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Tax Cuts and Jobs Act (TCJA)

Lincoln Financial Group Overview

OVERVIEW

On December 22, 2017, Congress passed the Tax Cuts and Jobs Act (TCJA or the Act) aimed at transforming the way individuals and businesses calculate their income tax bills and therefore changing the amount of federal tax each of us will pay. The Act contains significant alterations to existing tax law, and its scope and complexity will require time to fully understand how these changes will affect both individuals and businesses. One thing is certain: Life insurance continues to be an important part of the planning process for both individuals and businesses whether it is for estate, retirement income, or business-succession planning.

As we continue to review the Act in its entirety and assess the potential impact and opportunities, we want to provide an overview of some key elements of this new and multifaceted tax law.

1. Individual Taxation Changes and Consideration

2. Business Taxation Changes and Considerations

3. The Estate Tax Changes and Considerations

4. Planning after the Changes

1. Individual Taxation Changes and Considerations

Lower Income Tax Rates

There are now seven individual income tax brackets under the Act. The top individual income tax rate for ordinary income is 37%.

Tax rates for married individuals filing joint returns and surviving spouses	
If taxable income is:	The tax is:
Not over $19,050	10% of taxable income
Over $19,050 but not over $77,400	$1,905, plus 12% of the excess over $19,050
Over $77,400 but not over $165,000	$8,907, plus 22% of the excess over $77,400
Over $165,000 but not over $315,000	$28,179, plus 24% of the excess over $165,000
Over $315,000 but not over $400,000	$64,179, plus 32% of the excess over $315,000
Over $400,000 but not over $600,000	$91,379, plus 35% of the excess over $400,000
Over $600,000	$161,379, plus 37% of the excess over $600,000

Disappearing or Reduced Deductions, Larger Standard Deduction

Beginning this year, the Tax Cuts and Jobs Act suspends or reduces many popular tax deductions in exchange for a larger standard deduction.

- Individuals will only be able to claim an itemized deduction of up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the total of (1) state and local property taxes, and (2) state and local income taxes.
- Under current rules, alimony payments generally qualify for an above-the-line deduction for the payor and are included in the income of the payee. Under the new law, beginning in 2019, alimony payments aren't deductible by the payor or includible in the income of the payee (generally effective for any divorce decree or separation agreement executed after 2018). For any divorce decree or separation agreement executed prior to 2019, the new law will apply if such agreement is modified after 2018 and the modification expressly provides that the new law applies to the modification.

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- The itemized deduction for charitable contributions won't be chopped. But because most other itemized deductions will be eliminated in exchange for a larger standard deduction (e.g., $24,000 for joint filers), charitable contributions after 2017 may not yield a tax benefit for many because they won't be able to itemize deductions.
- The new law temporarily boosts itemized deductions for medical expenses. For 2017 and 2018, these expenses can be claimed as itemized deductions to the extent they exceed a floor equal to 7.5% of your adjusted gross income (AGI). Before the new law, the floor was 10% of AGI, except for 2017 when it was 7.5% of AGI for age-65-or-older taxpayers. But keep in mind that next year many individuals will have to claim the standard deduction because many itemized deductions have been eliminated.
- The principal residence mortgage interest deduction will be limited to interest on $750,000 of indebtedness for loans after 2017.
- Elimination of personal exemptions, the deduction for home equity debt, miscellaneous itemized deductions subject to the 2% floor (e.g., investment advisory fees and tax preparation fees), the Pease rule (i.e., phase-out of itemized deductions), the deduction for casualty losses (except for Federally declared disasters), and moving expenses (except for certain military personnel).
- Estate, Gift and GST tax exemptions will double to $10 million (expected to be $11.2 million for 2018 with inflation indexing). Thus, for a married couple, the combined exemptions would be $22.4 million in 2018.

Some Items Not Changing for Individuals

- The preferential top rate (i.e., 20%) on capital gains and qualified dividends.
- Annual exclusion gifts ($15,000 for 2018).
- The 3.8% net investment income tax is not changing, thus, net investment income (e.g., interest, dividends, capital gains, annuity income, and rents) will be taxable to the extent it exceeds the applicable thresholds (e.g., single taxpayers $200,000, married filing jointly $250,000).
- A taxpayer's ability to sell specific lots of securities. The original tax reform bills in the House and Senate would have forced FIFO treatment for the sale of securities (e.g., stocks).
- Stretch-out distributions for beneficiaries of IRAs and other qualified plans.
- Rules for excluding gain on the sale of a principal residence.

2. Business Taxation Changes and Considerations

Lower Tax Rates Coming for Businesses

- The TCJA will reduce tax rates for C-Corporations, effective for the 2018 tax year. Additionally, other businesses, including those operated as pass-throughs (such as partnerships, limited liability companies taxed as partnerships or S-corporations) may see their tax bills cut.
- The graduated C-corporation tax rates ranging from 15% to 35% will be reduced to a flat 21% rate.
- The corporate AMT is fully repealed beginning in 2018.
- A new like-kind exchange rule limits exchanges to real estate not held primarily for sale.
- The IRC Section 179 deduction will double to $1 million, subject to phase-out.
- Doubling of bonus depreciation to 100% and expansion to include used property. The effective date is for assets acquired and placed in service after September 27, 2017, and before January 1, 2023.
- Pass-through entities (e.g., partnerships, S-corporations, and sole proprietorships) will be entitled to a 20% qualified business income deduction. The provision is applicable for business owners with income under $157,500 ($315,00 for married filing jointly). In addition, the benefit is subject to phase-out.

3. The Estate Tax Changes and Considerations

Higher Exemption and Increased Transfer Opportunities

- The final bill centers on an increase in the lifetime exemption. Starting in 2018, the exemption will be $11.2 million for a deceased single taxpayer and $22.4 million for a married couple.
- However, this increase in the exemption amounts "sunsets" after December 31, 2025. Thus, starting on January 1, 2026, the 2017 estate tax, with the 2017 exemptions (indexed for inflation) fully return. AALU's *WRMarketplace* (WRM 17-50; 12/20/17) estimates this amount to be $6.3 million for singles and $12.6 million for couples beginning on January 1, 2026.
- Of importance here is to note that the inflation factor is being decreased. Under prior law, the unadjusted CPI was used to calculate the increase in exemption amounts. However, TCJA generally mandates the use of "chained" CPI (C-CPI-U). Chained CPI looks at alternatives.

The Congressional Budget Office uses the following example:

If steak and hamburger both increase in price, a consumer will choose hamburger over steak if the price of hamburger rises less than the price of steak. For purposes of CPI calculation, the lower "hamburger" rate is utilized in the CPI calculation. As a result, there is a lower increase in values using chained CPI. Unlike the exemption increases, the use of chained CPI is permanent.

4. Planning after the Changes

There are a number of important planning concerns after January 1, 2018:

Planning for Future Changes — Estate Tax Exemption

- The TCJA is due to sunset on January 1, 2026, meaning the estate planning being done today should include an understanding that the Act is not permanent and a long-term approach should be considered. Only estate taxes filed for tax years 2018 thru 2025 will be impacted by these changes.

Use It Now or Lose It Later — Gift tax and Generation Skipping Tax

- The key phrase for estate planning should be "Use it now or lose it later." The exemption increases apply to the gift tax and the generation skipping tax as well. As such, one of the most important planning concepts could be to use the higher exemptions for gift tax and GST taxes before the exemptions expire. In other words, consider using the higher gift tax exemption to increase gifts to trusts, especially ILITs, during the seven-year temporary increase.

  For example: Suppose a taxpayer fully utilized the 2017 exemption of $5,490,000 by the end of 2017. Starting in 2018, the taxpayer will have an additional exemption amount of $5,710,000 ($11,200,000 minus $5,490,000). This amount should be used for additional contributions to ILITs. Many ILITs do not have sufficient insurance amounts to cover last expenses. The rise in the exemption amount offers a golden opportunity to rectify this shortfall. Perhaps even more importantly, is to look at funding a "dynasty" or GSTT trust.

  By using the increase in exemptions, a dynasty trust can exempt property for many years without incurring any federal or state transfer taxes. Life insurance is critical in dynasty trust planning, since the trust needs more assets in each succeeding generation, as more beneficiaries will exist, and the trust will need more and more assets. Life insurance is the most effective way to increase dynasty trust assets.

- **It is important to note that there are no "clawback" provisions in the Act. This means that when the exemptions go down in 2026, there will be no retroactive adjustments imposing taxes on previous amounts that availed themselves of the temporary higher exemptions.**

Exclusions

- The annual exclusion is increased to $15,000 in 2018. This occurred not as a result of TCJA, but rather it occurred under the basic provisions of IRC 2503.

Charitable Giving

- Charities may be adversely affected by the TCJA increases to the standard deduction. It has been estimated that up to 90% of all income taxpayers will use the increased standard deduction, as opposed to using itemizing. In 2018, the standard deductions increase to $12,000 for a single taxpayer and $24,000 for a married couple filing jointly. The charitable deduction is not available to those who use the standard deduction — only those that itemize. As such, taxpayer users of the standard deduction may be less inclined to make charitable contributions, there being no tax effect in making those contributions.
- As such, charities may be looking for new sources of contributions, and one of the best sources can be life insurance policy gifts. With the charity as owner and beneficiary of a policy, the premiums paid by an insured donor are income tax deductible if the insured itemizes. The TCJA increases the limit on gifts to 60% of adjusted gross income (AGI) from the 50% limit that existed in 2017. This includes the deductible premiums where the charity is the owner and beneficiary of the policy.

As you can see, there are a lot of changes and opportunities that the TCJA presents for each of us. Knowledge and understanding are critical and Lincoln will continue to help you and understand this important change in our current tax law.

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