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The Advanced Consulting Group

White paper

The new tax law provides many tax planning opportunities

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The Tax Cuts and Jobs Act, was signed into law by the President on December 22, 2017. This new tax law is the most substantial overhaul of the Internal Revenue Code since 1986. With hundreds of pages of new law that impact almost every aspect of federal taxation, it will take many months to fully digest these changes and analyze their impact. We have a few planning strategies here, however, based on our initial review of the law.

An important aspect of the new tax law to keep in mind for any planning purposes is the impact of reconciliation on different provisions. Most corporate income tax changes (including the new corporate tax rate) are permanent. However, most provisions relating to the individual income tax (including the reduced tax rates) and the estate tax (including the increased exemption amount) are subject to reconciliation which means they revert back to 2017 law at the end of 2025. Also, note that most provisions are effective beginning with the taxpayer's 2018 tax year.

To be or not to be a C corporation

Some taxpayers may be tempted to convert their business to a C corporation because the new tax law reduces the corporate tax rate from a graduated rate of 15% -35% to a flat 21% rate. Corporations are still subject to double taxation, however, due to taxation of dividends paid to shareholders. Compare this tax treatment to the new highest individual tax rate of 37% which generally applies to all other business forms whose income is passed through to the owner's individual tax return. The disparity in rates is not so severe, however, because the new tax law also includes a 20% deduction for qualified business income for pass-through entities which drops the highest effective individual rate to 29.6%.[1] The application of the 20% deduction is complex and depends on multiple factors, including the nature of the business, wages paid, types of business assets and adjusted gross income of the taxpayer.

Tax rates should not be the sole reason to choose one business form over another. A business owner and his or her advisors will need to carefully consider which business form is most appropriate for the business. The new tax law will provide business advisors, accountants and lawyers ample opportunity for business planning.

Retirement plan contributions

IRS data suggests that more than 90% of businesses are organized as pass-through entities. Concern has been expressed that reducing the effective tax rate on pass-through entities below the business owner's individual tax rate may discourage owners from contributing to qualified plans. This is because current taxation on business income could be at lower rates than the ordinary income tax rates that will apply at the time of distribution. A business owner could mitigate this concern by making salary deferral contributions to a designated Roth account within the qualified plan and pay taxes currently on the contributions. If the Roth rules are followed, the contributions and related earnings will be distributed free of income tax.

Alternatively, personal service professionals such as doctors, lawyers, accountants, consultants, financial advisors, etc., whose businesses are set up as pass-through entities and who have adjusted gross income slightly above the deduction elimination thresholds ($415,000 for married filing joint (MFJ), $207,500 individual), may find that contributions to qualified retirement plans will be important to reduce their taxable income below the thresholds to take advantage of the deduction for qualified business income.

Estate and gift tax considerations

The new tax law doubled the estate and gift tax exemption amount. For estates of decedents who die, or for gifts made after December 31, 2017, the basic exclusion amount is $10 million (indexed for inflation occurring after 2011). For 2018, the exemption is $11.2 million ($22.4 million per couple). Note however, that the increased exemption amounts are set to revert back to 2017 levels in 2026. The increased exemption is an opportunity to make substantial gifts, free of tax over the next several years.

When making gifts consider the following:

- Gift of cash or high-basis property should be made during life (the basis will carry over to the donee)
- Gifts of low basis property may be better suited for a transfer at death so that it receives a step-up in basis

A beneficiary of a trust with low basis property could "decant" the trust so that the trust assets become part of the beneficiary's gross estate and subject to basis step-up at death.

Some gifting techniques include the use of irrevocable trusts, family limited partnerships, grantor retained annuity trusts, forgiving outstanding notes.

Maximizing charitable contributions

The deduction limit for cash donations to public charities and private operating foundations has been increased to 60% of AGI. As under current law, charitable deductions are only available to those individuals who itemize deductions.

Bunching charitable contributions

If the taxpayer's current annual charitable gifts do not exceed the new $12,000 standard tax deduction ($24,000 for MFJ), consider making two years' of charitable gifts in one year so the charitable deduction exceeds the standard tax deduction.[2]

Example: an individual intends to make $10,000 in 2018 charitable gifts and $11,000 in 2019 charitable gifts. There would be no incentive to itemize deductions in either year based on these contributions. However, if the charitable gifts are combined into one year, the taxpayer would be gifting $21,000 and could benefit from itemizing deductions.

Qualified Charitable Donations (QCD)

For those who are inclined to donate to charities, the most tax effective contribution is the use of a QCD. This allows the taxpayer to avoiding taxation on the contribution by giving money from a qualified IRA which is also counted towards the taxpayers required minimum distribution for the year from the IRA. The basic rules for a QCD are as follows:

- The IRA owner must be 70 ½ or older
- The distribution must consist of ordinary income
- The donation cannot exceed $100,000 per year
- The donation must be a direct transfer from the trustee or custodian to the charity
- The QCD must be reported on the individual's tax return

These are just a few planning considerations for taxpayers as they look ahead to the next several years. Tax experts will be evaluating the new law and the Internal Revenue Service will likely be issuing reams of guidance in the months ahead to provide additional planning opportunities.

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[1] This rate applies to income above $600,000 for married filing jointly.

[2] Deductions for qualified resident interest and up to $10,000 of state and local taxes paid are also still available as itemized deductions. In addition, for 2018, the medical expense deduction floor is lowered to those expenses which exceed 7.5% of AGI. These additional itemized deductions can be coupled with the bundled charitable deductions to make itemizing more valuable.

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