THE POWER OF BEING UNDERSTOOD

AUDIT I TAX I CONSULTING

RSM

TAX REFORM

Key considerations for individuals and business owners

October 23, 2018

RSM

Agenda

- Introduction
- Individual income provisions
- Business provisions
- Estate and wealth provisions

OVERVIEW OF INDIVIDUAL INCOME PROVISIONS

Individual impacts – income

	Tax Act	Observation	Planning
Brackets and rates	Seven tax brackets—10, 12, 22, 24, 32, 35, and 37 percent. The top individual rate of 37 percent will apply at incomes of $500,000/$600,000 .	Many other rates remain the same including capital gains (15 percent / 20 percent), unrecaptured 1250 (25 percent), collectibles (28 percent), net investment income (NII) (3.8 percent), and AMT (26 percent/28 percent); Note the large marriage penalty	Opportunities for planning with managing distributions from trusts; Consider shifting of income to kids but beware of new kiddie tax regime (taxed at trust brackets); Revisit investments based on lower brackets (taxable versus tax exempt)
Brackets and rates for estates and trusts	Condenses the number of tax brackets from seven to four, including 10, 24, 35 and 37 percent brackets	Highest marginal rate is for income in excess of $12,500; AMT exemption for trusts remains unchanged	Analyze distributions from a tax standpoint; Some deductions remain at the trust level; Maximize state tax deduction ($10,000) for each trust if possible
Alternative minimum tax (AMT)	Retained with higher exemptions ($70,300 / $109,400); phase-out of exemption increased to $500,000 / $1 million	Elimination of largest preference items and increased exemption means less taxpayers will be hit with AMT	Private activity bond interest and incentive stock option (ISO) taxability may now be reduced; Deductions such as charity may provide more tax savings (37 percent versus AMT bracket of 28 percent)

Individual impacts – income (cont.)

	Tax Act	Observation	Planning
Personal exemptions	Repeals	Increased child credit ($2,000) will make up for this; Those in AMT didn't benefit from this in the past	For lower income families, consider income minimization strategies to optimize the refundable portion of the credit
Standard deduction	Doubles to $12,000 / $24,000; retains additional deduction for blind and elderly	More taxpayers will now claim the standard deduction; Potential impact on home ownership due to less benefit from mortgage interest and property tax deductions	Maximize charitable contribution benefit across family; Consider 'bunching' of deductions; Analyze after tax benefit of mortgage interest deduction versus less expensive non-deductible alternatives such as margin loans
Mortgage interest	Limited to interest on $750,000 of indebtedness on newly purchased principal and second residences incurred after Dec. 15, 2017; not allowed for home equity loans.	The $750,000 limit is not indexed for inflation; Can refinance pre-Dec. 15, 2017 loans and still qualify for a deduction up to $1 million	Interest on a home equity line of credit used to refinance acquisition debt qualifies for a deduction; Potential deduction for interest attributed to home office or investments in excess of $750,000; Conversion to rental property prior to sale or 1031 exchange should be explored

RSM

Individual impacts – income (cont.)

	Tax Act	Observation	Planning
State and local tax deductions	Deduction of up to $10,000 for state and local property, income or sales taxes allowed	This limitation does not apply to business deductions; some states are looking to circumvent this limitation, many others are modifying their conformity with federal law which will likely result in increased state tax liabilities	Business owners should give increased scrutiny to whether taxes paid are personal or business; individuals may want to reconsider their state of residency
Charitable contributions	Deduction preserved, with increase in adjusted gross income (AGI) limitation from 50 percent to 60 percent on cash contributions	The contribution limit on appreciated property remains at 30 percent; deductions for rights to athletic seats is now eliminated; charitable contributions is one of the remaining itemized deductions; fewer people will benefit from charitable contributions with the higher standard deduction	If typical annual contributions will result in taking the standard deduction, consider ‘bunching’ several years of gifts together and donate to a donor advised fund; consideration should be given to timing of contributions to maximize the offset against ordinary income rather than capital gains/dividends; Consider use of charitable remainder trusts or charitable lead trusts
529 plans	Up to $10,000 of 529 plans can be used per student for public, private and religious elementary and secondary schools	It currently appears that existing balances may be used for these expanded purposes; the $10,000 limit is per beneficiary regardless of the number of accounts	With the expansion of the eligible schools, individuals should revisit gifting more to 529 plans, while there may not be a federal tax deduction, many states offer a deduction or credit; Consider use for college room and board (doesn’t qualify for 2503(e) exclusion); Take advantage of five year election

RSM

Individual impacts – income (cont.)

	Tax Act	Observation	Planning
Other deductions	Deductions for casualty and theft losses limited to those incurred in a disaster area Alimony paid for divorce after Dec. 31, 2018 not deductible/includible after 2018 .	Practically, this deduction is not used that often due to limitations and insurance reimbursements Alimony provisions do not expire/sunset; The provisions do not take effect for one year; This will impact planning for divorce agreements significantly	Maintain careful records of all home improvements to maximize the deduction Careful analysis of divorce agreements from a tax standpoint must be reviewed; Agreements in place but not yet finalized must be reviewed to consider the impact of this change on both spouses
Miscellaneous deductions	Eliminates miscellaneous deductions over 2 percent of AGI	The loss of 2 percent deductions will negatively effect many individual taxpayers	Consider approaching the investment advisor about alternative structures to their investment management fees such as a carried interest arrangement; For ultra high net worth individuals, consider comprehensive family entity restructuring to achieve trade/business deductibility based on *Lender Management versus U.S. Tax Court* case; increase investments in mutual funds; awareness of allocating tax preparation fees to business or rental activities

Individual impacts – income (cont.)

	Tax Act	Observation	Planning
Medical expenses	Medical expenses exceeding 7.5 percent of AGI deductible for 2017 and 2018; eliminates AMT preference for medical expense deductions for 2017 and 2018.	Most taxpayers don't qualify for this deduction due to the high AGI threshold; The change in the law will help taxpayers under age 65 by reducing the threshold from 10 percent to 7.5 percent	Consider 'bunching' of medical expenses to exceed the AGI threshold; Maximize other medical deductions such as health savings accounts
Overall limitation on deductions (Pease Limitation)	Suspends 3 percent of AGI limit on deductions	A small bright spot in itemized deductions	Increasing charitable deduction will result in more beneficial result due to lack of additional limitation
Individual retirement accounts (IRAs)	Conversion of traditional IRA to a Roth IRA cannot be recharacterized; can still convert traditional IRA into a Roth IRA.	This change disallows a prior planning opportunity; the 'backdoor Roth' is still available	Continue to contribute to a traditional IRA and convert to a Roth each year as a 'backdoor' contribution

Individual net operating losses

- For net operating losses (NOLs) arising in tax years ending after Dec. 31, 2017
  - NOL deduction to 80 percent of taxable income (determined without regard to such NOL)
  - Example: A has $90 NOL in 2018 that is carried forward to 2019. In 2019, A has $100 of taxable income. The NOL carryforward can only offset $80 of 2019 taxable income, and the remaining $10 NOL is carried forward indefinitely.

Individual net operating losses (cont.)

- For most taxpayers, carryback is repealed, but NOLs can be carried forward indefinitely
  - Terminate on death, but under section 1.642(h)-1, trust losses may flow to beneficiary

Exception

- Two year carryback for farming trade or business (defined in section 263A(e)(4))

Key provisions of prior law left undisturbed

- Income tax
  - The 3.8 percent tax on investment income under section 1411 and the .9 percent Medicare tax on compensation
  - Tax rates on capital gains and qualified dividends
  - Exclusion of gain on sale of a residence
  - Ability to identify the securities that an investor is deemed to sell, i.e., the Senate's proposal for a 'first-in, first out' method not included
  - Pre-tax contribution limits (including catch-ups) for 401(k) plans
  - Ability for beneficiaries to 'stretch' IRA withdrawals out over their lifetimes
  - Student loan interest deductions, adoption assistance programs, dependent care accounts, tuition waivers, employer paid tuition, teacher supplies deduction and Archer medical savings accounts

OVERVIEW OF BUSINESS PROVISIONS

Provisions impacting the business owner – Planning and complying

1. Corporate tax rates reduced from a top rate of 35 percent to 21 percent
2. Individual tax rate of owners reduced from a top rate of 39.6 percent to 37 percent
3. Pass-through entity deduction up to 20 percent of the qualified business income
4. Enhanced depreciation deductions for capital expenditures (bonus and section 179)
5. Alternative minimum tax repealed for corporations and higher exemption for individual owners
6. Potential limit on Interest deduction based on 30 percent of modified taxable income
7. NOL rule changes generally reduce value of NOL carryforwards
8. Active business loss limitations apply at the individual level
9. Small business exemptions exist for limits on interest deduction and accounting methods

RSM

Provisions impacting the business owner – Planning and complying(cont.)

10. Many tax credits preserved (TIPs, Work Opportunity Tax Credit (WOTC), research and development (R&D)
11. Charitable contribution deductions preserved
12. Deduction for domestic production activities (section 199) was repealed
13. Elimination of Tax Deductions for Entertainment
14. Transition to territorial system—mandatory tax up to 15.5 percent on accumulated foreign earnings (slightly higher rate for individuals)
15. Decoupled and diverse state income tax systems
16. Carried interest provisions added with 3 year holding period
17. Transaction related changes including limits on interest deductions and enhance write-offs
18. Estate and gift tax exemptions nearly doubled to approximately $11 million

PASS-THROUGH ENTITIES

20 percent pass-through deduction in a nutshell (section 199A)

- Deduction limited to 20 percent of qualified business income
- Applies to operating income of active businesses
  - If at 37 percent tax rate then the 20 percent deduction results in an approx. 29.6 percent federal tax
  - Compared to
    - 21 percent top corporate tax rate
    - 37 percent top individual tax rate
    - 39.8 percent top corporate/dividend tax rate
    - 29.6 percent potential pass-through tax rate
- Does not apply, generally, to professions or financial businesses
- Additional limitations based on greater of
  - 50 percent of W-2 wages (i.e., business must pay W-2 wages of 40 percent of income for full 20 percent deduction) or
  - 25 percent of W-2 wages plus 2.5 percent of original cost of depreciable, tangible property
- Business type and wage/asset limits do not apply below income limits ($315,000 MFJ)
- Only applies to income taxes (not self employment or NII tax calculations)

RSM

No benefits (above the income threshold) for owners of ‘specified service businesses’ defined as –

- Any trade or business involving the performance of services **in** the fields of health, law, ~~engineering, architecture~~, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, **or**
- Any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees [OR OWNERS],
- What does this mean?
  - For example, could a restaurant operation be a service business under this provision?

Problems and issues

- Employee versus independent contractor?
  - Conversions under $315,000?
- Are all ‘service businesses’ without large physical plants disqualified because their ‘principal asset’ is the skill and reputation of their employees or owners?
- Are dermatology clinics forbidden, but tanning salons allowed (property)?
  - Is there a better way?
- Can an owner without wages or assets pay himself a wage and get a 14 percent deduction, in effect?
  - Can partners be employees?
- Will ‘reasonable compensation’ rules apply to S corporations?
  - Will they apply to partnerships or proprietorships?

Revisiting the rate reductions for individuals investing in C corporations

- Current income tax rules
  - $100 of corporate income
    - Less $35 tax at 35 percent rate
  - $65 of cash on balance sheet
    - Less $13 tax at 20 percent rate
  - $52 of after tax cash
    - 48 percent combined tax rate
    - 3.8 percent tax on $65 or $2.47
    - All-in 50.47 percent tax rate

- Proposed income tax rules
  - $100 of corporate income
    - Less $21 tax at 21 percent rate
  - $79 of cash on balance sheet
    - Less $15.8 tax at 20 percent rate
  - $63.2 of after tax cash
    - 36.8 percent combined income tax rate
    - 3.8 percent tax on $79 or $3
    - All-in 39.8 percent tax rate

RSM

Example 1 – high income taxpayers – no wages or tangible property

- Investor with $1 million of salary income buys an empty lot for $1 million, paying $200,000 of cash and borrowing $800,000 at 5 percent interest, to use as a parking lot that generates gross parking fees of $200,000

- With $200,000 of gross income, but paying $40,000 to an independent contractor to manage the lot, and $20,000 for insurance and $40,000 of interest, there is $100,000 of net income

- The 20 percent deduction does not apply – not enough 'wages' and not enough 'depreciable property'

Example 2 – high income taxpayers - wages

- Investor with $1 million of salary income buys an empty lot for $1 million, paying $200,000 of cash and borrowing $800,000 at 5 percent interest, to use as a parking lot that generates gross parking fees of $200,000

- With $200,000 of gross income, but paying $40,000 to an employee to manage the lot, and $20,000 for insurance and $40,000 of interest, there is $100,000 of net income

- The 20 percent deduction of $20,000 applies – because at least $40,000 of wages were paid

Example 3 – high income taxpayers – tangible property

- Investor with $1 million of salary income buys parking structure for $1 million, paying $200,000 of cash and borrowing $800,000 at 5 percent interest, to generate gross parking fees of $200,000. With $200,000 of gross income, but paying $40,000 to a contractor to manage the facility, and $20,000 for insurance and $40,000 of interest, there is $100,000 of net income. Assume no depreciation deductions for simplicity.
- Even without wages the $20,000 deduction would be allowed.
  - The alternative annual limitation is 2.5 percent of the taxpayer's original $1 million investment in depreciable tangible property or $25,000 – plus 25 percent of wages paid if any.
  - $1 million base is not 'depreciated' down – it is unadjusted – for 10 years or full life if longer – as long as property is used in business.
  - Effectively assumes 'normal' return is 12.5 percent

Joint filers incomes below $315,000 – a special rule

No wage or asset requirements, and no service business limitations

- Phased-out quickly as income rises from $315,000 to $415,000
  - Close to 100 percent marginal tax rate?
- Many lawyers, accountants, physicians and dentists probably earn < $315,000 of household income
- For two married accountants, lawyers, physicians, or dentists each earning $150,000, the total deduction is $60,000 for a tax cut in the range of $15,000

RSM

C corporation versus flow-through – other considerations

- Future dividend/distribution expectations
- Future ownership considerations
- Accumulated earnings tax considerations
- Partnership conversion considerations
- Waiting period for S corporation ‘re-election’
- Exit strategy impacts
- Business valuation on sale
- Impact to any existing or planned estate/gift planning
- Future political/legislative changes

CAPITAL EXPENSES

Depreciation, expensing, bonus depreciation

Depreciation - complex analysis but generally…

- Basic, pre-bonus depreciation rules, viewed as non-economic by some, remain in baseline (MACRS)
- 100 percent bonus depreciation through 2022, then phased out through 2026
- Applies to new and used property acquired
- Changes to real property depreciation complex, and may depend on applying business interest limitations
- Applied for property acquired after Sept. 27, 2017
- Qualified improvement property (QIP) remains (Qualified LHI, restaurant and retail improvement eliminated) – But no life provided and needs to be 20 years or less to be 100 percent bonus eligible
- Section 179 - $1 million permanent expensing, s/t limitations and phase-outs beginning at $2.5 million (individuals not trusts)
    - QIP interior of non-residential rental property and will include roofs, HVAC, fire protection, Security Systems
    - Careful planning needed
- State conformity is a question and an opportunity

BUSINESS INTEREST DEDUCTIONS CUTBACK

Important changes to interest limitations

- Caps net interest deduction at 30 percent of an amount based on earnings (EBITDA) for four years, then limits the deduction to 30 percent of earnings before interest and taxes (EBIT)
- Taxpayers with average gross receipts of $25 million or less and car dealers using floor plan financing loans to fund their inventory are excluded from the interest limitation
- Allows ‘limited’ deductions to carry forward forever
- Various exceptions for real estate, utilities, farming and certain small businesses
- Special rules for partners and partnerships

RSM

Interest limitation using EBITDA

Company worth $3 million

Debt of $2 million @ 5 percent

Equity of $1 million

Earnings before interest and depreciation = $500,000

Depreciation = $200,000

Interest = $100,000

Taxable income before limitation = $200,000

Base for limitation = $500,000

30 percent of base = $150,000

No limitation applies

Carryforward allowed indefinitely

RSM

Interest limitation using EBIT

Company worth $3 million
Debt of $2 million @ 5 percent
Equity of $1 million

Earnings before interest and depreciation = $500,000
Depreciation = $200,000
Interest = $100,000
Taxable income before limitation = $200,000

Base for limitation = $300,000

30 percent of base = $90,000
$10,000 interest is ‘limited’

Carryforward allowed indefinitely

OTHER IMPORTANT BUSINESS DEDUCTION LIMITATIONS, LIBERALIZATIONS, OR DEFERRALS

Good news

- Financial statement deferred tax liability may be reduced
- Corporate AMT repealed after 2017 (but Individual AMT remains)
- Expanded use of cash method of accounting for small C corporations and partnerships with C corporation partners with < $25 million gross receipts
- Expands the uniform capitalization (UNICAP) small business exception
- Generally exempts certain small business taxpayers from requirement to keep inventory
- Expands percentage of completion method exception for certain construction contracts
- Retains R&D credit (but amortization after Dec. 31, 2022)
- Retains other credits including TIPs and WOTC (for hires on or before Dec. 31, 2019)
- Favorable depreciation rules (but QIP?)
- Repeals technical termination of partnerships

Not good news

- No more manufacturer's deduction (section 199)
- No more NOL carrybacks – some limitations and modifications to the carryforward rules
- Modifies the exclusion from income of certain contributions to capital (e.g., state/city grants)
- Limits like-kind-exchanges to certain real property
- Increased limitations on deductibility of certain expenses of entertainment
- Limits on business interest expense
- Limit on state income tax deductions for flow-throughs
- Deemed repatriation (good news, bad news)
- Changes public company executive compensation deductibility (section 162(m)) rules

RSM

New loss limitation rule applies to taxpayers other than corporations

- Prohibits deducting ‘excess losses’ against wage and/or investment income
- Excess business loss
  - The excess of deductions from all trades or businesses of the taxpayer in excess of
  - Gross income from such businesses plus $250,000 (single or MFS) or $500,000 (joint)
- Limitation is applied at the individual or trust level, not at the entity level
- Losses limited by rule carry over as NOL
- Excess loss limit applied after passive activity loss limits are applied

RSM

Important changes to NOL deductions

- Carryback and carryforward
  - Repeals the carryback period (two-year)
  - Provides for an indefinite carryforward period
  - Applicable to losses arising in taxable years ending after Dec. 31, 2017
- Limits NOL deduction to 80 percent of taxable income for losses arising in taxable years beginning after Dec. 31, 2017

RSM

CLOSE-UP ON REAL ESTATE

Multiple moving pieces in commercial real estate

- Reduced pass-through tax (via 20 percent deduction) likely to apply in many cases
- Real estate investment trusts (REITs) automatically get that benefit, possibly including mortgage REITs
- Potentially serious limits on 'active losses'
- Business interest disallowance will not apply
  - But at the cost of some depreciation benefits
- Like-kind-exchanges preserved
- Carried interest defined, but essentially preserved, longer holding period

CLOSE-UP ON PROFITS INTERESTS AND CARRIED INTERESTS

Treatment of carried interest

- Expressly recognizes the concept of different treatment for profits interests in an ‘applicable trade or business’ defined as
  - A regular, continuous and substantial activity of
  - Raising or returning capital, and either
    - Investing in or disposing of specified assets, or
    - Developing specified assets
  - Specified assets include securities, commodities, real estate, cash, options, derivatives and partnership interests
- But, for now, only applies a three-year holding period

CLOSE-UP ON PRIVATE EQUITY

Issues for private equity

- Generally good news for treatment of carried interest if held for three years
- Business interest limitations may limit leverage
- NOL rules and other rules may require restructuring
- Reconsider choice of entity (partnership versus corporation) for portfolio companies
- Founders or other individuals may have rate issues, self-employment issues and net investment income tax issues
- Write off of used assets in M&A transaction

RSM

OVERVIEW OF THE STATE TAX CONSIDERATIONS

State taxation – Decoupled and diverse state income tax systems

- Will states legislatures decouple?
  - Minnesota has decoupled. Minnesota has opted not to conform to Federal changes leading to potential for taking itemized deductions on MN return, but standard deduction for Federal purposes.
- A question of conformity
  - Rolling , fixed, selective
- Some provisions broaden the federal income tax base (e.g., interest expense limitations)
  - Potential windfall for states
- Some provisions allow deductions from the federal income tax base (e.g., bonus depreciation)
  - Expect decoupling for state purposes
- Other state responses
  - State income tax systems and rates could change
  - Deduction and exemption eliminations, base expansions and new taxes, e.g., gross receipts taxes
  - Continued aggressive nexus expansion
- Many planning opportunities exist
  - Location selection, nexus
  - Choice of entity and state specific elections
  - Capital expenditures, section 179
  - Credits and incentives

Individual impacts – estate, gift and trust

	Tax Act	Observation	Planning
Estate, gift and generation-skipping transfer tax (GST)	Exemptions are doubled to approximately $11.2 million, effective Jan. 1, 2018. The estate, gift and GST tax rates remain the same as existing law. Estate and GST tax not repealed Provisions sunset after 2025	Increased exemptions revert to 2017 law Jan. 1, 2026. Indexed for inflation post 2011. Annual exclusion increased to $15,000 per donee Basis step-up is retained for property subject to estate tax	All estate plans need review to consider changes necessitated by increased exemptions. Wills, testamentary trusts and revocable trusts need review to avoid unintended consequences. Increased capacity for gifting to family members and/or trusts Increased generation-skipping exemption offers opportunities for new planning as well as improving the GST status of existing trusts

Impacts – estate and trust income taxation

	Tax Act	Observation	Planning
Estate & trust income taxation	Section 1 - new tax rate schedule and brackets for income taxation	Seven brackets; top rate of 37 percent applies to income in excess of $12,500	Consider distribution planning to beneficiaries; focus on beneficiary taxation results
	Section 199A 20 percent pass-through deduction for "qualified business income"	Applies to estates & trusts invested in "qualified businesses" held in flow through entity	By investing in qualified operating businesses the top tax rate on business income may be reduced to 29.6 percent. Possible creation of multiple non-reciprocal trusts to avoid service business limitations. $157,500 threshold.
	Section 461 limitation for "excess business losses" of non-corporate taxpayers	Applies to estates & trusts (applies to non-corporate taxpayers)	Limits deduction of business losses to $250,000 per year; balance of loss is NOL
	Section 67(g) repeals miscellaneous 2 percent type deductions	Applies to estates & trusts; Trustee & Executor fees, tax prep fees & other administration expenses remain deductible under section 67(e), per IRS notice 2018-61	Examine "bundling" of broker fees to determine if trustee portion of 2% fees is reasonable (clients will likely push to have higher portion of broker fees be non-2% since 2% portion is now disallowed)
	Section 164(b)(6) $10,000 limit on deduction for state and local taxes	Applies to estates & trusts; no deduction for foreign real property taxes	Creation of multiple non-reciprocal trusts may provide multiple deduction limits

Impacts – estate and trust income taxation

	Tax Act	Observation	Planning
Electing small business trusts (ESBTs)	Applies individual charitable deduction limits and carry over provisions under section 170 to ESBTs	Charitable deductions for ESBTs subject to same limits as individuals. Prior to Act, the charitable deduction for trusts was computed based on its gross income assuming language was present in document – section 642(c)	Charitable deduction available for up to 60 percent of trust AGI for cash gifts, with carry over provisions like an individual for amounts in excess of limitation
	Section 199A deduction	Proposed regulations clarify that ESBT's qualify for 199A deduction	Potential for ESBT earnings to be taxed at 29.6%, depending on wages and property limitations. Possible creation of multiple non-reciprocal trusts to avoid service business limitations. $157,500 threshold.
	Section 1361 permits non-resident aliens as beneficiaries of ESBTs effective Jan. 1, 2018	Prior to the Act, non-resident aliens could not be ESBT beneficiaries	Makes ESBTs inherently more flexible for families as the world becomes more global
	Section 461 limitation for "excess business losses" of non-corporate taxpayers	There is some thought that the 461 limit may apply separately to the ESBT portion of the trust and again to the non-ESBT portion of a trust	If there is independent application of the limitation then this may increase the ability to claim business losses (ESBT portion and non-ESBT portion)

Observations on impact of reform on estate planning

- Doubling of the exemptions (and indexing thereafter) would effectively repeal the estate tax for many individuals
  - But sunsetting makes the planning more problematic
- The doubling of the estate tax exemption is reason enough to review the estate plan, e.g., the funding of a so-called ‘credit shelter’ trust (‘bypass trust’)
- Key inquiries will be
  - Whether the current or projected estate will be taxable in the first place, and
  - Whether there is a need (or, just as important, a desire) to reduce the taxable estate
    - Perhaps just use the increased exemption to fix problems with existing planning
- Plans for estate tax liquidity should be revisited
  - For increased exemptions, sunsetting, etc.

RSM

Impact of tax reform on transfer tax planning

- Increase in the estate, gift and GST exemptions to approximately $11.2 million (indexing thereafter) will effectively repeal the estate tax for many individuals
  - Jan. 1, 2026 these increased exemptions revert to 2017 amounts (indexed for inflation)
  - Potential for legislative changes after 2020 presidential and congressional elections that could reduce exemptions sooner than scheduled
- Basis step-up retained for assets subject to estate tax inclusion
- No change in transfer tax rates – top rate remains 40 percent
- Treasury has not addressed how the scheduled reduction in exemption amounts will be handled computationally; will there be ‘clawback?’
- Existing formula clauses in estate planning documents need careful review and can create unintended consequences in their current form
  - Formula clauses can result in ‘dis-inheritance’ or diminished assets passing to surviving spouse or to a martial trust
  - Existing testamentary charitable trust clauses in estate planning documents need careful review to determine if they remain appropriate or necessary

Impact of tax reform on transfer tax planning

- Due to the complexity of the transfer tax system, sophisticated estate planning lawyers must be engaged. These law changes necessitate a review of all estate and gift plans and related documents in order to insure flexibility in reacting to the scheduled and unscheduled changes in the law and to avoid unintended consequences with existing documents.
- Concepts to review and planning opportunities include:
  - Income tax basis step-up planning
  - Trust planning
  - Designated beneficiary review
  - Account designations
  - Retirement, financial and insurance planning
  - GST planning
  - Marital planning
  - Charitable planning
  - Educational funding

Income tax basis step-up planning

- With fewer individuals subject to transfer tax, income tax basis in inherited or gifted assets becomes more important in overall tax planning
- Basis step-up retained for assets subject to the estate tax inclusion
- Utilization of the power of substitution language in grantor trust agreements to permit exchanges of assets with grantor to achieve high basis assets for the trust (including cash) and low basis assets for grantor
- Electing portability of unused estate exemptions (DSUE) at first death
- Utilization of powers of appointment to trigger estate tax inclusion in estates where values are under the applicable exemption amounts
- Review formula clauses in wills and revocable trusts for funding by-pass trusts (no additional step-up at second death) versus marital deduction trusts (step-up at second death) to insure tax efficient result with asset basis

RSM

Trust planning for new and existing trusts

- Planning considerations include trust situs (including locations of assets, beneficiaries, administrators and trustees), state income taxation, trust duration, fiduciary and advisor appointments, trust governance, powers of appointment, grantor trust provisions, release of grantor trust status, S corporation provisions, needs of beneficiaries, distribution policies, trust accounting policies, generation skipping provisions, and maximization of asset basis
- Employ above considerations in wills and revocable trusts, new trust agreements or for decanting of existing trusts

Review of beneficiary designations and property characterization

- Review of beneficiary designations in light of increased transfer tax exemptions for IRAs, retirement plans, life insurance and annuities and coordination with current estate plan
- Review of financial account designations to coordinate with current estate plan.
  - Examples: Joint tenants with rights of survivorship, joint tenants, transfer on death or paid on death accounts
- Estate equalization considerations and options when estate consists of substantial separate property due to asset concentrations in one spouse

Retirement, financial and insurance planning

- Review of life and disability insurance coverage and needs
- Estate liquidity planning
- Review of casualty and liability insurance coverage and needs
- Conversions of (or contributions to) Roth IRAs
- Section 529 plan funding for educational needs
- Gifting to life insurance trusts to remedy underfunded or leveraged policies to maintain adequate death benefit, or to repay loans
- Gifting to irrevocable trusts to allow trust repayment of existing loans
- Review of retirement plan beneficiaries – consider charitable beneficiaries only in appropriate circumstances
- IRA distribution income tax planning

Generation-skipping tax planning

- Additional funding of existing GST trusts or creation of new dynastic trusts for generational planning
- Outright gifts to grandchildren and other ‘skip’ persons
- Review existing non-exempt or partially exempt trusts to determine if late allocations of GST exemption are appropriate
- Review estate plans to determine the optimal utilization of the increased GST exemption in their wills or revocable trusts
- Consider gifts to GST trusts to allow trust repayment of existing loans
- Create new GST exempt trusts to purchase assets from existing non-GST trusts
- GST exemption cannot be ported to surviving spouse

RSM

Marital planning

- Review estate plans to maximize basis step up at death through minimization of bypass trust funding and/or use of portability elections
- Use portability credit of surviving spouse to fund a new intentionally defective grantor trust (IDGT) with stepped up assets after first death
- Explore disclaimer planning for estates with sophisticated executors and cooperative surviving spouses
  - The will may leave everything into a qualified terminable interest property trust (QTIP or marital trust). The executor and surviving spouse then execute a qualified disclaimer (within 9 months of date of death) up to the exact amount that is preferable to pass to a bypass/credit shelter trust or by identifying specific high basis assets to pass to the bypass/credit shelter trust.

Charitable planning

- Charitable giving done during lifetime versus at death more beneficial due to lifetime income tax savings
- Use of low basis assets for funding charitable gifting
- Cash gifts to public charities – 60 percent of AGI limit
- Donor advised funds – IRS issued Notice 2017-73 regarding future proposed regulations for payment of personal pledges and purchase of tickets
- Donor advised funds must now report to IRS average grant amounts made
- Electing small business trusts – now subject to same charitable deduction limits applicable to individuals
- Deduction no longer available for charitable portion of collegiate athletic ticket purchases (no donative intent)

Education related planning

- Continued ability to fund $75,000 into section 529 plans with five year ‘spread’ election on Form 709
- Up to $10,000 per year per student may be used to fund qualified expenses for K-12 education – section 529(c)(7)
- Continued unlimited gift exclusion for direct payment of tuition to educational institutions
- Section 529 plan assets – rollovers allowed to Achieving a Better Life Experience (ABLE) Plans for disabled – section 529(c)(3)(C)(i)(lll)
- Section 529A ABLE plan changes – increased funding by beneficiary – section 529A

THANK YOU FOR YOUR TIME AND ATTENTION

APPENDIX

2018 Draft Form 1040, Page 1

Form **1040** Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return **2018** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

DRAFT AS OF August 13, 2018 DO NOT FILE

Filing status: ☐ Single ☐ Married filing jointly ☐ Married filing separately ☐ Head of household ☐ Qualifying widow(er)

Your first name and initial	Last name	**Your social security number**

Your standard deduction: ☐ Someone can claim you as a dependent ☐ You were born before January 2, 1954 ☐ You are blind

If joint return, spouse's first name and initial	Last name	**Spouse's social security number**

Spouse standard deduction: ☐ Someone can claim your spouse as a dependent ☐ Spouse was born before January 2, 1954 ☐ Full-year health care coverage or exempt (see inst.)
☐ Spouse is blind ☐ Spouse itemizes on a separate return or you were dual-status alien

Home address (number and street). If you have a P.O. box, see instructions. Apt. no. **Presidential Election Campaign** (see inst.) ☐ **You** ☐ **Spouse**

City, town or post office, state, and ZIP code. If you have a foreign address, attach Schedule 6. If more than four dependents, see inst. and ✓ here ▶ ☐

Dependents (see instructions): (1) First name	Last name	(2) Social security number	(3) Relationship to you	(4) ✓ if qualifies for (see inst.): Child tax credit	Credit for other dependents
				☐	☐
				☐	☐
				☐	☐
				☐	☐

Sign Here
Joint return? See instructions. Keep a copy for your records.

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparer Use Only

Preparer's name	Preparer's signature	PTIN	Firm's EIN	Check if: ☐ 3rd Party Designee ☐ Self-employed
Firm's name ▶		Phone no.		
Firm's address ▶				

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2018)

RSM

2018 Form 1040, Page 2

Form 1040 (2018) Page 2

DRAFT AS OF August 13, 2018 DO NOT FILE

Attach Form(s) W-2. Also attach Form(s) W-2G and 1099-R if tax was withheld.

1	Wages, salaries, tips, etc. Attach Form(s) W-2		1
2a	Tax-exempt interest	2a	b Taxable interest 2b
3a	Qualified dividends	3a	b Ordinary dividends 3b
4a	IRAs, pensions, and annuities	4a	b Taxable amount 4b
5a	Social security benefits	5a	b Taxable amount 5b
6	Total income. Add lines 1 through 5. Add any amount from Schedule 1, line 22		6
7	Adjusted gross income. If you have no adjustments to income, enter the amount from line 6; otherwise, subtract Schedule 1, line 36, from line 6		7
8	**Standard deduction or itemized deductions** (from Schedule A)		8
9	**Qualified business income deduction** (see instructions)		9
10	**Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-**		10
11	a Tax (see inst) (check if any from: 1 ☐ Form(s) 8814 2 ☐ Form 4972 3 ☐)		
	b **Add** any amount from Schedule 2 and check here ▶ ☐		11
12	a Child tax credit/credit for other dependents		b **Add** any amount from Schedule 3 and check here ▶ ☐ 12
13	Subtract line 12 from line 11. If zero or less, enter -0-		13
14	Other taxes. Attach Schedule 4		14
15	Total tax. Add lines 13 and 14		15
16	Federal income tax withheld from Forms W-2 and 1099		16
17	Refundable credits: a EIC (see inst.)	b Sch 8812	c Form 8863
	Add any amount from Schedule 5		17
18	Add lines 16 and 17. These are your total payments		18

Standard Deduction for—
- Single or married filing separately, $12,000
- Married filing jointly or Qualifying widow(er), $24,000
- Head of household, $18,000
- If you checked any box under Standard deduction, see instructions.

Refund

19	If line 18 is more than line 15, subtract line 15 from line 18. This is the amount you **overpaid**		19
20a	Amount of line 19 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐		20a
▶ b	Routing number	▶ c Type: ☐ Checking ☐ Savings	
▶ d	Account number		
21	Amount of line 19 you want **applied to your 2019 estimated tax** ▶	21	

Direct deposit? See instructions.

Amount You Owe

22	**Amount you owe.** Subtract line 18 from line 15. For details on how to pay, see instructions ▶		22
23	Estimated tax penalty (see instructions) ▶	23	

Go to www.irs.gov/Form1040 for instructions and the latest information. Form **1040** (2018)

2018 Form 1040, Schedule 1 (Above-the-line AGI Adjustments)

SCHEDULE 1
(Form 1040)

Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income

▶ Attach to Form 1040.
▶ Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074

2018

Attachment Sequence No. 01

Name(s) shown on Form 1040 | Your social security number

Additional Income

1–9b	Reserved	1–9b	
10	Taxable refunds, credits, or offsets of state and local income taxes	10	
11	Alimony received	11	
12	Business income or (loss). Attach Schedule C or C-EZ	12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐	13	
14	Other gains or (losses). Attach Form 4797	14	
15a	Reserved	15b	
16a	Reserved	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17	
18	Farm income or (loss). Attach Schedule F	18	
19	Unemployment compensation	19	
20a	Reserved	20b	
21	Other income. List type and amount ▶	21	
22	Combine the amounts in the far right column. If you don't have any adjustments to income, enter here and include on Form 1040, line 6. Otherwise, go to line 23	22	

Adjustments to Income

23	Educator expenses	23	
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	24	
25	Health savings account deduction. Attach Form 8889	25	
26	Moving expenses for members of the Armed Forces. Attach Form 3903	26	
27	Deductible part of self-employment tax. Attach Schedule SE	27	
28	Self-employed SEP, SIMPLE, and qualified plans	28	
29	Self-employed health insurance deduction	29	
30	Penalty on early withdrawal of savings	30	
31a	Alimony paid b Recipient's SSN ▶	31a	
32	IRA deduction	32	
33	Student loan interest deduction	33	
34	Reserved	34	
35	Reserved	35	
36	Add lines 23 through 35	36	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F **Schedule 1 (Form 1040) 2018**

RSM

2018 Form 1040, Schedule A

SCHEDULE A (Form 1040)
Department of the Treasury Internal Revenue Service (99)

Itemized Deductions

▶ Go to *www.irs.gov/ScheduleA* for instructions and the latest information.
▶ Attach to Form 1040.
Caution: If you are claiming a net qualified disaster loss on Form 4684, see the instructions for line 16.

OMB No. 1545-0074
2018
Attachment Sequence No. **07**

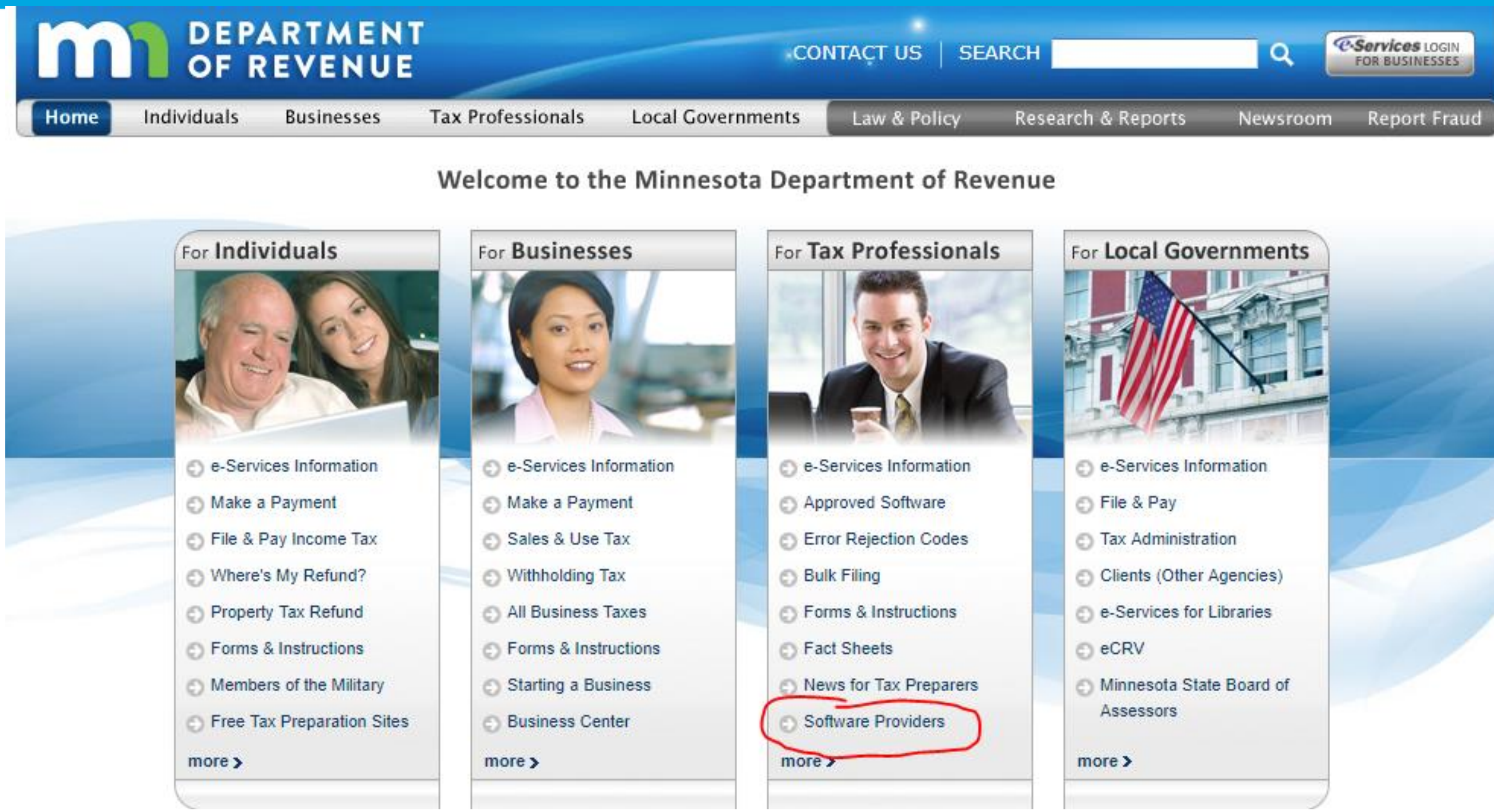
Name(s) shown on Form 1040 | **Your social security number**

DRAFT AS OF October 9, 2018 DO NOT FILE

Medical and Dental Expenses		**Caution:** Do not include expenses reimbursed or paid by others.		
	1	Medical and dental expenses (see instructions)	1	
	2	Enter amount from Form 1040, line 7 [2]		
	3	Multiply line 2 by 7.5% (0.075)	3	
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-		4
Taxes You Paid	5	State and local taxes.		
	a	State and local income taxes or general sales taxes. You may include either income taxes or general sales taxes on line 5a, but not both. If you elect to include general sales taxes instead of income taxes, check this box . . . . . ▶ ☐	5a	
	b	State and local real estate taxes (see instructions)	5b	
	c	State and local personal property taxes	5c	
	d	Add lines 5a through 5c	5d	
	e	Enter the smaller of line 5d or $10,000 ($5,000 if married filing separately)	5e	
	6	Other taxes. List type and amount ▶	6	
	7	Add lines 5e and 6		7
Interest You Paid **Caution:** Your mortgage interest deduction may be limited (see instructions).	8	Home mortgage interest and points. If you didn't use all of your home mortgage loan(s) to buy, build, or improve your home, see instructions and check this box . . . . ▶ ☐		
	a	Home mortgage interest and points reported to you on Form 1098	8a	
	b	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address ▶	8b	
	c	Points not reported to you on Form 1098. See instructions for special rules	8c	
	d	Reserved	8d	
	e	Add lines 8a through 8c	8e	
	9	Investment interest. Attach Form 4952 if required. See instructions	9	
	10	Add lines 8e and 9		10
Gifts to Charity If you made a gift and got a benefit for it, see instructions.	11	Gifts by cash or check. If you made any gift of $250 or more, see instructions	11	
	12	Other than by cash or check. If any gift of $250 or more, see instructions. You must attach Form 8283 if over $500 . . .	12	
	13	Carryover from prior year	13	
	14	Add lines 11 through 13		14
Casualty and Theft Losses	15	Casualty and theft loss(es) from a federally declared disaster (other than net qualified disaster losses). Attach Form 4684 and enter the amount from line 18 of that form. See instructions		15
Other Itemized Deductions	16	Other—from list in instructions. List type and amount ▶		16
Total Itemized Deductions	17	Add the amounts in the far right column for lines 4 through 16. Also, enter this amount on Form 1040, line 8		17
	18	If you elect to itemize deductions even though they are less than your standard deduction, check here . . . . ▶ ☐		

For Paperwork Reduction Act Notice, see the Instructions for Form 1040. Cat. No. 17145C **Schedule A (Form 1040) 2018**

Link to Draft 2018 MN Forms



2018 MN Form M1NC, Page 1

DEPARTMENT OF REVENUE FINAL DRAFT 10/17/18

* 1 8 1 3 4 1 *

2018 Schedule M1NC, Federal Adjustments

Minnesota has not adopted the federal law changes made after December 16, 2016, that affect federal adjusted gross income for tax year 2018.

Your First Name and Initial	Last Name	Social Security Number

*Before you complete this schedule, **read the instructions which are on a separate sheet.** Do not enter amounts in gray boxes.*

Adjustments to federal adjusted gross income (AGI)

				Additions	Subtractions
1		Bicycle commuting expenses reimbursed by your employer	1		
2		Moving expense deduction *(enclose Schedule M1MOVE)*	2		
3		Excess reimbursements received from your employer reported on line 8 of Schedule M1UE	3		
4		Student loan forgiven due to death or permanent disability	4		
5		Earnings from an education savings account used for K-12 education tuition expenses or rolled over to an ABLE account	5		
6		Casualty or theft gain *(Enclose Schedule M1CAT)*	6		
7		Distributed earnings from an ABLE account attributed to excess contributions	7		
8		This line intentionally left blank	8		
9		Income from qualified stock received from your employer that is deferred for federal tax purposes	9		
10		Adjustment for rule changes in capitalization provisions *(see instructions)*	10		
11	a.	Federal bonus depreciation in excess of 40% and on certain assets. Complete the worksheet in the instructions.	11a		
	b.	Enter the amount of allowable depreciation for assets on line 11a.	11b		
	c.	This line intentionally left blank	11c		
12	a.	Adjustment for Section 179 rules for expensing depreciable assets. Complete worksheet in the instructions.	12a		
	b.	Enter the amount of allowable depreciation for assets on line 12a.	12b		
	c.	This line intentionally left blank	12c		
13	a.	Adjustment for other depreciation provisions *(See instructions for further details)*	13a		
	b.	Depreciation on assets from line 13a disregarding changes in depreciation rules since December 16, 2016	13b		
14		Depreciation on assets reported on 2017 Schedule M1NC lines 3 and 6.	14		
15	a.	This line intentionally left blank	15a		
	b.	This line intentionally left blank	15b		
16		Deduction for certain business expenses such as employee fringe benefits, meals and entertainment expenses, certain settlement payments, and lobbying *(see instructions)*	16		
17	a.	Like-Kind exchange adjustment from Schedule LK	17a		
	b.	Recalculated cost recovery for property on Line 17a	17b		

9995

RSM

2018 MN Form M1NC, Page 2

2018 M1NC, page 2

181411

18	Adjustment due to 30 percent limitation on net business interest deduction	18		
19	Limitation on allowance of Partner's share of loss	19		
20	Adjustment for tax treatment of Alaska Native Settlement corporations and trusts	20		
21	Adjustment for capital gains invested in Opportunity Zones	21		
22	Adjustments due to the disallowance of an excess business loss	22		
23	a. Adjustment for Section 965 Deferred Foreign Income	23a		
	b. Amount of actual Section 965 repatriated income	23b		
24	Adjustment for Global Intangible Low Taxed Income	24		
25	Adjustment for Foreign Derived Intangible Income	25		
26	This line intentionally left blank	26		
27	Adjustment for related party amounts paid in hybrid transactions	27		
28	Adjustment due to changes in Subpart F	28		
29	**Additional Adjustments** *(see instructions)*	29		
30	Adjustments created by federal credits and tax incentives for businesses *(see instructions)*	30		
31	2017 Schedule M1NC carryforward loss or distribution from IRA with added Minnesota basis	31		
32	If you have an adjustment to income subject to a rule involving AGI (such as 2018 IRA deductions, Social Security Income, student loan interest deduction or rental real estate losses), see instructions	32		
33	This line intentionally left blank	33		
34	Add the amounts in the **Additions** column	34		
35	Add the amounts in the **Subtractions** column	35		
36	**If line 34 is more than line 35,** subtract line 35 from line 34. Enter the result here and on line 13 of Schedule M1M. **If line 35 is more than line 34,** subtract line 34 from line 35. Enter the result here and on line 40 of Schedule M1M.	36		
37	Enter the amount from line 1 of Form M1	37		
38	If line 34 is more than line 35, add line 36 to line 37. If line 35 is more than line 34, subtract line 36 from line 37.	38		

You must include this schedule when you file Form M1.

2018 MN Form M1SA – MN itemized deductions

DEPARTMENT OF REVENUE

FINAL DRAFT 10/16/18

181161

2018 Schedule M1SA, Minnesota Itemized Deductions

Your First Name and Initial	Last Name	Your Social Security Number

1 Medical and dental expenses *(see instructions)* . . . . 1 ■

2 Minnesota Adjusted Gross Income *(see instructions)* 2

3 Multiply line 2 by 10% (.10). 3

4 Subtract line 3 from line 1. If line 3 is more than line 1, enter 0. . . . . 4 ■

5 State and local income taxes or general sales taxes *(see instructions)*. . . . . 5 ■

6 Real estate taxes *(see instructions)* . . . . 6 ■

7 Personal property and other taxes *(see instructions)* . . . . 7 ■

8 Add lines 5 through 7 . . . . 8 ■

9 Home mortgage interest and points on federal Form 1098 9

10 Home mortgage interest and points not reported to you on Form 1098 *(see instructions)* ____ 10

11 This line intentionally left blank. 11

12 Investment interest expense 12

13 Add lines 9, 10, and 12. . . . . 13 ■

14 Charitable contributions by cash or check *(see instructions)* 14

15 Charitable contributions by other than cash or check *(see instructions)*. . 15

16 Carryover of charitable contributions from a prior year 16

17 Add lines 14 through 16. . . . . 17 ■

18 Casualty or theft loss *(enclose Schedule M1CAT)*. . . . . 18 ■

19 Unreimbursed employee expenses *(enclose Schedule M1UE)* . . . . 19 ■

20 Other expenses such as tax prep fees, safe deposit, etc. *(see instructions)* 20 ■

21 Add lines 19 and 20 21

22 Minnesota Adjusted Gross Income *(see instructions)* 22

23 Multiply line 22 by 2% (.02). 23

24 Subtract line 23 from line 21. If zero or less, enter 0. . . . . 24 ■

25 Other miscellaneous deductions *(see instructions)*. List type and amount ____ . . . . 25 ■

26 Add lines 4, 8, 13, 17, 18, 24, and 25 . . . . 26 ■

27 State and local income or sales tax addition *(determine from instructions)* . . . . 27 ■

28 Complete the worksheet in the instructions if your Minnesota Adjusted Gross Income is more than $190,050 ($95,025 if your filing status is married filing separate). . . . . 28 ■

29 Add lines 27 and 28 . . . . 29 ■

30 Subtract line 29 from line 26. Enter the result here and on line 4 of Form M1 . . . . 30 ■

9995

RSM

RSM US LLP

+1 800 274 3978
www.rsmus.com