THE NEW TAX LAW AND YOU

BY KRISTI MATHISEN, JD, CPA, PFS

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LNWM's in-house expert on tax and financial planning, Krisiti is an attorney and CPA with more than 20 years of experience in financial services.

What a difference a year makes! Last January, we interviewed LNWM's Kristi Mathisen on what "Taxes Under Trump" might look like. Since then, quite a few of the changes Kristi outlined have since become law, via the "Tax Cuts and Jobs Act" (TCJA) of 2017. So we thought we'd again sit down with Kristi for insights into the new tax law, and what we can expect for 2018 and beyond.

Q: Kristi, what did we get in terms of tax reform?

Kristi: Taxes will be lower for US taxpayers as a group. But some will pay more and some less. And the changes didn't do much for simplification – certainly no one will be filing using a postcard. Finally, the tax cuts do not pay for themselves — the federal deficit is expected to rise by nearly $1.5 trillion over the next 10 years.

Just as important: virtually all the changes to taxes on individuals will expire at the end of 2025, unless renewed by Congress.

Q: Who benefits the most from the new tax law?

Kristi: Overall, I would say the best tax news is for:

- **US corporations**
- **Owners of non-corporate businesses**
  (sole proprietorships, LLCs, LPs and S Corps.)
- **Households subject to the federal estate tax**
- **Households that usually claim the standard tax deduction**
  (do not itemize deductions)
- **Households with children or other dependents under 17 years old**

Q: Let's start in the middle with the estate tax.

Kristi: The estate tax was not repealed, but it was basically eliminated for many families. Between 2018 and the end of 2025 (when this provision expires), the amounts you can give away tax-free during your lifetime – or at death — have been doubled: to about $11.2 million for individuals ($22.4 million for a married couple).

There's more good news for the heirs or other beneficiaries of estates. The old valuation rules did not change. Upon death, the heirs inherit the assets at current market prices, limiting the amount of gains.

Q: What should people with large estates be doing?

Kristi: Review your estate plan as soon as you can! Documents may need changing to reflect how you want your wealth to be handled after you pass away, taking into account the larger exemptions. If family gifting and/or charitable giving is already part of your plan, making significant gifts now while the exemption is really large is a good idea.

Keep in mind that certain states – including Washington – levy their own estate taxes. And those are still in place. Gifts to family and charitable giving can also be used to reduce estate taxes at the state level.

On a side note, the maximum amount you can give tax-free to any number of individuals during your lifetime (without affecting your exemption) rises to $15,000 annually in 2018, or $30,000 for a married couple.

PERSONAL TAXES: A MIXED BAG

Q: What about personal income taxes?

Kristi: Most households – but certainly not all — will pay less in taxes due to:

- Slightly lower tax rates (see page 4);
- Tweaking of the federal tax brackets;
- Doubling the standard deduction;
- Doubling of the child tax credit.

Q: Who is likely to pay more in personal income taxes?

Kristi: People with lots of dependents over the age of 16. That's because the new law does away with all personal exemptions, which were worth $4,050 per person in 2017. There is a $500 credit for other dependents (17 or older) but that's not nearly enough to offset the loss of the personal exemption.

Also likely to pay more: households with large itemized deductions. That's because the new law limits some of the major deductions (see chart on page 3). One of the biggest changes is how much you can deduct annually for state and local taxes (SALT) – including sales, property, and income taxes. Starting in 2018, you can deduct only up to $10,000 annually for SALT.

There are major offsets, however. There is no longer a limit on overall deductions based on taxable income, and charitable contributions can total up to 60% of income (vs. 50% previously). In addition, the scope of the Alternative Minimum Tax (AMT) has been drastically reduced. Estimates are that the AMT will apply to far fewer households (50% to 60% fewer), due to changes in itemized deductions and expanded exemption levels.

Major Changes To Personal Taxes

1. **Standard Deduction Doubles**

	2017 Standard Deduction	2018 Standard Deduction
Married, filing jointly	$12,700	$24,000
Head of Household	$9,350	$18,000
Single	$6,350	$12,000
Married, filing separately	$6,350	$12,000

2. **No Personal Exemptions**
3. **Child Credit Doubles:** $2,000 for each dependent under 17 years old

What can households that lose deductions do?

Kristi: One strategy is to take advantage of the deductions still available and bunch them into certain years, especially during years of higher income.

On the horizon: Some major high-tax states — such as New York, New Jersey and California — are already proposing state legislation that will counter the effects of the federal government phasing out state tax deductions. We will be following this closely. But I would not make any tax-related decisions assuming any type of outcome. When it comes to taxes, you have to work with the laws currently in place.

What about taxes on investment income?

Kristi: No major changes there, which is somewhat surprising. Investment income, including long-term capital gains and qualified dividends, continues to be taxed at the same three rates: 0%, 15% and 20%, at brackets that resemble the old income-tax brackets. So for a couple filing jointly, the 15% rate kicks in at taxable income of $77,200; the 20% rate at $479,000.

New Deal on Itemized Deductions

Fewer itemized deductions are allowed starting in 2018. But there is no longer a limit on itemized deductions as percentage of taxable income.

	Allowed	Not Allowed Starting 2018	
Medical Expenses	✓		If higher than 7.5% of taxable income
State and Local Taxes	✓		Capped at $10,000 annually
Charitable Contributions	✓		Cash gifts are limited to 60% of Adjusted Gross Income
Mortgage Interest	✓		Limited to $750,000 in mortgages issued after 12/15/2017. Mortgages up to $1 million issued before that date are grandfathered
Investment Interest Expense	✓		
Other Deductions*	✓		
Home Equity Interest		X	
Mortgage Financing Points		X	
Unreimbursed Employee Expenses		X	
Tax Preparation Fees		X	
Investment Management Fees		X	
Casualty Losses		X	Except federal disasters
Other Investment Expenses		X	

*Miscellaneous deductions including gambling losses,, estate taxes on IRAs, and trust expenses of a grantor trust.

Q: And the taxes levied on higher-income Americans as part of the Affordable Care Act?

Kristi: As we expected, those two surtaxes were left in place: we still have the 3.8% surtax on net investment income; and the additional 0.9% Medicare tax on earnings.

BUSINESSES BENEFIT THE MOST

Q: Let's talk about businesses. What's happening there?

Kristi: By far, the biggest changes in the new law are those affecting businesses. They are sweeping – and most are permanent. US corporations are now taxed at a flat rate of 21%, down from a top rate of 35%, and there some other major benefits, including no Corporate Alternative Minimum Tax, and favorable tax rates to encourage bringing offshore income back to the US. This means a hefty rise in the after-tax income of many corporations, which is likely to benefit shareholders and investors.

Q: What about owners of businesses that aren't corporations?

Kristi: They stand to benefit as well. If you personally pay the tax on your business' income — you are a sole proprietor, a partnership, Limited Liability Co. (LLC) or an S corporation — you could qualify for a new deduction that is up to 20% of the business income (through 2025, when this provision expires if not renewed).

The 20% deduction, known as 199A, is one of the most complicated aspects of the new law. It may apply to some real estate income, and in modified way, even to estates and trusts.

New vs. Old Personal Tax Brackets

Married, Filing Jointly				Single			
2017		2018		2017		2018	
Taxable Income	Tax Rate	Taxable Income	Tax Rate	Taxable Income	Tax Rate	Taxable Income	Tax Rate
0 to $18,650	10%	0 to $19,050	10%	0 to $9,325	10%	0 to $9,525	10%
$18,651 to $75,900	15%	$19,051 to $77,400	12%	$9,326 to $37,950	15%	$9,526 to $38,700	12%
$75,901 to $153,000	25%	$77,401 to $165,000	22%	$37,951 to $91,900	25%	$38,701 to $82,500	22%
$153,101 to $233,350	28%	$165,001 to $315,000	24%	$91,901 to $191,650	28%	$82,501 to $157,500	24%
$233,351 to $416,700	33%	$315,001 to $400,000	32%	$191,651 to $416,700	33%	$157,501 to $200,000	32%
$416,701 to $470,700	35%	$400,001 to $600,000	35%	$416,701 to $418,400	35%	$200,001 to $500,000	35%
Over $470,700	39.6%	Over $600,000	37%	Over $418,400	39.6%	Over $500,000	37%

The calculation is easiest if your total taxable income is under $315,000 for couples filing jointly and $157,500 for everyone else. Within these levels, the 20% deduction is limited only if you also have capital gains and dividend income. At higher income levels, however, the tax deduction decreases and is even eliminated depending on a variety of factors, including the type of business and the amount paid in wages.

For example: Say you're a married, self-employed software engineer with net business income of $180,000 in 2018. With your spouse's wages, your total taxable income is $300,000. Your 199A deduction would then be about $36,000 (20% of $180,000). On the other hand, if your taxable income was $425,000, you could not claim the deduction at all.

Q: What in general would you advise in terms of tax planning for 2018?

Kristi: There are certain situations that I would say demand review early on, given the new tax law:

- Estates valued at more than $5.6 million ($11.2 million for couples)
- Business owners
- Households that claim more than $24,000 in itemized tax deductions annually ($12,000 for singles)
- Households that normally pay the Alternative Minimum Tax

For everyone in general, it's good to get an estimate of whether your taxes will be higher or lower in 2018. If lower, you can consider strategies that work well in lower-tax years, such as converting an IRA to a Roth IRA, or taking higher distributions from retirement accounts. If higher, consider things like ramping up contributions to tax-advantaged retirement accounts and donating to charity.

Here at LNWM, we take an integrated approach to wealth planning and can advise on a wide variety of strategies in light of the new tax law. Each situation is different, and we would be happy to discuss in detail what the new tax law means for you personally. ◘

ALSO IN THE TAX LAW

BUSINESS

Businesses with average annual revenue up to $25 million, can:

- Continue to deduct all interest expense they pay on their debt;
- Use the cash method of accounting;

Businesses of all sizes get more opportunities to write off the cost of equipment and other property against taxable income. And there is a new tax credit for businesses of all sizes for paid family and medical leave up to 12 weeks.

However, some common business deductions were repealed, including: entertainment, employee transit passes, qualified parking, lobbying expenses.

PERSONAL

529 Savings Plans – You can now make withdrawals from any 529 Plan — up to $10,000 per student annually — to help pay for K-12 (elementary and high school),

Alimony – Alimony payments will no longer be deductible starting in 2019. However, those who receive the alimony will not be taxed on it.

Roth IRAs – If you convert a regular IRA into a Roth IRA starting in 2018, you will not be permitted to undo the conversion later on.

ABOUT THE AUTHOR

KRISTI MATHISEN is managing director of tax and financial planning at Laird Norton Wealth Management. In addition to being LNWM's in-house expert on tax and estate planning, she provides advice on philanthropic strategies to the firm's client service team and to clients directly. Kristi is an attorney and CPA with more than 25 years of finance-related experience, much of it in accounting. She has a bachelor's degree in business administration with an accounting concentration from the University of Washington and a Juris Doctor from the University of Washington School of Law. Kristi is a member of the Washington State and King County Bar Associations, the CPA Society of Washington State and the American Institute of CPAs.

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