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Early ambitions for a tax bill that would lead to postcard-sized returns have morphed into a law that stretches over 1,000 pages. In it, corporate rates and SALT deductions are slashed, the estate tax survives, and favorable carried interest tax treatment lives to fight another day.

We're going to need a bigger postcard

What started as an effort at tax simplification finished as anything but. But finish it did.

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What a long strange trip. One recalls the journey began back in the improbable days of the Trump campaign with a one-page website proposal for tax reform, on to the "Big Six" nine-page proposal in September, and then the real sausage making on Capitol Hill, to which we were all treated, blow by blow, on cable news.

Finally we have what feels, for the moment, like closure. In truth, the bill's over 1,000 pages include a number of provisions that are not only new, but in some cases untested concepts in U.S. tax law, and as such, completely devoid of agency rule making and the guidance of the courts. In this sense, the passage of the Tax Cut and Jobs Act (TCJA) represents a conclusion, but also just a beginning.

THE NEW LAW

The TCJA is a lengthy document, but we'll try here to make its long story as short as possible. Here's a take on what matters for our clients.

Individual Ordinary Income Tax Rates:
There remain seven individual brackets, with a top rate of 37%, but they are configured differently. The top rate kicks in at $600,000, a slightly lower rate and higher threshold than the current 39.6% at $470,700. The next highest rate, 35%, will begin at $400,000, slightly lower than the current $416,700.

The next tier of 32% will start at $315,000. That rate presently is 33% but begins much lower than the new threshold, at $233,350. So, for many, some relief here.

Current

Taxable Income	Rate
$0 - $18,650	10%
$18,650 - $75,900	15%
$75,900 - $153,100	25%
$153,100- $233,350	28%
$233,350- $416,700	33%
$416,700- $470,700	35%
$480,050 and up	39.6%

All brackets for married, filing jointly

New

Taxable Income	Rate
$0 - $19,050	10%
$19,050 - $77,400	12%
$77,400 - $165,000	22%
$165,000 - $315,000	24%
$315,000 - $400,000	32%
$400,000 - $600,000	35%
$600,000 and up	37%

For example, a taxable income of $500,000 would generate tax, under current rates, of $143,231 versus $126,379 under the new law.

Also, there apparently is not a "bubble tax" or claw back of the benefits of the lower tax bracket rates as had been in the House bill. And there is a deafening silence on the "Obamacare" 3.8% surtax on net investment income (and so it remains).

Capital Gains Taxation:
Capital gains and qualified dividend rates remain unchanged, although they will be calibrated to the new brackets. Notably: the requirement of "FIFO" sales of stock, a stealth capital gains tax that would have effectively required selling lower basis stock before higher basis stock, was thankfully left on the cutting room floor.

Capital Gains When Selling a Home:
Although both the House and Senate proposed to limit this in various ways, those efforts also fell to the editor's shears. The exclusion remains at $500,000. The test remains ownership and use as a principal residence for at least two out of the last five years before sale.

Carried Interest:
Whodathunk…..taxation of carried interest at capital gains rates, in a practical sense, successfully survived the gauntlet. The only change is that the assets generating the income have to have been held more than three years, or else they will be taxed as ordinary income.

Pass-through Business Entities:
The new law gives advantage to income that flows from certain types of entities directly to business owners. These include LLCs, S-corps, partnerships etc.

The relief takes the form of a deduction. Beginning in 2018 individuals will be able to deduct 20% of qualified business income flowing to them from these "pass-through" entities. This effort to provide business income tax relief at the personal level, not just the corporate level, is a novel – and new – component of U.S. tax law. Not surprisingly, it is subject to a series of constraints and limitations.

If you believe you may be affected, please see the accompanying article, A Pass through the Changes for Pass-through Entities[1].

State & Local Taxes (including property tax):
These "SALT" items, which are currently deductible, did not fare well under the TCJA. Taxpayers may now deduct up to $10,000 total in any combination, but no more. Importantly, the law specifically disallows any attempts to prepay 2018 SALT items.

For those living in high state income tax environments this amounts to a significant loss of deduction – one that will offset much, if not all, of the advantage gained from tax rate changes. Enjoy your lump of coal.

Mortgage Interest:
This one went back and forth, with the final version allowing a deduction on up to $750,000 of mortgage debt. Existing mortgages are grandfathered up to the current $1 million level; this would also extend to refinancings. Interest on home equity (HELOCs), however, will no longer be deductible.

Charitable Contributions:
As is widely known, this deduction survived, but there is some further modest good news. The AGI limitation on contributions of cash to public charities will increase to 60% from the current 50%.

Alimony:
Should it be an issue, for any divorce or separation agreement executed after 12/31/2018, alimony and maintenance will not be deductible by the payor, nor an item of income to the payee.

529 Plans:
These had been limited to making payments for higher education i.e. college level and above. Now, payments of up to $10,000 per year/per child may be made to private or religious schools. This should include any level of education and is good news for parents of school-age children. Also, funds in 529 Plans can now be rolled over into ABLE accounts if desired. ABLE accounts are similar to 529 Plans, but are used for individuals with significant disabilities, for accessible housing and transportation, personal

1. memberfieldpointprivate.com/docs/white_paper_pass_throughs.pdf

assistance services, assistive technology and health care not covered by insurance, Medicaid or Medicare. They can be an alternative to a special needs trust.

401(K) Plans &IRAs:
They have, thankfully, remained unscathed.

Alternative Minimum Tax (AMT):
....and talk about successfully running the gauntlet! Against all odds and to the everlasting chagrin of every tax professional, the AMT remains on the books, albeit in a somewhat watered-down version of its old self.

The exemption amount increases to $109,400 (it is currently $84,500) and the exemption phase-out level increases significantly from $160,900 to $1 million. All of which begs the question, how widely will the AMT actually affect people going forward? As we have said previously, the architecture of the new law, effectively, creates a flat tax (in the sense of a tax with a broad base because of limited deductions), but with lower marginal tax rates. That is exactly what the AMT is, although with a lower 28% top rate. With a few exceptions, it is hard to see many people falling into it going forward.

Estate, Gift & Generations Skipping Transfer Tax (GST):
After much back and forth, all remains as before except for a meaningful increase in the exemption level. It doubles from the current $5.49 million to $11.2 million. For a married couple with proper planning this means they will not be subject to wealth transfer taxes on estates of $22.4 million or less. Still, due to the pyramid nature of wealth, the number of estates overall subject to these taxes will decrease by considerably more than 50%.

THOUGHTS AND OBSERVATIONS
The result here is something of a mishmash. It most certainly is not tax simplification, not even close (so much for that postcard). Moreover, most of the changes on the individual side expire in 2025.

Why do I have the feeling that major tax reductions on the corporate side are being subsidized by the individual taxation side of the ledger?

Provisions survived that I would have bet heavily against (including a generous gambling loss provision), most obvious being continued favorable taxation for carried interest, and survival of the alternative minimum tax. I was also moderately surprised that the estate tax wasn't repealed. In fact, it won't even eventually sunset. Nor were the exemption increases phased-in, they go into effect immediately!

The benefit of the new tax rules affecting pass through business entities, including REITs, given all the limitations and constraints, could turn out to be something of a jump ball. Much remains TBD; once the professional tax planning community gets going, hold on to your hat!

While it may be a tax reduction act for some, it certainly won't be for high earners in high state income tax environments. The loss of the SALT deductions and restrictions on mortgage interest will be keenly felt by many.

The need for estate and wealth transfer planning for larger estates remains alive and well. Any plans that had been on hold pending a resolution of tax reform should now move forward. A number of planning techniques such as CLATs and CRUTs, which many thought might become obsolete, are still quite viable for larger estates.

529 Plans for younger parents − and grandparents making contributions to them − are meaningfully more attractive than before.

As we seem to be saying a lot lately, the ink is still drying on this completed version of "tax reform" and the long, strange journey aside, there is much more to come. While the new laws are not going anywhere soon (it took 36 years to get here), our understanding of their consequences, the full scope with which they will be applied, and techniques for navigating them are just beginning to unfold.■

Provision	Old	New
Long-term capital gains (top rate/threshold)	23.8% (incl. 3.8% Obamacare / $470,700)	Unchanged but recalibrate to new brackets
Carried interest	Taxed at capital gains rates	Recalibrate to new brackets. Assets must be held 3+ years or ordinary income rates apply.
Pass-through entities	Taxed as ordinary income	May qualify for a 20% deduction, but conditions exclude many professional and service businesses
Standard deduction	$12,700	$24,000
SALT (State and Local Tax Deduction)	State and local income, property and sales tax fully deductible	Capped at $10K. Pre-pays of 2018 tax in 2017 disallowed.
Mortgage interest deduction	Interest on $1M deductible	Existing mortgages grandfathered. New mortgages capped at $750K. HELOC interest no longer deductible.
Capital gain on sale of house	No tax on first $500K	Unchanged
Charitable contributions	Cash to Public Charities - Subject to AGI constraint: 50%	AGI limit raised to 60%
Obamacare tax	3.8% on short- and long-term capital gains, interest income; 0.9% Medicare payroll tax	Individual mandate repealed; no tax change
Alimony and maintenance	Deductible to payor; taxable as income to recipient	Not deductible; not taxed as income
Education	529 savings plans limited to college costs	529 savings plans now include K-12 expenses to $10k/student
AMT	Parallel tax system, 28% on expanded base of taxable income with reduced deductions	Survives. Exemption rises to $109.4K from $89.5K; exemption phase-out rises from $160.9K to $1M.
Estate and gift tax	40% on assets over $5.49M (indiv.)	40% on assets over $11.2M
Corporate tax rate	Federal rate 35%	Falls to 21%
Repatriation Tax	N/A	15.5% for financial assets, 8% for physical assets

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