WRMarketplace

An AALU Washington Report

The *WRMarketplace* is created exclusively for AALU members by experts at Greenberg Traurig and the AALU staff, led by Jonathan M. Forster, Steven B. Lapidus, Martin Kalb, Richard A. Sirus, and Rebecca Manicone. *WRMarketplace* #17-47 was written by Greenberg Traurig Shareholder Jonathan M. Forster.

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TOPIC: Decoding Tax Reform: Senate Passes Its Bill – What It Says & What's Next?

MARKET TREND: The tax reform process took a major step forward with the Senate's passage of its tax reform legislation. While certain aspects of the final tax bill remain hard to predict as the Senate and House work out their differences, there will be plenty of opportunity for planning under any new tax laws, once enacted.

SYNOPSIS: Over the weekend, the Senate passed its version of the Tax Cut and Jobs Act ("Senate Bill") making some significant last-minute changes from its prior mark-up ("Prior Senate Bill"), including (1) the retention of the individual and corporate alternative minimum taxes ("AMTs"), (2) an increase in the deduction for qualified business income from pass-through entities from 17.4% to 23%, and (3) an allowance of a state and local income tax ("SALT") deduction of up to $10,000 for property taxes (similar to the House's version of the Tax Cut and Jobs Act ("House Bill")). While we now have more insight into the final frame-work for tax reform, the Senate and House Bills still differ in several key areas, including (1) the individual and corporate AMTs, (2) transfer taxes, (3) taxation of pass-through entity income, (4) individual tax rate/brackets and deductions, and (5) various business and international tax provisions. Significant changes are likely as these bills proceed to joint conference for reconciliation to produce legislation that both the Senate and House can pass.

TAKE-AWAYS: Republicans still have key decisions to make in conference. However, all issues are resolvable, and the expectation in Washington is that a tax bill will be signed into law by the end of the year. Whatever its ultimate form, it's clear that the envisioned tax reform will impact individuals and businesses at all income levels and make major changes in tax planning. What's not clear is whether every individual will see a reduced tax bill, as the proposed reforms significantly complicate an already complex tax code. This added complexity, coupled with the uncertainty regarding the sustainability of these changes over time, will make life insurance and legacy planning even more critical for clients to achieve maximum effectiveness in their plans under the new reforms. This should afford a unique opportunity for advisors and their clients to plan for both the short and long-term.

With the passage of the Senate Bill, the tax reform process has taken a critical step forward. Although key details still need to be worked out in joint conference, and AALU continues to spare no effort in working to improve the final bill, Republicans remain on target to enact tax reform legislation by year-end. With that in mind, below is a detailed update of how notable tax provisions of the current House and Senate Bills compare to current tax law.

SNAPSHOT COMPARISON: NOTABLE PROPOSALS

Note under the Senate Bill that: (1) highlighted areas indicate items of change from the prior Senate Bill, and (2) expiring provisions revert to current law at the start of the specified year.

INDIVIDUAL TAX

Select Provisions	**Current Law**			**House Bill**			**Senate Bill (Expire as of 2026)**		
		Single	Joint		Single	Joint		Single	Joint
Income Tax Rates & Brackets*	10%	$0-$9,525	$0-$18,650	12%	$0-$45,000	$0-$90,000	10%	$0-$9,525	$0-$19,050
	15%	$9,525-$38,700	$18,650-$75,900	25%	$45,000-$200,000	$90,001-$260,000	12%	$9,525-$38,700	$19,050-$77,400
	25%	$38,700-$93,700	$75,900-$153,100	35%	$200,000-$500,000	$260,001-$1,000,000	22%	$38,700-$70,000	$77,400-$140,000
	28	$93,700-	$153,100-	39.6	$500,000	$1,000,000 and	24%	$70,000-	$140,000-

INDIVIDUAL TAX

Select Provisions	Current Law			House Bill			Senate Bill (Expire as of <u>2026</u>)		
	%	$195,450	$233,350	%**	and over	over		$160,000	$320,000
	33%	$195,450-$424,950	$233,350-$416,700	**On income over $1 million ($1.2 million, joint), 12% bracket is phased-out by applying 6% surcharge until tax savings from first bracket are recouped (e.g., added 6% on $1 million - $1.2 million (single) and $1.2 million -$1.614 million (joint)).			32%	$160,000-$200,000	$320,000-$400,000
	35%	$424,950-$426,700	$416,700-$470,700				35%	$200,000-$500,000	$400,000-$1,000,000
	39.6%	$426,700 and over	$470,700 and over				38.5%	$500,000+	$1,000,000+
Capital Gains Rates	0%, 15%, and 20%			Same as current law			Same as current law		
AMT	On income over certain thresholds (e.g., $54,300 (single) and $84,500 (joint))*			Repealed			Retains AMT with increased thresholds (e.g. $70,300 (single) and $109,400 (joint))*		
Income from Pass-Through Entities	Taxed at individual income tax rates			**<u>25% maximum tax rate</u>** on "business income" of active businesses (not income paid for work of owner) Owners receiving distributions can elect to: (1) treat 30% as business and 70% as wage income or (2) determine ratio of business to wage income based on capital investment Distributions from passive business activities treated as 100% income			**<u>23% deduction</u>** for individual taxpayers on domestic "qualified business income" from pass-through entities, subject to various restrictions and limitations. Wages paid to owners and certain income from specified services businesses are excluded from deduction.		

INDIVIDUAL TAX			
Select Provisions	**Current Law**	**House Bill**	**Senate Bill (Expire as of 2026)**
Standard Deduction *	$6,350 (single) $12,700 (joint)	$12,200 (single) $24,400 (joint)	$12,000 (single) $24,000 (joint)
Personal Exemption	$4,050*	Repealed	Repealed
SALT Deduction	Allowed	Allowed only for individual state and local property taxes up to $10,000	Same as House Bill
Mortgage Interest Deduction	Allowed on loans up to $1 million on a principal and second residence and on interest on up to $100,000 of a home equity line	Reduces deduction limitation to $500,000 for debt on principal residence only as of **11/2/2017**	Same as current law except deduction for home equity indebtedness is repealed
Gain on Sale of Principal Residence	Exclusion allowed for gain of up to $250,000 (single) / $500,000 (joint) on sale of a residence used as principal residence for 2 of last 5 years	Same exclusion amount as current law but (1) use of principal residence must be for 5 of last 8 years **and** (2) phases out for taxpayers with average annual adjusted gross income over 3 years exceeding $250,000 (single) / $500,000 (joint)	Same exclusion amount as current law except use of principal residence must be for 5 of last 8 years (new use restriction does not apply if residence under contract before 1/1/2018)
Taxation of Sales of Individual Stock	For shares purchased at different times/costs, taxpayer can select which shares to sell first	Not addressed	Applies a first-in/first-out (FIFO) rule where shares bought first (often at a lower cost) are deemed sold first, likely accelerating gain recognition
Individual Mandate	Individuals must have minimum health insurance coverage or pay a penalty	Not addressed	Repeals the individual mandate as of 2019 (does **not** expire in 2026)

*Subject to annual inflation indexing.

TRANSFER TAX			
Select Provision	**Current Law**	**House Bill**	**Senate Bill (Expire as of 2026)**
Gift Tax	40% top rate $5 million exemption* ($5.49 million in 2017; $5.6 million in 2018)	Top rate drops to 35% in **2025** Doubled exemption ($10 million)* starting **2018**	Top rate remains 40% Doubled exemption ($10 million)* starting **2018**. Upon expiration, exemption would revert to $5 million, as inflation adjusted to 2026
Estate Tax[1]	40% top rate $5 million exemption* ($5.49 million in 2017; $5.6 million in 2018)	Top rate remains 40% until **2025** Doubled exemption ($10 million)* starting **2018** **Full repeal** starting **2025**	Top rate remains 40% Doubled exemption ($10 million)* starting **2018**. Upon expiration, exemption would revert to $5 million, as inflation adjusted to 2026
GST Tax[2]	40% flat rate GST exemption **equals** gift/ estate tax exemption under IRC §2010(c)	Rate remains 40% until **2025** Doubled exemption ($10 million)* starting **2018** **Full repeal** starting **2025**	Rate remains 40% Doubled exemption ($10 million)* starting **2018**. Upon expiration, exemption would revert to $5 million, as inflation adjusted to 2026
Basis Step Up at Death	Yes	**Yes**	Yes (would **not** expire in 2026)

*Subject to annual inflation indexing.

CORPORATE TAX			
Select Provision	**Current Law**	**House Tax Bill**	**Senate Tax Bill (Permanent Changes)**
C Corp. Rate	35% max rate (flat rate for personal service corporations (**PSCs**))	20% flat rate (25% for PSCs) effective starting **2018**	20% flat rate (including for PSCs) effective starting **2019**
Corporate AMT	Applied to C corporations	Repealed	**Retains current AMT**

RESOLVING DIFFERENCES

Differences between the House and Senate Bills must now be resolved in joint conference to produce a bill that can pass both chambers. Key areas of disagreement that must be addressed include: (1) the individual and corporate AMTs, (2) gift, estate, and GST taxes, (3) taxation of pass-through entity income, (4) individual tax rate/brackets and deductions, and (5) various business and international tax provisions. We are likely to see changes in several of these areas.

GEARING UP

With tax reform and 2018 fast approaching, advisors are likely already geared up for year-end planning with their clients. Right now, the focus should remain on planning items that continue to make sense with or without tax reform, including: (1) acceleration of deductions and credits and deferral of income, (2) charitable planning; (3) annual gifts, (4) completion of purchases of life insurance coverage to preserve flexibility and pricing; and (5) the laying of groundwork for reviews of existing legacy plans to adapt to new tax provisions.

TAKE-AWAYS

Republicans still have key decisions to make in conference. However, all issues are resolvable, and the expectation in Washington is that a tax bill will be signed into law by the end of next week. Whatever its ultimate form, it's clear that the envisioned tax reform will impact individuals and businesses at all income levels and make major changes in tax planning. What's not clear is whether every individual will see a reduced tax bill, as the proposed reforms significantly complicate an already complex tax code. This added complexity, coupled with the uncertainty regarding the sustainability of these changes over time, will make life insurance and legacy planning even more critical for clients to achieve maximum effectiveness in their plans under the new reforms. This should afford a unique opportunity for advisors to engage with clients to plan for both the short and long-term.

NOTES

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This information is intended solely for information and education and is not intended for use as legal or tax advice. Reference herein to any specific tax or other planning strategy, process, product or service does not constitute promotion, endorsement or recommendation by AALU. Persons should consult with their own legal or tax advisors for specific legal or tax advice.

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[1] Note that the potential for an increase and then drop in the available federal estate tax exemption has previously raised the issue of "clawback," which arguably results in greater estate tax liability if lifetime gifts are made using a higher unified gift/estate tax exemption, but the donor later dies when the unified gift/estate tax exclusion has decreased. The issue was significantly discussed in 2012, before enactment of the American Taxpayer Relief Act of 2012, when it appeared that the federal gift and estate tax exemption would decrease from $5.12 million to $1 million. Although this result did not seem to reflect the legislative intent at the time and many commentators eventually came to the conclusion that clawback would not occur, Congressional or IRS clarification likely would have been needed or desired to confirm this outcome. The Senate Bill, however, seems to provide a proactive resolution of this issue in §11061(b) ("Modifications to Estate Tax Payable to Reflect Different Basic Exclusions Amounts") by giving the IRS authority to prescribe regulations to address any difference between the basic exclusion amount at the time of any gifts by a decedent and the basic exclusion amount at the decedent's death.

[2] The GST tax exemption is defined statutorily to match the "basic exclusion amount" set for the unified gift and estate tax under IRC §2010(c) (i.e., $5 million, as adjusted annually for inflation). As a result, the Senate Bill's proposed changes to IRC §2010(c), which would double the basic exclusion amount for gift and estate tax purposes, also would automatically apply for GST tax purposes.