

Business Signals

A periodic newsletter about the legal implications of issues affecting businesses and business owners in the Central Gulf Coast region.

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Client Alert: Things Every Business Person Must Know About Tax Reform.

Section One: Individual Taxes and Estate and Gift Taxes

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As you are probably aware from recent news reports, Congress has now passed a major tax reform bill, called the Tax Cuts and Jobs Act of 2017. Whether you agree with the bill or not, this Act represents the most significant reform of the Tax Code since 1986, and impacts virtually every area of taxation, including corporate taxes, individual taxes, estate and gift taxes, and even international taxation.

Because of the significance of this tax reform, we felt it appropriate to provide a summary to our clients of

the major changes that have been brought about by the Act, so that you can review how this Act will impact you moving into 2018.

Individual Tax Reform: There are numerous changes to the way individuals will be taxed, and one of the major

changes involves new individual tax rates. There are still seven tax brackets for individuals, with the lowest rate remaining at 10% but the highest rate dropping from 39.6% to 37%, regardless of whether you are filing as a single individual, married filing jointly, married filing separately or as head of household. Also, the rates between the 10% bracket and the 37% bracket are now lower. For Capital Gains Tax Rates, under this Act the breakpoints between the 0% and 15% rates and between the 15% and 20% rates are the same as under present law, but the rate thresholds are slightly different under this Act. The new rate thresholds are effective from January 1, 2018 to December 31, 2025.

Perhaps the most significant change brought about by the Tax Act lies in the revisions to the standard deduction and related deductions. This Act increases the standard deduction to \$24,000.00 for a married couple filing jointly, \$18,000.00 for an unmarried individual with at least one qualifying child, and \$12,000.00 for single filers. Such amounts will be indexed for inflation in tax years

beginning after 2018. These standard deduction amounts will expire after December 31, 2025.

While the standard deduction is being increased, the personal exemption and many other miscellaneous itemized deductions (such as investment fees and expenses) are suspended for 2018.

For those itemized deductions that will still be allowed, the taxpayer is no longer subject to a cap on those deductions—they are now unlimited. The new Act does set limits and new qualification rules for itemized deductions. The primary change in this area involves the elimination of the deduction for interest for second mortgages for a personal residence. Also, the mortgage interest deduction on a first mortgage will be limited to \$750,000.00 of new debt.

Importantly, the state and local tax deduction has now been limited to \$10,000.00, regardless of whether the taxpayer is married filing jointly or filing as a single individual. Additionally, for couples getting divorced after 2018, alimony will no longer be deductible by the payor and will no longer be includable as income to the payee.

The child tax credit has now been doubled (now \$2,000 per child), and the income thresholds for those who can claim this credit have been raised significantly.

There may be other changes you may need to know depending on your status, income level, the makeup of your family, and other factors.

Estate and Gift Taxes: Congress has made a major change in the area of estate and gift tax, one which will hopefully render these taxes moot for most of our

clients, at least for the next few years. Specifically, Congress doubled the basic exclusion amount for each individual for estate, gift, and generation skipping taxes, from \$5.6 million per person in 2017 to approximately \$11.2 million in 2018. We say “approximately” because the current totals are subject to an inflation adjustment which makes specific calculation of the exclusion amount unknowable at this time, without further guidance from the IRS. However, we have attached a spreadsheet to this memo which we believe provides a good approximation of how the exclusion amount will increase each year until 2025.

While this would appear to be wonderful news for taxpayers, there is a catch to this particular provision, in that the increase in the exclusion amount is scheduled to phase out in 2026, and the exclusion amount will revert to the 2017 amount, adjusted for inflation. We estimate that the estate tax exemption in 2026 will be approximately \$6.4 million dollars per person. Also, it bears noting that this Tax Act received ZERO votes from the Democratic Senators and Representatives, so whether it remains the law is largely dependent on Republicans retaining control over at least one branch of Congress and/or the Presidency prior to 2026.

Regardless, for today this means is that a married couple will be able to exclude over \$22 million dollars in assets from estate, gift and generation skipping taxes until at least 2025. For many of our clients, this means that their estate plans may no longer be impacted by estate and gift taxes, which means that your estate plans currently in effect may be inappropriate and/or unnecessary. It

also means that many of the limitations regarding gifts in the past are no longer relevant, and you can effectively draft your estate plan however you wish without having to worry about estate and gift taxes, at least until 2025.

Importantly, the new Tax Act leaves in place a few rules in this area that are beneficial to taxpayers. For starters, the tax rate of forty (40%) percent remains unchanged. This 40% tax rate is an historical low for estate and gift taxes, which used to be in excess of fifty (50%) percent. Furthermore, Congress is still allowing for estates of deceased individuals to adjust the tax basis in their assets up to fair market value at the date of

death. This "step up" basis is an important tax planning point for those clients who may not otherwise be affected by the estate tax laws but who inherit appreciated assets. It will allow for many of our clients to avoid payment of significant income taxes on the sale of those assets, provided they structure their estates appropriately.

Conclusion: In our next alert, we will address the most significant tax changes for business owners. However, the changes in individual taxation and estate and gift taxes are important for all taxpayers to consider as they begin their tax planning for 2018, and should be considered by business owners as well.

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