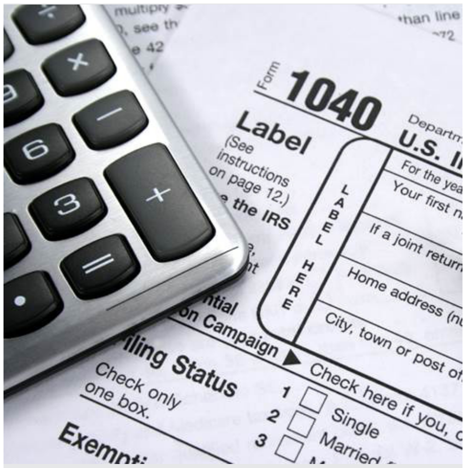
TIMELY INSIGHTS

WINTRUST WEALTH SERVICES

JANUARY 2018



Key Provisions of 2017 Tax Reform

Final provisions of the 2017 tax reform bill and their impact on individual investors and business owners.

The turn of the calendar page usually ushers in a few small tax adjustments—allowable 401(k) and IRA contributions may get bumped up a bit to account for inflation, along with IRA income limits and estate/gift tax exclusion amounts.

But 2018 brings more sweeping changes on the tax front, thanks to major legislation that Congress passed and was signed into law in the final days of 2017.

The provisions listed here are effective starting in 2018, unless stated otherwise. **Items in blue will expire on December 31, 2025.** Therefore, any planning ideas should be evaluated in light of the fact that these particular changes are scheduled to revert back to pre-2018 tax law within a relatively short time frame. The remaining provisions are not scheduled to expire unless otherwise noted.

Tax brackets for individuals, trusts, and estates

Changes

- For individuals, the new law provides for the same number of tax brackets, but with lower rates and different income thresholds. See the charts on page 2 for income thresholds associated with each bracket.
- The tax rates for trusts and estates have also decreased and now consist of only four brackets:

  New rates: 10%, 24%, 35%, and 37%.
  Old rates: 15%, 25%, 28%, 33%, and 39.6%.

Impact

- Rates for qualified dividends and long-term capital gains are unchanged. The income thresholds for the capital gain brackets are no longer tied to the ordinary income brackets. See the charts on page 2 for a comparison of the capital gain and ordinary income brackets.
- Congress did not repeal existing Medicare taxes (the 0.9% additional payroll tax, or the 3.8% tax on net investment income) that apply to higher-income taxpayers. These apply when adjusted gross income (AGI) exceeds $250,000 (joint) or $200,000 (single).

Planning Considerations

Since taxable income is determined after applying your deductions, it will be important to evaluate how the loss of deductions may off set the benefit of lower rates.

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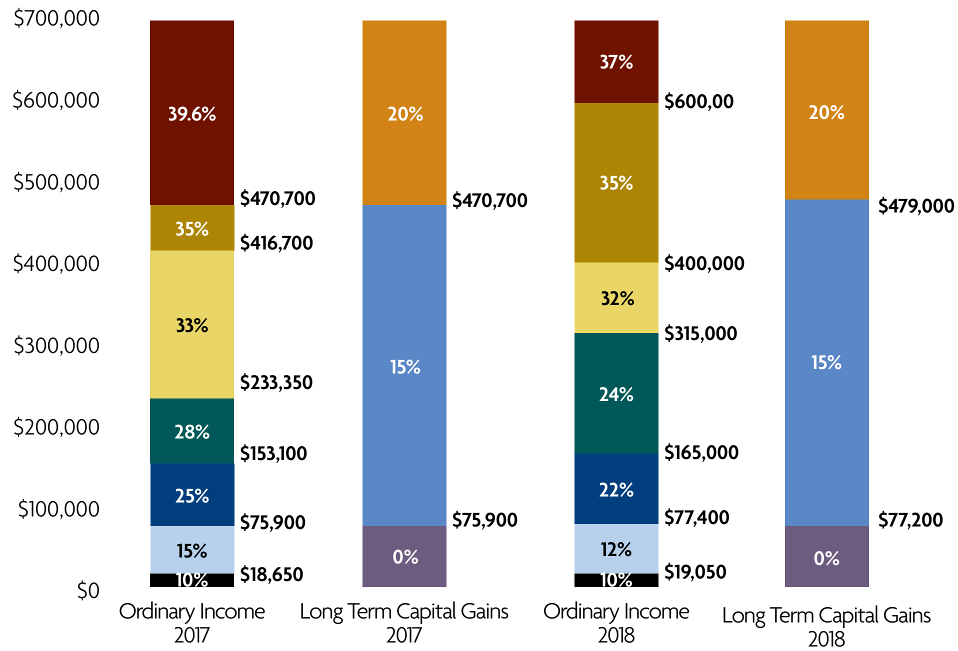
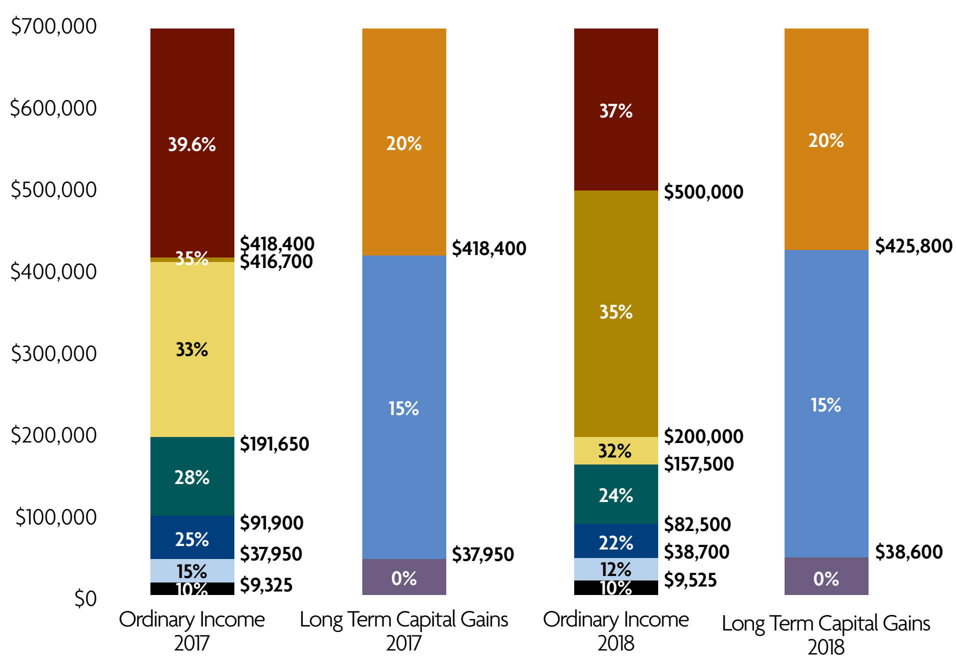
Married Filing Jointly



Single Filers



Deductions, exemptions, and the child tax credit

Changes

- The standard deduction is doubled to $24,000 for those who are married, filing jointly (or qualifying widowers) and $12,000 for those who are single or married, filing separately.
- Personal and dependent exemptions (previously $4,050 per person) have been eliminated.
- The deduction for state and local taxes is capped at $10,000 for the sum of state and local

The standard deduction is doubled, but personal and dependent exemptions are eliminated, and state and local tax deductions are capped at $10,000.

property taxes and income taxes (or sales tax in lieu of income tax). Property taxes paid in carrying on a trade or business will not be subject to this $10,000 cap.

- The limit on mortgage interest deduction on qualified acquisition debt is reduced from $1,000,000 to $750,000. This applies to interest on loan balances up to $750,000 used to buy, build, or improve a primary home or one second home. This reduction only applies in cases where the incurred debt occurred on or after December 15, 2017.
- Mortgage interest paid on home equity lines of credit (used for something other than to buy, build, or improve a home) may no longer be deducted.
- Charitable donations made in cash may now offset up to 60% of your AGI (up from 50%).
- Deductions for investment expenses, tax prep fees, and unreimbursed employee expenses have been eliminated.
- Casualty losses are limited to those attributable to a federally-declared disaster area.
- The phase-out of itemized deductions has been eliminated for higher-income taxpayers.
- The child credit has increased (from $1,000 to $2,000), and the income level at which it phases out has also increased, therefore allowing more taxpayers to benefit.
- The Alternative Minimum Tax exemption increased, allowing more taxpayers to escape AMT.
- Medical expenses exceeding 7.5% of your AGI are deductible (down from 10%). This reduced limit applies only for 2017 and 2018.
- Alimony payments for divorce agreements entered into and/or modified after December 31, 2018 will no longer be deductible by the payer and may not be taxed as income.

Impact
The extent to which these changes will affect you depends on your personal tax situation, but generally speaking:

- Those who do not itemize will likely benefit from a larger standard deduction.
- Those taxpayers who previously itemized could find themselves limited to a standard deduction that is smaller than the amount they used to get under itemization.
- The repeal of personal exemptions may be lessened or offset by the increased standard deduction and/or child credit.
- The $10,000 cap on state income (or sales) and property tax will most affect those with multiple residences where they are paying property taxes or live in high-tax states.

For taxpayers who are charitably inclined and over age 70 1/2, it will be important to evaluate whether it is more beneficial to make a contribution of cash, stock, or a qualified distribution from your IRA.

Planning Considerations
- Some taxpayers may want to consider "bunching" deductions, using the standard deduction in some years and saving their itemized deductions for other years.
- Another way to accomplish this goal with regard to charitable donations could be to "bunch" gifts to donor-advised funds.
- For taxpayers who are charitably inclined and over age 70 1/2, it will be important to evaluate whether it is more beneficial to make a contribution of cash, stock, or a qualified distribution from your IRA.

Education tax benefits and ABLE accounts

Changes

- Tax-free 529 rollovers may now be made into ABLE accounts, provided they do not exceed the annual contribution limit for the ABLE account.
- Contributions to ABLE accounts count toward the saver's credit and can be increased by the amount of the beneficiary's earned income (up to federal poverty line).
- Qualified distributions from a 529 plan now allow for $10,000 annually to be used toward elementary and secondary tuition.

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Impact

- Both 529 college savings plans and ABLE accounts (designed for disabled beneficiaries) become more attractive tools for meeting savings goals.

Planning Considerations

- Those seeking use of 529 funds for early education will now want to consider increased contribution goals.
- To maximize the saver's credit, work with a tax advisor to determine the best way to make ABLE account contributions, as the credit could equal up to 50% of your contribution (maximum credit is $1,000).

IRA contributions and conversions

Changes

- IRA contribution recharacterizations now exclude Roth IRA conversions. (Normal IRA contributions may still be recharacterized.)

Impact

- Taxpayers who want to convert their Traditional IRA to a Roth IRA must understand that recharacterization is no longer an option and will need to carefully consider the consequences as doing so is irreversible.

Those trying to weigh the risks and benefits of a Roth conversion against the uncertainty of the markets, may wish to test out smaller, multiple conversions throughout the course of the year, or over multiple years.

Planning Considerations

- Years in which you have a decrease in income or a market value decline can set the stage for a beneficial Roth conversion.
- Those trying to weigh the risks and benefits of a Roth conversion against the uncertainty of the markets, may wish to test out smaller, multiple conversions throughout the course of the year, or over multiple years.

Taxation of a child's investment income

Changes

- Investment income of a child will be taxed at trust income tax rates rather than individual income tax rates.

Impact

- For children under age 24 who are full-time students, investment income is no longer taxed at their parent's rate but at trust rates. The top trust income tax rate is the same as the top rate for an individual. However, the top trust rate applies at a much lower level of income likely resulting in a higher tax bill under this new rule.

Planning Considerations

- Review your goals for gifting to a minor along with the various vehicles available for holding funds in a child's name.

- For minors, a trust and a custodial account may now have similar tax implications, but they still differ when it comes to distribution requirements and control of assets.
- If gifts are intended for education, the tax rules for 529 plans are considerably more attractive than other options.
- For other gifts, investment choices will be important in order to control the amount and character of income generated while the child is subject to these rules.

Estate, gift, and generation-skipping taxes

Changes

- This exclusion amount is doubled to $11,200,000 per person.
- This exclusion will continue to be inflation-adjusted in future years.

Impact

- A deceased spouse may transfer unused exclusion amounts to a surviving spouse, as was previously the case.
- Rules pertaining to a "step-up" in cost basis for assets at time of death for capital assets remain as-is.
- Married couples are eligible to transfer $22,400,000 with no federal estate tax.

Estate plans created before 2013 should definitely be reviewed, and even recently created plans may need to be reconsidered in light of dramatically higher exclusions.

Planning Considerations

- Existing estate plans for married couples often call for automatic, maximum funding of a "credit shelter" trust at the first spouse's death.
  - This plan construction could result in less-than-optimal use of the deceased spouse's exclusion, and sacrifice the opportunity for a "step-up" in cost basis at time of death.
  - Estate plans created before 2013 should definitely be reviewed, and even recently created plans may need to be reconsidered in light of dramatically higher exclusions.
- Instead of forgoing estate tax planning, it may make sense to actually do more. More specifically, higher thresholds for generation-skipping exclusions may provide a significant opportunity to undertake multi-generational wealth preservation planning.
- Those who are charitably inclined should seek to consider adjustments to their overall strategy and timing. For example, considering a lifetime giving strategy that would provide an income tax deduction in lieu of a charitable bequest (which would not be of benefit in cases where estate tax is not owed), may prove more effective. Alternatively, charitable donations coming from IRAs, qualified retirement plans, or deferred annuities could be distributed to charities with no income tax.

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Business income and deductions

Changes

- There is now a new deduction for 20% of qualified business income of S corporations, partnerships, and sole proprietorships.
  - » Generally speaking, this special deduction can be applied toward business profits, not wages earned by the business owner.
  - » It generally cannot exceed 50% of wages paid by the business: however, capital-intensive businesses may qualify for an alternative limitation based on the value of capital assets.
  - » This deduction does not apply toward the following fields: health, law, accounting, actuarial science, performing arts, consulting, athletics, investment or brokerage services, or any business where the principal asset is the reputation or skill of one or more of its employees.
  - » A notable exception: owners with taxable income below $315,000 (if married filing jointly) or $157,500 (if single) are still permitted to take this deduction, without regard to the limit for wages or specified services businesses.
- Taxpayers may deduct 20% of income received as qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income.
- The tax rate for C Corporations is reduced to a flat rate of 21%.
- Corporate AMT is eliminated.
- Qualified business property may be expense for a 5 years period before gradually phasing out.
- Increased limits for expensing are allowed under Section 179 and certain real property improvements are added as qualifying property.

Impact

- A business' entity choice may no longer be the best choice for tax purposes.
- Businesses that have been waiting to invest in capital expenditures may now reap significant tax benefits.

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Planning Considerations

- Before considering a change of business structure or entity type, it makes sense to evaluate how the expiration of these new rules in 2025 will impact the short- and long-term value of any particular strategy.
- Many questions remain about the details of how the deduction for pass-through entities will apply.
- Business owners will want to evaluate whether it is beneficial (and practical) to segregate "favored" and "unfavored" business activities into different entities. The type of business activity conducted may have a significant impact on whether it will benefit from the new pass-through deduction.

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State and local taxes

Changes

As some state tax provisions are linked to federal tax provisions, each state will have to decide whether or not to carry through with federal changes. Many states typically update their laws to conform to some (but usually not all) changes.

Impact

- Differences in state and federal laws lead to additional complexity, record keeping, and tax prep costs.

- Some states use federal taxable income as the starting point of their tax calculation. If your federal taxable income increases due to the loss of several federal deductions, your state tax bill could increase even without any state law change.

Planning Considerations

- Income tax
    - » Consider any tax strategies considered in light of both federal and state tax consequences.
    - » Consider the impact of the new law for 2018 estimated tax payments.
- Estate/Gift/GST tax
    - » The thresholds for state estate tax are often considerably lower than the federal applicable exclusion.
    - » A few states have "tied" their exemptions to the federal exclusion. It will be important to monitor whether these states continue that link, or choose to "decouple."
    - » For a more thorough approach to preserving your family's wealth, remain mindful of the potential impact of state taxes in places where your heirs and beneficiaries live.

We are not a tax or legal advisor. Although this summary is not intended to replace discussions with your tax advisor, it may help you to comprehend the tax implications of your investments and plan efficiently going forward.

The individual provisions listed each represent a significant change to current law. In combination, the overall effects will vary widely among taxpayers. As time passes, we will have more clarity on the details and more planning strategies to share. Now is the time to gather your advisor team. Your financial advisor, estate attorney, and tax advisor will be instrumental in determining what action steps are best for you in the short-term and the long-term.