Trumping Uncertainty

Examining the Implications of the ~~Heir Cuts and Odd Jobs Act~~ Tax Cuts and Jobs Act

Thomas J. Pauloski, J.D.
National Managing Director
Wealth Planning and Analysis Group

Bernstein does not provide tax, legal, or accounting advice. In considering the information contained in this presentation, you should independently verify all conclusions before implementing any strategy on your own behalf or on behalf of your client.

Comparative Highlights of Prior Law and "The-Legislation-Formerly Known-As-the-Tax-Cuts-and-Jobs-Act"

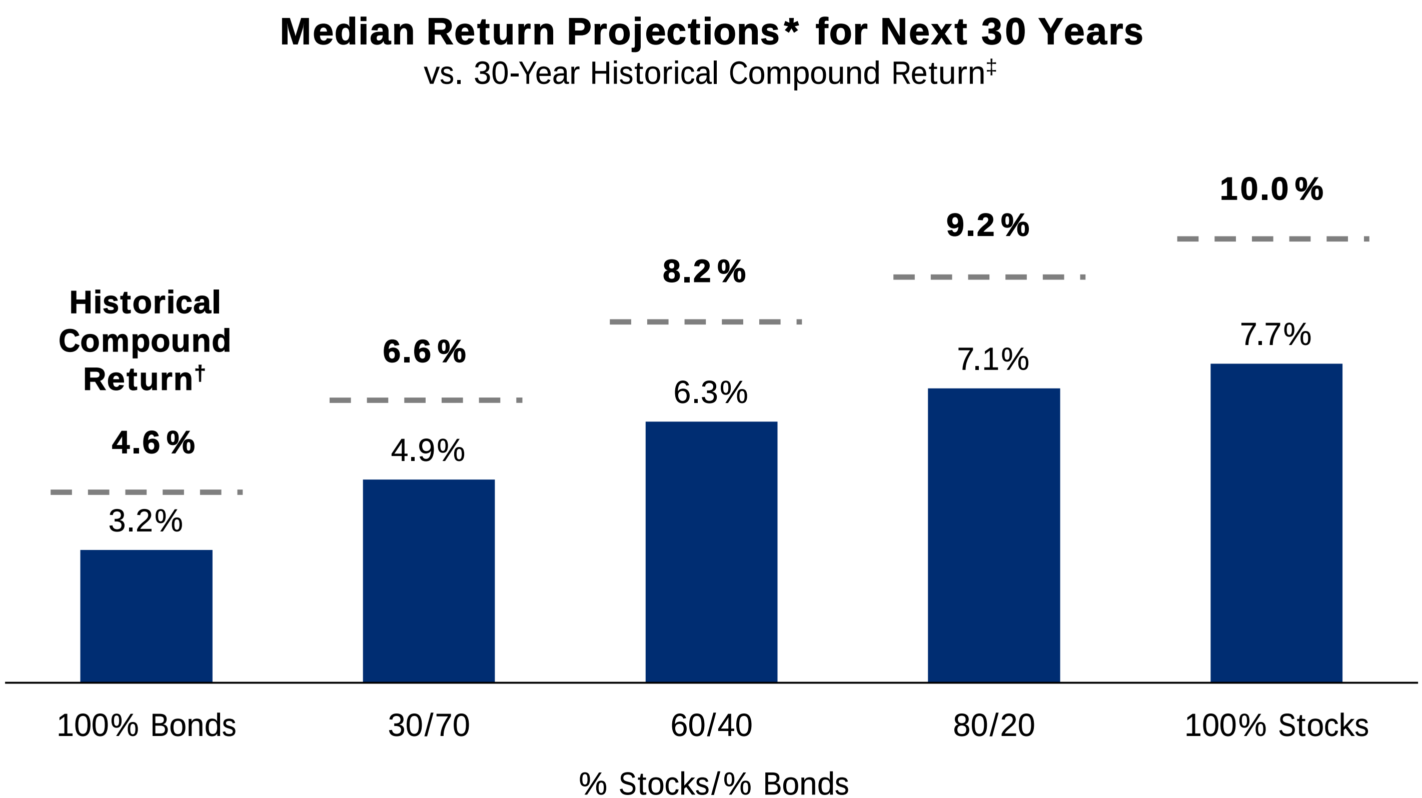
ATRA, et al.

	2017	2018
Top marginal corporate income tax rate	35%	21%
Top marginal individual income tax rate	39.6%	37%, but up to 20% of domestic qualified business income is deductible
Surtax on net investment income	3.8%	Same
Nonitemizers	Combination of standard deduction and personal exemptions	2x standard deduction; personal exemptions eliminated
Itemized deductions	Subject to "3% cutback"	"3% cutback" and most deductions repealed; state and local tax deduction limited to $10,000 per year
Estate and GST taxes	$5.49M inflation-indexed exclusion; 40% "flat" rate	Same, except 2x prior basic exclusion amount through 2025
Step-up in income tax basis at death	Applies to all decedent's estates	Same

Sources: https://www.congress.gov/congressional-report/115th-congress/house-report/466/1?overview=closed and AB

Tax-Efficient Investing

Future Returns Are Likely to Be Lower . . .



Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed. **Data do not represent past performance and are not a promise of future results or a range of future results**. See Appendix, Notes on Wealth Forecasting System, for details.

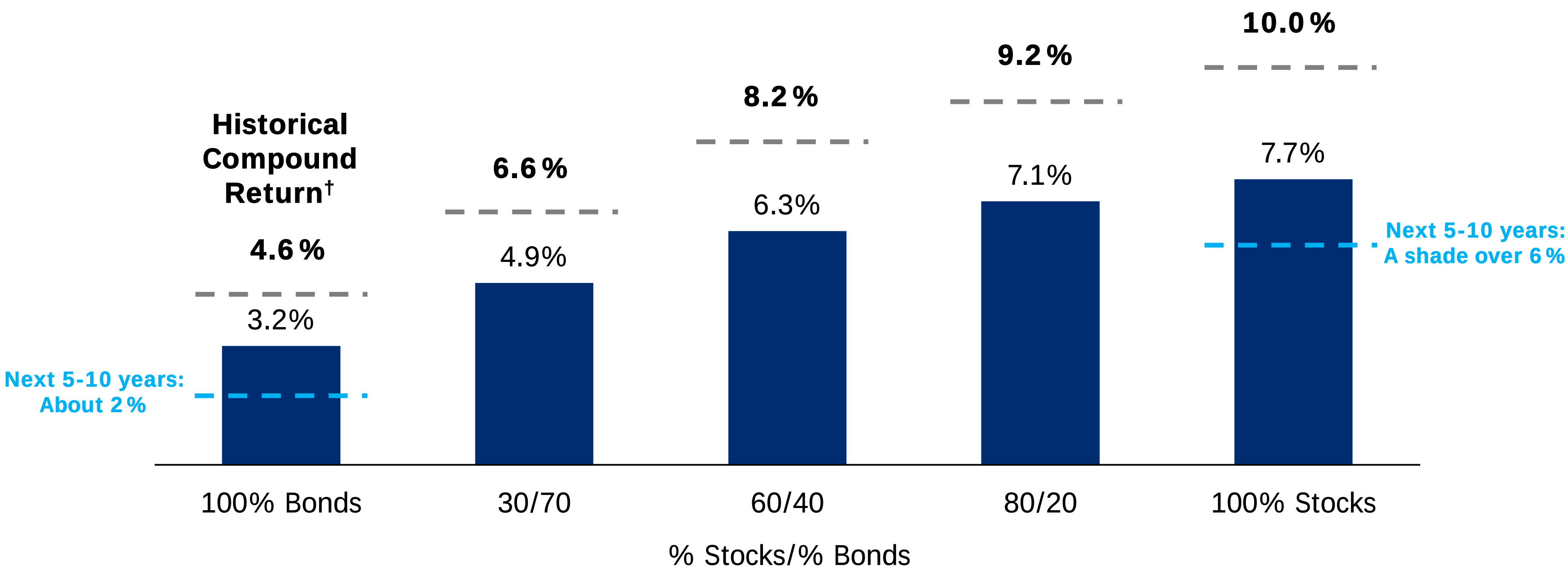
*Projected pretax 30-year compound annual growth rate. Stocks (or "global equities") are modeled as 21% US diversified, 21% US value, 21% US growth, 7% US small-/mid-cap,22.5% developed international, and 7.5% emerging-market stocks, and bonds are modeled as intermediate-term diversified municipal bonds. Reflects Bernstein's estimates and the capital-market conditions as of December 31, 2015.

‡Historical compound return calculated from January 1, 1986, through December 31, 2015 with equities represented as follows: 70% S&P 500 and 30% MSCI EAFE from 1986 through 1987, and 70% S&P 500, 25% MSCI EAFE, and 5% MSCI EM thereafter; bonds represented by the Lipper Short/Intermediate Municipal Bond Fund Average.

Sources: Lipper, MSCI, Standard & Poor's, and AB

. . . Especially in the Next 5-10 Years

Median Return Projections* for Next 30 Years
vs. 30-Year Historical Compound Return‡



Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed. **Data do not represent past performance and are not a promise of future results or a range of future results**. See Appendix, Notes on Wealth Forecasting System, for details.

*Projected pretax 30-year compound annual growth rate. Stocks (or "global equities") are modeled as 21% US diversified, 21% US value, 21% US growth, 7% US small-/mid-cap,22.5% developed international, and 7.5% emerging-market stocks, and bonds are modeled as intermediate-term diversified municipal bonds. Reflects Bernstein's estimates and the capital-market conditions as of December 31, 2015.

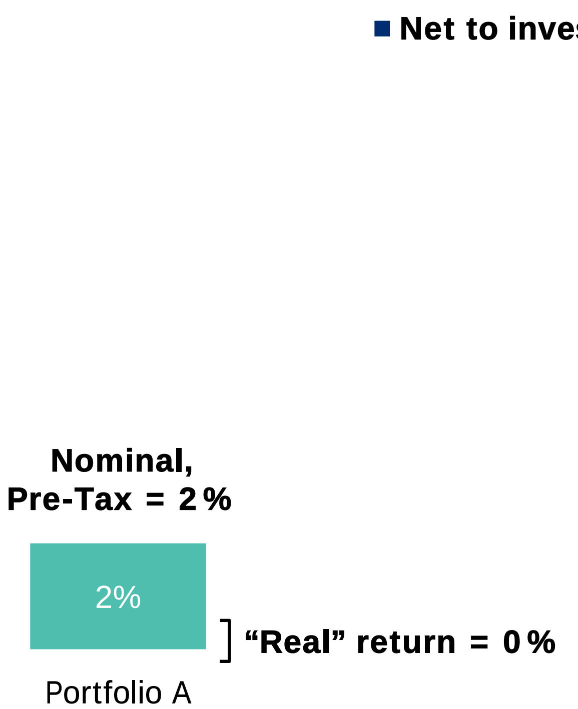
‡Historical compound return calculated from January 1, 1986, through December 31, 2015 with equities represented as follows: 70% S&P 500 and 30% MSCI EAFE from 1986 through 1987, and 70% S&P 500, 25% MSCI EAFE, and 5% MSCI EM thereafter; bonds represented by the Lipper Short/Intermediate Municipal Bond Fund Average.

Sources: Lipper, MSCI, Standard & Poor's, and AB

Which of the Following Portfolios Do You Like Best . . .
A Tax-Exempt Portfolio that Barely Keeps Up with Inflation?

Hypothetical Portfolio Returns, Net of Inflation and Income Taxes*

Assumes:
- 2% Inflation
- 50% Ordinary Income Tax Rate
- 33% Long-Term Capital Gain Tax Rate



Data do not represent past performance and are not a promise of future results or a range of future results.

*"Portfolio A" means hypothetical tax-exempt portfolio that is expected to return 2% per year over the illustrated period; "Portfolio B" means hypothetical portfolio that is expected to return 6% per year over the illustrated period with all returns characterized as qualified dividends and long-term capital gains and taxed at long-term capital gain tax rate; "Portfolio 3" means hypothetical portfolio that is expected to return 10% per year over the illustrated period with all returns characterized as ordinary income and short-term capital gains and taxed at ordinary tax rate.

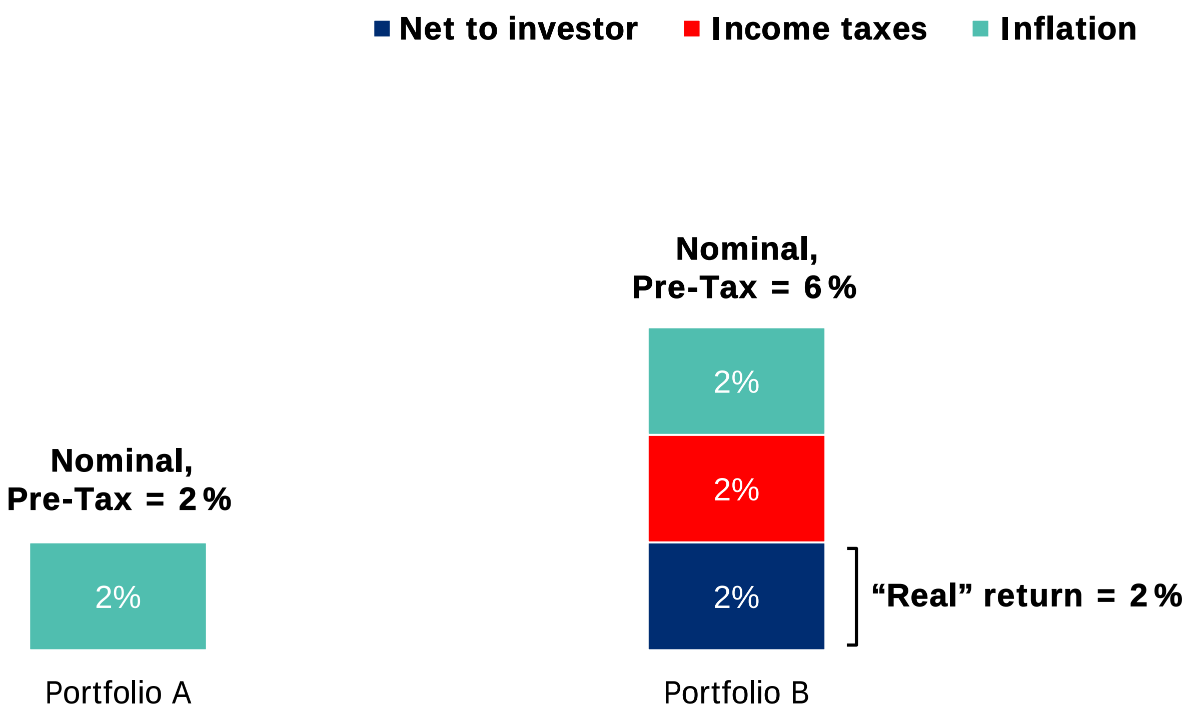
Source: AB

. . . A Higher-Returning Portfolio that Loses Two-Thirds of Its Return to Inflation and Taxes?

Hypothetical Portfolio Returns, Net of Inflation and Income Taxes*

Assumes:

- 2% Inflation
- 50% Ordinary Income Tax Rate
- 33% Long-Term Capital Gain Tax Rate



Data do not represent past performance and are not a promise of future results or a range of future results.

*"Portfolio A" means hypothetical tax-exempt portfolio that is expected to return 2% per year over the illustrated period; "Portfolio B" means hypothetical portfolio that is expected to return 6% per year over the illustrated period with all returns characterized as qualified dividends and long-term capital gains and taxed at long-term capital gain tax rate; "Portfolio 3" means hypothetical portfolio that is expected to return 10% per year over the illustrated period with all returns characterized as ordinary income and short-term capital gains and taxed at ordinary tax rate.

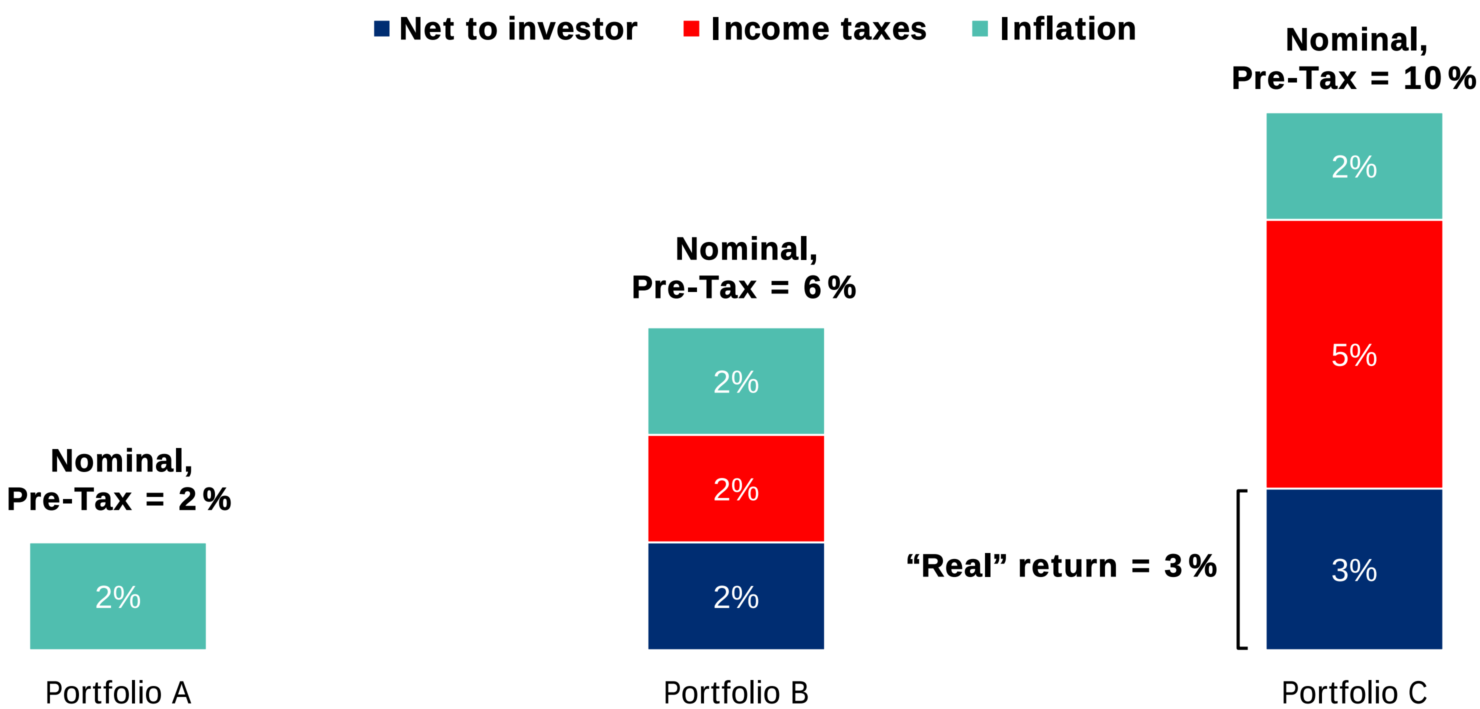
Source: AB

. . . Or a High-Returning, Very Tax-Inefficient Portfolio that Loses 70% of Its Return to Inflation and Taxes?

Hypothetical Portfolio Returns, Net of Inflation and Income Taxes*

Assumes:

- 2% Inflation
- 50% Ordinary Income Tax Rate
- 33% Long-Term Capital Gain Tax Rate



Data do not represent past performance and are not a promise of future results or a range of future results.

*"Portfolio A" means hypothetical tax-exempt portfolio that is expected to return 2% per year over the illustrated period; "Portfolio B" means hypothetical portfolio that is expected to return 6% per year over the illustrated period with all returns characterized as qualified dividends and long-term capital gains and taxed at long-term capital gain tax rate; "Portfolio 3" means hypothetical portfolio that is expected to return 10% per year over the illustrated period with all returns characterized as ordinary income and short-term capital gains and taxed at ordinary tax rate.

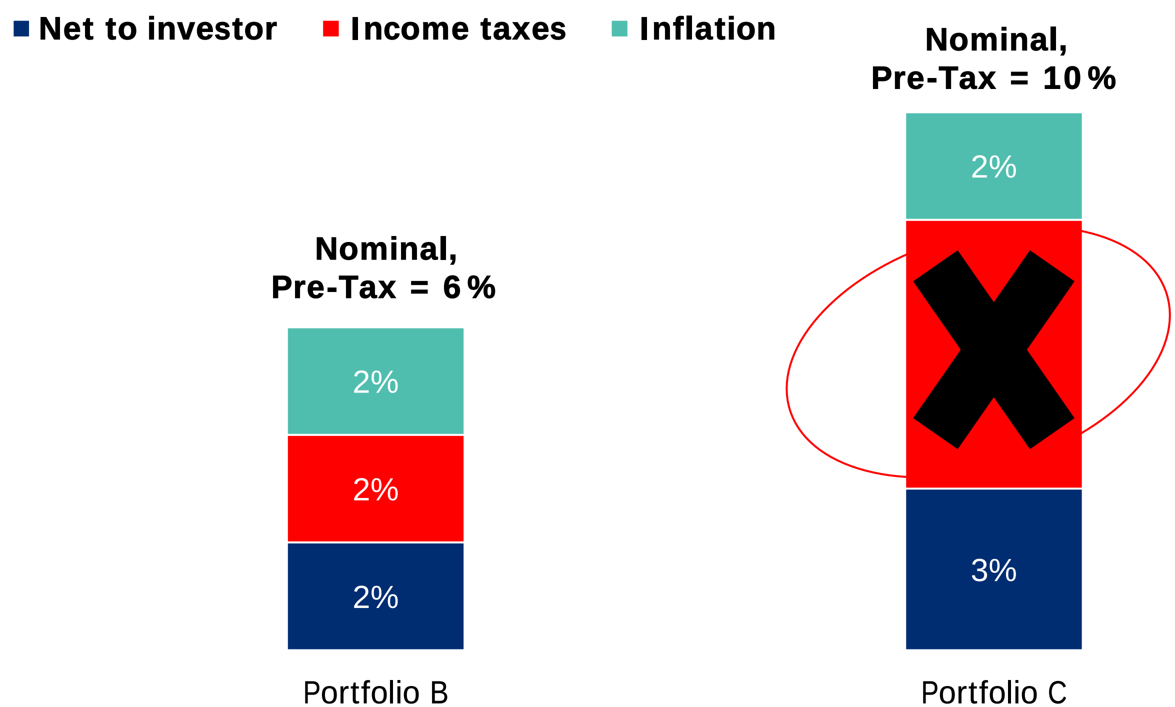
Source: AB

But What if We Could Eliminate the Income Tax . . .

Hypothetical Portfolio Returns, Net of Inflation and Income Taxes*

Assumes:

- 2% Inflation
- 50% Ordinary Income Tax Rate
- 33% Long-Term Capital Gain Tax Rate



Data do not represent past performance and are not a promise of future results or a range of future results.

*"Portfolio A" means hypothetical tax-exempt portfolio that is expected to return 2% per year over the illustrated period; "Portfolio B" means hypothetical portfolio that is expected to return 6% per year over the illustrated period with all returns characterized as qualified dividends and long-term capital gains and taxed at long-term capital gain tax rate; "Portfolio 3" means hypothetical portfolio that is expected to return 10% per year over the illustrated period with all returns characterized as ordinary income and short-term capital gains and taxed at ordinary tax rate.

Source: AB

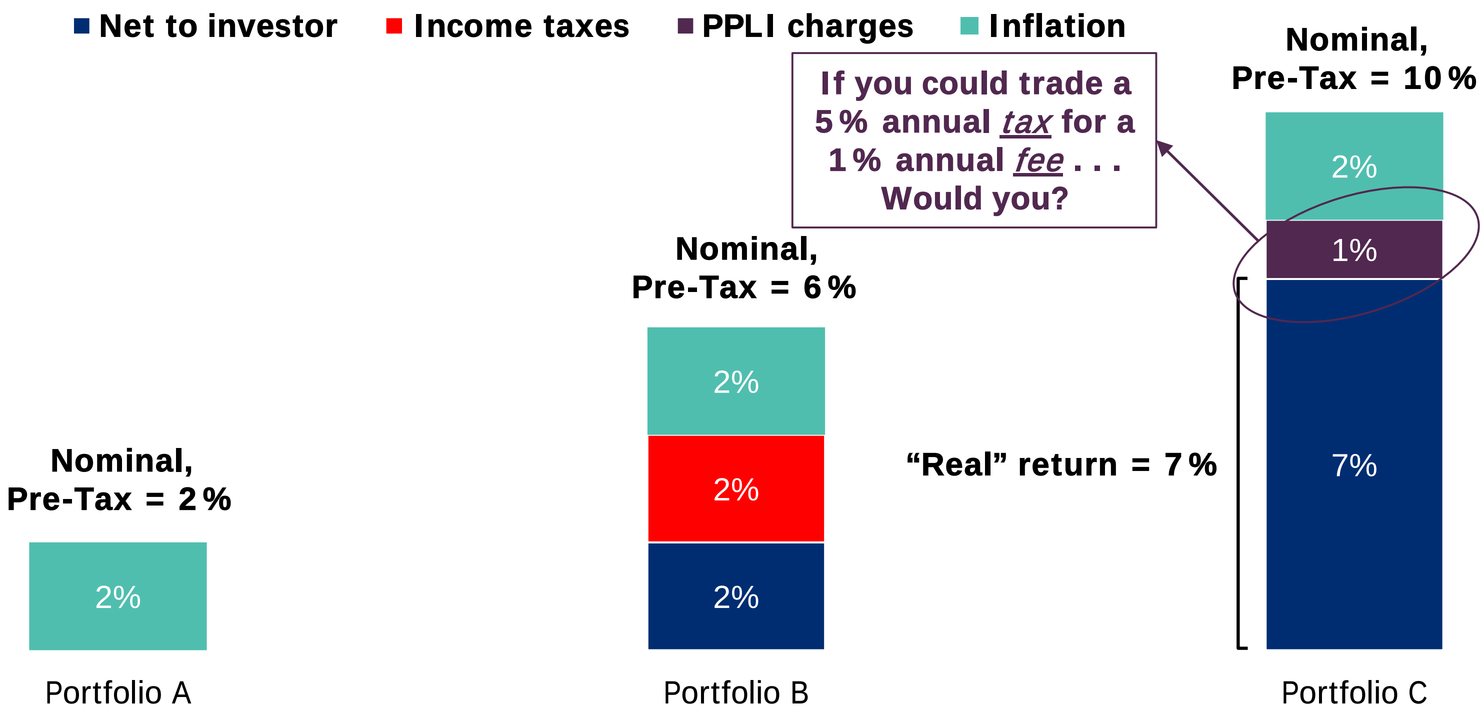
BERNSTEIN

. . . And Replace It with Something More Reasonable?

Hypothetical Portfolio Returns, Net of Inflation and Income Taxes*

Assumes:

- 2% Inflation
- 50% Ordinary Income Tax Rate
- 33% Long-Term Capital Gain Tax Rate



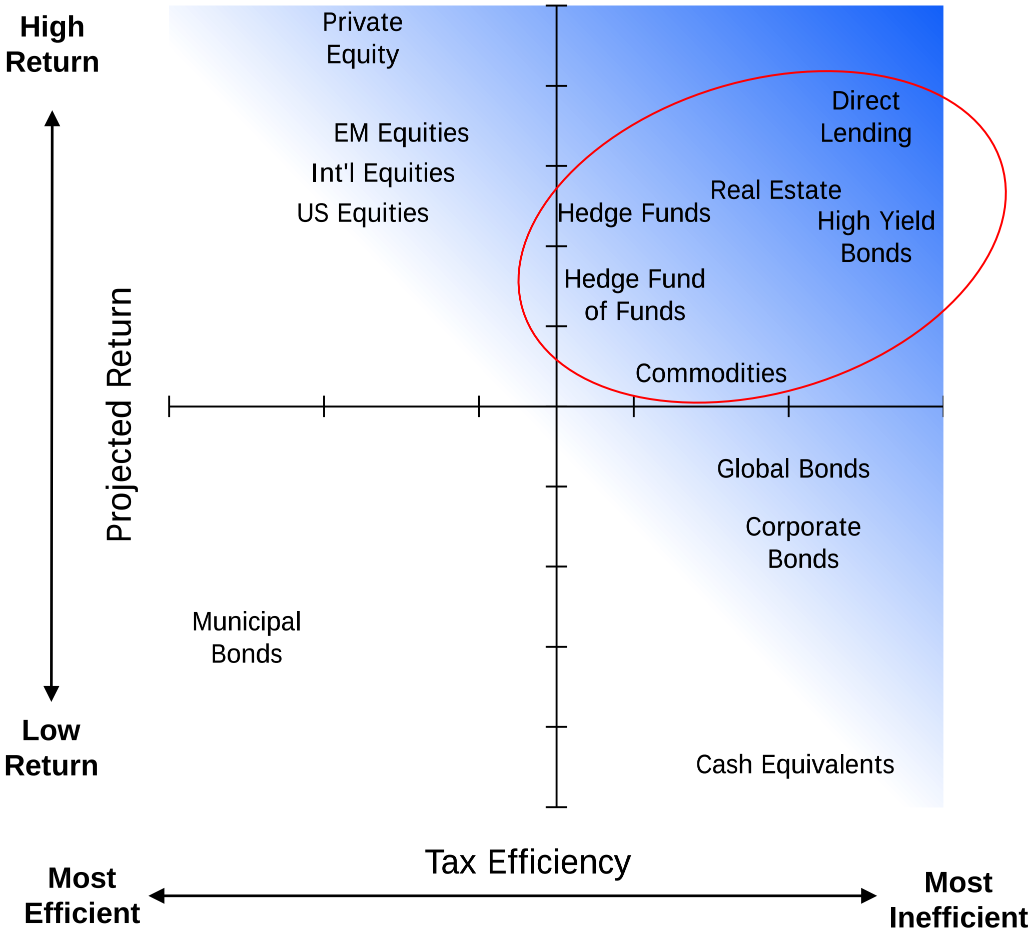
Data do not represent past performance and are not a promise of future results or a range of future results.

*"Portfolio A" means hypothetical tax-exempt portfolio that is expected to return 2% per year over the illustrated period; "Portfolio B" means hypothetical portfolio that is expected to return 6% per year over the illustrated period with all returns characterized as qualified dividends and long-term capital gains and taxed at long-term capital gain tax rate; "Portfolio 3" means hypothetical portfolio that is expected to return 10% per year over the illustrated period with all returns characterized as ordinary income and short-term capital gains and taxed at ordinary tax rate.

Source: AB

What Types of Investments Are We Talking About?

Asset Classes Best Suited to PPVA / PPVUL

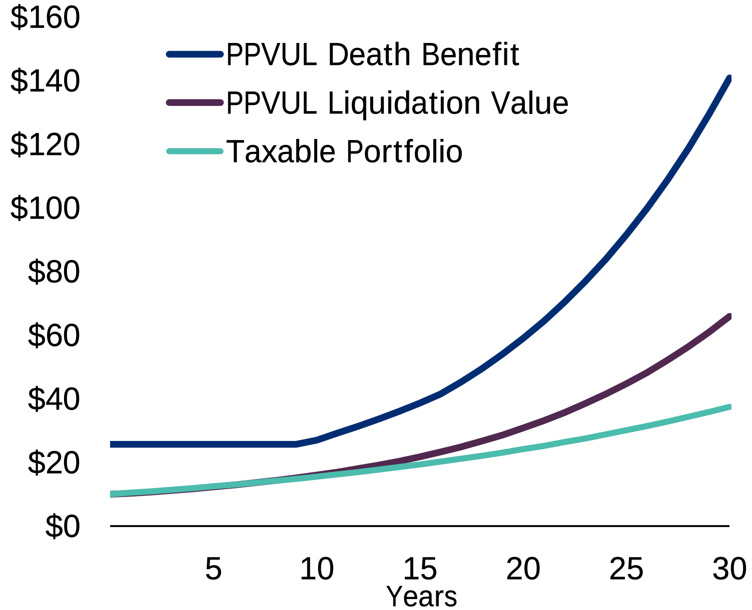


+ **High-returning investments**
  - Returns must be sufficient to offset contract / policy costs
+ **Tax-inefficient investments**
  - Examples of such income include taxable interest, rental income, and short-term capital gains
+ **Illiquid investments**
  - Often tax-inefficient in nature
  - Long time horizon

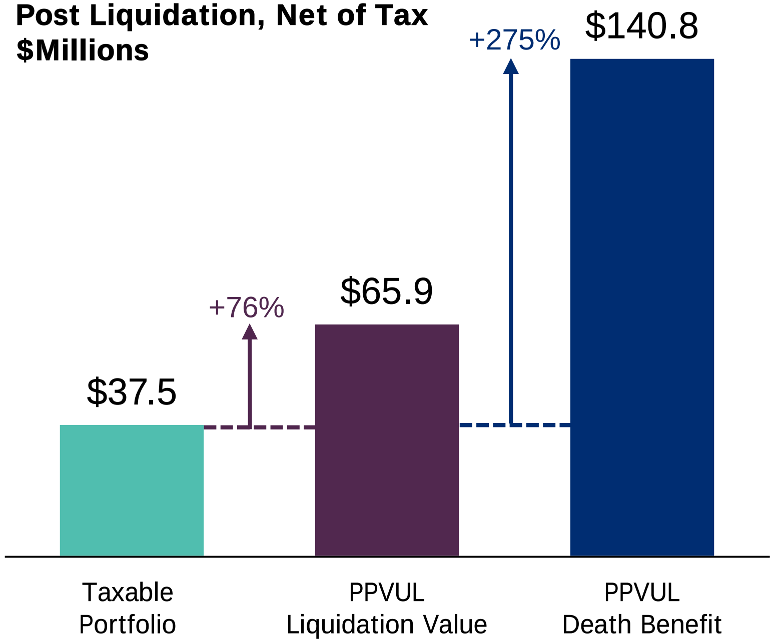
For illustrative purposes only. Data do not represent past performance and are not a promise of actual future results or a range of future results. AB is not a legal, tax, estate, or insurance advisor. Investors should consult these professionals as appropriate before making any decisions.
Source: AB

Proposed Strategy: Wrap These Investments in an Inexpensive, "Private Placement" Life Insurance Policy

Growth of $10 Million
Post Liquidation, Net of Tax
$Millions



Portfolio Values at Year 30
Post Liquidation, Net of Tax
$Millions



*Assumes 10.0% return each year, consisting 100% of ordinary income / short-term capital gain. Income taxes computed at an effective ordinary income / short-term capital gain tax rate of 55% and an effective long-term capital gain / qualified dividend tax rate of 35%. For each year depicted, "Taxable Portfolio" is the value of the portfolio net of taxes due for income, realized capital gains and unrealized capital gains. For each year depicted, "PPVUL Liquidation Value" is net of ordinary income tax for embedded growth of PPVUL policy (cash value). "PPVUL Death Benefit" represents the death benefit (no tax). PPVUL Assumptions – Insured: Male, Age 60, Preferred; Situs: Delaware; Modified Endowment Contract (MEC); Face Amount: $25,680,000; Investment: $10,000,000; Policy Underwriting Charge: $2,000; Premium Load Components – Year 1: $227,000 Total (Federal DAC Tax: $100,000, State Premium Tax: $2,000, Distribution Charge: $125,000); Annual M&E (assessed on Total Account Value): $10,000,000 to $40,000,000 = 0.45%, $40,000,000 and above = 0.35%; Annual COI (Cost of Insurance): cost of providing death benefit. Data do not represent past performance and are not a promise of actual future results or a range of future results.
Based on AB analysis and illustration provided by insurance provider. AB is not a legal, tax, estate, or insurance advisor. Investors should consult these professionals as appropriate before making any decisions.
Sources: Lombard International and AB

20% Deduction for Qualified Business Income (QBI)

Quick Math Quiz: You Are a Shareholder of a Company Doing Business in the US . . . Which New Tax Rate Appeals to You?

1. "C" corporation = Flat **21%** rate
2. "S" corporation = Individual rates apply, up to **37%**
3. "S" corporation with 20% deduction for QBI = Effective rate of up to **29.6%**

Source: AB

Quick Math Quiz: You Are a Shareholder of a Company Doing Business in the US . . . Which New Tax Rate Appeals to You?

1. "C" corporation = Flat **21%** rate
2. "S" corporation = Individual rates apply, up to **37%**
3. "S" corporation with 20% deduction for QBI = Effective rate of up to **29.6%**

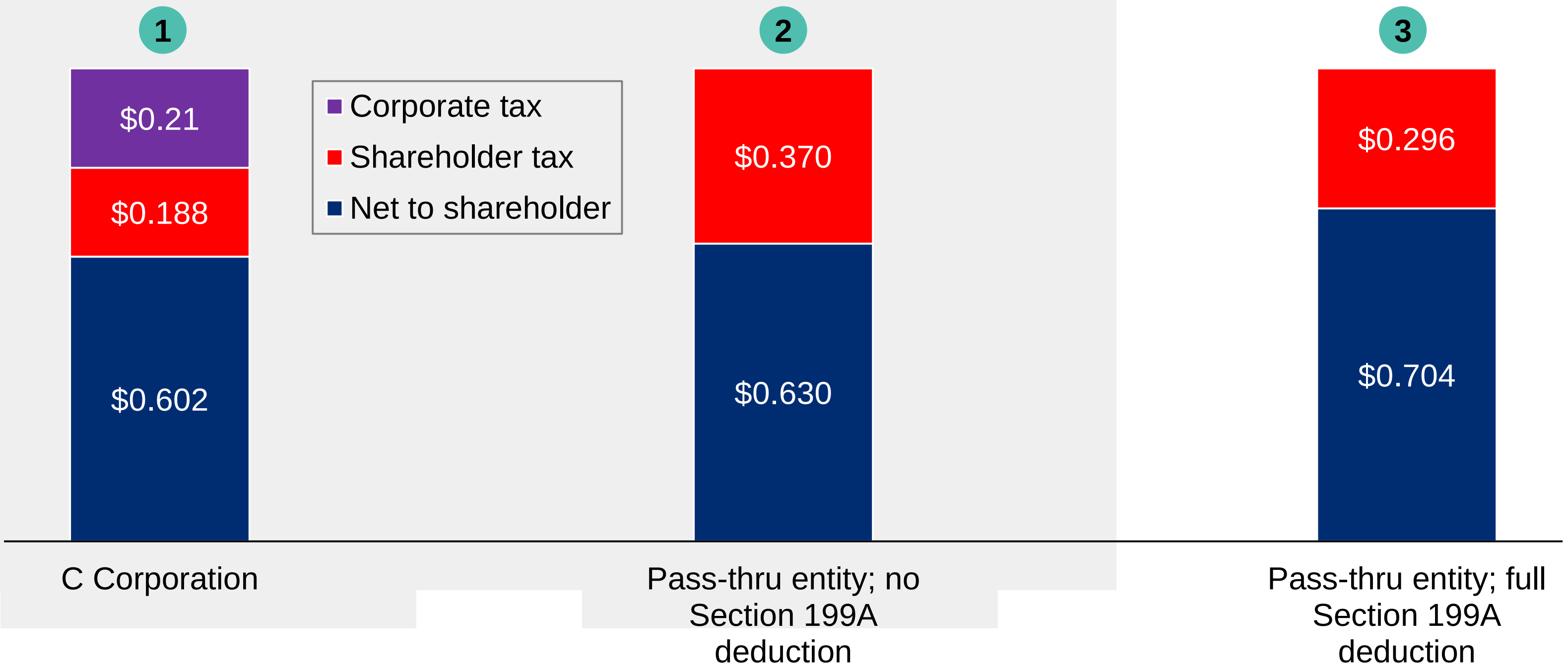
Oddly, the correct answer is probably "3." Here's why . . .

Source: AB

Choice of Entity: Tracing $1 of Trade or Business Income

Highest marginal federal income-tax brackets

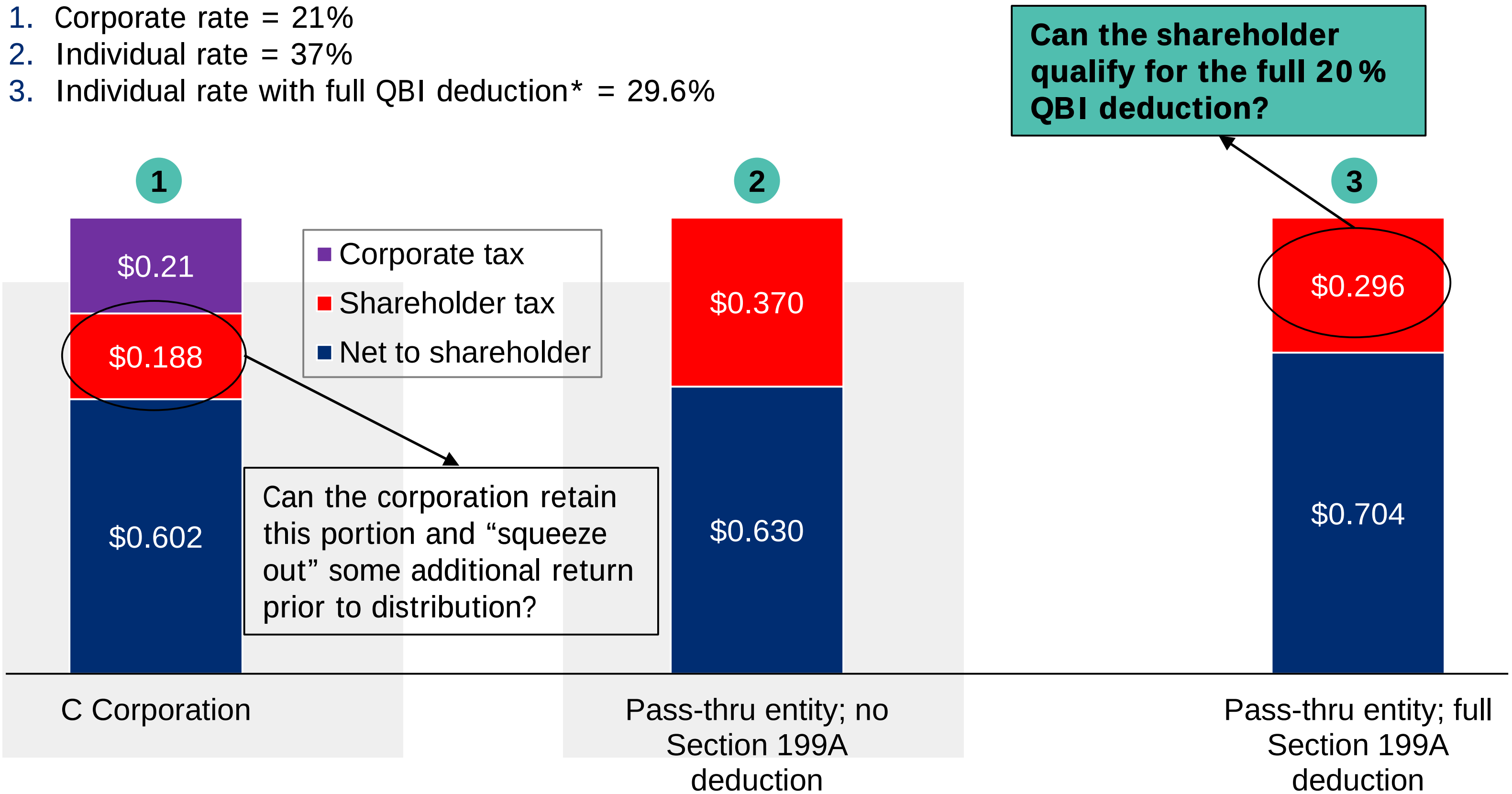
1. Corporate rate = 21%
2. Individual rate = 37%
3. Individual rate with full QBI deduction* = 29.6%



*Up to 20% of qualified business income (QBI) is deductible under new Section 199A of the Internal Revenue Code of 1986, as amended (IRC).
Sources: Sections 1, 11, and 199A of the Internal Revenue Code of 1986, as amended (IRC), and AB

Choice of Entity: Two Key Issues

Highest marginal federal income-tax brackets
1. Corporate rate = 21%
2. Individual rate = 37%
3. Individual rate with full QBI deduction* = 29.6%



*Up to 20% of qualified business income (QBI) is deductible under new Section 199A of the Internal Revenue Code of 1986, as amended (IRC).
Sources: IRC §§ 1, 11, and 199A, and AB

A Few Basic Requirements for the QBI Deduction

- Must be a US trade or business
- Business cannot be a "C" corporation, so the following ordinarily will qualify
  - Proprietorship
  - Partnership (including most LPs and LLCs)
  - "S" corporation
- Income received as an employee or in the form of a guaranteed payment does *not* qualify as QBI
- *No* QBI deduction for
  - Capital gain income
  - Most dividends
  - Interest

Source: AB

"Okay, Sounds Good . . . How Do I Qualify for the QBI Deduction?" Answer These Three Simple Questions

- "Am I poor?"
  - For this purpose, the kinder, gentler Internal Revenue Code defines "poor" as
    - An individual whose taxable income is no more than $157,500 this year; or
    - A married couple whose taxable income is no more than $315,000 this year
  - If you are "poor," congratulations! You can deduct 20% of your QBI!!*
- "Do I wear a pocket protector?"
  - Most people in a "service" business (e.g., doctor, lawyer, consultant, or investment manager, among others) can't get the 20% QBI deduction unless they are "poor"
  - But even if "rich," if you are an (a) architect or (b) engineer, you qualify for the QBI deduction!
- "Do I have business partner named `Donald'?"
  - Owners of businesses that have (a) few wage-earning employees and (b) little or no depreciable property are limited in the amount of QBI they can deduct
  - But businesses that have lots of depreciable property (e.g., business-related real estate) or lots of employees should be able to steer clear of those limitations

*The QBI deduction is phased out for individuals with taxable income greater than $157,500 up to $217,500, and for couples with taxable income greater than $315,000 up to $415,000. See IRC § 199A(b)(3)(B), (e)(2).
Sources: IRC § 199A and AB

"I Want the Full QBI Deduction, But Congress Apparently Thinks I'm 'Rich' . . . What Else Can I Do?"

- Reduce your taxable income
  - Maximize contributions to qualified retirement plans, including
    - Individual retirement account (IRA), 401(k), or 403(b) plan (*not* Roth);
    - Profit-sharing plan; and
    - Cash balance plan
  - If itemizing deductions, increase charitable contributions
- Separate nonqualifying service business activities from qualifying businesses (e.g., spin off business real estate from one's medical practice)
- Shift ownership (and K-1 income) among multiple taxpayers, potentially including taxable trusts

Source: AB

Charitable Contribution Strategies

Eliminated or Curtailed Many of Our Favorite Income Tax Deductions

- Eliminated
  - Miscellaneous itemized deductions
  - Alimony (beginning in 2019)
- Restricted
  - State and local taxes: Limited to $10,000 per taxpayer, per year
  - Mortgage interest: Still deductible, but limit of $750,000 on residential debt and other restrictions
- Still available
  - Ordinary and necessary business expenses
  - Investment interest
  - Medical expenses above 7.5% of adjusted gross income through 2018, 10% thereafter
  - **Charitable contributions**

Source: AB

Example: "Bunching" Annual Charitable Contributions*

Continue with $10,000 Annual Giving

	2018	2019	2020	2021
Mortgage Interest	$6k	$6k	$6k	$6k
State & Local Taxes	$10k	$10k	$10k	$10k
Charitable Gifts	$10k	$10k	$10k	$10k
Total Deductions	**$26k**	**$26k**	**$26k**	**$26k**
Amount Above Standard Deduction	**$2k**	**$2k**	**$2k**	**$2k**

Tax savings for annual donations:
- $740 in each of years 1 through 4
- $2,960 over four years

Double Gifts in Alternate Years

	2018	2019	2020	2021
Mortgage Interest	$6k	$6k	$6k	$6k
State & Local Taxes	$10k	$10k	$10k	$10k
Charitable Gifts	**$20k**	-	**$20k**	-
Total Deductions	**$36k**	**$16k**	**$36k**	**$16k**
Amount Above Standard Deduction	**$12k**	**$0**	**$12k**	**$0**

Tax savings alternate-year donations:
- Tax savings of **$4,440** in years 1 and 3
- **$8,880** savings over four years

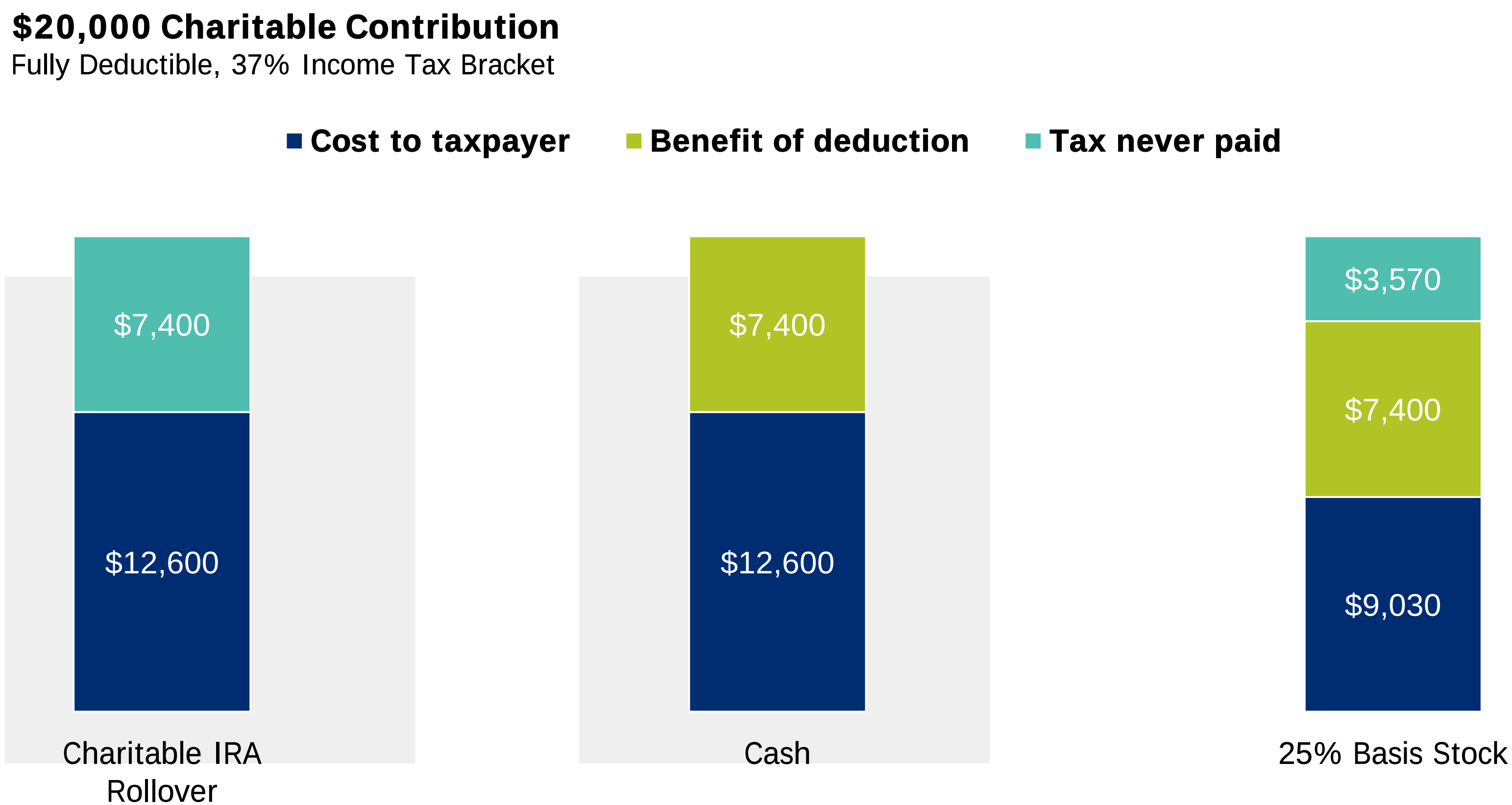
In this example, "bunching" saves nearly $6,000 over four years

*Effective 2018, the standard deduction was increased to $24,000 (from $12,700 in 2017) for married taxpayers filing jointly, expiring after 2025. Assumes cash gifts and 37% effective tax rate.

Bernstein is not a legal, tax or estate advisor. Investors should consult these professionals as appropriate before making any decisions.

Sources: www.irs.gov and AB

Finding the Most Tax-Efficient Source for Charitable Contribution*

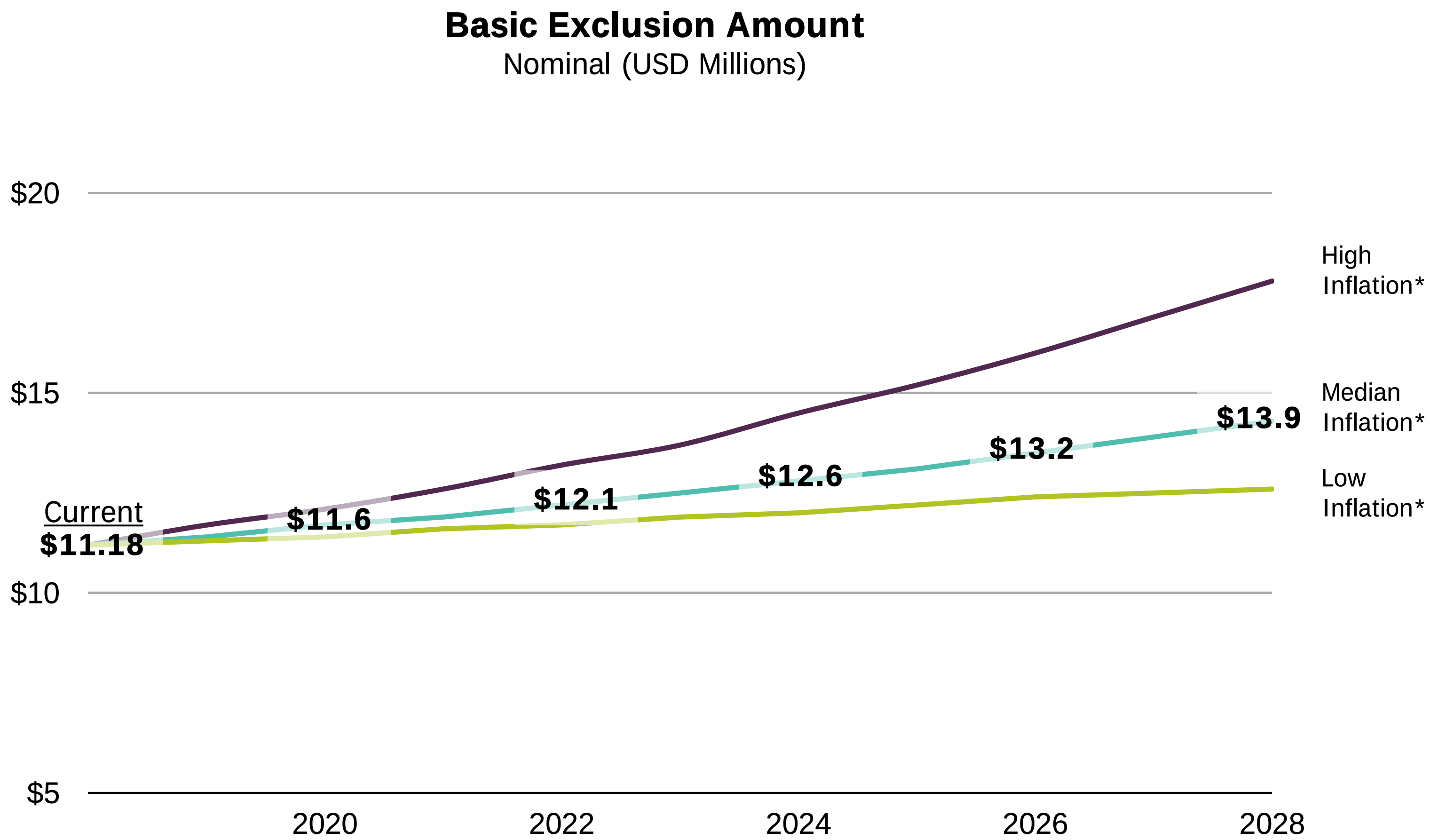


"Charitable IRA Rollover" means tax-free IRA distribution by taxpayer age 70½ or older to public charity that is not donor-advised fund or supporting organization. See IRC § 408(d)(8). "25% Basis Stock" means contribution to public charity of long-term capital gain property having adjusted basis equal to 25% of fair market value at time of contribution. "Cost to taxpayer" means value of contributed property reduced by economic benefit of any deduction and income tax otherwise payable avoided due to contribution. "Benefit of deduction" means economic benefit of fully deductible contribution, assuming effective income tax rate of 37%. "Tax never paid" means (i) in case of Charitable IRA Rollover, 37% ordinary income tax that would have been paid on taxable distribution from IRA; and (ii) in case of 25% Basis Stock, 23.8% long-term capital gain tax that would have been paid upon sale of stock. Each case assumes taxpayer has adequate income in year of contribution to deduct contribution in full.

Source: AB

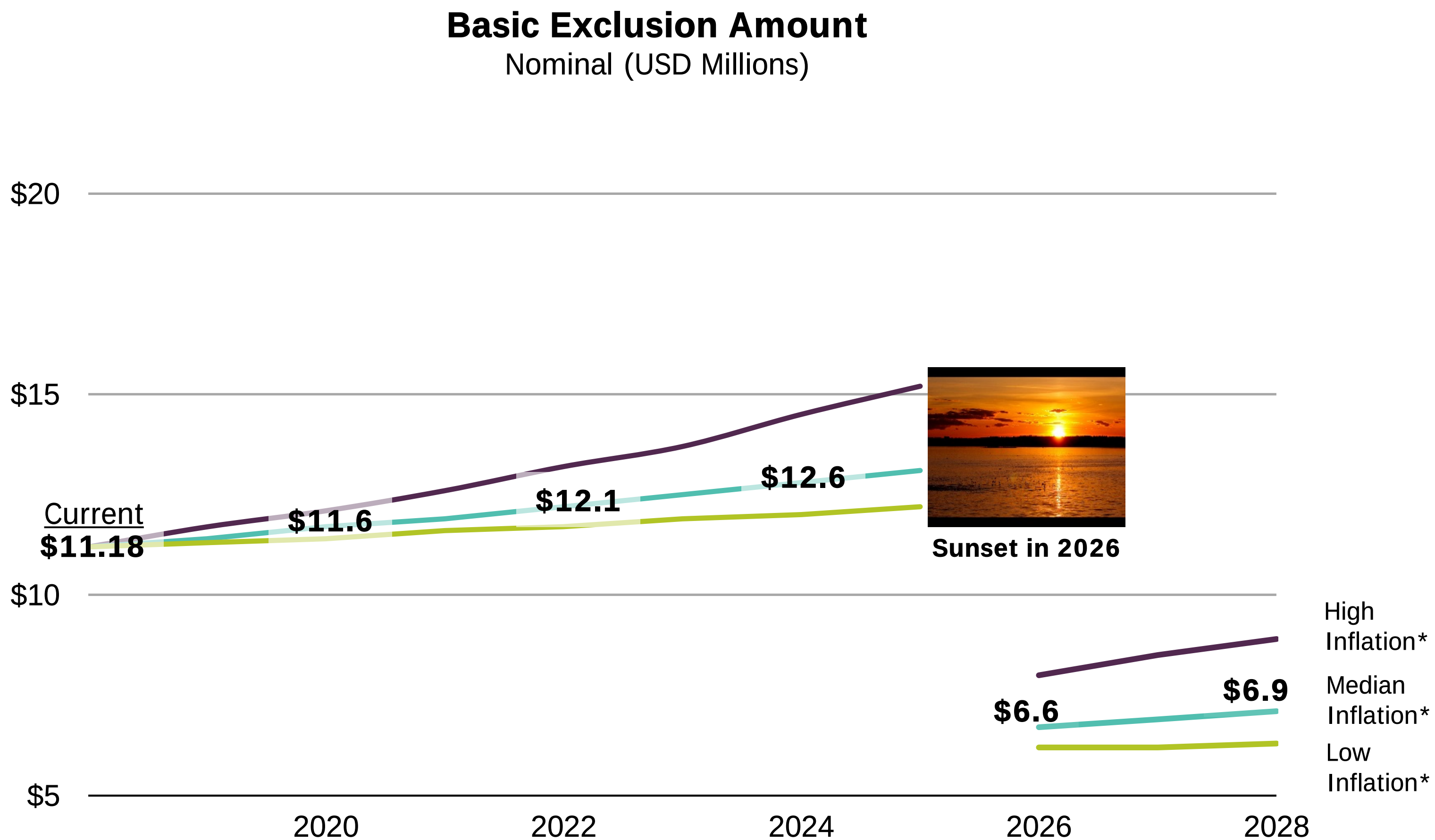
For the "Lucky" Few to Whom the Estate Tax Still Applies . . .

Projected Effect of Inflation on Basic Exclusion Amount . . .



*Based on projected increases in "chained" CPI-U, rounded (except for 2018) to the nearest $100,000 in this display. Basic exclusion amount shown is for an individual, based upon 10th ("high"), 50th ("median"), and 90th ("low") percentile outcomes for the inflation-adjusted basic exclusion amount.
Based on Bernstein's estimates of the range of returns for the applicable capital markets. **Data do not represent past performance and are not a promise of actual results or a range of future results.** See Appendix, Notes on Wealth Forecasting, for details.
Source: AB

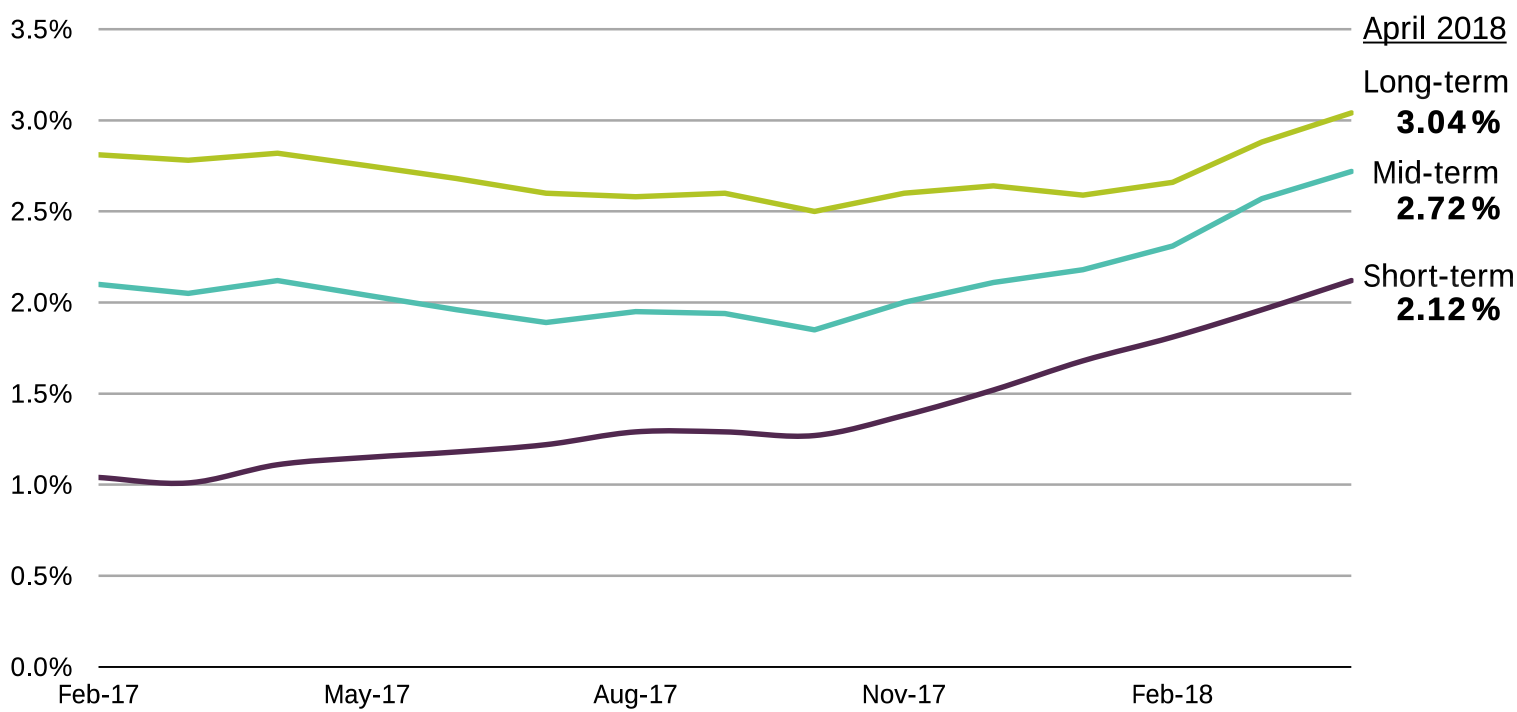
. . . Unless We Get This



*Based on projected increases in "chained" CPI-U, rounded (except for 2018) to the nearest $100,000 in this display. Basic exclusion amount shown is for an individual, based upon 10th ("high"), 50th ("median"), and 90th ("low") percentile outcomes for the inflation-adjusted basic exclusion amount.
Based on Bernstein's estimates of the range of returns for the applicable capital markets. **Data do not represent past performance and are not a promise of actual results or a range of future results.** See Appendix, Notes on Wealth Forecasting, for details.
Sources: AB

Potential Strategy: Lock in Today's Still-Low Interest Rates . . . But Retain the Option to Complete the Gift Later

Applicable Federal Rates (AFR)
February 2017 to Present



Source: www.irs.gov

Favor Leveraged Transactions Over Applicable* Exclusion Gifts . . . For Now

Installment Sale or Loan at AFR

- Scalable
- "Reversible": A sale or loan can be
  - Unwound or
  - Converted to a gift in whole or in part by forgiving the debt
- Key driver (interest rates) are likely to rise, which may dilute the effectiveness of the strategy if postponed
- "Free" step-up in basis at death is preserved

Applicable Exclusion Gift

- Limited to available exclusion
- Irreversible
- Key driver (higher applicable exclusion amount) is likely to remain in effect until at least early 2021
- "Free" basis step-up at death is impaired

*The "applicable exclusion amount" means the basic exclusion amount plus any deceased spousal unused exclusion amount. See IRC § 2010(c)(2).
Bernstein is not a legal, tax or estate advisor. Investors should consult these professionals as appropriate before making any decisions.
Source: AB

A B BERNSTEIN