



5 THINGS YOU
NEED TO KNOW ABOUT
TAX REFORM



HERITAGE
WEALTH MANAGEMENT

DISCLOSURES

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5 THINGS YOU NEED TO KNOW ABOUT TAX REFORM

Chapter 1 | Pg 5

Your Household Could Be Impacted

Chapter 2 | Pg 6

You Might Have a New Tax Bracket

Chapter 3 | Pg 7

Some of the Changes Will Expire

Chapter 4 | Pg 8

Businesses Could See Multiple Benefits

Chapter 5 | Pg 9

Overseas Holdings May Decrease

INTRODUCTION

The 2017 Tax Cuts and Jobs Act has triggered the most far-reaching overhaul of the U.S. tax code in more than 30 years.¹ But what does it mean for you?

In general, most Americans can expect a tax cut. The Tax Policy Center projects that taxes will fall for all income groups, increasing after-tax income by 1.5%. However, the Tax Policy Center warns that some individuals and households could actually see a higher tax bill.²

Businesses should benefit from a number of the changes, including a reduction in the top tax bracket from 35 percent to 21 percent. The Tax Foundation's Tax and Growth Model projects that Gross Domestic Product could increase by 2.86 percent over the next decade, or an average of 0.29 percent per year.³

The nature of any nation's tax system influences everyday decisions made by both individuals and businesses. These current changes provide an opportunity to review certain financial and investment strategies, and see how they may be influenced by the new tax rules.

In this guide we'll explore five ways you could be affected by the new tax laws. Keep in mind, this guide is for informational purposes only, and is not a replacement for real-life advice, so make sure to consult your tax, legal and accounting professionals before modifying your tax strategy.

YOUR HOUSEHOLD COULD BE IMPACTED

To help get a better idea of how the Tax Cuts and Jobs Act would impact taxpayers, the Tax Foundation created a sample tax return for six hypothetical households.⁴ The table below shows how the tax bill impacts each household in the group.

Figure 1: The Impact of the New Tax Rules on Six Hypothetical Households⁵

	JASON	AMBER	SOPHIE & CHAD	SOREN & LINNEA	LAURA & SETH	JOE & ETHAN
Ordinary Income	\$52,000	\$75,000	\$165,000	\$325,000	\$2,000,000	\$48,000
Marital Status	Single	Single	Married	Married	Married	Married
Earners	1 earner	1 earner	2 earners	2 earners	1 earner	Retired
Children	2 Kids	No Kids	2 Kids	3 Kids	2 Kids	No Kids
Tax-deferred Retirement Contributions	\$4,000	\$5,500	\$20,000	\$37,000	\$18,500	\$0
Itemization	Std. Ded.	Std. Ded.	Itemizing	Itemizing	Itemizing	Std. Ded.
Current Law	\$5,198	\$16,104	\$29,345	\$71,629	\$713,234	\$3,497
Proposed	\$3,306	\$14,327	\$27,122	\$62,012	\$694,330	\$3,227
Tax Liability Change	-\$1,892	-\$1,777	-\$2,224	-\$9,617	-\$18,904	-\$270
Tax Liability	-36%	-11%	-8%	-13%	-3%	-8%
Change in After-Tax Earnings	3.64%	2.37%	1.35%	2.96%	0.95%	0.56%

Source: Tax Foundation, 2017

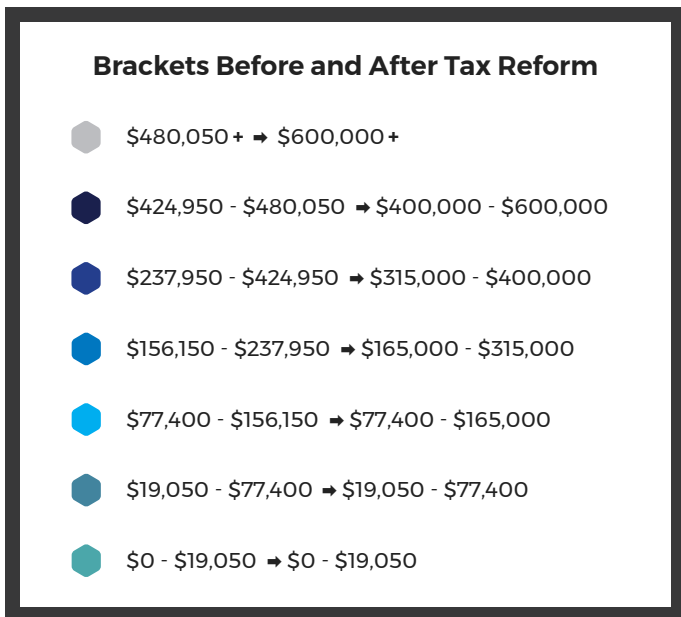
Here are some of the major changes for households:

- Near doubling of the standard deduction. Increases to \$24,000 for joint filers, \$18,000 for heads of household, and \$12,000 for single filers and elimination of personal exemption.
- A \$10,000 cap on the state and local tax deduction.
- A bump in the child tax credit and the expansion of eligible families. The child tax credit increases to \$2,000 while increasing the phaseout to \$400,000 for married couples.
- Mortgage interest deductibility limited to mortgages up to \$750,000 in principal value.
- 529 plans may now be used to fund elementary and secondary education.⁶
- Raises the exemption for the alternative minimum tax. For married filers, the increase is to \$109,400 from \$86,200, and the phaseout is increased to \$1 million.
- Elimination of the ability to “undo” a Roth conversion.⁷
- The estate tax exemption was raised to \$11.2 million, a doubling of the \$5.6 million that previously existed. Individuals benefiting from this change may want to re-evaluate the strategies they have in place to address the tax and liquidity issues related to their estate.

YOU MIGHT HAVE A NEW TAX BRACKET

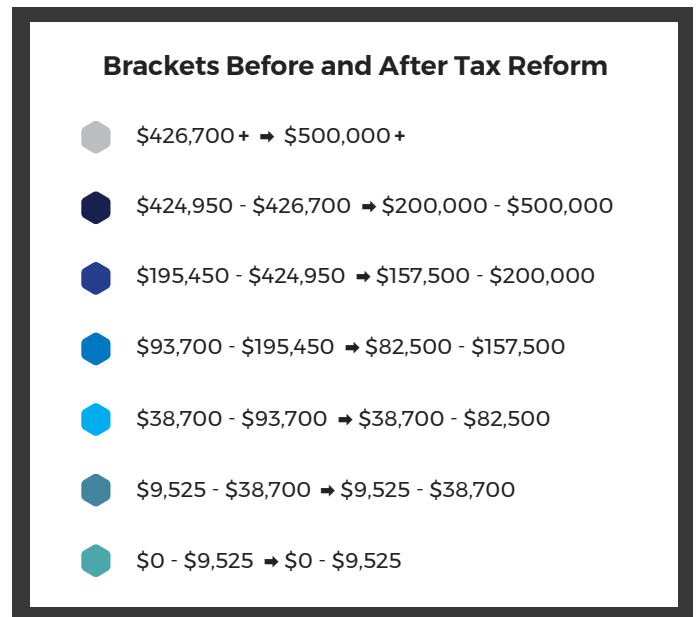
The Tax Cuts and Jobs Act lowers most individual tax rates. Most notably, it reduces the top marginal rate from 39.6 percent to 37 percent. The seven-bracket structure we're used to will remain intact, but the bracket widths themselves are modified (currently, these brackets are scheduled to expire in 2025). For now, take a look at the table below and see how the tax brackets are different in 2018.

Figure 3: Before and After Tax Brackets for Married, Filing Jointly

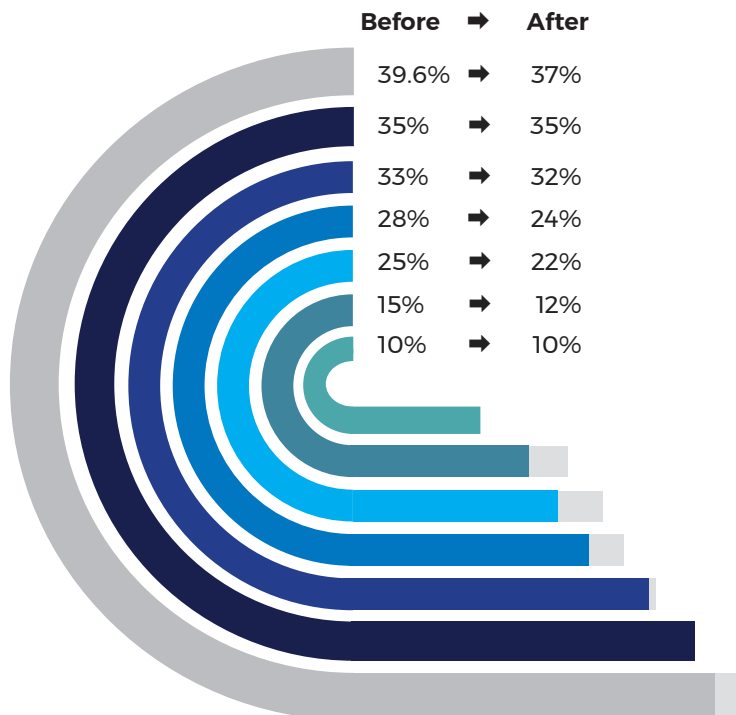


Source: Tax Foundation, 2017

Figure 2: Before and After Tax Brackets for a Single Filer



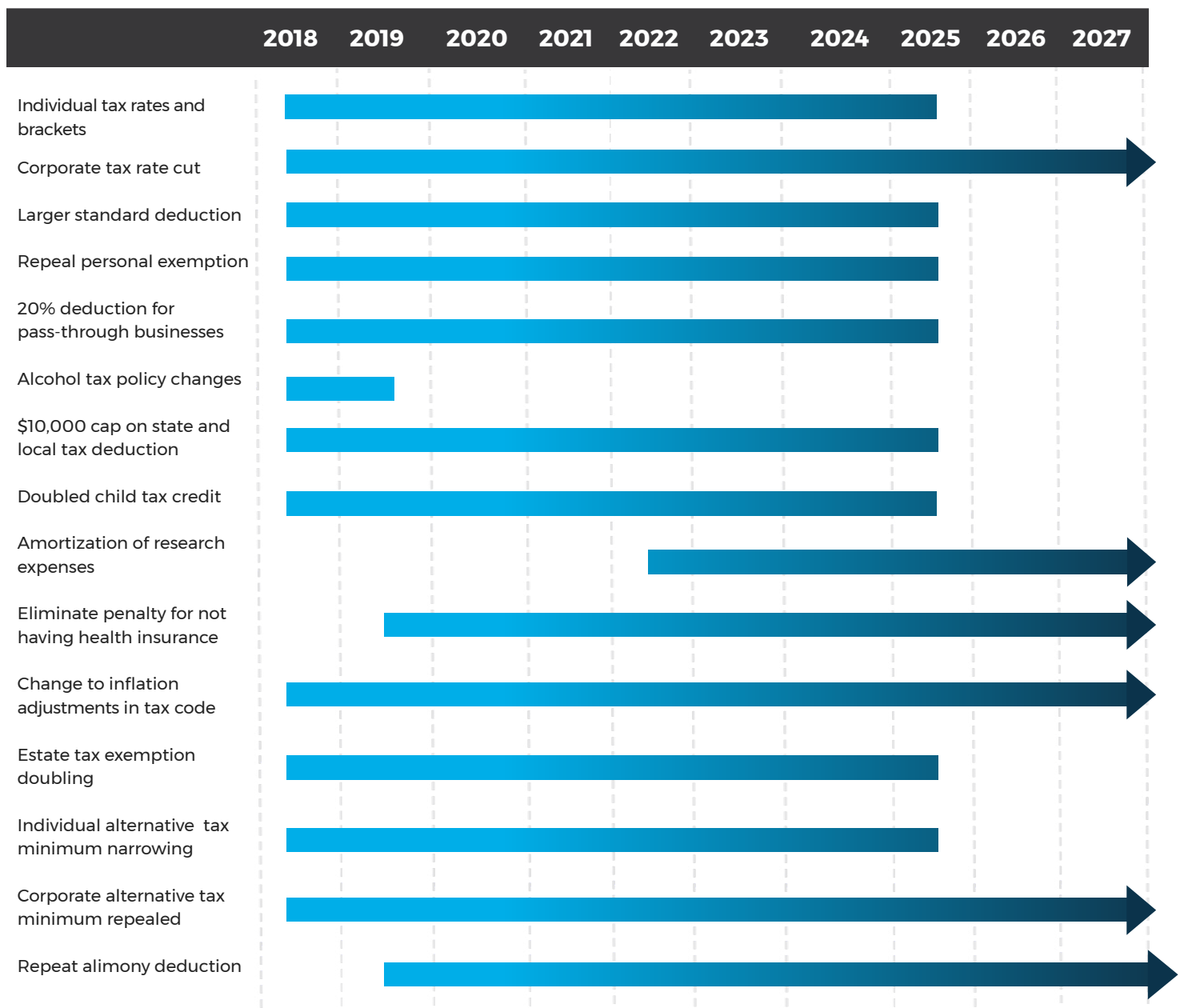
Source: Tax Foundation, 2017



SOME CHANGES WILL EXPIRE

To stay within the \$1.5 trillion, 10-year budget, lawmakers scheduled many of their tax cuts to expire. A couple of the key provisions expire in 2018 and 2019, while others are set to expire in 2025. The decrease in the corporate tax rate from 35 percent to 21 percent is permanent. This table below illustrates how the provisions are structured.

Figure 4: Expiration Dates for Certain Provisions



Source: The Wall Street Journal, December 17, 2017

BUSINESSES COULD SEE MULTIPLE BENEFITS

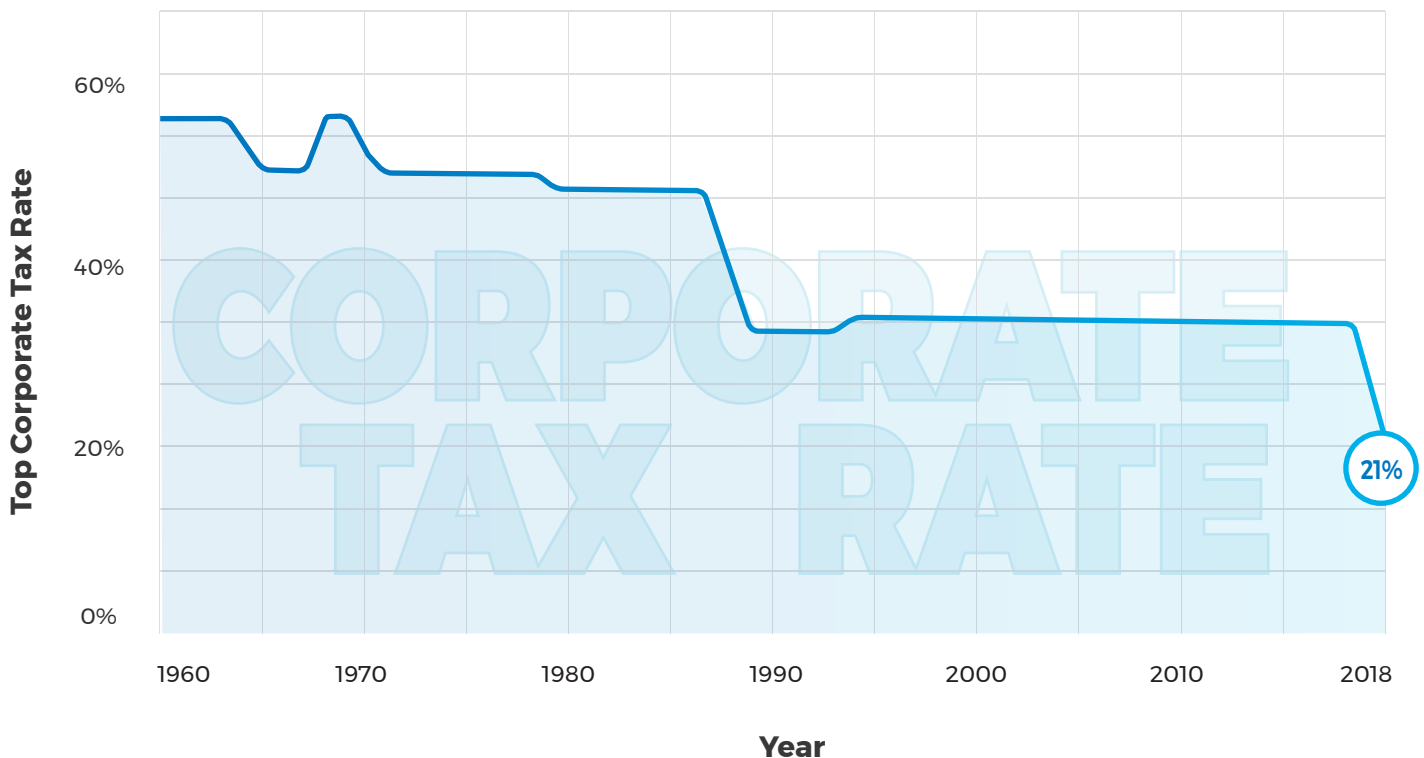
A major centerpiece of the Tax Cuts and Jobs Act is a reduction in the top corporate tax bracket, which is reduced from 35 percent to 21 percent. Unlike some of the changes for individual taxpayers that are set to expire, the corporate tax rate will be lowered permanently, starting in 2018.

Businesses may also benefit from a number of key changes, such as:

- Full and immediate expensing of capital investments (phased out after five years)
- Implementation of a territorial tax system to tax only income earned within the U.S.
- A special, one-time tax on repatriation of foreign holdings (see Section 5. Overseas Holdings May Decrease)
- Repeal of the corporate Alternative Minimum Tax (AMT)
- A 20 percent deduction of qualified business income for certain pass-through entities⁸

Figure 5: Lowering the the top marginal corporate tax rate⁹

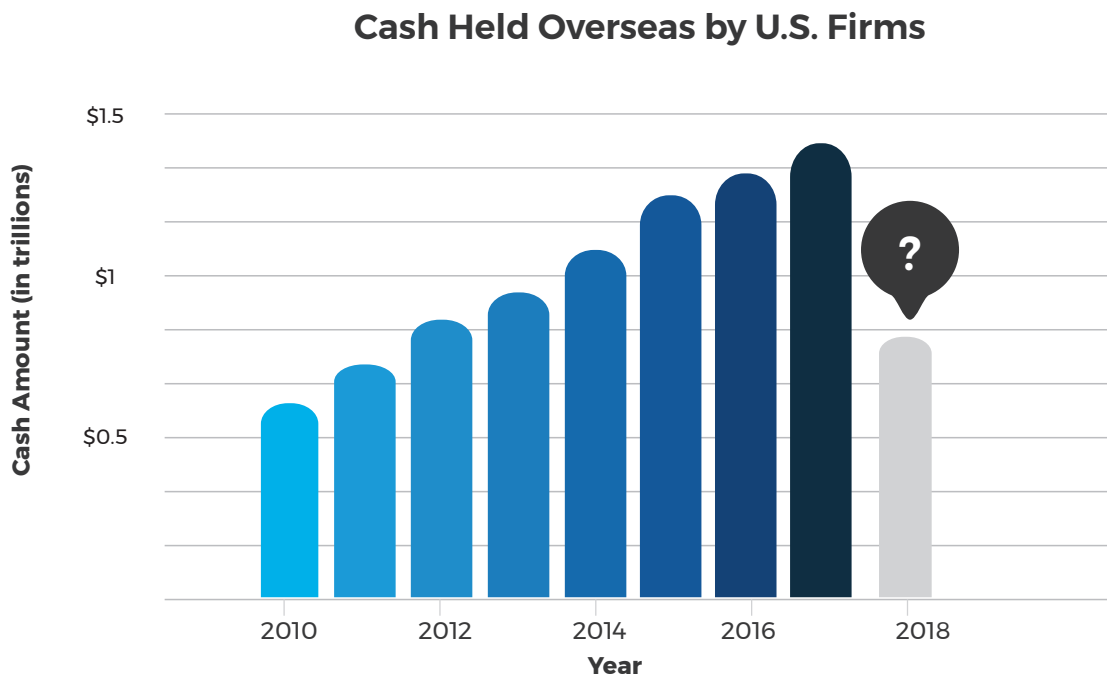
Source: The Tax Policy Center, Urban Institute & Brookings Institution, 2017



OVERSEAS HOLDINGS MAY DECREASE

At the end of 2017, approximately \$1.4 trillion was held in foreign countries by U.S. nonfinancial corporations.¹⁰ The Tax Cuts and Jobs Act created a new, one-time “transition tax” on an international firm’s accumulated overseas profits. The one-time tax is 15.5 percent for liquid assets (cash and cash equivalents), and 8 percent for physical assets.¹¹

Figure 6: A change in Overseas Holdings?



Source: The Wall Street Journal, December 6, 2017.

Lowering the tax to 15.5 percent could free up billions of dollars to return to the U.S. When American companies got the opportunity to bring foreign cash home at a lower tax rate in 2004, 94 percent of every repatriated dollar was returned to shareholders.¹¹

On the other hand, this windfall may prove far less exciting than in 2004. Companies may opt to repurchase shares, pay dividends, or expand operation in the U.S. In any event, it will be interesting to observe how many corporations do choose to take advantage of this opportunity to return overseas cash to the U.S., and how it might affect markets, shareholders, and workers.¹²

DISCLOSURES & SOURCES

Introduction

1. CNN.com, December 20, 2017
2. The Tax Policy Center, Urban Institute & Brookings Institution, 2017. The Tax Policy Center found that slightly more than 12 percent of taxpayers would see a tax increase relative to current law.
3. Tax Foundation, 2017. The 2.86 percent increase is over the current baseline forecasts.

Section 1

Figure 1 Source: Tax Foundation, 2017

4. Calculations in Figure 1 are specific to tax year 2018, and do not reflect the expiration of many individual provisions. Calculations exclude employer-sided payroll taxes.
5. With each household, certain assumptions were made to complete the tax return. For example, Sophie and Chad are a dual-income family with two children. The calculation assumes a \$340,000 home financed with a 30-year mortgage with 3.5 percent interest rate loan and a 20 percent down payment. Property tax rate is 1 percent, charitable contributions are 2.5 percent of income, and an effective state and local income tax rate of 5 percent. This particular hypothetical couple has \$20,000 in tax-deferred retirement contributions and can claim the full child tax credit.
6. The tax implications of 529 College Savings Plans can vary significantly from state to state, and some plans may provide advantages and benefits exclusively for their residents. Please consult legal or tax professionals for specific information regarding your individual situation. Withdrawals from tax-advantaged education savings programs that are not used for education are subject to ordinary income taxes and may be subject to penalties.
7. To qualify for the tax-free and penalty-free withdrawal of earnings, Roth IRA distributions must meet a five-year holding requirement and occur after age 59½. Tax-free and penalty-free withdrawal also can be taken under certain other circumstances, such as a result of the owner's death. The original Roth IRA owner is not required to take minimum annual withdrawals. The Tax Cuts and Jobs Act repeals the rules permitting the recharacterization of Roth conversions, effective starting in 2018.

DISCLOSURES & SOURCES

Section 2

Figure 2 Source: Tax Foundation, 2017

Figure 3 Source: Tax Foundation, 2017

Section 3

Figure 4 Source: The Wall Street Journal, December 17, 2017

Section 4

Figure 5 Source: The Tax Policy Center, Urban Institute & Brookings Institution, 2017.

8. Service industries (e.g., health, law, professional services) are generally excluded, except where income is below \$315,000 for joint filers and \$157,500 for other filers. This provision is set to expire December 31, 2025.
9. This graph portrays the top rate applicable at the federal level for domestic companies. Different rates apply to non-resident or foreign-owned companies.

Section 5

Figure 6 Source: The Wall Street Journal, December 6, 2017. Based on data compiled by Moody's Investor Services

10. The Wall Street Journal, December 6, 2017
11. The Heritage Foundation, December 19, 2017
12. The Wall Street Journal, December 29, 2017