Sentinel Trust
Together, families prosper℠

OnWatch

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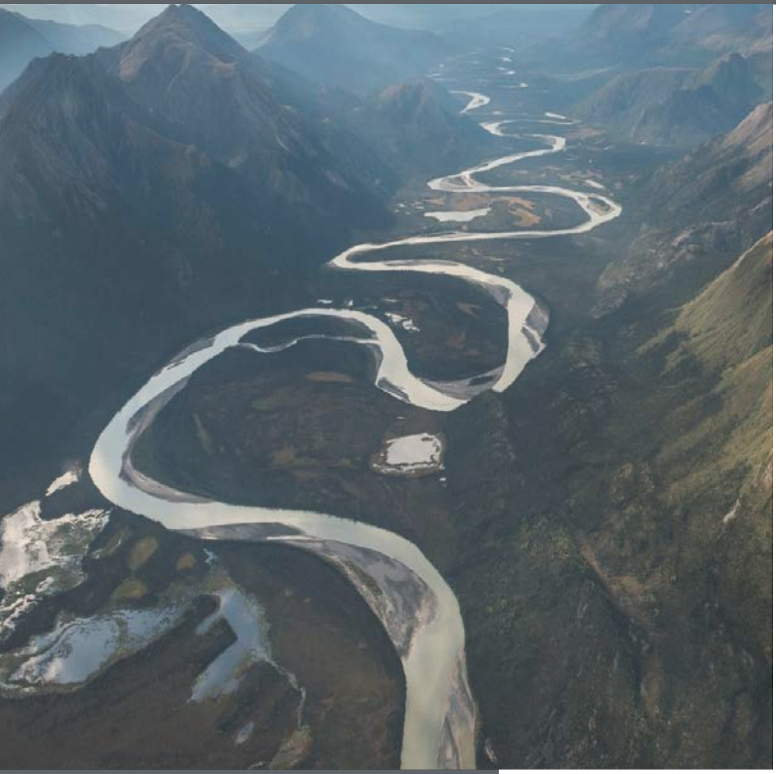

# NAVIGATING THE WATERS OF TAX REFORM

**DAVID ZAHN, CPA, CFP®**
*Vice President and Shareholder*
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**On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act of 2017 (TCJA). This is significant legislation, and a tax bill of this magnitude has not been enacted since 1986. Given the sweeping nature of this legislation, all taxpayers are affected.**

The TCJA is far from the tax simplification that many had hoped. It leaves the Internal Revenue Code as extensive and complex as ever. Given its newness and the lack of IRS guidance, legislators and practitioners are still trying to unpack many of the intended and unintended consequences of these changes. *Chart A* provides a few highlights of this legislation.

Some additional changes include:

- **Mortgage Interest Deduction:** As noted in the chart, mortgage interest deductions are limited. Mortgages in existence prior to December 16, 2017 are grandfathered. With some constraints, a refinancing will not cause loss of grandfathered status. Interest on home equity lines of credit (whether pre-existing or new) will no longer be deductible.

- **State and Local Income Tax Deduction:** Limited to a maximum combined deduction of $10,000 (These include state income tax, state and local property tax, and sales tax.)

## In This Issue:

Chart A:

| | Previous Law | Law under the Tax Cuts & Jobs Act (Effective January 1, 2018) |
|---|---|---|
| Individual Tax Rates | Seven (7) tax brackets with the highest rate of 39.6% | Seven (7) tax brackets with lower rates and higher thresholds. Highest rate of 37% |
| Corporate Tax Rates | Maximum rate of 40% | Maximum rate of 21% |
| Trust Tax Rates | Maximum rate of 39.6% on income over $12,500 | Maximum rate of 37% on income over $12,500 |
| Alternative Minimum Tax | Limits tax benefits for higher income earners and some corporations | Increases exemption and phase-out amounts for individuals (reduces number of people required to pay); repeals corporate AMT |
| Estate, Gift, and Generation Skipping Tax Exemptions | 2017 exemption of $5.49M | Increases exemption to $10M, indexed for inflation ($11.18M for 2018) |
| Pass-through Business Income (S-Corporations, LLCs, LLPs, and Partnership /Sole Proprietors) | Taxed at taxpayer's income tax rate | 20% deduction allowed on qualified business income; limitations apply on personal service businesses |
| Home Mortgage Interest Deduction | Allows deduction of interest on first $1M of a mortgage | Limits deduction to interest on first $750K of a mortgage |
| Affordable Care Act Individual Mandate Penalty | Penalties exist for failure to maintain minimum essential coverage under ACA | Reduces penalty to $0 |

- **Limitation on Itemized Deductions (Pease Limits)**: These limits on the overall itemized deductions of higher income earners are repealed starting this year.
- **Miscellaneous Itemized Deductions**: Deductions for expenses like tax preparation fees and investment advisory fees (that were reduced by 2% of adjusted gross income) will no longer be allowed.
- **Section 529 Plans**: Previously limited to college expenses, annual distributions of up to $10,000 per student may be made for qualified elementary or secondary school expenses.
- **Standard Deduction:** Doubles to $12,000 for individual tax filers and $24,000 for joint filers.
- **Personal and Dependency Tax Exemptions**: Deduction is disallowed.

Because of its broad and sweeping nature, it is difficult to generalize who will clearly benefit and who will be negatively impacted. In general, high-income taxpayers will benefit from the reduction of personal income tax rates and expanded income tax brackets, the deduction available on qualified pass-through business income, and the doubled estate and gift tax exemption.

### Timing Itemized Deductions

You may get less or no benefit from itemized deductions due to the combination of the increased standard deduction, the $10,000 limit on state and local taxes, the repeal of miscellaneous itemized deductions, and the limited mortgage interest deduction.

Periodically bunching multiple years of charitable contributions into a single year can increase tax savings. To explain, suppose you and your spouse typically contribute $10,000 per year and pay $10,000 or more each year in state and local taxes. You have no mortgage interest. Because your combined itemized deductions ($10,000 contributions and no more than $10,000 taxes) are less

Because your combined itemized deductions ($10,000 contributions and no more than $10,000 taxes) are less than the $24,000 standard deduction, you use the standard deduction, meaning you get no benefit from your itemized deduction. If you instead delay your 2018 contributions and make them in 2019, you can combine them with your 2019 contributions and taxes for a total of $30,000 of itemized deductions. You get the benefit of the 2018 standard deduction of $24,000, plus a $30,000 deduction in 2019 for a total over two years of $54,000. That's better than $24,000 per year for a total of $48,000. You then repeat this process in 2020 and 2021. If you pay less than $10,000 of state and local taxes annually, you might benefit from bunching up to $10,000 into one year, but you must be careful to avoid late payment penalties.

*"Because of its broad and sweeping nature, it is difficult to generalize who will clearly benefit and who will be negatively impacted. In general, high-income taxpayers will benefit from the reduction of personal income tax rates and expanded income tax brackets, the deduction available on qualified pass-through business income, and the doubled estate and gift tax exemption."*

You should also consider using a donor advised fund to help with bunching contributions. You can make several years' worth of contributions to the fund (to receive the deduction) and then parcel out the money to the ultimate charities over the succeeding years.

## Rental Properties

The $10,000 cap on the sales, state income, and real estate tax deduction could encourage taxpayers to rent their secondary homes for a portion of the year. Renting causes a proportionate part of the property taxes to become deductible against rental income separate from the $10,000 cap regime. The property must be rented at least 15 days of the tax year to qualify.

## IRA Qualified Charitable Contributions

Taxpayers who have attained 70½ should consider making charitable contributions directly from their IRAs. Doing so avoids the income recognition from an otherwise taxable distribution, while still satisfying required minimum distributions for the year. Although such contributions are limited to $100,000 annually, this is a much more attractive tax play for taxpayers who no longer itemize deductions because of the increased standard deduction amount.

## 529 Plans

Currently, some 30 states offer state income tax deductions for contributions made to a 529 Plan. For those facing state income tax and wanting to fund children's, grandchildren's, or others' education, look to opening a 529 Plan in a state where the deduction can be used to reduce state income taxes (reducing state income taxes is even better than getting a deduction for them for federal purposes.) A lump-sum contribution to a 529 plan of up to five (5) times the annual exclusion amount can be made ($75,000 for 2018) for each beneficiary. Married couples can double that amount.

## Lifetime Gifting

Because of the increased gift, estate, and generation skipping tax exemptions ($11.18 million for singles and $22.36 million for married couples), there is an opportunity to increase lifetime and annual exclusion giving. These exemptions decline by about half (returning to roughly their 2017 levels) for gifts and estates after 2025. You should strongly consider using these increased amounts before then (or even earlier if political party control of the presidency and congress changes in the interim).

Unfortunately, the first taxable gifts made eat up the portion of the exemption that will not disappear. For example, if a single person makes taxable gifts anywhere between roughly $5.6 million and $11.2 million, she will have no remaining exemption come 2026. Alternatively, if she makes only $5 million of taxable gifts in that period, she will have only about $600,000 remaining exemption in 2026. So, it's better to use the full $11.2 exemption before the expected decline.

It is important to keep in mind that this tax bill was passed under budget reconciliation procedures. These procedures allowed the Republicans to pass the bill without the threat of a filibuster. However, they also required that the legislation not increase the Federal deficit by more than $1.5 trillion during the 10-year period of the budget. As a result, much of this tax legislation is scheduled to expire on December 31, 2025.

Given the sunset and the current lack of IRS interpretation and guidance, we generally recommend going slowly with changes to your estate plan or business entity structures. The complexities of the new law clearly make it even more important to involve tax, legal, and financial advisors in your planning.

**At Sentinel Trust, we take a holistic view of tax, estate, investment, family business, governance, and philanthropic goals, coupled with watchful eye over key regulatory developments, to devise and cultivate highly customized wealth plans for every client. Contact your Senior Relationship Officer to let us know how we can help you navigate the changing landscape of tax reform.**

# IMPACTS
## *of Rising Interest Rates*

**CULLEN BROCK**
*Client Investment Advisor*

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*Vice President and Shareholder*
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> Interest rates lie at the center of finance, influencing decisions to save or invest and affecting everything from corporate capital structures, government spending policy, currency exchange rates and the family balance sheet.

In the United States, the Federal Reserve Bank (Fed) influences interest rates by setting the rate for all banks to lend to each other. Typically, during times of economic stress, interest-rate benchmarks remain low to create a more accommodative environment for lending and borrowing.

Throughout the years following the Great Financial Crisis of 2007-2008, the Fed deliberately kept rates at low levels to stimulate economic growth with low borrowing rates. As economic conditions have improved, the Fed has begun raising rates after a prolonged period of holding them near zero.

### Portfolio Management Implications

Interest rate movements have implications for tactical positioning within investors' asset allocations because rate levels influence the relative attractiveness of one asset class over another. The Fed has forecast several interest rate increases this year and in 2019. So, investors need to consider how higher rates will affect their portfolios.

When rates were near zero, income-sensitive investors moved out of bonds and into dividend stocks, real estate investment trusts (REITS), and master limited partnerships. While these investments added income, they also came with higher risk than traditional bonds. Rising rates attract investors back to bonds. As a result, funds flow out of assets like equities to purchase higher-coupon-paying new-issue bonds.

While rising interest rates generally mean a sound economic environment, one side effect is a decrease in the market value of existing bond positions. Why? Because as rates rise, newly issued bonds generally will pay higher interest rates than bonds that were issued in a lower-rate environment. Therefore, investors are willing to pay less for bonds with older, lower coupon rates and more for bonds with current, higher coupon rates. Some other asset classes historically have exhibited price sensitivity to interest rates. REITs and higher yielding stock sectors like utilities and telecommunications tend to be priced based in part on their steady dividend payouts. As interest rates rise, those payouts become less attractive relative to the higher bond-interest rates. Conversely, financial-sector stocks can be potential beneficiaries of a rising rate environment because those companies' profit margins should improve, resulting in stock-price appreciation.

### Family Finance Considerations

Of course, rising interest rates also can affect family finances. Borrowers should be aware of the payment terms of any outstanding loans, especially those with variable rates. Those will rise as other market-based rates rise. Loans that may be tied to adjustable interest rates include credit cards, student and auto loans, and adjustable rate mortgages.

Homeowners with adjustable rate mortgages must be particularly wary. These mortgages usually entice borrowers with an initial period of lower-than-prevailing rates. At the expiration of this introductory period, the lender has the right to adjust the rate to a new level consistent with the then prevailing market. As market rates rise, borrowers are likely to be unpleasantly surprised when their rates are reset, potentially much higher, for the duration of the loan. Refinancing to a fixed-rate structure while rates are still historically low is a great option for many borrowers. Some might be better served by refinancing to another adjustable rate mortgage to extend the duration of the introductory rate.

With about a decade of declining and low interest rates, many people have forgotten the potential impacts—both good and bad—of rising and higher rates.

**We recommend that you speak with your Client Investment Advisor to determine the risks and opportunities they present to you.**

# Is Wealth Planning a Team Sport?

**LESLIE KIEFER AMANN, JD**
*Senior Vice President and Shareholder*
*Chief Fiduciary Officer*

It's hard to imagine any professional endeavor where the odds of success are increased by "going it alone." The coach needs a team; a director needs a cast and crew; even the strongest leader needs followers. Unfortunately, the business of wealth planning seems to have more than its share of dedicated loners unwilling or unable to collaborate with other professionals. That's unfortunate because families benefit from having a cooperative team of experts who communicate and work together for the best interests of the family.

At a minimum, a wealth planning team will need advisors with management, tax, legal and accounting expertise. But many families also need advisors with experience in philanthropy, someone who understands corporate and family governance, an expert with deep knowledge of the insurance industry, or advisors who manage special assets such as real estate, minerals or art. Some families need someone who can mediate internal disputes or help family members who have special needs.

The wealth planning world has become increasingly complex. Even if one individual has expertise in several areas, there are no wealth planning superheroes able to leap tall buildings and provide everything a family with complex wealth might need. That's why professional trustees assemble a team and then continue to introduce new members with new areas of expertise.

Some clients find this approach uncomfortable. (Some advisors do too.) After all, often the wealth was created by a maverick entrepreneur who plunged into a venture never tried before and without any help. Such grit and determination are rarely combined with patience for what can seem like "action by committee." Such people usually are reluctant to trust anyone else with control. But there is a great difference between the skills required for the generation of wealth and those best suited to the preservation, planning and transfer of wealth.

A collaborative approach to wealth planning and management provides many advantages. A family with several advisors working together on a problem and bringing a variety of resources to the process can undertake more sophisticated solutions with greater confidence. Recall the old expression: When all you have is a hammer every problem looks like a nail. A family with a corporate tax issue and only an accounting advisor might explore only accounting solutions. But a tax issue might be better resolved by a change in legal structure, a shift in the allocation of investments, or even the purchase of life insurance or some other transaction to hedge or delay the payment of the tax.

Existing advisors are more likely to know specialists in needed fields and will have resources to verify their credentials. They may have specific experience with another specialist who will know what works and what does not; that can reduce the amount of time required to create and implement a plan and increase the chance of success.

Surprisingly, collaborative planning can reduce costs. When the entire team participates in a discussion, there is less chance of miscommunication, fewer meetings are needed, and delegation between advisors is more effective. The possibility of mistake is reduced by virtue of having more than one set of eyes reviewing documents and transactions. And, when a team of dedicated professionals has worked together to craft a plan, the client is more likely to go forward and execute with confidence.

The ultimate goal of a true collaborative approach to wealth planning is to build a team that can do much more for your family than any individual advisor could do – to build a whole that is greater than the sum of its parts.

Is wealth planning a team sport? We think so.

Sentinel Trust Company is a family-owned, multi-family office focusing on the unique needs of affluent families and their closely held companies and foundations. Sentinel Trust provides advice on investment, tax, and estate strategies, serves as corporate trustee, and provides lifestyle services with a personal touch.

*Together, families prosper* SM

Founded in 1997 as the successor to two established, investment-focused single family offices, Sentinel Trust offers the stability of an institutional firm, the entrepreneurial spirit of a young firm, the personal feel of a family office and the in-house technical skills of independent planning and investment management firms.



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