

With the welcome distraction of family and friends during the holiday season fading in the rearview mirror, it's time to pause and reflect on 'where we've been' and 'where we're going' with respect to the tax environment and general planning landscape.

Last year, in addition to reviewing notable developments under current law, our 2016 Year-End Tax Update endeavored to unpack then President-elect Trump's tax plan, recognizing that a candidate's campaign rhetoric will likely deviate substantially from any legislation ultimately implemented. This year's Tax Update endeavors to provide a useful overview of certain notable transfer tax (think estate and gift taxes) and income tax (think individual and corporate taxes) provisions from the significant and sweeping changes within the newly adopted Tax Cuts and Jobs Act of 2017 (the "Act") widely reported in the press.

It is important to note that like most tax reform acts of recent memory, tax reform under the Tax Cuts and Jobs Act, although dramatically altering the landscape, is not necessarily 'permanent.' **While many of the provisions affecting businesses are generally here to stay, most of the provisions affecting individuals (including transfer tax provisions relating to gift, estate, and generation skipping transfer taxes) will begin to sunset on December 31, 2025, reverting back to prior law beginning on January 1, 2026.**

We encourage you to review this Tax Update in consultation with your CPA, personal tax advisors, and other professional advisors so as to best identify planning opportunities.

General Highlights from the Act

While each of the following are more fully addressed in this Tax Update, here is the major headline news from the Act:

- ▶ The exemption for **federal** estate, gift, and generation skipping transfers increases to \$11,200,000 per person (\$22,400,000 per married couple) with an inflationary index.
- ▶ The **Massachusetts** exemption for estate taxes remains at \$1,000,000 per person (\$2,000,000 per married couple), and **without** an inflationary index.
- ▶ Seven income tax brackets remain, with lower rates and increased income thresholds. The top bracket of 37% kicks in at \$500,000 for single filers and \$600,000 for married couples filing jointly. The AMT still exists, but was reworked.
- ▶ The standard deduction and the availability of certain itemized deductions underwent a major overhaul (e.g. mortgage interest, charitable gifts, state and local taxes, alimony payments, etc.).
- ▶ The top corporate tax rate is reduced from 35% to 21%, effective for tax years beginning after December 31, 2017, without sunset contemplated.

Overview of Notable Estate & Gift Tax Provisions

Under the Act, the **federal** wealth transfer, estate and gift tax planning, and creditor protection planning opportunities are incredibly advantageous. For those of you who took advantage of certain advanced estate planning opportunities in recent (and previously unprecedented) years, kudos! But, for those of you who did not, the Act continues to provide a second, juicy bite at the apple in 2018 and beyond.

- ▶ The **federal** exemption amounts for the estate tax, gift tax, and generation skipping transfer tax remain unified and indexed annually for inflation after 2011. The Act doubles the exemption amount from \$5,000,000 to \$10,000,000 per person.
 - The indexed amount for 2017 was \$5,490,000 per person and the indexed amount for 2018 under the Act will be \$11,200,000 per person. The Act effectively doubles the previously scheduled indexed amount for 2018 (\$5,600,000 exemption per person) under prior law.

- For all married couples, these amounts are effectively combined, allowing a total of \$22,400,000 to pass to the next generation (or anyone else) free of federal transfer taxes in 2018. As has been the case in recent years, this now includes *all* married couples (including same-sex married couples) irrespective of where they live (or die).
 - These provisions ‘sunset’ after December 31, 2025. Beginning January 1, 2026, the exemptions revert back to \$5,000,000 per person indexed for inflation after 2011. The Act directs regulations be implemented to protect additional exemption used during this period from ‘claw back’ post sunset.
- ▶ Under the Act, the **federal** applicable tax rate for estates, gifts, and generation skipping transfers exceeding the exemption amounts remains 40% in 2018.
 - ▶ Under the Act, the **federal** opportunity for spousal ‘portability’ with respect to a Deceased Spouse’s Unused Exemption Amount (“DSUEA”) continues in 2018. Portability simply means that the surviving spouse can use the deceased spouse’s unused exemption amount (except for Generation Skipping Transfer Taxes).
 - ▶ The **federal** annual exclusion amount for (non-charitable) gifting remains unchanged in its calculation, and increases to \$15,000 per person for 2018 as anticipated. Married couples can continue to participate in ‘gift-splitting’ to effectively transfer \$30,000 to any beneficiary. A donor may make gifts up to the annual exclusion amount to an unlimited number of recipient donees, provided the aggregate of gifts from a donor to a particular donee does not exceed \$15,000 in the tax year.
 - Gifts for qualified tuition payments or medical expenses are unlimited (not subject to annual exclusion limitations) if paid directly to the educational or medical institution, and gifts to a Section 529 Plan may be front-loaded for up to five years of annual gifts (\$75,000 by an individual and \$150,000 with gift splitting) before they are subject to federal gift tax.

Recognizing the significance of certain continuing federal planning opportunities, it remains crucial to curb (mildly) our enthusiasm and keep in mind the following:

- ▶ Independent of federal tax law provisions, **Massachusetts** estate tax law continues to make available an exemption amount of only \$1,000,000 per person (\$2,000,000 for married couples *with proper planning*), and **without** an inflationary index.
 - The applicable estate tax rate for Massachusetts estates is determined by calculating the size of the taxable estate using a sliding scale up to 16%.
 - There is **no spousal portability** available with respect to DSUEA in Massachusetts – it’s “use it or lose it” with respect to the exemption amount.
- ▶ For clients who are tax residents of states **other than Massachusetts**, there may be other state estate or inheritance taxes applicable and which may present valuable planning opportunities.

Overview of Notable Income Tax Provisions

The following is a high-level overview of certain notable income tax provisions affecting 2018 income tax filings (for income earned in 2017):

- ▶ **INCOME TAXES:** The top income tax rate for individuals and married couples filing jointly with 2017 taxable incomes exceeding \$418,400 and \$470,700 respectively (up from \$415,050 and \$466,950 respectively in 2016) will remain at 39.6%.
 - The standard deduction rises to \$6,350 for singles and married persons filing separately, and \$12,700 for married couples filing jointly in 2017 (up from \$6,300 and \$12,600 respectively in 2016), and the standard deduction for Heads of Households rises to \$9,350 in 2017 (up from \$9,300 in 2016).
 - The personal exemption amount remains \$4,050 for 2017, the same as 2016.
- ▶ **CAPITAL GAINS & DIVIDENDS TAXES:** The capital gains and qualified dividend income tax rate for individuals and married couples filing jointly in a 39.6% bracket remains 20% in 2017. Filers in the 25% through 35% brackets continue to pay a 15% rate.

- ▶ **ALTERNATIVE MINIMUM TAXES (AMT):** The AMT exemption amounts in 2017 are \$54,300 for single filers (phasing out at \$120,700), \$84,500 for married couples filing jointly (phasing out at \$160,900), and \$42,250 for married couples filing separately. These AMT exemption amounts are increases from \$53,900, \$83,800, and \$41,900 respectively for 2016. In 2017, the 28% tax rate applies to taxpayers with taxable incomes above \$187,800 (\$93,900 for married couples filing joint returns).
- ▶ **ITEMIZED DEDUCTIONS & PERSONAL EXEMPTIONS PHASE OUT:** Phase out of itemized deductions and personal exemptions for individuals and married couples filing jointly (with adjusted gross incomes exceeding \$261,500 and \$313,800, respectively in 2017) began in 2013, potentially subjecting more income to tax than was previously the case. These amounts are up from \$259,400 and \$ 311,300, respectively in 2016.
- ▶ **HEALTHCARE AND MEDICARE SURTAXES:** A healthcare surtax of 3.8% on passive net investment income (“NII”) continued in 2017 and operates in conjunction with (i.e. in addition to) rate increases for capital gains and qualified dividend income. The NII rate for high-income taxpayers effectively rises to 23.8%.
 - An additional Medicare surtax of .9% applies to wages and self-employment income in excess of \$200,000 for individuals, \$250,000 for married couples filing jointly, and \$125,000 for married couples filing separately.
- ▶ **TRUST INCOME TAXES:** Trust income generated by certain types of trusts is generally subject to the highest income tax rate (39.6%) and the Healthcare Surtax on NII (3.8%) if the trust earned more than \$12,500 in 2017 (up from \$12,400 in 2016).
 - Many trusts, however, such as Revocable Living Trusts and Grantor Trusts, will pay income taxes determined by the Grantor’s individual tax bracket.

Overview of Tax Cuts and Jobs Act of 2017 (the “Act”)

The following is a high-level overview of certain notable individual income tax provisions from the Act that will affect income earned this year in 2018 (2019 income tax filings):

- ▶ **INCOME TAX BRACKETS:** The Act retains seven brackets, but lowers the rates and increases the income thresholds as follows:

Rate	For Unmarried Individuals, Taxable Income Over	For Married Individuals Filing Joint Returns, Taxable Income Over	For Heads of Households, Taxable Income Over
10%	\$0	\$0	\$0
12%	\$9,525	\$19,050	\$13,600
22%	\$38,700	\$77,400	\$51,800
24%	\$82,500	\$165,000	\$82,500
32%	\$157,500	\$315,000	\$157,500
35%	\$200,000	\$400,000	\$200,000
37%	\$500,000	\$600,000	\$500,000

- ▶ **ALTERNATIVE MINIMUM TAX (AMT):** The Act maintains the AMT for individuals; however, with significant exemption increases and the limitations on certain itemized deductions, many clients may no longer be subject to AMT.
 - The AMT exemption amounts in 2018 are \$70,300 for single filers (phasing out as \$500,000), and \$109,400 for married couples filing jointly (phasing out at \$1,000,000). These AMT exemption amounts are increases from \$54,300 for single filers (phasing out at \$120,700) and \$84,500 for married couples filing jointly (phasing out at \$160,900).
 - In 2018 the AMT will be levied at 26% for AMTI less than \$191,500; otherwise at 28%. In 2017, the 28% tax rate applies to AMTI above \$187,800.

► **CHANGES IN DEDUCTIONS:** The Act includes several key provisions impacting individual income tax deductions:

- Increase in the standard deduction for single filers and married taxpayers filing jointly to \$12,000 (up from \$6,300) and \$24,000 (up from \$12,600) respectively. These increases come with the elimination of the personal exemption and the suspension of miscellaneous itemized deductions (previously subject to 2% AGI floor).
- Permissible itemized deduction preserved for State and Local Taxes (SALT), but limited to \$10,000 in the aggregate for property, income, and sales taxes. The Act states that federally taxpayers may not take a deduction in 2017 for prepayment of SALT imposed for tax years after December 31, 2017.
- Permissible itemized deduction preserved for mortgage interest on existing and refinanced mortgages, but limited as follows:
 - (i) Taxpayers can deduct interest on mortgage debt up to \$750,000 for a newly acquired principal or second home.
 - (ii) Existing mortgages are grandfathered up to the current \$1 million limit if with respect to a principal or second home, the debt was incurred on or before December 15, 2017; or with respect to a principal residence only, the taxpayer entered into a written binding contract on or before December 15, 2017 to close on the purchase of such residence before January 1, 2018, the home is actually purchased before April 1, 2018, and the debt is incurred on or before April 1, 2018.
 - (iii) Interest on home equity loans or home equity lines of credit (new or existing) is no longer deductible.
- The deduction for charitable gifts is retained and expanded to allow taxpayers to deduct up to 60% of their AGI for gifts of cash to public charities. However, with the increase in the standard deduction, clients may consider making periodic, larger charitable gifts to a Donor Advised Fund, for instance, and then continuing with traditional annual giving.
- The Act eliminates the deductibility of alimony payments (previously deductible by the payor and includable as income by the recipient) for agreements executed after December 31, 2018. Unless adopted voluntarily, agreements entered into before this date, even if modified after, will remain deductible by the payor and includable as income by the recipient.

The following is a high-level overview of certain notable business income tax provisions from the Act that will affect income earned this year in 2018 (2019 income tax filings):

- **INCOME TAX BRACKETS:** The Act reduces the top corporate tax rate from 35% to 21%, effective for tax years beginning after December 31, 2017, without sunset.
- **ALTERNATIVE MINIMUM TAX (AMT):** The Act eliminates the AMT previously applicable to corporations.
- **DEDUCTION FOR QUALIFIED BUSINESS INCOME:** The Act permits the deduction of 20% of 'qualified business income' received from a pass-through company such as an 'S' corporation, partnership, limited liability company, or sole proprietorship. At the new 37% top individual tax rate, the 20% deduction approximates a 29.6% marginal federal rate, but is subject to many limitations.
 - Deductibility is restricted to taxable incomes below \$157,500 for single filers, and \$315,000 for married couples filing jointly, and phased out entirely above \$207,500 for single filers, and \$415,000 for married couples filing jointly.
 - The provisions affecting the deductibility of QBI for pass-through entities are scheduled to sunset for tax years beginning in 2026.

This Tax Update is provided for informational purposes. It is not intended to be, and should not be relied upon or considered to be, professional advice on these issues as they relate to your individual and personal tax, financial, and estate planning situation. Every set of client facts, goals, and objectives is unique and therefore warrants tailored counseling and advice. If you have questions about any of the material contained in this Tax Update, you should please consult with your CPA, personal tax advisors, and other professional advisors so as to best identify planning opportunities and understand how the change in law impacts your specific situation.

Contact us to set up a time to discuss your individual estate planning needs:

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