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12 Common Questions on Tax Reform

Still unclear about how tax reform will affect you in 2018? Here we provide guidance on some of the most common questions.

April tax time has passed, leading many to wonder about next year and how 2018 returns will be affected under the new tax reform. Below are some of the most common questions we hear from clients and some planning considerations to help you address them.

Mortgage Interest Deductibility

I have read that mortgage interest will only be deductible for mortgages of $750,000 or less. I have an existing mortgage of $850,000. Can I still deduct all of my mortgage interest?

The new limit applies to mortgages taken out after December 15, 2017. As long as your existing mortgage was taken out prior to that date, it will be unaffected. The former limit of $1 million will continue to apply and, if you itemize, you should still be able to fully deduct the interest for income tax purposes on your $850,000 mortgage.

If I keep my existing $850,000 mortgage and then take out an additional mortgage, for example on a second home, what is my deduction limit?

If you decide to take out an additional mortgage, you would not be able to deduct the interest on it. This is because the new limit is $750,000 in total, and your existing mortgage of $850,000 already exceeds this amount.

What happens if I refinance my existing $850,000 mortgage?

If you refinance your existing mortgage which was taken out prior to December 15, 2017, the $1 million cap would still apply as long as you do not increase the mortgage amount.[1]

Home Equity Loans

I am considering a home equity loan (HEL) to pay for some home improvements. I read the interest is no longer deductible. Is that true?

The wording of the new law has been a source of confusion for many. Interest on HELs and home equity lines of credit (HELOC) is still deductible as long as the loans are used to buy, build, or substantially improve your home, and the amount of the loan or line, in combination with any other mortgage debt, does not exceed the new $750,000 limit. A substantial improvement is defined by the Internal Revenue Service (IRS) as adding value to the home, such as a kitchen remodel; prolonging the home's useful life, such as replacing the roof; or adapting your home to new uses.[2]

It will be important to have documentation on how the HEL or HELOC is used.

[1] If your existing mortgage matures prior to 12/31/2025, the $1 million cap only applies until the existing maturity date. Extending the term beyond the initial maturity date will not extend the $1 million cap (see IRC §163(h)(3)(F)(iii)(II)

[2] For specifics see IRS Publication 527 and speak to your tax advisor.

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What happens if I use a HEL or HELOC to cover a mix of expenses?

If, for example, you use a HEL or HELOC to pay for college, a trip to Aruba, and a new kitchen, only the interest paid on the portion used to cover the costs of the new kitchen may be deductible (subject to the $750,000 aggregate limit).

Important HEL/HELOC Facts

HELs are included in the new $750,000 mortgage cap explained above. Also HEL interest is only deductible if you use the proceeds to substantially improve the property you took the loan against. If you own two homes and you take the loan against home one, you cannot deduct the interest related to improvements made to home two.

If you have already used a HEL for something that under the new tax legislation is no longer deductible, you can no longer deduct the interest payments.

Gifting

I hear that the new tax law increased the amount I can gift without paying tax. Should I gift more to my family now?

The IRS has increased the annual exclusion gift limit from $14,000 to $15,000 in 2018. This means that you can gift up to $15,000 ($30,000 for a married couple who elects to split gifts) to anyone without gift tax consequences.[3] For those who wish to gift more, the new tax legislation effectively doubled the lifetime estate and gift exclusion amount to $11.18 million for an individual/ $22.36 million for a married couple in 2018.[4] This could create a window of opportunity to transfer assets, such as a business ownership or forgiveness of a loan.

Before you make additional gifts be sure that you have planned for your future needs because once you gift an asset, you cannot take it back.

Also there is still some question as to how the gifts you make now will be treated by the IRS in the future. For example, if you gift $11 million now but pass away when the exclusion amount falls back to an estimated $6.7 million, which is slated to happen in 2026[5], it is not clear if the IRS will seek to include the $4.3 million[6] when calculating your estate tax. It is anticipated that the IRS will issue regulations that will provide additional guidance on this in the near future.

If I decide to make gifts, what type of assets are best for gifting?

Determining which assets are best to gift is dependent on a number of factors. You should consult with your tax and legal advisors to determine what is best for you. For some, ownership of a family business can be a good candidate for gifting as it may accomplish other planning objectives, such as business transition goals. You may also want to consider forgiving an existing loan to a family member or to a trust for their benefit, such as a mortgage you took out for your children or grandchildren. You may want to focus on income tax minimization if estate taxes are no longer a concern for you due to

[3] Rev. Proc. 2017-58, October 19, 2017.

[4] Rev. Proc. 2018-18, March 5, 2018.

[5] Estate and Gift Exclusion amount is scheduled to increase every year based on inflation. The base exclusion amount (2010 dollars) is $5 million, $10 million under the Tax Cuts and Jobs Act.

[6] This occurs because prior gifts are added back to the gross estate to determine the amount subject to estate tax. (IRC §2001(b)).

the higher exemption limits. It is, however, important to remember the higher exemptions are not permanent.

How might tax reform affect the way I give to charity?

Philanthropy is most often driven by the desire to affect change and support organizations that are important to the donor.[7] If that is the case for you, then you should consider making or continuing your charitable gifts.

You may want to explore "bunching" charitable gifts in the years you itemize. Instead of gifting $10,000 per year, a $30,000 gift every three years, possibly through a donor advised fund or other vehicle, may increase your tax benefit. Those who itemize and make charitable donations consisting of a mix of cash and other assets may want to consider new tax provisions providing increased benefits for cash contributions.[8] There is no longer a limit on how much you can itemize.

How can I be sure the withholding from my paycheck is still accurate?

Because of the breadth of changes to this year's tax landscape, you may want to do more than rely on the new withholding tables. The IRS has put out an updated withholding calculator that uses a number of factors to provide a rough estimate of overall withholding and income taxes for 2018. It can be found at https://www.irs.gov/individuals/irs-withholding-calculator.[9]

I have set up 529 plans for my children's education. I have heard they can be used in expanded ways now.

529 plans have been expanded to allow tax-favored withdrawals of up to $10,000 per student per year for elementary and secondary school expenses, including tuition for public, private, or religious schools, but not home schooling.[10] Distributions should be coordinated for families with multiple plans for a single child to determine that this limit is not exceeded.

You can also now transfer funds in 529 plans to Achieving a Better Life Experience Act (ABLE) accounts for certain family members with special needs.[11]

Some states automatically conform to federal law to determine which distributions are qualified; others do not. This means not all states will allow tax-free distributions for elementary or secondary school tuition. If your state does not recognize this use, it may subject the distribution to state income tax and possible penalties including recapture of any tax deduction for contributions.

I have property in a trust. Do the taxes the trust pays count as part of the new $10,000 limit on the state and local tax (SALT) deduction?

If the property is held in trust for business (rental) or investment

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[7] US Trust, The 2016 US Trust Study of High Net Worth Philanthropy, October 2016.

[8] IRC §170(b)(1)(G) limits the deduction a taxpayer may claim for charitable contributions of cash. Prior to the tax reform legislation passed in 2017, the limitation was based on 50% of the taxpayer's adjusted gross income (AGI). Contributions in excess of this limitation may be carried over and deducted over the next five tax years. This limit for cash contributions has been increased to 60% of AGI, which is higher than the limit for charitable contributions of other types of property.

[9] This calculator is a simplified estimate and should not replace a discussion with your tax advisor, but it may provide a place to start the conversation.

[10] IRC §529(c)(7).

[11] IRC §529(c)(3)(C)(i)(III).

purposes, the real estate taxes are deductible by the trust and are not subject to the $10,000 limit. If the property is not held for business or investment purposes, a trust that has land as an asset and pays its own income tax (a non-grantor trust) can deduct real estate taxes as part of the SALT deduction, up to $10,000. If the trust is a grantor trust, which does not pay its own income tax, it cannot.

Some are suggesting it may make sense to put multiple properties in individual trusts to garner multiple $10,000 deductions. In our opinion, this should be considered with extreme caution.

Conclusion

Tax reform is certainly complicated. And you will likely have more questions, particularly as the Treasury and IRS provide further guidance on the legislation. Now that 2017 tax filing season has come to a close for many, it's a good time to review your wealth plans with your advisors.

For more information, please contact your PNC advisor.

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