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President Trump Signs Tax Reform Legislation

Earlier today President Trump signed H.R. 1 (formerly known as the Tax Cuts and Jobs Act, or the "Tax Act"), a \$1.5 trillion tax cut representing the first overhaul of the United States Tax Code in more than three decades. In this Advisory, we summarize many of the significant provisions of the Tax Act that we expect may affect our clients, which will take effect in 2018.

INDIVIDUAL INCOME TAX BRACKETS

Beginning in 2018, there will still be seven tax brackets; however, the top marginal income tax rate will be 37%, instead of the current rate of 39.6%. Rates for capital gains and qualified dividends will not change.

2018 Tax Year Income Tax Brackets, Single Filer

| <i>Current Law</i> | | <i>Tax Cuts and Job Act</i> | |
|--------------------|-----------------------|-----------------------------|-----------------------|
| 10% | \$0 - \$9,525 | 10% | \$0 - \$9,525 |
| 15% | \$9,525 - \$38,700 | 12% | \$9,525 - \$38,700 |
| 25% | \$38,700 - \$93,700 | 22% | \$38,700 - \$82,500 |
| 28% | \$93,700 - \$195,450 | 24% | \$82,500 - \$157,500 |
| 33% | \$195,450 - \$424,950 | 32% | \$157,500 - \$200,000 |
| 35% | \$424,950 - \$426,700 | 35% | \$200,000 - \$500,000 |
| 39.6% | \$426,700+ | 37% | \$500,000+ |

2018 Tax Year Income Tax Brackets, Married Joint Filers

| <i>Current Law</i> | | <i>Tax Cuts and Job Act</i> | |
|--------------------|-----------------------|-----------------------------|-----------------------|
| 10% | \$0 - \$19,050 | 10% | \$0 - \$19,050 |
| 15% | \$19,050 - \$77,400 | 12% | \$19,050 - \$77,400 |
| 25% | \$77,400 - \$156,150 | 22% | \$77,400 - \$165,000 |
| 28% | \$156,150 - \$237,950 | 24% | \$165,000 - \$315,000 |
| 33% | \$237,950 - \$424,950 | 32% | \$315,000 - \$400,000 |
| 35% | \$424,950 - \$480,050 | 35% | \$400,000 - \$600,000 |
| 39.6% | \$480,050+ | 37% | \$600,000+ |

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The new income tax brackets will expire after 2025.

INCOME TAX DEDUCTIONS, EXEMPTIONS & CREDITS

The Tax Act:

- Almost doubles the standard income tax deduction to \$12,000 for single filers, \$18,000 for heads of household, and \$24,000 for joint filers (compared to \$6,500, \$9,550, and \$13,000, respectively, under current law), starting in 2018 and lasting until 2026. However, most itemized deductions, as well as the personal exemption—which currently allows taxpayers to deduct \$4,150 from income for each person claimed on their tax returns—are eliminated.
- Limits the deduction for state and local taxes (SALT). Under the Tax Act, taxpayers may deduct a maximum of \$10,000 combined for state and local property, income and sales taxes. Taxpayers may not take a deduction in 2017 for prepaying state or local income taxes imposed for 2018; however, you may benefit from prepaying real estate taxes for 2018 before the end of the year, and from making your estimated income tax payment for the fourth quarter of 2017 before the end of the year (as opposed to waiting until the January 15 deadline to make that payment). If you live in a high-tax state such as Connecticut, New York or New Jersey, the \$10,000 limitation on the deduction for property taxes and state and local income taxes from your federal tax bill could offset the savings from the lower federal income tax rates.
- Limits the mortgage interest deduction to interest incurred on the first \$750,000 in principal value. Existing mortgages are grandfathered in up to the current \$1,000,000 limit if (i) with regard to a principal residence or second home, the debt was incurred on or before December 15, 2017, or (ii) with respect to a principal residence only, (a) the taxpayer entered into a written contract on or before December 15, 2017 to close on the purchase of such residence before January 1, 2018, (b) the home is actually purchased before April 1, 2018 and (c) the debt is incurred on or before April 1, 2018. Interest on home equity loans or lines of credit is no longer deductible.
- For 2017 and 2018 only, permits taxpayers to deduct medical expenses that exceed 7.5% of adjusted gross income (AGI). Beginning in 2019, medical expenses must exceed 10% of AGI to be deductible, as under current law.
- Increases the percentage of income limits on deductions for charitable gifts. Under the new law, taxpayers may deduct up to 60% of their AGI for gifts of cash to public charities, up from the current 50% limit.
- Retains the deduction for student loan interest.

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- Removes most other itemized deductions, including the deduction for tax preparation expenses, such as the bill from your tax preparer or the cost of tax software, investment expenses, and the deduction for moving expenses (unless you are a member of the military); and, in addition, the payment of alimony under divorce or separation agreements dated after 2018 cannot be deducted (although those receiving the alimony will not be taxed on the income).
- Raises the exemption level for the Alternative Minimum Tax (AMT) to \$109,400 for married couples, up from \$86,200, and to \$70,300 for individuals, up from \$54,300. The AMT exemption phase-out threshold will be increased to \$1,000,000 for married couples and \$500,000 for individuals, so fewer people will be subject to the AMT. The exemption levels revert to current levels in 2026.
- Increases the child tax credit from \$1,000 to \$2,000 for each child, and increases the income level above which the credit is phased out from \$110,000 to \$400,000 for married couples, and from \$75,000 to \$200,000 for single parents. The first \$1,400 would be a refundable credit for those taxpayers who owe less in taxes than the value of the credit.

FEDERAL ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER (“GST”) TAX

The Tax Act doubles the federal estate, gift and GST tax exemptions to \$10,000,000 per person, indexed for inflation after 2011—which set these exemption amounts at \$11,200,000 in 2018. Once these exemption amounts “sunset” for decedents dying after December 31, 2025, the estate and gift tax exemption will revert back to \$5,000,000 per person, indexed for inflation from 2011.

The 2018 gift tax annual exclusion amount under current law, \$15,000 per recipient, remains intact

BUSINESS INCOME TAXES

The Tax Act makes numerous changes to business income taxes, and we don’t purport to cover all of those in this Advisory; however, the changes likely to be most relevant to individuals are the following.

- The tax rate on income earned by a C corporation—which currently are taxed at a maximum rate of 35%—will be permanently reduced to 21%. This is the lowest rate since 1939.

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- There is a 20% deduction for “qualified business income” received from a partnership, LLC, S corporation or sole proprietorship. The definition of qualified business income is detailed and complex and is subject to numerous exceptions, but this deduction—which will be limited for pass-through entities in the service industry—could be very advantageous to our clients operating businesses through a pass-through entity. Clients operating businesses through pass-through entities will also want to analyze whether or not it makes tax sense to convert the entity into a C corporation. This comparison will involve a balancing of the lower rate applied to C corporations against the fact that dividend distributions from C corporations are subject to a second level of tax.
- The corporate AMT is repealed beginning in 2018.
- Beginning January 1, 2019, the penalty on individuals who do not purchase health insurance coverage is repealed.
- The 3.8% tax on net investment income is retained.

FINAL THOUGHTS

The Tax Act will certainly impact your personal, estate and business planning when it takes effect next year. We plan to send advisories throughout 2018 with additional information as to how your planning may be affected. In the meantime, we welcome your call to review your plan in light of the Tax Act.

All of us here at Wiggin and Dana wish you and your loved ones a very happy and healthy New Year.

MISCELLANEOUS PROVISIONS

- The Tax Act affects the taxation of carried interest, in that the service provider will need to hold the interest in the underlying assets for three years to receive capital gains treatment.
- Effective for contributions made after December 31, 2017, 529 accounts may distribute up to \$10,000 tax-free per student each year for expenses related to public, private or religious elementary or secondary schools.
- Beginning in 2018, a traditional IRA converted to a Roth IRA can no longer be converted back to a traditional IRA.

This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.