RESOURCES

Post-TCJA planning techniques to benefit individuals

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The signing of the Tax Cuts and Jobs Act (TCJA) in December of 2017 brought significant changes to the Internal Revenue Code (IRC). This legislation's effect on the IRC is pervasive, altering individual taxation, corporate taxation, estate and gift taxation and every area in between. Your clients will be looking to you as their go-to adviser for consultation on the new changes. This is your opportunity to employ some planning techniques to add value to your conversations with clients of all income levels.

Charitable contributions

Under the TCJA, the standard deduction for married taxpayers filing jointly will increase to $24,000 ($12,000 for single taxpayers). Deductions for state and local taxes (SALT) will be capped at $10,000, while miscellaneous itemized deductions subject to the 2% floor will be eliminated.

Many taxpayers without substantial itemized deductions other than a deduction for SALT, who have historically itemized their deductions under pre-TCJA laws, may now find themselves using the standard deduction. This group of taxpayers, if charitable, can consider some planning techniques related to charitable contributions.

- **Consider "bunching" charitable contributions.**
  Most married taxpayers may find it challenging to accumulate enough charitable contributions to push their itemized deductions beyond the new standard deduction. In effort to itemize, and thus maximize the tax benefit of charitable contributions, taxpayer may consider grouping several years of donations into one year, rather than donating piecemeal over multiple years. In years without charitable contributions, the increased standard deduction can be claimed. Using a donor-advised fund can be considered in conjunction with this strategy.
- **Consider qualified charitable distributions (QCDs).**
  For IRA owners subject to the required minimum distribution (RMD) rules, QCDs are a tax-efficient way to avoid inclusion of RMDs in taxable income while simultaneously contributing to a charity. QCDs can satisfy annual RMD requirements up to $100,000, per taxpayer. It's important to note that, currently, QCDs cannot be made to donor-advised funds.

Sec. 199A qualified business income (QBI) deduction

The QBI deduction, afforded by Sec. 199A, has certainly been one of the most discussed provisions of the TCJA. Sec. 199A generally allows taxpayers (other than corporations) a deduction of up to 20% of QBI from taxable income, subject to limitations.

Determining eligibility for this deduction can become onerous, involving multiple tests and calculations. The key to simplifying Sec. 199A is remaining under the taxable income threshold (if possible). Remaining under this threshold exempts a taxpayer from further testing, thus allowing the taxpayer to take the deduction regardless of whether the business is a specified service business. The taxable income limit for married taxpayers filing jointly is $315,000 ($157,500 for single taxpayers). The deduction may be partially or completely phased out once taxable income exceeds this threshold. For further guidance, check out the Sec. 199A flowchart and Sec. 199A FAQs.

There are multiple ways to reduce taxable income to remain below the threshold. One of the most efficient courses of action, from a tax and financial planning perspective, may be making a deductible contribution to a self-employed retirement account. This approach will lower taxable income while also funding retirement. One must consider whether this deduction is worth more now or later, as future taxable retirement account distributions will generate ordinary income.

While it is important to plan for those laws shaping the current tax landscape, it's also important to keep a watchful eye on the future. Most provisions of the TCJA "sunset" after 2025. Unless they are extended, they will expire then.

To that end, when considering what form will be most beneficial for an entity to take on (LLC, C corporation, S corporation, etc.), it may be prudent to consider alternatives to a Sec. 199A-centric plan. Depending on long-term goals, an alternative approach could be forming a C corporation with the goal of qualifying for Sec. 1202 treatment (qualified small business stock). Sec. 1202 allows for potential gain exclusion on the sale of certain small business stock and is a complicated subject requiring in-depth planning.

Alternative minimum tax (AMT)

With the limitation of the SALT deduction, as well as the elimination of certain itemized deductions, many taxpayers who have historically been subject to the AMT may not be anymore. Furthermore, the TCJA's increase of the AMT exemption, accompanied by an increase of the exemption amount phaseout threshold, further reduces the likelihood that taxpayers will be subject to the tax. For these reasons, tax events with benefits that have previously been muted by the AMT, such as the exercise of incentive stock options (ISOs), may be seen more frequently.

ISOs, unlike non-qualified stock options, are eligible to receive preferential tax treatment. This preferential treatment is the exclusion of income equal to the bargain element (fair market value less the strike price) of the option at the time of exercise. However, this income is only excluded for ordinary tax purposes. This event still increases AMT income. This inclusion of the bargain element in AMT income has the potential to thwart the underlying benefit of ISOs. But, if AMT affects fewer taxpayers, ISOs may become more attractive as a form of compensation.

Conclusion

While challenges abound this new tax and financial planning environment, these challenges will create many opportunities to add value for clients. With any planning done in response to the TCJA, it is important to remember that many of the TCJA's underlying provisions will expire after 2025 without any legislative intervention. Ultimately, before implementing any of these strategies, you should assess your client's tax and financial situation holistically in determining what fits best for their long-term financial goals.

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