December 20, 2017

Dear Client:

House and Senate leaders finished reconciling and approving the final version of the H.R.1 Tax Cuts and Jobs Act (the "tax bill or bill") yesterday and today. President Trump is scheduled to sign it officially into law sometime next week. Arguably, this is the most significant tax legislation since 1986 when the passive activity rules were implemented. The partisan politics underlying this bill wherein it passed in the Senate on the narrowest of margins speaks volumes, but we will leave that discussion for another day, as we are now focused on how these changes will affect taxpayers as we transition into 2018 and beyond.

First, it is important to note that many of the provisions have a sunset in 2025 driven by the mandate to keep the impact on the federal deficit to less than $1.5 trillion. With the specter of rising interest rates, coupled with the budget woes of state and local governments, a dose of caution is not unwarranted as you chart your future economic circumstance. At that time, if there are no Congressional acts to extend H.R.1's components, the individual tax provisions will sunset, and the tax law will revert to its current state.

The new tax bill cuts the top corporate tax rate from 35 percent to 21 percent in 2018. The top individual tax rate will drop from 39.6 percent to 37 percent. The tax bill cuts income tax rates, doubles the standard deduction, and eliminates personal exemptions.

Income Tax Brackets

The final tax bill keeps the seven income tax brackets but **lowers tax rates**. As mentioned above, these rates will revert to the current rate in 2026 unless there is further action by Congress. Until then, the plan establishes the following rates. There are also different tax rates for Head of Household and Married Filing Separately filing statuses.

Income Tax Rate		**Income Levels for Those Filing As:**	
Current	**Tax Bill**	**Single**	**Married-Joint**
10%	10%	$0-$9,525	$0-$19,050
15%	12%	$9,525-$38,700	$19,050-$77,400
25%	22%	$38,700-$82,500	$77,400-$165,000
28%	24%	$82,500-$157,500	$165,000-$315,000
33%	32%	$157,500-$200,000	$315,000-$400,000
33%-35%	35%	$200,000-$500,000	$400,000-$600,000
39.6%	37%	$500,000+	$600,000+

The bill **eliminates most itemized deductions.** . The loss of deductions for unreimbursed meals and entertainment may cause those who have taken advantage of this rule to request their employer reimburse them for these business-related costs or demand higher levels of compensation. The deduction for investment advisory fees is also gone. Commissions added to the purchases and sales of stocks may be a better alternative. While not technically itemized deductions, these changes also eliminate moving expenses, except for members of the military.

The bill **repeals the deduction for alimony payments** and their inclusion in the income of the recipient. In order to give taxpayers time to adjust to this new balance in assessing benefits and burdens, the new alimony rules will apply only to divorce or separation instruments executed after December 31, 2018.

The bill keeps deductions for charitable contributions, property and income taxes, mortgage interest, and retirement savings. However, it **limits the deduction for taxes to $10,000**. Taxpayers must choose between property and income or sales taxes. Also, it **limits the deduction on mortgage interest** to the first $750,000 of debt (currently it is $1 million). Current mortgage-holders aren't affected and refinanced loans, obtained prior to 2018, will also be exempt from the new limit. No deduction will be allowed for home equity loans.

The bill **expands the deduction for medical expenses** for 2017 and 2018. It allows taxpayers to deduct medical expenses that are 7.5 percent or more of adjusted gross income. Currently, medical expenses that are 10 percent or more of income are deductible. At least 8.8 million people benefited from the deduction in 2015.

It **doubles the standard deduction** for everyone. A single filer's deduction increases from $6,350 to $12,000. The deduction for Married and Joint Filers increases from $12,700 to $24,000. As a result, 94 percent of taxpayers will take the standard deduction. The National Association of Home Builders and the National Association of Realtors opposed this. As more taxpayers take a standard deduction, fewer would take advantage of the mortgage interest deduction. That could lower housing prices. But this could be a good time to do that. Many people are concerned that the real estate market is in a bubble that could lead to another collapse.

The bill **repeals the Obamacare tax** on those without health insurance. Without the mandate, the Congressional Budget Office estimates 13 million people would drop their plans.

The government would save $338 billion by not having to pay their subsidies. But health care costs will rise because fewer people will get the preventive care needed to avoid expensive emergency room visits.

It **eliminates personal exemptions**. Taxpayers can currently subtract $4,150 from income for each person claimed as a dependent on their tax return. Under the Trump tax plan, families with many children would pay higher taxes despite the increased standard deductions. For example, a married couple with two children making $56,000 a year would pay $68 more a year.

The bill doubles **the estate tax exemption** to $11.2 million for singles and $22.4 million for couples. That would help the top 1 percent of the population who pay it. These top 4,918 tax returns contribute $17 billion in taxes. This aspect is particularly important to recognize since these new limits revert back to current levels in 2026.

The bill **keeps the Alternative Minimum Tax**, but increases the exemption from $54,300 to $70,300 for singles and from $84,500 to $109,400 for joint. The exemptions phase out at $500,000 for single taxpayers and $1 million for joint, much higher than the previous phase out exemption level. The exemption levels revert to current levels in 2026.

It keeps the **deduction for student loan interest**. The House bill had eliminated it. The House bill added a **tax on graduate students' income** for teaching and research. Most of that income is a tuition waiver, not wages. That additional tax was stripped from the final bill. Grad students do most of the country's basic medical and scientific research.

Child and Elder Care Deductions

The final bill **increases the Child Tax Credit** from $1,000 to $2,000. The credit is refundable up to $1,400. But more than a third of low-income families don't make enough to take advantage of the increase. The plan also increases the income level from $110,000 to $400,000 for married tax filers.

The final bill allows parents to use **529 savings plans** for tuition at private and religious K-12 schools. They can also use the funds for certain educational expenses for home-schooled students.

It allows a **$500 credit for each non-child dependent.** The credit helps families pay for caring for elderly parents.

Business Taxes

The final tax bill **lowers the maximum corporate tax rate** from 35 percent to 21 percent, the lowest since 1939. The United States has one of the highest corporate tax rates in the world. But most corporations don't pay more than 15 percent.

It **creates a 20% standard deduction** for pass-through businesses. This is possibly the most complex and contentious aspect of the bill and will require more time and attention to thoroughly sort out for each impacted taxpayer. See our accompanying endnote for further insight on these new rules[i]. The deductions are limited once the income reaches $157,500 for singles and $315,000 for joint. Pass-through businesses include sole proprietorships, partnerships, limited liability companies, and S corporations. They also include real estate companies, hedge funds, and private equity funds, but limitations exist for taxpayers providing primarily professional services.

The bill limits **corporations' ability to deduct interest expense to 30 percent of income** excluding depreciation. That makes it more expensive for financial firms to borrow. Companies would be less likely to issue bonds and buy back their stock. Stock prices could fall. But the limit generates revenue to pay for other tax breaks.

There are new Section 179 Expensing and Bonus Depreciation Rules. The bill allows **businesses to deduct higher levels of depreciable assets** acquired in one year instead of amortizing them over several years. It does not apply to structures with certain exceptions. To qualify, the equipment must be purchased after September 27, 2017, and before January 1, 2023. Up to $1 million in qualified equipment can be written off in a year under section 179. The write off phases-out when purchases exceed $2.5 million in a year.

The new law generally liberalizes the use of the **cash method of accounting** for businesses with average annual gross receipts under $25 million. **Net Operating losses (NOLs) may no longer be carried back** by businesses other than farmers. NOL carryforwards are limited to 80% of taxable income.

The final bill **eliminates the corporate AMT.** The corporate AMT had a 20 percent tax rate that kicked in if tax credits pushed a firm's effective tax rate below that level. Companies could no longer deduct research and development spending or investments in low-income neighborhood. Elimination of the corporate AMT adds $40 billion to the deficit.

It advocates a change from the current "worldwide" tax system to a **"territorial" system.** Under the current system, multinationals are taxed on income earned overseas. They don't pay the tax until they bring the profits home. As a result, many corporations leave it parked overseas. Under the territorial system, they aren't taxed on that foreign profit. The theory being advocated by the current administration is these entities will be more likely to reinvest it in the United States. This may benefit certain sectors, such as pharmaceuticals and high-tech companies the most.

The tax bill allows companies to repatriate the $2.6 trillion in foreign cash stockpiles. They pay a one-time low tax rate of 15.5 percent on cash and 8 percent on equipment. The Congressional

Research Service found that a similar 2004 tax holiday provided little boost to the economy. Companies distributed repatriated cash to shareholders, not employees. The repatriation could also raise Treasury note yields. Corporations hold most of the cash in 10-year Treasury notes. When they sell them, the excess supply would send yields higher.

The final bill **allows oil drilling in the Arctic National Wildlife Refuge**. This is projected to add $1.1 billion in revenues over 10 years, but it is also anticipated that drilling in the refuge won't be profitable until oil prices are at least $70 a barrel.

It **retains tax credits** for electric vehicles and wind farms. The final bill **cuts taxes on beer, wine, and liquor,** but left out an amendment proposed by Sen. Cory Gardner to repeal the federal prohibition on cannabis and provide banking for that industry.

All the above will take time to fully absorb but we are dedicated to fully understanding the Tax Cuts and Jobs Act of 2017 and how to best implement planning strategies for our clients. We will be following up with you as we identify tactics and opportunities in the coming year that are relevant to you. 2018 could be a critical period for some with respect to planning opportunities and positioning for financial planning and retirement needs.

Sincerely,

SEIGNEUR GUSTAFSON LLP
Certified Public Accountants and Consultants

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[i] **Pass-through income deduction**

For tax years after 2017 and before 2026, individuals would be allowed to deduct 20% of "qualified business income" from a partnership, S corporation, or sole proprietorship, as well as 20% of qualified real estate investment trust (REIT) dividends, qualified cooperative dividends, and qualified publicly traded partnership income. (Special rules would apply to specified agricultural or horticultural cooperatives.)

A limitation on the deduction would be phased in based on W-2 wages above a threshold amount of taxable income. The deduction would also be disallowed for specified service trades or businesses with income above a threshold.

For these purposes, "qualified business income" would mean the net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer. These items must be effectively connected with the conduct of a trade or business within the United States. They do not include specified investment-related income, deductions, or losses.

"Qualified business income" would not include an S corporation shareholder's reasonable compensation, guaranteed payments, or—to the extent provided in regulations—payments to a partner who is acting in a capacity other than his or her capacity as a partner.

"Specified service trades or businesses" include any trade or business in the fields of accounting, health, law, consulting, athletics, financial services, brokerage services, or any business where the principal asset of the business is the reputation or skill of one or more of its employees.

The exclusion from the definition of a qualified business for specified service trades or businesses phases in for a taxpayer with taxable income in excess of $157,500 or $315,000 in the case of a joint return.

For each qualified trade or business, the taxpayer is allowed to deduct 20% of the qualified business income with respect to such trade or business. Generally, the deduction is limited to 50% of the W-2 wages paid with respect to the business. Alternatively, capital-intensive businesses may yield a higher benefit under a rule that takes into consideration 25% of wages paid plus a portion of the business's basis in its tangible assets. However, if the taxpayer's income is below the threshold amount, the deductible amount for each qualified trade or business is equal to 20% of the qualified business income with respect to each respective trade or business.