ADVANCED MARKETS

Insights & Ideas

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Congress Passes Tax Cut Act – Overview, Observations, Initial Action Steps

H.R. 1, "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" ("Tax Cuts and Jobs Act"), was passed by Congress on Dec. 20, 2017, and signed into law on Dec. 22, 2017 by the President.

This edition of AMI is the first of many communications about this legislation. It provides an overview of some of the major changes under the new law and some of our initial observations regarding some planning opportunities involving life insurance.

As always, financial advisors and their clients are strongly encouraged to work with the client's attorney and CPAs to review financial, estate and business planning strategies when considering the potential impacts of the new law and determining the appropriate action based upon the client's specific facts and circumstances.

Major Provisions Impacting Individuals

Income Tax Rates and Brackets

The current seven individual tax rate brackets are modified under the Act to be 10%, 12%, 22%, 24%, 32%, 35%, and 37%% effective **after** December 31, 2017 and **before** January 1, 2026.

New brackets are as follows:

Single Individuals Income Tax Rates

If taxable income is:	The tax is:
Not over $9,525	10% of taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000	$45,689.50 plus 35% of the excess over $200,000
Over $500,000	$150,689.50 plus 37% of the excess over $500,000

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Married Filing Jointly and Surviving Spouse Income Tax Rates

If taxable income is:	The tax is:
Not over $19,050	10% of taxable income
Over $19,050 but not over $77,400	$1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $165,000	$8,907 plus 22% of the excess over $77,400
Over $165,000 but not over $315,000	$28,179 plus 24% of the excess over $165,000
Over $315,000 but not over $400,000	$64,179 plus 32% of the excess over $315,000
Over $400,000 but not over $600,000	$91,379 plus 35% of the excess over $400,000
Over $600,000	$161,379 plus 37% of the excess over $600,000

Married Filing Separate Income Tax Rates

If taxable income is:	The tax is:
Not over $9,525	10% of taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $300,000	$45,689.50 plus 35% of the excess over $200,000
Over $300,000	$80,689.50 plus 37% of the excess over $300,000

Head of Household Income Tax Rates

If taxable income is:	The tax is:
Not over $13,600	10% of taxable income
Over $13,600 but not over $51,800	$1,360 plus 12% of the excess over $13,600
Over $51,800 but not over $82,500	$5,944 plus 22% of the excess over $51,800
Over $82,500 but not over $157,500	$12,698 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$30,698 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000	$44,298 plus 35% of the excess over $200,000
Over $500,000	$149,298 plus 37% of the excess over $500,000

Changes to Personal Exemption & Standard Deductions

The personal exemption amount is reduced to zero from December 31, 2017 until January 1, 2026 and standard deduction amounts also change during that time frame and are $12,000 for single filers, $18,000 for head of household filers and $24,000 for married joint filers.

Changes to Itemized Deductions

After December 31, 2017 and before January 1, 2026, there are changes to itemized deductions, including:

1. State and local income and property tax deductions capped at $10,000 in total.
2. Mortgage interest deduction will generally be limited to $750,000 of acquisition indebtedness.
3. Home equity interest deduction is suspended.
4. Charitable deductions limitation for cash donations is increased to 60% of AGI (up from 50% of AGI).
5. The moving expense deduction is suspended, except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station.

For tax years beginning after Dec. 31, 2016, and ending before Jan. 1, 2019, the Tax Cuts and Jobs Act provides that any taxpayer may deduct medical expenses to the extent they exceed 7.5% of the taxpayer's AGI.

For divorce agreements executed after December 31, 2018, the deduction for alimony will not apply and the recipient of the alimony will not include alimony in income.

There are many other provisions affecting itemized deductions, a discussion of which is beyond the scope of this overview.

Individual Alternative Minimum Tax (AMT) Has Been Eased

For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Individual AMT exemption was increased to $70,300 for single filers and $109,400 for married joint filers and the thresholds for the phase-out of the AMT exemption were also increased to $500,000 for single filers and $1 million for married joint filers.

Transfer Tax Changes

The estate, gift and generation skipping transfer tax systems (GST) remain. The new law doubles the estate, gift, and GST tax basic exclusion amounts from $5 million to $10 million, and these exclusions will continue to be indexed for inflation. For 2018, the expected estate, gift and GST exemption amounts are $11.2 million for single taxpayers and $22.4 million for married taxpayers. The increases in the basic exclusion amounts under the new law sunset or expire after 2025.

Medicare Surtaxes Remain

The additional 0.9% tax on earned income and the 3.8% surtax on net investment income under the Patient Protection and Affordable Care Act of 2010 remain unchanged.

Major Provisions Impacting Businesses

Corporate Income Taxes

The corporate income tax rate is reduced from a top rate of 35% to 21% and the corporate AMT is repealed for tax years after December 31, 2017.

Pass-Through Businesses

For tax years after December 31, 2017 and before January 1, 2026, a new Code Section 199A provides for a 20% deduction for certain qualified business income for noncorporate tax payers. For pass through business owners, the new law generally provides a deduction for up to 20% on business profits, thereby reducing their effective marginal tax rate to 29.6%, to align pass through applicable rates on business profits with the lower corporate rates applicable to C Corporations under the new law.

For married joint filers with taxable income over $315,000 and for single filers with income over $157,500, the deduction is limited. An extended discussion of how the limitations work is beyond the scope of this overview. In many cases, the deduction will be limited to 50% of the entity's W-2 wage income amounts. The deduction limitations are designed to prevent personal service wage income from qualifying for the deduction. The deduction is designed to apply to business profits.

Life Insurance Transfer for Value Rule Changes

Under the new law, the exceptions to the transfer-for-value rule do **not** apply to a transfer of a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale. The term "reportable policy sale" means the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer's interest in the life insurance contract. An indirect acquisition includes the acquisition of an interest in a partnership, trust, or other entity that holds an interest in the life insurance contract. This provision pertains to life insurance sales that take place in a commercial context, such as life settlements.

In these situations, because the transfer for value rules will not apply, some part of the death benefit ultimately payable under such a contract may be includible in income.

In addition to the substantive rule change, there are also new tax reporting requirements under the new law for reportable sales as defined in the new law. These provisions are applicable for tax years after December 31, 2017.

Some Planning Implications for Advanced Planning – Initial Observations - Five Initial Suggested Action Steps

Focus on Non-Tax Planning Reasons for Life Insurance

With the increase in the basic exclusion amount from federal estate tax (expected to be $11.2 million for single taxpayers and $22.4 million for married taxpayers in 2018), most taxpayers will not be subject to the federal estate tax.

For these clients, it continues to be important to focus on the non-tax reasons to incorporate life insurance into their planning. Fundamentally, planning involves asking whether clients have arranged their affairs in a way that provides what they want will be distributed to whom they want when they want. These issues have not changed. Financial and estate plans should be reviewed to ensure that they are working the way clients intend and that the plans are sufficiently funded. Financial advisors will continue to uncover opportunities to incorporate life insurance into planning by identifying client goals, analyzing strategies to achieve those goals and helping clients implement those strategies. In many cases, this will involve working with the client's other advisors (e.g. attorneys and CPAs).

The death benefit of life insurance continues to provide liquidity to meet survivor needs depending upon the client facts and circumstances (e.g. providing for basic needs of children, providing money for education, providing money for special needs children). This has not changed and financial advisors have another opportunity to emphasize this to clients as they review their plans for appropriate coverage under the new law.

Explore the Relevance of Cash Value Accumulation Life Insurance in Planning

In addition, depending upon the case, life insurance can provide the potential to accumulate cash value that can be used to supplement retirement income accumulation vehicles such as annuities and investments in the client's portfolio. Clients should maximize retirement planning vehicles such as qualified plans first. In addition, clients should also explore other financial vehicles such as annuities and investments when conducting their retirement planning. It is important to note that cash value accumulation life insurance offers a potential additional way to supplement other strategies. Financial advisors should explore the relevance of cash value accumulation life insurance in planning.

Point Out That Certain Life Insurance Policies Can Accelerate the Death Benefit and Provide Supplemental Income In The Event of A Qualifying Chronic Illness

Certain permanent cash value life insurance contracts also offer riders which allow clients to accelerate death benefits in the event of a qualifying illness. This can be very important for clients concerned about the impact of potential costs associated with chronic care during retirement.

Remember That Additional Exclusion Amounts for High Net Worth Clients Provide Opportunity

For those clients with more than the federal estate tax exclusion amount ($11.2 million for single taxpayers, $22.4 million for married taxpayers), the additional amount that they are now allowed to gift provides many opportunities including but not limited to: gifting additional money to irrevocable trusts to help complete plans already in progress, gifting additional money to irrevocable trusts to help unwind split dollar or other financing arrangements, establishing new trusts to help accomplish their planning objectives. The overall goal of many high net worth individuals is to transfer as much wealth to the next generation or next generations in the most tax efficient way possible. The increased basic exclusion amount may provide them with additional opportunities to do so.

Review Buy Sells and Other Business Coverages When Clients Address Business Planning Implications

Many business clients will be meeting with their attorneys and CPAs to review their business and entity structures to determine whether they should change business structures considering the new law. Financial advisors should look for ways to be a part of the team approach in helping clients review their business plans. Regardless of whether the clients change business structure, the financial advisor can emphasize the importance of an updated business continuation plan and proper funding of the plan. The financial advisor can also evaluate sufficiency of coverage for other purposes (e.g. key person insurance, debt repayment, etc.).

Conclusion

The purpose of this alert is to outline major changes under the new tax law and outline some of the major implications. This is a major change to the law and this alert is not an exhaustive review of the new law or its implications. More detail, more explanation and more ideas will follow over time. It is always important for financial advisors to work with the client’s attorney and CPA and it will be very important for financial advisors to work with them given the new law.

In conclusion, in our view, the new law will spark renewed interest in planning and create an environment of increased planning activity, which should drive more business in 2018. As Prudential Individual Life Advanced Markets may be helpful in that process, we look forward to being of assistance. We can be reached at 800-800-2738, Option 4.

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