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RECONCILIATION: NEARING AN END

YEAR-END CONSIDERATIONS AS TAX REFORM BECOMES LIKELY

House and Senate Republicans announced today that a deal on tax reform is pending which indicates that a vote should take place on a hybrid bill prior to the holiday recess. The major details are beginning to be reported by news outlets while smaller differences in the plans are yet to be determined. However, despite complete information today, we have a roadmap of possible changes that could go into law as soon as January 1, 2018. See below for a summary of the major items within the tax reform legislation bills that were passed in the House and the Senate. We hope to see the text of the final bill by Friday this week.

As we finalize 2017 tax planning with clients during the last two weeks of the year, we urge conversations with tax advisors and suggest that the following considerations are discussed depending on unique income tax circumstances:

1. Income Deferral: Each of the plans provides a tax cut for most individuals so if possible, it likely makes sense to defer income into 2018. Top federal income tax rates may be lowered from 39.6% to as low as 37% in the most recent releases from top GOP aides working on the compromised plan. Note that this top rate proposal is lower than either plan already passed by the House or the Senate. How can income be managed over a tax year? Consider deferring year-end bonuses until the next calendar year or perhaps delay a planned ROTH IRA conversion that would generate income in the current tax year.

2. Review Your Deductions: The current proposals would significantly increase the standard deduction to $24,000 for Joint Filers. If you currently itemize your deductions but could become subject to the standard deduction in 2018, you may consider accelerating charitable gifts. You may also consider prepaying booster fees to your Alma Mater that are currently deductible (in part) as charitable contributions but will no longer be allowed as deductions in the future.

3. Prepay What May be Lost: There has been a lot of discussion around the elimination or significant limitation of the State and Local Income Tax (SALT) deduction. Particularly if you are a resident of a state with high income tax and you are not subject to the Alternative Minimum Tax (AMT), you may consider prepaying state and local taxes in the current year. The most recent compromised position suggests that state income tax or sales tax along with property taxes could be deducted for those who itemize up to a total of $10,000. Regardless of the possible change, the SALT deduction for many of the wealthiest taxpayers in high income tax states would be significantly reduced.

4. Homeowners under Pressure: While the Senate plan does not change the mortgage interest deduction, there is speculation that this item will be negotiated and that mortgage interest may only be deductible on home purchases up to $750,000. Those with home equity indebtedness should possibly consider pay downs as the interest deduction up to $100,000 will likely be eliminated. Further, as referenced above, the deductibility of property taxes will likely be capped. Those with high property tax liabilities may consider a prepayment for 2018 this year assuming they are not subject to AMT. Finally, it is important to know that the tax-free capital gain on the sale of a primary home up to $500,000 for Joint Filers may require the homeowners to live in that residence for five out of the last eight years rather than current law which mandates residence for two out of the last five years.

5. Beware of FIFO: Typically, when a portfolio is rebalanced or cash is raised from liquid securities, those positions are sold to minimize capital gains: the highest cost tax lot is sold first. Suggested changes from the Senate would no longer allow investors to select specific tax lots upon liquidation instead requiring the first tax lots purchased to be sold first (FIFO). If significant portfolio rebalancing is expected in the near term on low cost basis stock positions, be ready to act in the current year. Recent releases indicate this proposal may be eliminated from the final plan.

6. 529 Plan Bonus: 529 College Education Plans provide tax free growth of assets that will be used for qualified college related expenses. These eligible costs may soon be extended to include elementary and high school expenses as well. Early 2018 may be an important time to consider further transfers into such savings plans.

7. Owners of Pass-Through Entities May Get Relief: Business owners will have to closely analyze their business structure to determine they are effectively taking advantage of proposed laws that would allow a reported 20% deduction for pass-through income allocated to the taxpayer (equivalent 29.6% top tax rate for pass through income). It is still unclear if income levels would eliminate the deduction or if certain industries would be prohibited from taking the deduction. On a side note, be sure to pay all 2017 business entertainment expenses prior to 12/31/2017 as the deduction of entertainment costs will likely no longer be allowed.

8. Corporations Are the Winners: The proposals include a decrease of the Corporate Tax rate from 35% to 20% while broad speculation today indicates the rate may be slightly pushed up to 21%. Further, repatriated earnings may be taxed at 10-15%.

9. Federal Estate Tax May No Longer Be a Concern for Most: Over the last 15+ years, estate plans have changed numerous times as tax law has evolved. Next year may be the most important year yet to review personal plans and ensure they are still reasonable given the significant changes proposed in each plan below. Each plan would double the lifetime exemption amount to $10M allowing a married couple to transfer $20M tax free to their heirs. The combined bill may allow an exemption as high as $11M per taxpayer, or $22M per couple. The House Plan would also repeal the Estate Tax all together after 2023. The Generation-Skipping Transfer exemption would tentatively match the Estate Tax exemption.

SUMMARY OF THE CURRENT PLANS PASSED IN THE HOUSE AND THE SENATE:

SOURCE STRATEGAS (12/5/2017)

Strategas' Comparison Of House & Senate Tax Bills

Individual Provisions

Provision	House Bill	Senate Bill	Strategas' View
Individual Tax Rates	Four tax brackets at 12%, 25%, 35%, and 39.6%. The threshold for the top bracket is increased to $1mn for married taxpayers, and there is a clawback of the 12% income tax rate for incomes over $1mn. Indexed to chained CPI-U.	Seven tax brackets at 10%, 12%, 22.5%, 25%, 32.5%, 35%, and 38.5%. The threshold for the top bracket is increased to $1mn for married taxpayers. Indexed to chained CPI-U. Sunsets after 2025.	Senate version most likely to be included in final bill.
Personal Exemption/ Standard Deduction	Repeals the personal exemption, but increases the standard deduction from $12,700 for married individuals to $24,000. Indexed to chained CPI-U.	Repeals the personal exemption, but increases the standard deduction to $24,000 for married filers. Retains the enhanced standard deduction for the elderly and blind. Indexed to chained CPI-U. Sunsets after 2025.	Senate version most likely to be included in final bill.
AMT	Repeals.	Kept in place at last minute.	Repealed
Family/ Child Tax Credit	Creates a new Family Tax Credit that increase the child tax credit to $1,600 per child under 17, provides a $300 credit for each parent, and a $300 credit for non-child dependents. Limit on refundable portion remains $1,000. Phase-out is increased from $110,000 to $230,000 for joint filers.	Increases the child tax credit to $2,000 per qualifying child under 18 and provides a $500 credit for non-child dependents. Limit on refundable portion remains $1,000 and to receive refundable portion the Social Security number of each child must be included. Threshold for phase out increases to $500,000 for joint filers. Sunsets after 2025.	Senate version most likely to be included in final bill. We expect to see Senate amendments on this provision to make the credit even more generous.
SALT	Repeals the state and local tax deduction for income and sales taxes. Retains the deduction for property taxes up to $10k and for taxes paid or accrued in the carryout out of a trade, business, or producing income.	Repeals the state and local tax deduction for income and sales taxes. Retains the deduction for property taxes up to $10k and for taxes paid or accrued in the carryout out of a trade, business, or producing income.	Senate change on Friday brings closer to the House and $10k property tax deduction likely to remain while state income and sales taxes will no longer be deductible.
Estate Tax	Doubles the exclusion from $5mn to $10mn. Repeals the estate tax after 2023 and lowers the gift tax's top rate to 35%.	Doubles the estate tax and gift exemption to $10mn, but does not repeal it. Sunsets at the end of 2025.	Senate version most likely to be included in final bill.
Student Loans	Repeals the deductions for interest on student loans and qualified tuition and related expenses. Income from discharge of student debt due to death disability would no longer be included in taxable income.	Provides that income resulting from discharge of student debt due to death or total permanent disability would no longer be included in taxable income. Sunsets after 2025.	Senate version most likely to be included in final bill.

SUMMARY OF THE CURRENT PLANS PASSED IN THE HOUSE AND THE SENATE:

SOURCE STRATEGAS (12/5/2017)

Medical Expenses	Repeals	Last minute Senate changes allows 7.5% deduction for medical expenses.	Senate version most likely to be included in final bill.
Mortgage Deduction	Limits the mortgage deduction for newly purchased homes from $1mn to $500k, and permits the deduction for only a taxpayer's principal residence.	Maintains current law mortgage deduction, but repeals the deduction for interest on home equity indebtedness. Sunsets at the end of 2025.	Senate version most likely to be included in final bill.
Rehabilitation Credit	Repeals the rehabilitation credit for old and/or historic buildings	Repeals the 10% credit for pre-1936 buildings. Provides a 20% credit for qualified rehabilitation expenditures with respect to a certified historic structure and that the 20% credit be claimed ratably over a five-year period starting in the taxable year placed into service.	Senate version most likely to be included in final bill.
Electric Vehicle Tax Credit	Repeals electric vehicle, also known as plug-in, tax credit	Maintains current law	Senate version most likely
Carried Interest	Increases the holding period from one year to three years to qualify for the tax-advantaged treatment	Increases the holding period to three years for qualification as long-term capital gain.	Included
Retirement Accounts	No major changes	Consolidates contribution limits for employees in 457(b) plans and 401(k) or 403(b) plans by the same employer. Repeals allowance for additional elective deferrals and catch-up contributions under 403(b) and 457(b) plans. Repeals allowance for employer contributions to 403(b) plans for up to 5 years following employee termination. Limits contributions to qualified DC or 403(b) plans to the lesser of $54,000 or employee's compensation. Employees cannot make catch-up contributions to retirement accounts if wages of $500k or more were earned the preceding year. Repeals allowance of Roth or traditional IRA contributions to be recharacterized as the other.	Senate version most likely to be included in final bill.

SUMMARY OF THE CURRENT PLANS PASSED IN THE HOUSE AND THE SENATE:
SOURCE STRATEGAS (12/5/2017)

Cost Basis of Specified Securities	No changes	Requires that the cost of any specified security sold, exchanged, or disposed of beginning in 2018 is to be determined on a FIFO basis except to the extent that average basis method is allowed. Regulated investment companies (mutual funds, ETFs, and other RICs) are exempt.	The Senate version is likely to be included as revenue is short and other issues are taking precedence. One year phase in may be the best outcome for the brokerage industry.

Business Provisions

Provision	House Bill	Senate Bill	Strategas' View
REIT Dividends	Imposes a maximum tax rate of 25% on dividends received from a public or private REIT (applies to dividends funded out of rental income and interest)	Includes REIT dividends (other than any portion that is a capital gain dividend) as qualified income for the purpose of the 23% pass-through deduction. Combined with the decrease in the highest income tax level to 38.5%, the maximum tax rate on REIT dividends would be 29.6%.	Senate Bill
Pass-Through Income	Treats net income from passive business activity as business income and eligible for the 25% pass-through rate. Owners and shareholders with active business income can have 30% of income at the 25% rate with the remaining 70% subject to ordinary individual rates. Owners and shareholders could opt to use a formula if they believe passive income would account for greater than 30% of activity. Taxpayers actively participating in personal services businesses generally would not be eligible for the 25% tax rate. Also provides a 9% tax rate (phased in over 5 years) for the first $75k in net business taxable income for active shareholders or owners earning less than $150k (married) in taxable income from the pass-through business. The benefit is reduced for those earning more than $150k until it is phased out at $225k. Businesses of all types would be eligible for the preferential rate so long as income permits.	Provides for a 23% deduction of domestic qualified business income from partnership, S-corporation, or sole proprietorship structures. Deduction does not apply to services business unless taxable income does not exceed $500k for married couples with a phaseout over a $100k range from that level. Taxpayers with business income from sole proprietorships, partnerships or S-corporations are limited to a deduction of 50% of the W-2 wages of the partnership or S-Corp, or 50% of the W-2 wages of the sole proprietorship. The wage limit does not apply for taxpayers with taxable income of $500k or less (married jointly) or $250k (individuals). The wage limit is phased in over the next $100k for joint filers are $50k for individual. Provision sunsets at the end of 2025.	The Senate bill version is cheaper and likely to be included as the final provision. 29.6% tax rate for pass through income.

SUMMARY OF THE CURRENT PLANS PASSED IN THE HOUSE AND THE SENATE:

SOURCE STRATEGAS (12/5/2017)

Corporate Tax Rate	Lowers the rate to 20% beginning in 2018.	Lowers the rate to 20% beginning in 2019.	We expect a higher rate of around 22-23% beginning in 2018. Alternatively we may see a two-step phase in for 25% in 2018 and then to 20% in 2019
Corporate Alternative Minimum Tax	Repeals	Maintained	AMT was maintained at the last minute in the Senate. AMT will likely be repealed.
100% Business Expensing	Provides 100% expensing for capital equipment purchases for 5 years except for utilities and real property businesses. Provides for an additional year for certain property with longer production periods. Expands qualified property to used property provided it is the taxpayer's first use.	Provides 100% expensing for capital equipment purchases for 5 years except for utilities. Provides for an additional year for certain property with longer production periods. An additional 5 years was added at the last minute in the Senate.	Senate version most likely to be included in final bill.
Section 179 Expensing	Increases the threshold for 5 years for immediate expensing to $5mn with a phase-out increase to $20mn. Permanently adds qualified energy efficient heating and air-conditioning property to Section 179.	Increases the threshold for 5 years for immediate expensing to $1mn with a phase-out increase to $2.5mn. Expands the definition of property to include certain property connected to furnishing lodging and increases eligibility for certain improvements to nonresidential real property.	Senate version most likely to be included in final bill.
Net Interest Deduction	Limited to 30% of EBITDA, but exempts utilities and real property businesses.	Limited to 30% of EBIT, with carryforwards allowed indefinitely. Exempts utilities and real property businesses, but the limitation applies to pass-throughs at the partnership level. Farming businesses can elect to not be subject to the limitation if they use the alternative depreciation system for property with a recovery period of 10+ years.	House is making this a negotiating priority. While the Senate wants the House to accept the Senate version, if there is any negotiation, the House version will likely win out.

SUMMARY OF THE CURRENT PLANS PASSED IN THE HOUSE AND THE SENATE:
SOURCE STRATEGAS (12/5/2017)

Amortization of Research & Experimental Expenditures	Requires amortization over five years (instead of expensing) for research and experimentation expenses	Specified research and experimental expenditures must be capitalized and amortized ratably over five years beginning at midpoint of taxable year in which expenses were paid or incurred. Expenditures from research outside the US must be done over 15 years.	Senate version most likely to be included in final bill.
Cruise Ships	Maintains current law	Maintains current law	No changes to cruise ships
Orphan Drug Tax Credit	Repeals	Limits the tax credit to 27.5% of qualified clinical testing expenses (currently the credit is 50%)	
Advance Refunding	Repeals the tax exclusion for interest on advance refunding bonds for bonds issued beginning in 2018	Repeals the tax exclusion for interest on advance refunding bonds for bonds issued beginning in 2018	Repealed
Wind Tax Credit	Repeals inflation adjustment for electricity produced from renewable resources. The base amount of the PTC, generally available for wind facilities, is 1.5 cents/kilowatt hour so the tax payer's credit would revert to this level. The 30% ITC for small wind energy is available for construction beginning prior to 2020 and then phased out in 2021 and 2022. Extends the residential energy tax credit for energy efficient property to property put in place prior to 2022 with phase-outs beginning in 2021.	Maintains current law	Senate version most likely to be included in final bill.
`Like Kind Exchanges	Disallows a deferral of gain or loss on like-kind exchanges of personal property, but makes no change for real property, except in the exchange of real property held primarily for sale.	Disallows a deferral of gain or loss on like-kind exchanges of personal property, but makes no change for real property, except in the exchange of real property held primarily for sale.	House & Senate versions equivalent, included.

SUMMARY OF THE CURRENT PLANS PASSED IN THE HOUSE AND THE SENATE:
SOURCE STRATEGAS (12/5/2017)

Private Activity Bonds	Repeals the tax exemption for interest on newly issued PABs	Preserves PABs	Senate version most likely to be included in final bill.
University Endowments	Imposes 1.4% excise tax on net investment income of private colleges and universities with at least 500 students where the fair value of the institution's assets, and those assets formally held by related organizations at the preceding taxable year, is equal or greater than $250k/student.	Imposes 1.4% excise tax on net investment income for private colleges and universities with at least 500 tuition paying students where the fair market value of assets and assets of related organizations, at the preceding taxable year, other than assets directly used in carrying out the institution's exempt purpose, is equal or greater than $250k/student.	House & Senate versions equivalent, included.
Insurance	Modifies the operations loss deductions for life insurance companies; repeals the small life insurance company deduction; imposes an 8% surtax on life insurance income (which is a placeholder provision for other changes); repeals the special 10-year period for adjustments to take into account changes in a life insurance company's basis for computing reserves; changes the life insurance company proration rules; repeals the special rule for distributions to shareholders from pre-1984 policyholders surplus accounts; replaces the fixed 15% reduction in the reserve deduction for P&C insurance companies with a fixed 26.25% reduction; requires P&C insurance companies to use a higher rate to discount their unpaid losses; repeals the elective deduction and related special estimated tax payment rules; increases the capitalization rates for specified insurance contracts	Repeals the operations loss deductions for life insurance companies and allows the NOL deduction; repeals the small life insurance company deduction; changes the special 10-year period for adjustments to take into account changes in a life insurance company's basis for computing reserves to 4 years; repeals the special rule for distributions to shareholders from pre-1984 policyholders surplus accounts; replaces the fixed 15% reduction in the reserve deduction for P&C insurance companies with a reduction equal to 5.25% divided by the top corporate rate; repeals the elective deduction and related special estimated tax payment rules; extends the amortization period for specified policy acquisition expenses; imposes reporting requirements for life insurance contracts; provides that no adjustment is made for mortality, expense, or other reasonable charges incurred in determining the basis of a life insurance or annuity contract;	Senate version most likely to be included in final bill.

SUMMARY OF THE CURRENT PLANS PASSED IN THE HOUSE AND THE SENATE:
SOURCE STRATEGAS (12/5/2017)

International Tax Provisions

Provision	House Bill	Senate Bill	Strategas' View
International Tax System	Transitions to a 100% territorial tax system.	Transitions to a 100% territorial tax system.	Territorial tax system
Deemed Repatriation	Imposes at 14% for cash/cash-equivalents and 7% for plant and equipment.	Imposes at 14% for cash/cash-equivalents and 7% for plant and equipment.	Same provision. House has some language that could exempt some banking income for liquidity/fiduciary reasons
Base Erosion	Limits interest deduction for US corporations with foreign affiliates to the extent that the US corporation's share of global net interest expense exceeds 110% of the US corporation's share of global earnings EBITDA. Disallowed interest can be carried forward 5 years on a FIFO basis; Imposes a 20% excise tax on payments, besides interest, from a US corporation to a related foreign corporation that are deductible or included in a depreciable asset, unless the foreign corporation chooses to treat them as income related to US trade or business making them subject to full US taxation. Only applicable to international financial reporting groups with payments from a US corporation to foreign affiliates of at least $100mn annually; Subjects US parent of foreign subsidiaries to US taxation on 50% of the US parent's foreign high returns.	Reduces the interest deduction for US corporations with foreign affiliates by the product of US net interest expense and the debt to equity differential percentage of the worldwide affiliated group. Allows interest expense not deductible to be carried forward indefinitely; Denies the deduction for any interest or royalty amount paid from a hybrid transaction or to hybrid entity where there is no corresponding inclusion to the related party in its home country or if the related party is able to deduct the amount in its home country; Includes a patent box system, imposing a 12.5% tax on foreign income generated from intellectual property; Repeals the special code rules for DISCs and IC-DISCs; Prohibits shareholders who receive dividends from corporations which are defined as surrogate foreign corporations from being entitled to lower rates on qualified dividends.	Senate version most likely to be included in final bill.

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Elizabeth Mackie is a Managing Director and member of the Research Team at Edge Capital. Since joining Edge in 2007, she has been instrumental in working with some of our largest clients to build customized portfolio solutions, solve the unique challenges of multi-generational families, and build relationships with clients' trusted advisors. Elizabeth now focuses her time on building long-term client relationships as well as capital markets research, strategy due diligence, and idea generation that is implemented across Edge client portfolios.

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