



# 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. Sirius, and Rebecca Manicone. WRMarketplace #17-45 was written by Greenberg Traurig Shareholder Jonathan M. Forster and Associate Jennifer Smith.

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**WRM #17-45**

**TOPIC: Decoding Tax Reform: Interim Update - Where We Are Now.**

**MARKET TREND:** The tax reform process continues to move full speed ahead as the House and Senate advance versions of their tax reform legislation.

**SYNOPSIS:** Last week, the tax reform effort took major steps forward, as the House passed its version of the Tax Cut and Jobs Act (“House Bill”) and the Senate Finance Committee passed its legislative mark-up (“Senate Bill”). Yet, the Bills differ in several key areas, including: (1) estate and GST taxes, (2) the state and local income tax (“SALT”) deduction for individuals, (3) tax rates on pass-through entity income, and (4) the individual healthcare mandate (“individual mandate”). Significant compromises likely will be required in some of these areas to produce revenue-neutral legislation that both the Senate and House can pass.

**TAKE-AWAYS:** Tax reform will inevitably serve as a catalyst for exploring new opportunities for life insurance and legacy planning. As some major legislative compromises are expected before we see a final bill, in the interim, life insurance advisors should (1) stay engaged with clients by getting them on the calendar now for plan reviews, (2) stay focused on helping clients complete beneficial planning by year-end, including non-taxable gift and sale transactions, charitable plans, and life insurance purchases, and (3) stay tuned to AALU for up-to-date information as Congress races to complete tax reform on the aggressive timeline they have laid out.

Despite the fact that Congress is moving quickly on tax reform, Republicans still need to make critical decisions and face a number of political challenges. Key details of tax reform will

change. In the interim, here is how notable individual, transfer, and business tax provisions of the current House and Senate Bills compare to current tax law and some practical insights on how advisors should be proceeding now.

## SNAPSHOT COMPARISON: NOTABLE PROPOSALS

INDIVIDUAL TAX			
Select Provisions	Current Law	House Bill	Senate Bill
Income Tax Rates	10%, 15%, 25%, 28%, 33%, 35%, 39.6%	12%, 25%, 35%, 39.6%	10%, 12%, 22%, 24%, 32%, 35%, 38.5% Expires after 2025
Top Income Tax Bracket*	\$418,401+ (single) \$470,700+ (joint)	\$500,001+ (single) \$1,000,000+ (joint)	\$500,001+ (single) \$1,000,000+ (joint)
Capital Gains Tax Rates	0%, 15%, and 20%	Rates same as current law but thresholds adjusted	Rates same as current law but thresholds adjusted
AMT	On income over \$54,300 (single) and \$84,500 (joint)*	Repealed	Repealed only through 2025
Standard Deduction*	\$6,350 (single) \$12,700 (joint)	\$12,200 (single) \$24,400 (joint)	\$12,000 (single) \$24,000 (joint) Expires after 2025
SALT Deduction	Allowed	Allowed only for individual state and local property taxes up to \$10,000	Repealed, except for SALT paid in for trade or business or state and local property taxes on business assets Repeal expires after 2025
Mortgage Interest Deduction	Allowed on loans up to \$1 million	Reduces deduction limitation to \$500,000 for debt incurred after 11/2/2017 Interest only deductible on a taxpayer's principal residence	Retains current deduction limit for acquisition debt but repeals deduction for home equity indebtedness Repeal of home equity deduction expires after 2025
Personal Exemption	\$4,050*	Repealed	Repealed only through 2025
Individual Mandate	Individuals must have minimum health insurance coverage or pay a penalty	Not addressed	Repeals the individual mandate

\*Subject to annual inflation indexing.

TRANSFER TAX			
Select Provision	Current Law	House Bill	Senate Bill
Gift Tax	40% (total gifts over \$5.49 million)*	Doubled exemption (\$5M/\$10M to \$10M/\$20M)* and drop in top rate from 40% to 35% as of 1/1/2018 <u>No repeal</u>	Doubled exemption* as of 1/1/2018 <u>No repeal</u>
Estate & GST Taxes	40% (for estates/total GST transfers over \$5.49 million)*	Doubled exemption* and drop in top rate from 40% to 35% as of 1/1/2018 <u>Full repeal</u> as of 1/1/2024	Doubled exemption* as of 1/1/2018 <u>No repeal</u>
Basis Step Up at Death	Yes	Yes	Yes

\*Subject to annual inflation indexing.

CORPORATE/BUSINESS TAX			
Select Provision	Current Law	House Tax Bill	Senate Tax Bill
Income from Pass-Through "Business" Entity	Taxed at individual income tax rates	25% maximum tax rate on portion of "business income." Owners receiving distributions from active business activities can elect to: (1) treat 30% as business income 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% business income Income from personal service entities (e.g., for doctors, lawyers) not eligible.	Deduction instead of changing rates on income. Individual taxpayer can deduct 17.4% of domestic "qualified business income" from pass-through entity. Expires after 2025.
C Corp. Rate	35% max rate (flat rate for personal service corporations (PSCs))	20% flat rate (25% for PSCs) effective 1/1/2018	20% flat rate (repeal of special rate for PSCs) effective 1/1/2019
Corporate AMT	Applied to C corporations	Repealed	Repealed

## **SOMETHING'S GOTTA GIVE: THE ART OF COMPROMISE**

Differences between the House and Senate Bills primarily result from the Senate's need for a revenue-neutral bill that the Senate can pass with just 51 votes under budget reconciliation. Currently, the Senate Bill is revenue-neutral after the prescribed 10-year budget window, but the House Bill is not. Key areas of disagreement that impact revenue neutrality include: (1) estate and GST taxes, (2) the SALT deduction, (3) tax rates on pass-through entity income, and (4) the individual mandate. Compromises likely will be needed in one or more of these areas to produce final legislation that can pass both the House and Senate.

## **IN THE INTERIM: NEW CHALLENGES/NEW OPPORTUNITES**

Given the uncertainty surrounding crucial components of the final tax reform package, it's too early for an in-depth take on the potential legacy and life insurance planning impact. Regardless of the content, however, tax reform will inevitably serve as a catalyst for life insurance and legacy planning. For example, areas where new planning approaches may develop include:

- Increased state income tax planning due to the loss of the SALT deduction
- Additional charitable deduction planning to make up for the loss of other individual tax deductions

## **WHAT NOW?**

With Republicans pushing to finish tax reform before year-end, **advisors should:**

- **Stay Engaged.** Advisors should initiate contact with clients now to schedule estate and life insurance plan reviews, particularly since the holiday season starts to limit the number of business days available before year-end. Advisors also should use tax updates as a way to "touch" clients on a regular basis throughout the reform process so they remain engaged in the planning.
- **Stay Focused.** Advisors and clients should stay focused on completing year-end planning that makes sense regardless of tax reform, for example: (1) close non-taxable gift and sale transactions, including annual exclusion gifts and installment sales to grantor trusts, as these transactions can provide benefits even with an estate tax repeal, (2) implement charitable techniques that can provide income tax deductions, and (3) complete life insurance purchases that provide flexibility for future changes but preserve insurability now.
- **Stay Tuned.** Given the speed at which tax reform is moving, it will be important for advisors to stay on top of the proposed changes as the House and Senate work to develop a legislative compromise. AALU will continue to provide its members with the most up-to-date information and relevant analyses to help them communicate promptly with their clients and allied advisors.

## TAKE-AWAYS

Tax reform will inevitably serve as a catalyst for exploring new opportunities for life insurance and legacy planning. As some major legislative compromises likely are pending before we see a final bill, in the interim, life insurance advisors should (1) stay engaged with clients by getting them on the calendar now for plan reviews, (2) stay focused on helping clients complete beneficial planning by year-end, including non-taxable gift and sale transaction, charitable plans, and life insurance purchases, and (3) stay tuned to AALU for up-to-date information as Congress races to the finish on tax reform.

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