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THE 2018 TAX CUTS AND JOBS ACT

FARRAR GATES & GREEN, LLC

70 Years of Combined Expertise

Offices in Danvers & Marblehead, MA

Individual Income Tax Rates

- Current seven ordinary income tax rates (10%, 15%, 25%, 28%, 33%, 35%, 39%) are maintained but rates and thresholds have been lowered (10%, 12%, 22%, 24%, 32%,35%, 37%).
  - *Seven-bracket system provides a slower increase in progressivity of the individual provisions of the new law.*
  - *Marriage penalty is present in the highest tax bracket.*
- Kiddie tax applies the estates' and trusts' ordinary and capital gains rates to the net unearned income of a minor.
  - *Applying the estate and trust tax rates to the kiddie tax rules will result in higher taxes for minors because the brackets for estates and trusts are more compact than the brackets for individuals*

Capital Gains and Dividends

- Net capital gains and qualified dividends would continue to be taxed at the current 0%, 15%, and 20% rates, and also would continue to be subject to the 3.8% net investment income tax.

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Inflation and AMT

- Brackets indexed for inflation using the Chained Consumer Price Index (C-CPI) instead of the current Consumer Price Index for All Urban Consumers (CPI-U).
  - *C-CPI takes into consideration substitutions consumers make given rising prices of certain goods and services with the result that the brackets will rise slower than they otherwise would have under CPI-U.*
- Retains the individual AMT
- Increases the exemption amounts ($70,300 single/$109,400 married filing jointly) and phase-out thresholds ($500,000 single/$1m married filing jointly)
  - *Increases to the AMT exemption and phase-out amounts will make it less likely that individual will owe AMT.*

Limitation on Losses

- Tax reform disallows excess business losses for taxpayers other than C corporations
- Losses can be carried forward and treated as part of the taxpayer's NOL carryforward
- Excess business loss is the excess of the taxpayer's business deductions against the taxpayer's business income over the following thresholds
  - *500,000 for MFJ*
  - *250,000 for others*

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Gain from Sale of Principal Residence

- Retains current law ownership period for the exclusion of gain from the sale of a principal residence

Tax Free Retirement Vehicles

- Retains retirement savings options such as 401(k)s and Individual Retirement Accounts (IRAs)
- Repeals rule allowing IRA contributions to one type to be re-characterized as a contribution to the other type

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Net Operating Losses

- Tax reform will eliminate the carryback option for net operating losses, but they will be carried forward indefinitely (eliminating the 20 year carryforward limitation)
  - *Elimination of the carryback will affect taxpayers from a cash flow standpoint by not being able to request refunds from the government*
- The maximum NOL allowed to be used will be 80% of taxable income
- Allowed NOL for AMT purposes remains at 90% of AMTI

Deductions for Higher Education

- Continues to allow graduate students to exclude the value of reduced tuition from taxes
- Continues to allow deductions for student loan interest and for qualified tuition and related expenses

Section 529 Plans

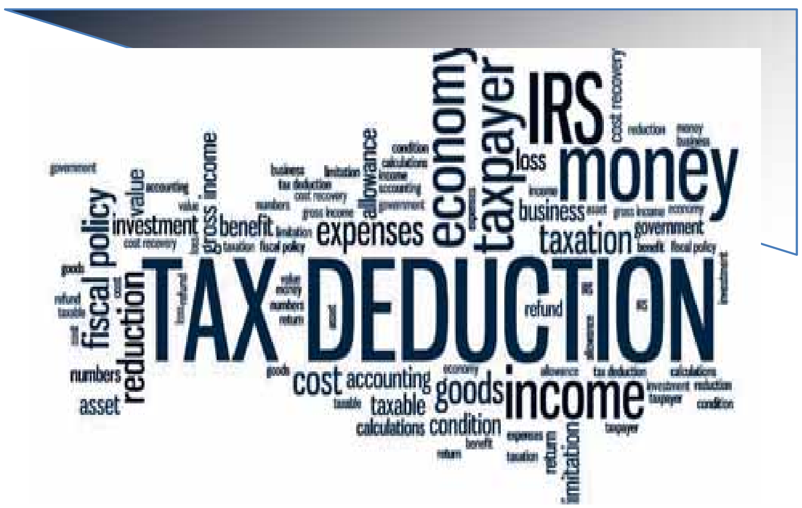
- Allows distributions of up to $10k per student tax-free from 529 accounts to be used for elementary, secondary and higher tuition; can be used for some expenses associated with homeschool

Medical Expense Deduction

- Applies to expenses that exceed 7.5% of adjusted gross income (AGI) in 2017 and 2018, and expenses that exceed 10% of AGI thereafter
- Deduction will be allowed for regular tax and for AMT

Tax Deduction Limitation

- Caps deduction at $10,000 which can be taken for the aggregate of state and local real property and income taxes or state and local sales taxes



Mortgage Interest Deduction

- Caps deduction at $750,000 of debt; $1m for debt incurred before 12/15/17. Reverts back to $1m 1/1/26, regardless of when debt incurred. Available for second homes.
- Eliminates deduction for interest on home equity debt.
  - *If home equity proceeds are used to improve the home, then the loan balance can be included along with the mortgage and will be deductible under the threshold applicable based on when the loans were originated.*

Charitable Donations

- Retains deduction for charitable donations and increases the AGI limitation for charitable contributions from 50% to 60%
- 80% deduction for college seating rights eliminated
- Taxpayers must now be able to provide written acknowledgement for all charitable contributions
  - *Under old law, taxpayers only needed documentation for gifts over $250*

Deductions

- Increase of the standard deduction to
  - *12,000 for single*
  - *18,000 for single with at least one qualifying child*
  - *24,000 for married filing joint*
- Repeals deductions for tax preparation, moving expense and alimony payments (after 2018)
  - *Alimony income / deduction elimination essentially removes the shifting of income from the higher taxpayer to the lower taxpayer, presumably*
- All itemized deductions subject to the 2% floor would be repealed (e.g., home office deductions, license and regulatory fees, dues to professional societies)

Deductions

- Deductions for personal casualty losses eliminated (except in federally declared disaster areas)
- Overall limitation on itemized deduction repealed
- Deductions that are still available for **estates** and **trusts** include:
  - *Probate court fees and costs, fiduciary bond premiums, legal publication costs of notices to creditors or heirs, cost of certified copies of the death certificate, costs related to fiduciary accounts, costs of investment advisors, attorney and accountant*

Deductions Implications

- With the repeals and limitations of many itemized deductions and doubling of the standard deduction…
  - *Many taxpayers will not be itemizing their deductions unless they have significant charitable contributions and / or mortgage interest*
  - *Elimination of various itemized deductions will increase net investment income tax but potentially allow more investment interest expense for those that previously had limitations due to investment expenses*
  - *Elimination of the deduction for home equity loans will curtail the use of a taxpayer’s equity as a piggybank to finance other pursuits*
- Increase in AGI limitations for cash contributions may incentivize large donors to make additional donations which may offset loss of contributions from smaller donors who may no longer give due to larger standard deduction

Deductions Planning

- Continue to use home equity loans
  - *Renovate the home (as long as new loans are below $750,000, when combined with current mortgage)*
  - *Invest in your business or other investments (interest expense)*
- Consider operating pass-through entity as a C corporation to continue to deduct state income taxes
- Regarding itemized deductions that continue to be deductible (charitable deductions), consider “bunching” deductions to be able to take advantage of them

Credits

- Increases child tax credit to $2,000 per qualifying child (of which $1,400 refundable)
  - *Phase-out starts at AGI over $400,000 (MFJ)*
  - *New $500 nonrefundable dependent credit*
  - *Replaces the now discontinued personal exemption*
- Adoption credit retained

ACA Individual Mandate

- Reduces shared responsibility payment (individual mandate) to zero effective months beginning after 12/31/18
  - *Removes the excise tax on individuals who do not maintain health insurance unless a specific exception applies*
- Provision does not sunset

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Estate Tax

- Gift and estate tax regimes left essentially untouched except for the basic exclusion amount
  - *Maximum rate 40%*
  - *Portability*
- Basic exclusion amount doubled to $10.98m beginning in 2018
- Step-up in basis rules untouched
- Treasury Secretary given legislative authority to deal with potential disparity in basic exclusion amount at time a gift is made and basic exclusion amount at death (dubbed "the clawback")

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Estate Tax Implications

- Despite repeated efforts to repeal the estate tax for the last 20 years, the estate tax remains, for the most part, as it always has been since the gift and estate tax regimes were unified in 1976.
- The increase in the basic exclusion will again substantially reduce the amount of estates otherwise required to pay estate tax as occurred with the increase in the basic exclusion amount to $5m in 2010.
- Because portability remains, a couple with a combined estate of $20m will not pay estate tax.
- For 2018, the basic exclusion amount indexed for inflation was $5.6m, which would mean it is now $11.2m, but will probably be slightly less due to indexing using the C-CPI.

Estate Tax Planning

- In general, the approach to wealth transfer tax minimization planning will remain the same both before and after the new law – with fewer taxpayers concerned about estate taxes when devising estate plans.
- For those taxpayers still facing a significant estate tax bill without proper planning, the same wealth transfer planning techniques that have been used in the past will continue to be effective under the new law.
- As taxpayers had to deal with under the 2001 law regarding the potential clawback due to the reduction in the basic exclusion amount upon the expiration of the 2001 law, they will have to deal with it under the new law but the new law directs the Secretary to resolve the issue.

Estate Tax Planning

- For those taxpayers who will continue to have an estate tax issue under the new law, immediate action is necessary to maximize the benefit of the additional $5.6m of exclusion they now have (with the assumption that the Secretary will act under the legislative directive regarding the clawback).
- As has been the case since 2012, because of the compression of the difference in the maximum gift tax rate (40%) and the maximum capital gain tax rate (23.8%), taxpayers will continue to need to model the benefits of
  - *Giving assets now (effecting an estate tax freeze), versus*
  - *Holding assets until death (for basis step-up)*

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www.farrargatesgreen.com

Danvers, MA
153 Andover Street, Suite 108A

Marblehead, MA
24 Tioga Way

978.605.5030