AdvisorFacts

NEWPORT GROUP™

First Quarter 2018 Issue

Tax Reform Recap

By Sam Brkich, Newport Group and Tim Hanford, ADC Strategies, LLC
February 20, 2018

On December 22, 2017, President Trump signed into law the major tax reform bill known as the "Tax Cuts and Jobs Act." Now the hard work is beginning. Because of the speed with which the legislation moved through Congress (less than two months from the first committee markup), and because most of the proposed changes were not revealed until the very last minute, there are numerous drafting and policy errors and unclear provisions in the final legislation. The Congressional tax-writing committees are gathering lists of potential legislative fixes to be included in eventual "technical corrections" legislation, but because of partisan divisions over the underlying bill, it does not appear that Congress will move on technical corrections this year. Instead, the Treasury Department and the Internal Revenue Service are planning to fix as many of the problems and answer as many open questions as they legitimately can through the administrative guidance process.

On February 7, the Treasury and IRS released an updated priority guidance plan that identifies the most time-sensitive pieces of guidance needed to implement the tax reform law. They have indicated that they would like to issue this critical guidance as soon as possible and, in any case, before the end of the year. The IRS has also created a web page where taxpayers can see the guidance (so far, just a trickle) that has been issued.

Tax reform was as much about politics as it was about policy. President Trump and Congressional Republicans are continuing to claim credit for cutting individual income taxes for at least 80% of Americans, with the tax cuts beginning to show up in paychecks this month. They also happily boast of the growing number of large companies (350 by one recent count) that are paying out bonuses, increasing wages, or adding to 401(k) plans in response to the corporate tax cuts. Congressional Democrats are continuing to portray the tax bill as cutting taxes for the wealthy while providing "crumbs" (in the words of House Minority Leader Nancy Pelosi, D-CA) to everyone else. Both Republicans and Democrats expect the tax reform law to play a major role in the November elections that could determine control of the Senate and the House of Representatives. Recent polling suggests that Americans are becoming increasingly supportive of the tax reform law.

Corporate Tax Rate

The tax reform law permanently reduces the corporate tax rate from 35% to 21% starting in 2018. It also repeals the corporate alternative minimum tax (AMT) and allows companies to get refunds of past AMT payments.

Pass-Through Businesses

The tax reform law provides a 20% deduction for certain pass-through businesses, but includes provisions targeted at certain professions (law, accounting, financial services, etc.) to prevent highly-compensated individuals from shifting income for their personal services into pass-through business income to get the deduction.

Business Interest Deductions

The tax reform law generally limits business interest deductions to the sum of interest income and 30% of adjusted taxable income (ATI). For the first four years, ATI would be a higher number because it would be computed without regard to depreciation.

Life Insurance

The tax reform law does not tax life insurance inside buildup or death benefits or change the tax treatment of corporate- or bank-owned life insurance. There are provisions targeted at life settlement transactions that require reporting of policy sales, clarify the tax basis of life insurance contracts, and modify the transfer for value rules. These provisions may require clarification to prevent unintended results; Treasury and IRS have identified them as needing rapid guidance. There are also $23 billion of tax increases on life insurance companies (including changes to net operating losses, changes to the computation of reserves, modification of rules for life insurance proration, and changes to the capitalization of policy acquisition expenses) that may result in an increase in the cost of life insurance.

Retirement Plans

Despite earlier concerns about rumored changes to retirement plans, the tax reform law does not reduce the pre-tax limits for contributions to 401(k) retirement plans or retirement plan benefit limits. Apparently there was enough general confusion on this question that the IRS felt compelled to issue an announcement this month that the tax reform law does not affect 2018 pension plan limitations. The final tax reform law does contain small changes to retirement plan rules including repeal of a special rule permitting recharacterization of IRA contributions and extended rollover periods for certain plan loan offsets.

Non-Qualified Deferred Compensation

The House and Senate tax reform bills each initially had a provision that would have substantially reduced the ability to defer income under various types of non-qualified plans and stock options. However, through the efforts of the Newport Group and others in the business community to point out the adverse consequences of the proposals, the final tax reform law does not include any such provision.

Executive Compensation and Fringe Benefits

Prior law denied public companies a deduction for compensation over $1 million paid to five identified key people (covered employees). The tax reform law provides that once a person is a covered employee, they remain so forever, and, with grandfathering of existing arrangements, eliminates the prior-law exception for performance-based compensation. The tax reform law also denies employer deductions for various types of fringe benefits including club membership dues and transportation fringe benefits.

Other Key Provisions

For years through 2025, the tax reform law changes the individual tax rate structure in several ways, including setting the highest rate at 37% for couples making more than $600,000 ($500,000 for single filers). The tax reform law keeps in place the individual AMT, but significantly increases the exemption. A controversial provision in the tax reform law limits the itemized deduction for state and local income, property, and sales taxes to $10,000 in the aggregate. Politicians in several states are currently exploring options to ameliorate the impact. For new mortgage loans, the tax reform law limits interest deductions (first and second homes) to loans of less than $750,000. It also eliminates the deduction for home equity loan interest. The tax reform law doubles the estate, gift, and generation-skipping tax exemptions to $10 million (indexed for inflation) through 2025.

Sam Brkich is the Senior Vice President and General Counsel of Newport Group. Tim Hanford is the owner of ADC Strategies, LLC in Washington, DC and advises Newport Group's non-qualified and insurance service team on governmental affairs.

Disclaimers

Note that the views expressed above do not constitute investment advice; readers are encouraged to consult their own legal counsel. This release is a high-level summary of a complex subject that is intended for Newport Group's clients and intermediary partners and should not be understood as providing a comprehensive discussion of all issues or requirements under the regulations or as a guide to compliance.

The information contained herein is for informational and/or educational purposes only and is not intended to provide legal or tax advice. Consult with your tax professional, legal advisor or financial advisor prior to taking any action based upon this information. The information contained herein is based on authorities that are subject to change and is provided on an "as is" basis without warranty of any kind. Newport Group does not assume any liability for any errors, omissions or damages resulting from the use of the information. This document may not be reproduced or distributed in any form or by any means without Newport Group's written permission.