The Hunt for Loopholes Begins
January 10, 2018

"Don't tax you, don't tax me, tax that fellow behind the tree," quipped Senator Russell Long, who chaired the powerful Senate Finance Committee from 1966 to 1981. In 2017, as the year wound to a close, House Republicans introduced their version of tax reform. Few individuals thought such a massive undertaking could be signed into law before the end of the year, but that is exactly what happened. In the hectic days that preceded Christmas, the president signed into law the most sweeping change in the tax code since 1986.

As with every law change there are proverbial winners and losers, however our intent is to simply summarize, at a high level, changes we can expect in 2018. We anticipate that 2018 will be a very busy year for Tax Attorneys and Certified Public Accounts, as they search for loopholes and approaches that assist their clients in reducing their overall tax burden.

What Does it Actually Mean?

The new tax code will result in substantive tax reform for corporations. It will eliminate the corporate alternative minimum tax (AMT) and consolidate the corporate tax rate down to a single 21% tax rate from 35%. These changes will be permanent. For individuals, the new legislation is a series of cuts and tweaks, which may potentially introduce more tax planning complexity and will be subject to another infamous sunset provision after the year 2025.

Over 80% of Americans will get a tax cut in 2018, while just 5% of taxpayers are expected to pay more (Tax Policy Center, Washington Post). In most cases, cuts are expected to be modest; however, much will depend on individual circumstances. Below we have attempted to highlight some of the key takeaways without getting too detailed. Sources for this review include the Tax Policy Center and Kitces.com.

- The 10% bracket remains unchanged, while the 15% bracket declines to 12%, the 25% to 22%, the 28% to 24%, the 33% to 32%, the 35% holds steady, and the 39.6% slips to 37%. The thresholds are modestly adjusted above the new 22% bracket.

- The standard deduction nearly doubles to $12,000 for single filers and $24,000 for married filers, reducing the incentive to itemize and simplifying the process for some taxpayers.

- The $4,150 personal exemption is eliminated, and the $1,000 child tax credit doubles to $2,000. In general, rules for charitable contributions remain unchanged.

- By itself, the combination of points one, two, and three will provide modest tax relief for most families. But I must caution, it will still depend on your individual circumstances.

- Those in high-tax states could see the biggest hit, as there will be a $10,000 cap on state, local, and property tax deductions.

- For investors, the preferential treatment for long-term capital gains and dividends remains intact, as is generally the case for retirement accounts.

- One important change to note: the new law repeals rules that allow for recharacterizations of Roth conversions back into traditional IRAs. Once you convert into a Roth, there will be no going back.

- The 3.8% Medicare surtax on investment income for high-income taxpayers was retained. Since the levy entered the tax code, we have crafted strategies that reduce its bite; however, the tax survived tax reform and is likely to remain a permanent feature of the tax code going forward.

- The Alternative Minimum Tax (AMT) for individuals was not repealed, but exemptions have been widened. This change will impact fewer taxpayers who were falling into AMT brackets.

- The estate tax survived, but the exemption will double from $5.6 million to $11.2 million for individuals, and from $11.2 million to $22.4 million for couples.

- The new tax bill also repeals the Obamacare mandate that requires all individuals to obtain health insurance. It becomes effective 2019.

- Finally, it’s important to point out that many of the more popular changes in the tax code for individuals will sunset in 2025. While many may eventually become permanent, as we saw with the Bush tax cuts of 2001 and 2003, there’s no guarantee this will happen again.

- For Business: Given that the 21% corporate tax rate applies only to C-corps, there will be a 20% deduction for pass-through entities, such as S-corps, partnerships, and LLCs. I believe this will be a welcome benefit for many business owners, but complex rules may limit the pass-through for some entities.

What Does it Actually Mean?

We expect that the rewrite of the tax code will produce unintended benefits and unexpected consequences. From an economic standpoint, Congress and the President hope that changes, especially as they relate to business, will encourage firms to open new plants, expand operations in the U.S., and level the playing field with the global community. Prior to reform, the U.S. corporate rate was the third highest among 188 nations (Tax Foundation). About 90% of economists surveyed by the Wall Street Journal expect a modest boost to growth in 2018 and 2019, but after that, opinions diverge. If tax incentives boost productivity, it could lift long-run GDP potential, which would yield a significant benefit. If the economic benefits end after a two-year sugar high, it will likely be deemed a failure. Early anecdotal data offer some encouragement, as several large firms announced year-end bonuses or wage hikes tied to the lower corporate tax rate. At a minimum, the lower tax rate increases long term after-tax earnings, which played a big role in the late-year stock market rally. It could also boost corporate stock buybacks and dividends going forward, which would create an added tailwind for stocks. That said, we are cautiously optimistic it will encourage entrepreneurship and economic growth, which would benefit hard-working Americans.

At Voisard Asset Management Group, we understand that uncertainty breeds questions and concerns. As laws change that may impact your personal situation and goals, so should your financial plan. Regularly reviewing your plan with your financial advisor is extremely important and should not be overlooked. If you haven’t created a financial plan or haven’t visited your plan in a while, we would love to assist you. It’s amazing how much a simple conversation can do for an individual!

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