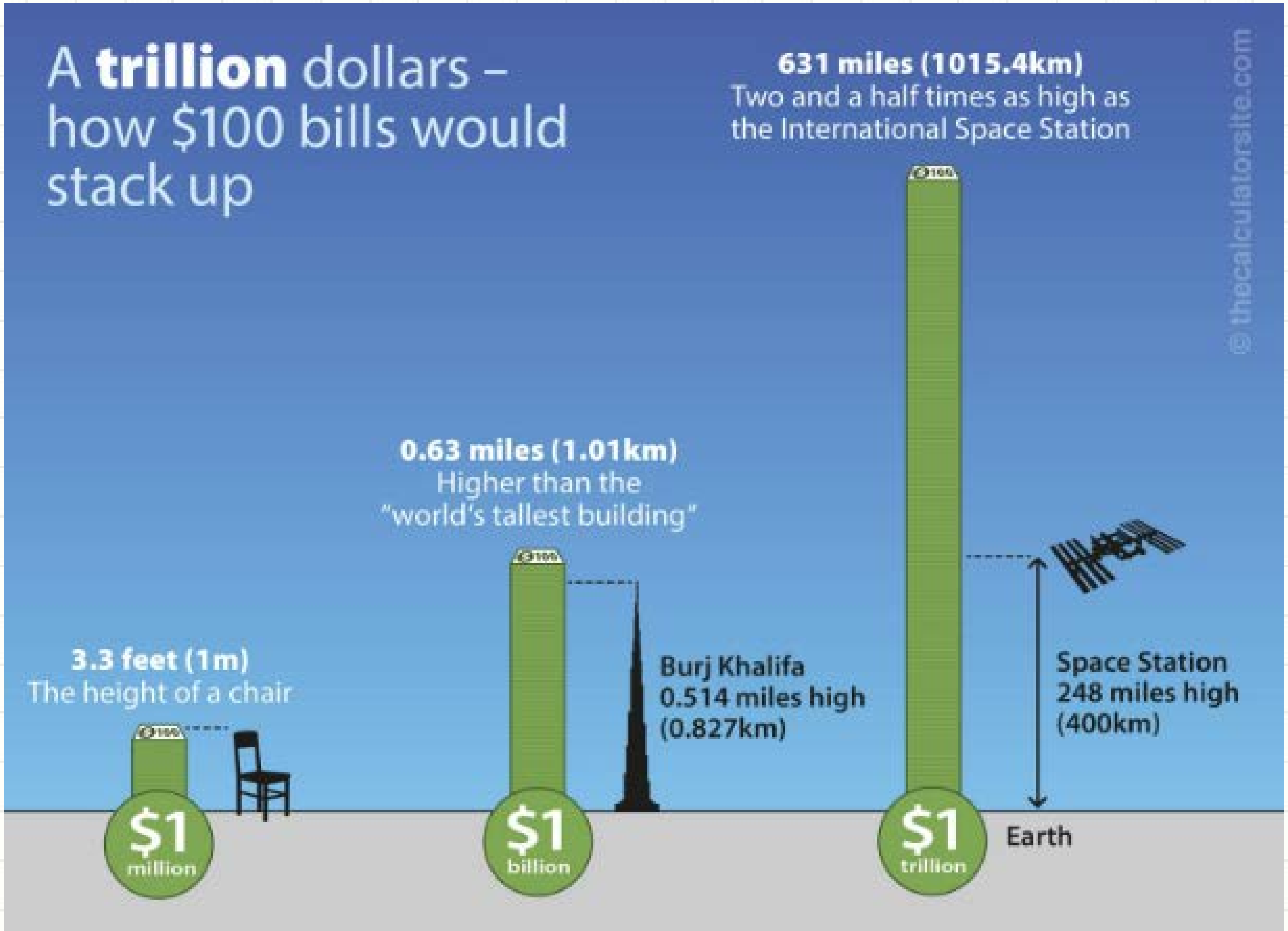
$1.456 Trillion Added to Deficit (10 Years)

- What is Projected "Growth"?
  - Tax Foundation, a "right leaning" organization estimates $1 Trillion of Growth (many disagree)
  - Tax Cuts Will <u>Not</u> "Pay for Itself"

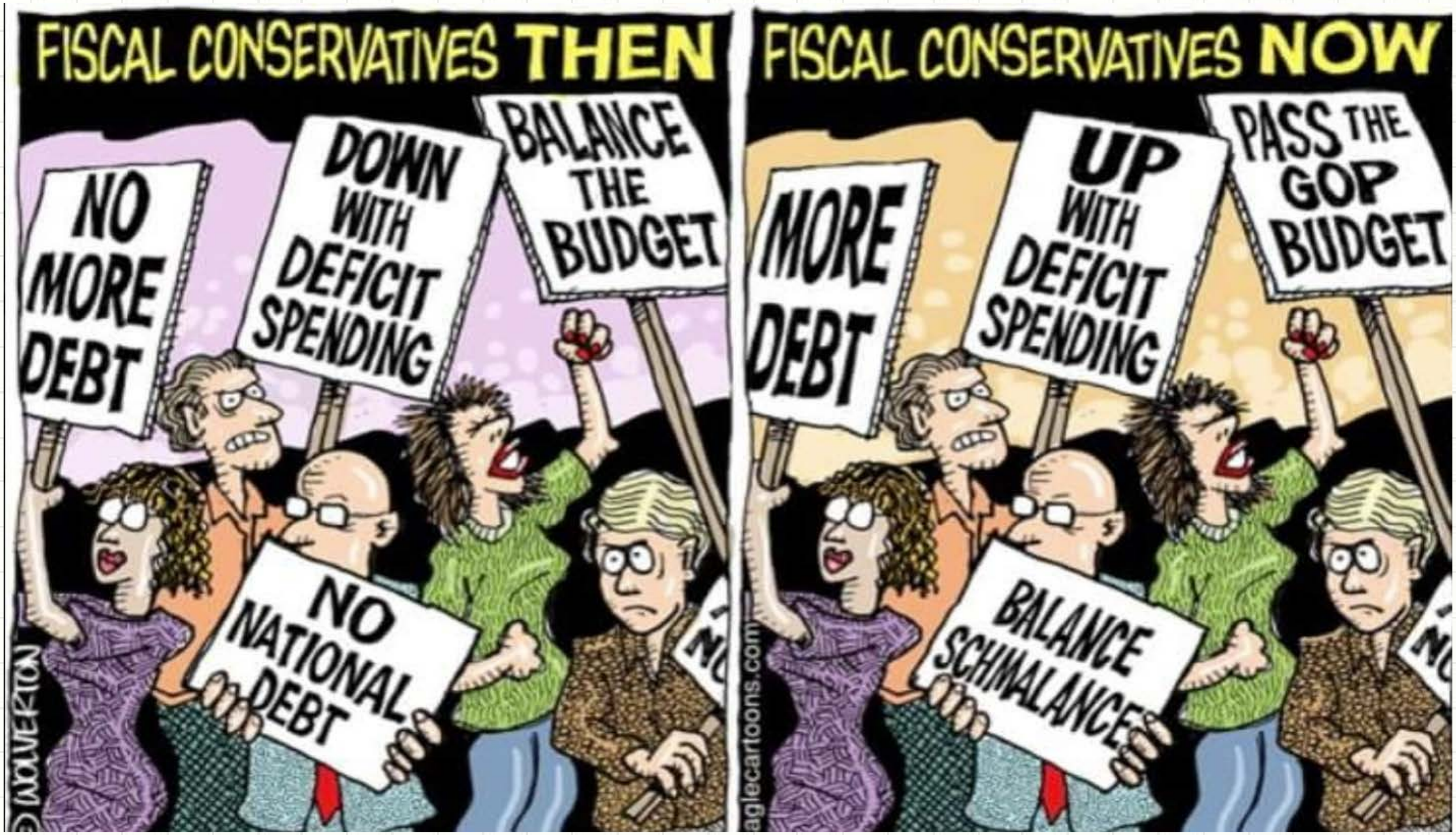
- Aggregate Debt = $15 Trillion
  - 2018: 78% of GDP
  - 2028: 96% of GDP **(100% = Death Zone?)**
  - Projected 2018 Deficit = $804 Billion

- Future (pick your poison):
  - Budget Cuts?
  - Tax Increases?
  - Entitlement Cuts?
  - Do Nothing?

How Much is a Trillion Dollars?
$1,000,000,000,000



Are Fiscal Conservatives Extinct?



"I would like to find a way — and I don't know what exactly that's going to be — how do we get bipartisan consensus to fix these looming, debt problems we've got on the horizon." Paul Ryan, soon to be "former" House Speaker

Permanent & Temporary Cuts

Business Tax Cuts

Individual Tax Cuts

Permanent

Temporary

"Sunsetting" on 12/31/2025*

*Under the "Byrd Rule," without 60 votes, Senators can block legislation which increase the federal deficit beyond a 10 year period.

The Math of the "Sunset"

Budget Resolution "Capped" 10 Year Deficit Increase at $1.5 Trillion

10 Year Cost of 2017 Act	$2.7 Trillion
8 Year Cost of 2017 Act	<u>($1.47 Trillion)</u>
"Savings" of 8 yr. (vs. 10 yr.) Sunset	**$1.23 Trillion**
Projected Cost of "Removing the Sunset" (making the Tax Cuts Permanent in 2026)	Trillions

Significant Possibility Individual tax cuts will <u>not</u> be made permanent

<u>Or in other Words, Individuals can look forward to (i) a Tax Increase in 2026; or (ii) the further "Blowing Up" of the Deficit!!!</u>

Individual Tax Rates

The tax rate brackets have been lowered. There are still 7 tax brackets but the overall rates have come down.

Old Vs. New Tax Brackets For Marrieds Filing Jointly

Old brackets		New brackets	
Taxable income	Tax rate	Taxable income	Tax rate
$0-$19,050	10%	$0-$19,050	10%
$19,051-$77,400	15%	$19,051-$77,400	12%
$77,401-$156,150	25%	$77,401-$165,000	22%
$156,151-$237,950	28%	$165,001-$315,000	24%
$237,951-$424,950	33%	$315,001-$400,000	32%
$424,951-$480,050	35%	$400,001-$600,000	35%
$480,051+	39.6%	$600,001+	37%

Sources: docs.house.gov, taxfoundation.org

Dividend and capital gains rates unchanged

The top tax bracket for qualified dividends and capital gains is 20% (23.8% if the net investment income tax applies).

Individual Tax Rates on Capital Gains & Dividends are the Same

Individuals	Married/filing jointly	Tax rate*
$0–$38,600	$0–$77,200	0%
$38,601–$425,800	$77,201–$479,000	15%
Over $425,800	Over $479,000	20%

Plus the 3.8% surtax on Net Investment Income

(applicable to single filers over $200,000 in modified adjusted gross income (MAGI) and for married couples with more than $250,000 in MAGI)

Business Rate Changes

Corporate tax rate	Reduced from 35% to 21%
New deduction for small business owners	20% deduction on "Qualified Business Income" (QBI), subject to limitations
Enhanced expensing for capital spending	For the next five years, corporations can immediately expense capital investments
Repatriation of overseas profits	Tax rate of 15.5% on cash, 8% on non-liquid assets

Major Individual Tax Changes

- **Medical Expenses** (threshold reduced to 7.5% of AGI, from 10%)
- **Repeal Casualty Loss Deduction** (N/A federally declared disasters)
- **Repeal of Itemized Deduction Phase Out**
- **Elimination of Personal Exemptions**
- **Repeals of Obama Care Individual Mandate Penalty**
- **Dramatic Increase in Standard Deductions will Reduce Number of Itemized Filers** (30% to 12%?)
  - Single $**12,000** (from $6,350)
  - Head of Household **$18,000** (from $9,350)
  - Married Filed Jointly **$24,000** (from $12,700)

Major Individual Changes (Con'd)

- **Repeal Qualified Moving Expenses** (military exception)
- **Charitable Contributions**
  - ➢ AGI limit increased (from 50% to 60%) for cash contributions
    - ➢ if <u>only</u> cash gifts made to public charities
- **ROTH IRA Recharacterizations disallowed** (permanent)
- **Kiddie Tax/Not tied to Parents' Rates** (children [up to age 23] unearned income over $2,100 taxed under trusts & estates rate brackets).
- **Repeal of Special Alimony Tax Treatment** (permanent)
  - ➢ Not deductible by payor or included in the income of the payee;
  - ➢ Divorces <u>after 2018</u> (prior agreements grandfathered in…)
  - ➢ Will affect Divorce Negotiations? (more expensive for payor spouse)
- **Section 529 Plans** (may pay $10K per student [from all plans] for elementary/secondary tuition, plus certain home schooling expenses (permanent), plus "sunsetting" 15k rollovers to ABLE accounts

Repeal of Miscellaneous Itemized Deductions

Expenses for Profit Orientated Activities (not Trade or Business)
Under Prior Law, such Expenses had to Exceed 2% AGI to be Deductible

- **Unreimbursed employee expenses** (i.e., union & professional dues, work uniforms, tools & supplies, work-related education, professional journals, work meals & lodging, licenses, malpractice insurance etc.)
- **Estate Planning Legal & Tax Preparation Fees**
- **Investment fees and expenses**
- **Appraisal fees for casualty loss determination**
- **Excess deductions (including Legal Fees) "Flowing" to a Beneficiary in Final Year of an Estate or Trust**
  - Pre-Termination Planning: Sell Assets to generate gains?

Child Tax Credit & AMT

Child Tax Credits: (children under age 17 at end of year)

- **Increased to $2,000 @ child**
- Phase Out Threshold increased to $400K AGI (Married) and $200k (others)
- Does not outweigh loss of prior $4k Personal Exemption for many

Alternative Minimum Tax

- **Projected 200,000 AMT Filers (vs. 5 Million prior law)**

- Exemption increased to $109,400 (Married) and $70,300 (others)
- Phase Out threshold Increased to $1M AMTI (married) and $500k (others)
- **The increased Exemptions and Phase Out Thresholds, combined with the new $10k SALT deduction limitations (discussed below), will mean that dramatically fewer taxpayers will be "caught" by the AMT snare.**

Reducing Itemized Filers by Capping the "SALT" Deduction at $10K

(N/A to Income Producing Properties reported Sch. C or Sch. E)

- State and Local Tax Deduction ("SALT") is capped at $10k (Married) $5k (Single)
- **Prevents Many Taxpayers in High Property Tax States (IL) from Itemizing** because itemized deductions must exceed the new high $24k (married)/$12k (single) Standard Deduction Limits
- Itemized Filers also hurt by Harsher Mortgage Interest Rules (limited to $750k of indebtedness, with no deduction for home equity lines)
- Did Pre-Paying 2018 Real Estate Taxes "Work"?
  - IRS says "Yes" for Illinois Taxpayers (Lien on Property)
  - But AMT eliminated benefit for some taxpayers

Dealing with the $10k "SALT" Deduction

- "Bunching" Charitable Contributions in Alternate Years
  - Make all your 2019 Charitable Contributions before 12/31/2018
  - No additional contributions until "double pay" year of 2020, & so on…
  - CRTs, CLTs & Foundations
- Contributions to "Donor Advised Funds
  - Investment fund controlled by Donor at Fidelity (or other sponsoring financial company) which makes distribution to Donor's charities over a number of years
  - Upfront charitable deduction, even if charities receive fund in later years
- "Qualified Charitable Distributions"
  - IRA "RMDs" to Charities (age 70 ½ ; capped $100k)

- Gifting/Dividing Non-Grantor Trusts to Each Own Separate Properties
- "Blue State Rescue Charities" Not in Illinois (yet)
  - Receive Property Tax Credits for "charitable" contributions to State Sponsored Charities

20% Deduction on Qualified Business Income (“QBI” Deduction)

Two Structural Choices of Operating a Business

- **C Corporation**
  - two levels of taxation; top rate reduced from 35% to **21%**);
  - Attractive reinvestment rate (plus advantageous IRC 1202 stock sales)

- **Pass Through Entities** (one level of taxation)
  - Sole Proprietorship
  - S Corporation
  - Partnership

- **QBI Rules – Consider Entity Changes**
  - Sole Proprietorship
  - S Corporation
  - Partnership

<u>20% QBI Deduction – Top Federal Rates</u>

Theory: Deduction Maintains 10% rate Differential

- **<u>Prior to 2017 Act</u>**
  - **C Corporations – 50.47%**
  - **Flow Through Entities – 40.8%**
    - About a <u>10% advantage</u>
- **<u>After 2017 Act</u>**
  - **C Corporations – 39.8%**
  - **Flow Through Entities <u>without</u> QBI Deduction– 37%**
    - About a 2.8% advantage
  - **Flow Through Entities <u>with</u> QBI Deduction– 29.6%**
    - The <u>10% advantage is "Maintained"</u>

What is Qualified Business Income ("QBI")?

- Income from a Qualified Trade or Business
  - Business by Business Analysis
    - How do you treat two businesses in one entity?
  - Limitations on "Specified" Service Businesses ("STOBs)

- Plus "Qualified" REIT/Cooperative Dividends & Publicly Traded Partnership Income

- Excludes
  - Investment-type income (e.g. – interest and dividends)
  - Short Term or Long Term capital gains or losses;

IRC 199A - 20% Deduction on Qualified Business Income (“QBI”)

- **20% x QBI = Deduction**

- **Subject to Limitations Based on:**
  - Owner’s Taxable Income
    $315,000/married; $157,500/Single
  - Type of Business
    Is it a “Tainted” (STOB) Service Business?
  - Entity Choice

Owner's Taxable Income Limits Not Exceeded

Identical Businesses have Different Deductions based on Entity Choice and Taxable Income of Owners

	Sole Proprietorship	S Corporation	Partnership
Business Income	$200,000	$200,000	$200,000
W-2 Wages	N/A	($80,000)	N/A
Guar. Payments	N/A	N/A	($80,000)
Net Income/QBI	**$200,000**	**$120,000**	**$120,000**
Tentative 20% Deduction	$40,000	$24,000	$24,000
50% W-2 Wages	N/A	N/A	N/A
Final QBI Deduction	**$40,000**	**$24,000**	**$24,000**

Owner’s Taxable Income Limits Exceeded

Identical Businesses have Different Deductions based on Entity Choice and Taxable Income of Owners

	Sole Proprietorship	S Corporation	Partnership
Business Income	$500,000	$500,000	$500,000
W-2 Wages	N/A	($125,000)	N/A
Guar. Payments	N/A	N/A	($125,000)
Net Income/QBI	**$500,000**	**$375,000**	**$375,000**
Tentative 20% Deduction	$100,000	$75,000	$75,000
50% W-2 Wages	$0	$62,500	$0
Final QBI Deduction	**$0**	**$62,500**	**$0**

QBI Deduction Mechanics

20% of pass through income can be deducted
After taking the deduction, tax rates of **up to 37**% apply

Up to $315,000 (married)
Individual Income
($157,500 single)

Full Deduction

Over $315,000 (married)
Individual Income
($157,500 single)

Deduction is **phased out for law, consulting, and other service businesses**. For other businesses, the **maximum 20% deduction is limited to the Greater of:**

50% of W-2 Wages paid

25% of W-2 Wages paid plus **2.5%** of "**Qualified Property**"
(includes Real Estate & Equipment;
$10M rental bldg. = $250k deduction)

"W-2 Wage Limitations"
(Anti-abuse rule to discourage not paying salaries in order to increase 20% deduction)

The "Magical" 28.57% W-2 Formula

Presume Owner over $315k/$157.5 Taxable Income Limits, with $1M of Qualified Business Income ("QBI")

	QBI Deduction
• Sole Proprietorship: $1M QBI; $0 W-2 Wages	$0
• Partnership: $1M QBI; $0 W-2 Wages	$0
• S Corporation: $800 QBI; $200k W-2 Wages	$100k (50% wage)

➢ **Increase Wages to 28.57% of QBI to Maximize Deduction**

Proof:
$285,700 W-2 Wages X 50% = $142,850
$714,300 X 20% = $142,860

LISI Income Tax Planning Newsletter #142 (May 3, 2018)
http://www.leimbergservices.com

Owner's Taxable Income Limits are Key

Phaseouts by Extra" Income:
-$100k joint filer
-$50k single filer

- Is Owner's Income over $315,000 (married) or $157,500 (single)?

Lawyers, Accountants & Other *"Specified Service Trade or Business"*

Other Businesses

	Over $415k		**$315k -$415k**
Lawyers, Accountants & Other *"Specified Service Trade or Business"*	**No Deduction**		Deduction Phase –out
Other Businesses	W-2 Wage Limitations		*Modified Rules*

The Penalized Specified Service Trade or Business ("STOB")

Engineers & Architects (not Lawyers) are Exempt!

§199A defines a Specified Service Trade or Business to be any trade or business which is described in section 1202(e)(3)(A) with modifications.

The §1202(e)(3)(A) definition is "any trade or business involving the performance of services in the <u>fields</u> of health, law, ~~engineering, architecture~~, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees or owners

QBI Division Strategy for "STOBs"

"STOB" Businesses – Separate Non-Professional Business from "Tainted" Professional Businesses

Facts: 25 Attorney law firm with $20M revenues. 10 Partners earn an average of $450k. Since the business a "STOB" and each Partner's income exceeds the $415k Phaseout, there appears to be no 20% QBI Deduction

Planning: Divide businesses into separate entities to shift profits to non-legal entities that qualify for the 20% QBI Deduction

(Non Legal Services)

Law Firm Support LLC

QBI Deduction

$$$ ←

Services →

(Legal Services)

Law Firm Services LLC

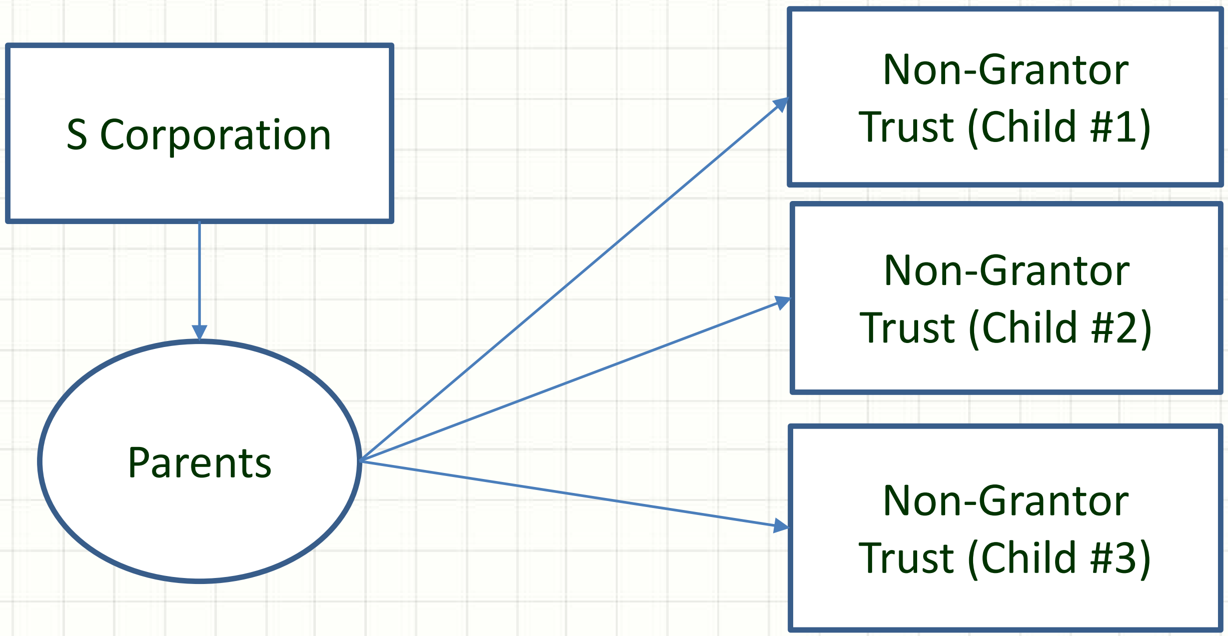
No QBI Deduction

- Most employees shifted to this entity

- Contracts with Law Firm Services LLC to provide services for receptionist; secretarial; IT support; file retention & property management.

QBI Multiple Owner Division Strategy

Divide Business Interests Among as Many Different Owners as Possible, each to receive up to $157,500 of Taxable Income



- Parents Gift Non-Voting Stock to separate Children's Trusts (or directly to family members). Trusts make "ESBT" elections to preserve S election.

- Three (3) entities = Three $157,500 QBI Deduction Limits to Work with
  - ➢ 20% Deduction on first $157,500 of Net income

- Is it worth it?
  - 20% times 37% rate x $157,500 income = $11, 655 tax savings per trust

Other Strategies

- Contributions to Pension/Qualified Plans
  - Reduce Owner's Income below $315k/$157.5k Income Limits

- If Over $315k/$157.5k Income Limits
  - Equipment or Real Estate Purchases
  - Incentive to Pay W-2 Wages
  - "Magic" 28.57% W-2 Formula

- Problems with Management Company Structures?
  - Uncertainty whether W-2 Wages paid by a Management Company as a central payor of wages, can "flow through" to the affiliated companies for QBI purpose

The Independent Contractor Dilemma

Two Secretaries working for the same employee, could have
Significantly Different Federal Income Tax Liabilities

Employee

Independent Contractor

- Secretary #1 - Employee
  Not Eligible for 20% QBI Deduction
- Lower Employment Taxes?
- Group benefits, such as Health Insurance & Pension Plans

- Secretary #2 - Sole Proprietorship
  Eligible for 20% QBI Deduction
- Offset by higher Employment Taxes?
- IRS "Audit Risk" of Improper Classification

Tax Cuts and Jobs Act

Increased Estate/Gift Tax Exclusions

Single

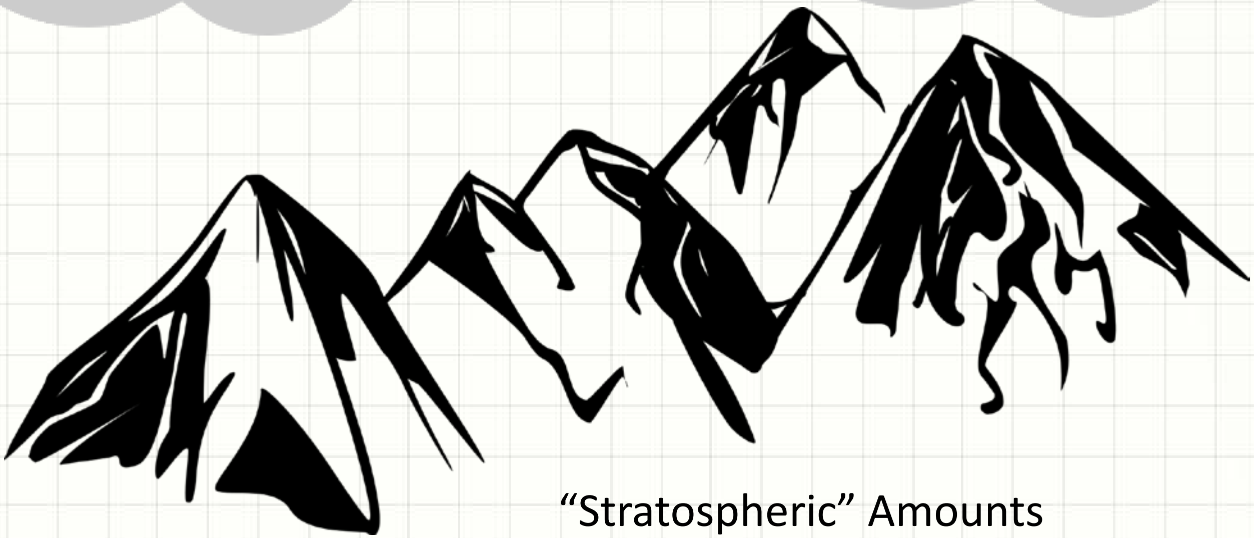
$11,180,000

Federal Exclusion Amount

Married

$22,360,000

Federal Exclusion Amount



"Stratospheric" Amounts

The Federal Estate Tax is Effectively Repealed

- 2.7M Deaths in U.S. (2016)
- 11,200 Decedents had Assets Greater than $5M (.0041%); 4 in a thousand
- 4,142 Decedents had Assets Greater than $10M (.0015%); 1.5 in a thousand
    - (Does population of Tax Lawyers/Accountants exceed this group?)

<u>The New Estate Planning Paradigm</u>

- Estate Taxes are <u>not</u> a major concern for <u>Most Clients</u>

- Increasing Importance of <u>Income Tax Planning</u>
- Flexible Trust Provisions
- Dealing with the Loss of “Stepped up” Basis for Credit Shelter Trusts (“CST”) Assets

But Wait, How About the Illinois Estate Tax?

$11.18 Million
Federal
Estate Tax
Exclusion

Leaving IL “Escapes” IL Estate Taxes

$4 Million
Illinois
Estate Tax
Exclusion

But Wait, Doesn't the $11.18M Exclusion "Sunset" in 2026?

Sunset Provision Requires Maximum Flexibility in Planning

$11.18 Million

2018-2025

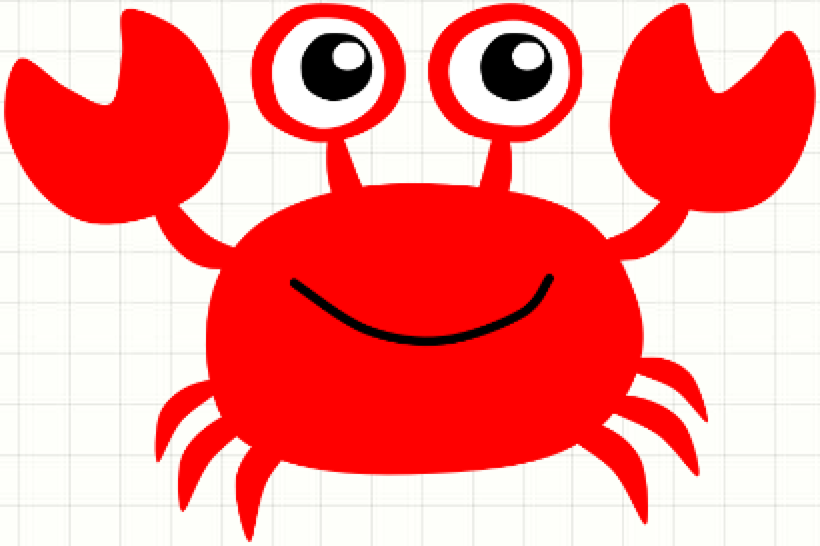
$5.59* Million

2026 & on???

* Plus Inflation Adjustment

But Wait, Is there a Gift "Clawback" if the Law Sunsets?

Does Gifting the Estate Tax Exclusion Amount which Later "Sunsets," Trigger Estate Taxes at Death?



- $11.8M Gift in 2018; Donor Dies in 2026
- Exclusion reduced to $6.2M* in 2026
- **Is the entire Gift added back to Donor's Estate at Death, triggering Federal Estate Taxes"?!!**
- Uncertainty. IRS Regulations in 2018?; Clawback viewed as unlikely…

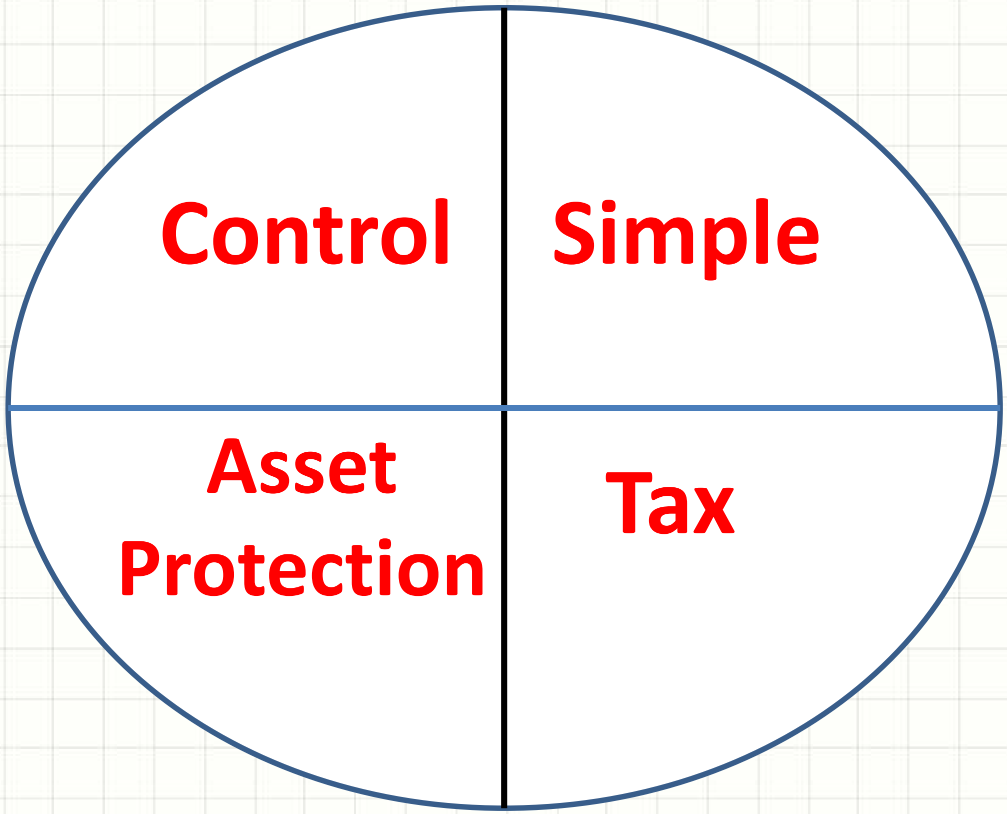
* Inflation Adjustment

Common Drafting Approaches

Need to Review Current Documents

- Standard "A – B" Trust Plan
  - Unwanted Results?
- "Outright Gift to Spouse" Plan
- Disclaimer Trusts
- Single Marital QTIP Trusts
- Joint Trusts
- Dynasty Trusts
  - Asset Protection for Children's Inheritances
- Unwind "Needless" Discount Mechanisms

What Are the Needs of the Client?



“Flexible” Trust Provisions

- Trust Protectors (“TP”)

- Independent Trustees (“IT”)
- How are these “Players” Weaved into your Estate Planning Document?
  - Specific persons are named as TP or IT in Trust Instrument; or
  - An “Appointer” (typically the Trustee) appoints TP or IT on an “as needed” basis;
    - “Remover” should probably be different than the “Appointer”

Powers Granted to Trust Protectors

(760 ILCS 5/16.3(d))

- Typical Powers
  - Amend Trust for tax purposes
  - Increase, decrease or modify interests of beneficiaries;
  - Remove & Appoint Trustees;
  - Grant or Modify Powers of Appointments
  - Terminate Trust
  - Mediate disputes;
  - Change Situs

- Can the TP Fiduciary Duties be Waived in the Trust Instrument?

- Can TPs be "related or subordinate" to the beneficiary or Grantor (IRC 672(c)?

  (father, mother, children, brother, sister, or employee…)

Independent Trustee ("IT")

Independent Trustee. The then acting Independent Trustee, if any, may (but shall not be required to) distribute to or for the benefit of the Beneficiary as much of the net income and principal of the trust as the Independent Trustee determines in the Independent Trustee's **sole discretion/best interests**.

- Typically not a "related or subordinate party" of the Grantor or any beneficiary (IRC 672(c))
  (father, mother, children, brother, sister, or employee…)

- Qualifies for "Liberal" Decanting (760 ILCS 5/16.4)
  - "Sole Discretion" or "Best Interests" standard meets the definition of "Absolute Discretion"
  - IT has broad powers to change trust and grant power of appointment to beneficiary

Estate Tax Portability

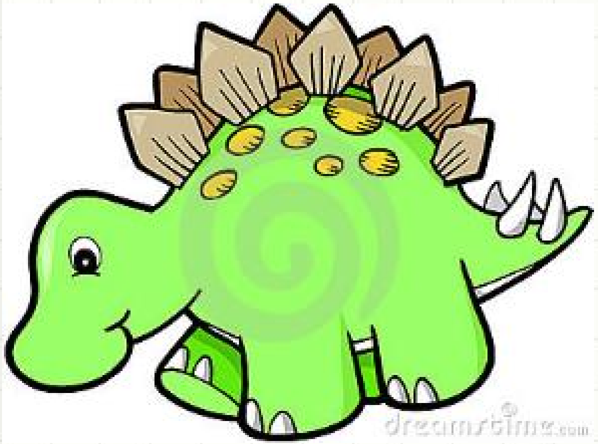
- Capturing the "Unused" Estate Tax Exclusion of the 1st Deceased Spouse
  - Estate Tax Return (Form 706)

Malpractice Trap?

ARE ESTATE PLANNERS UNDER AN OBLIGATION TO ADVISE ALL SURVIVNG SPOUSES OF ESTATE TAX PORTABILITY, EVEN FOR THOSE WHO SEEMINGLY WOULD NOT BENEFIT?

Standard A – B Trusts

Becoming Extinct?



- Credit Shelter Trust ("CST")
  Automatically Funded

- Tax Whip Saw
  - CST was Unnecessary -**No Estate Tax Savings**
  - Upon Surviving Spouse's Death, CST Assets do not Receive "Stepped up" Basis, resulting in **Higher Income Taxes** (vs. if CST not established)

- Review Formula Clauses
  - Danger Sign: Spouse is <u>not</u> a Beneficiary of the CST could mean unintentional disinheritance of Spouse

The Credit Shelter Trust Debacle

"Joe & Mary Clients"

2001 - CST Plan ($675k Exclusion)

Joe's Living Trust	$1M
Mary's Living Trust	$1M
Other Assets	$500k

2002 - Joe Dies

Credit Shelter Trust	**$1M**
Mary's Assets	$1.5M

2018 "Checkup"

Credit Shelter Trust	**$2.5M**
Mary's Assets	$1M
Unused Exclusion	$10.18M

The Problem: CST was "Unnecessary" (No Estate Taxes)

- Upon Mary's Death - No "Stepped-up" Basis in CST
- **$450,000 of unnecessary income taxes?!!**

The "Basis Coupon"

- Basis Planning Techniques generally "Force" Inclusion of CST Assets in the Surviving Spouse's Estate to obtain Basis Step-up

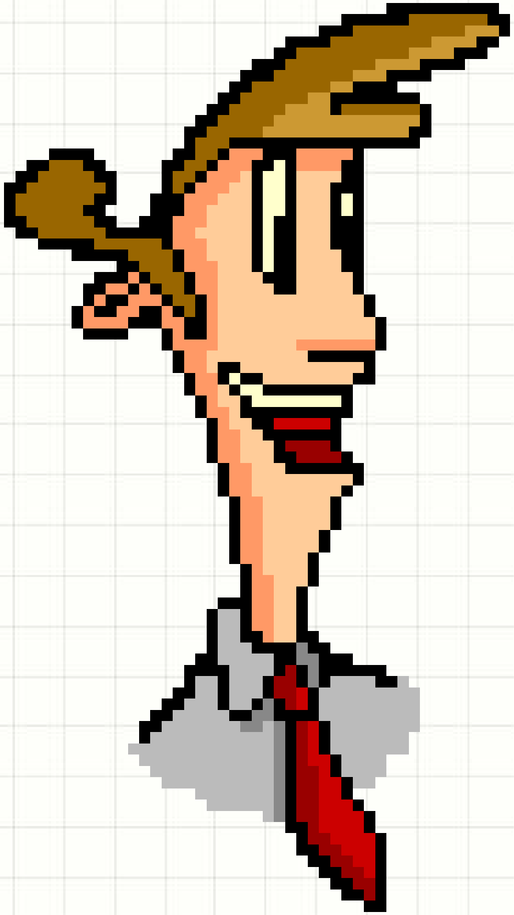
- Surviving Spouse's "Unused" Estate Tax Exclusion Amount is a "**Basis Coupon**" which can generate Stepped-up Basis for CST Assets

CST "RESCUE" STRATEGIES

Planning to Achieve CST Basis Step-up at Survivor's Death

- #1 Low Basis Assets Distributed to Spouse
- #2 Trust Protector Grants Spouse Testamentary GPA over SPA
  - Superior results with a "Formula" GPA?
- #3 "Formula" GPAs in Trust Document
- #4 The "Delaware Tax Trap" (See IRC 2041(a)(3))
  - Successive Powers of Appointment
  - Hard to Understand. Easy to Implement.

THE END



Questions?