MARCH 2018 I VOL. 72, NO. 2

JOURNAL OF FINANCIAL SERVICE Professionals

JOURNAL DISCUSSION GUIDE

How Does the Tax Cuts and Jobs Act of 2017 Affect Your Clients?

1. Which statement(s) about tax savings in 2018 for various taxpayers is (are) correct?
   I. A single client with $100,000 in taxable income will save less in taxes than a married couple with $100,000 in taxable income who file a joint return.
   II. A single client with $200,000 in taxable income will save more in taxes than a married couple with $200,000 in taxable income who file a joint return.
   A. I only C. Both I and II
   B. II only D. Neither I nor II

2. True or False: A single taxpayer who has $400,000 in taxable income will pay more in taxes in 2018 than in 2017, despite the reduction in tax rates enacted under the Tax Cuts and Jobs Act of 2017.
   A. True B. False

3. All of the following statements about marginal tax rates under the Tax Cuts and Jobs Act of 2017 are correct **EXCEPT**:
   A. Under the new law, the 24 percent marginal rate for a single individual starts at $82,500 and ends at $157,500.
   B. Under the new law the highest marginal tax rate is 39.6 percent, unchanged from prior law.
   C. The new law allows more of the client's income to be taxed using the lower tax brackets, regardless of what rate applies.
   D. Under the new law, the lowest marginal tax rate is 10 percent, as compared with 15 percent under prior law.

4. All of the following statements about tax law changes enacted by the Tax Cuts and Jobs Act of 2017 (TCJA) are correct **EXCEPT**:
   A. The TCJA eliminates an above-the-line deduction for alimony payments for any divorce agreement entered into after 2018.
   B. The standard deduction has been increased from $6,350 to $12,000 for single taxpayers.
   C. The medical expense threshold is 10 percent under the new law as compared to the 7.5 percent rate for 2017.
   D. The TCJA eliminates the deduction for home equity loan interest.

5. Katie and Arthur have two children, aged 6 and 8, and used the standard deduction when filing their tax return for 2017. How will the increase in the standard deduction combined with the elimination of the personal and dependency deductions that were enacted by the Tax Cuts and Jobs Act of 2017 impact their taxable income for 2018?
   A. Katie and Arthur's taxable income will not change.
   B. Katie and Arthur's taxable income will increase by $4,900.
   C. Katie and Arthur's taxable income will increase by $7,800.
   D. Katie and Arthur's taxable income will decrease by $7,800.

6. All of the following statements about personal income tax changes enacted under the Tax Cuts and Jobs Act are correct **EXCEPT**:
   A. The ceiling on charitable deductions listed on Schedule A has been reduced to 40 percent.
   B. The standard deduction for married taxpayers filing jointly has increased to $24,000.
   C. The new law caps deductions for state, local, and real estate taxes at $10,000.
   D. The new law disallows Roth IRA recharacterizations.

Tax Court Weighs in on "Captive Insurers"

7. All the following statements about captive insurance companies and the *Avrahami* case are correct **EXCEPT**:
   A. Captive insurers are created pursuant to Section 831(b) of the Internal Revenue Code (IRC).
   B. After they formed their captive insurance company, the Avrahamis were able to reduce their business insurance premiums from $1.3 million to $150,000.

C. The Avrahamis incorporated their captive insurance company in St. Kitts in 2007 and filed elections under IRC Section 953(d) to be taxed as a U.S. corporation.
D. Captive insurance companies are designed to insure the risks of their owner or owners.

8. Which statement(s) about the IRS's position on the validity of Feedback (the Avrahami's captive insurance company) is (are) correct?
   I. The IRS argued that Feedback was not a valid insurance company because several of Feedback's policies included uninsurable risks.
   II. The IRS argued that Feedback was not a valid insurance company because it failed to distribute risk because it had an insufficient pool of insureds.
   A. I only C. Both I and II
   B. II only D. Neither I nor II

9. All of the following statements about the Tax Court's holding in *Avrahami* are correct **EXCEPT**:
   A. Judge Mark V. Holmes, writing for the Tax Court, found that there was an inadequate risk distribution in the Feedback insurance.
   B. The court found that the premiums charged by Pan American Reinsurance Company for Feedback to participate in a terrorism risk insurance pool were grossly excessive.
   C. The premiums paid to Feedback in 2009 and 2010 were treated as foreign-sourced income.
   D. The fact that Feedback lent money to the Avrahamis was a one of the factors used by the court to reach the conclusion that Feedback did not operate like an insurance company.

10. True or False: IRS Notice 2016-66 lists coverage that involves an implausible risk as a disqualifying attribute for a captive insurer.
   A. True B.False

11. All of the following are disqualifying attributes for a captive insurer as listed in IRS Notice 2016-66 **EXCEPT**:
   A. The captive does not have capital adequate to assume the risks that the contract transfers from the insured.
   B. The coverage provided does not match a business need or risk of the insured.
   C. The insured's premium payments are determined without an underwriting or actuarial analysis that conforms to industry standards.
   D. The insured's premium payments are significantly lower than the premiums prevailing for coverage offered by an unrelated, commercial insurance company.

Irrevocable Life Insurance Trust Regrets: Options for Trusts That Are Unneeded (or Seem That Way)

12. According to IRS reports, how many estate tax returns were filed in 2015?
   A. 48,050 C. 15,852
   B. 22,000 D. 11,917

13. All of the following statements about why it is important for new advisors to be familiar with planning strategies for the federal estate tax are correct **EXCEPT**:
   A. The growing population of billionaires, projected to be 12 percent of the U.S. population by 2025, calls for an understanding of federal estate taxes and their implications for large estates.
   B. New advisors need to be able to provide guidance to clients about tax law changes and their implications for previously established estate plans.
   C. New advisors will need to be able to address questions related to the use of irrevocable life insurance trusts as a federal estate planning tool and what options exist for terminating an irrevocable trust.
   D. A number of states have an estate, gift, or inheritance tax threshold that has overall implications for estate liquidity needs.

14. All of the following statements about addressing irrevocable life insurance trust (ILIT) “regrets” are correct **EXCEPT**:
    A. In the case of a healthy insured and a trust that owns a term policy, one option for addressing ILIT regrets is to let the policy lapse and purchase a new policy.
    B. In certain circumstances, the insured may be able to buy the policy from the trust.
    C. The trustee could distribute the trust assets to the beneficiaries, if allowed by the terms of the trust.
    D. Because an irrevocable trust is generally designed to be unavailable to the grantor, decanting or judicial authorization are the only effective options for the client who wants to get a life insurance policy out of an irrevocable trust.

15. All of the following statements about decanting are correct **EXCEPT**:
    A. Decanting is a possibility for a grantor who wants to change the terms under which the irrevocable life insurance trust assets are maintained.
    B. Twenty-five states have decanting statutes—that is, statutory provisions that allow the contents of one trust to be moved to another trust.
    C. Decanting statutes in all states prohibit removing the income interest of a beneficiary.
    D. The advice of a local attorney is a necessity when considering decanting because the rules vary widely from one state to another.

A 50-State Review of ABLE Act 529A Accounts

16. All of the following statements about the ABLE Act are correct **EXCEPT**:
    A. The ABLE Act amends Internal Revenue Code Section 529 to establish tax-free savings accounts for individuals with disabilities.
    B. ABLE account distributions are excluded from the designated beneficiary’s income for the respective tax year.
    C. Savings in an ABLE account will jeopardize a beneficiary’s eligibility for Social Security income.
    D. Federal law requires that each state have an ABLE account program.

17. All of the following statements about state ABLE programs are correct **EXCEPT**:
    A. Currently Wyoming is the only state that has not enacted ABLE legislation.
    B. Qualified individuals seeking an ABLE account are not required to enroll in their home state’s program.
    C. Twenty-nine states have ABLE Act programs that are open for enrollment.
    D. Florida, Georgia, Kentucky, Louisiana, Missouri, and Vermont are the only states currently accepting out-of-state residents for enrollment in the ABLE Act accounts.

18. Which statement(s) about the use of a trustee or professional financial manager for managing an ABLE account is (are) correct?
    I. In direct contrast to special needs trusts, ABLE accounts do not require use of a trustee or a professional financial manager.
    II. The majority of state ABLE programs encourage do-it-yourself account management.
    A. I only C. Both I and II
    B. II only D. Neither I nor II

19. Which statement about state income tax benefits for ABLE account use is correct?
    A. Maryland law allows an income tax deduction of up to $2,500 per contributor per ABLE account beneficiary per year.
    B. Ohio law allows for the deduction of $2,000 in contributions to an ABLE account but only if the accountholder is under age 21.
    C. In both Michigan and South Dakota taxpayers who file jointly can deduct up to $10,000 in contributions to an ABLE account.
    D. Oregon and Virginia are the only states that offer tax benefits to out-of-state residents.

20. True or False: Under federal law, contributions to ABLE accounts cannot exceed the annual exclusion for federal gift tax.
    A. True   B. False

21. All of the following statements about ABLE account provisions in various states are correct **EXCEPT:**
    A. The highest ABLE account balance ceiling is in Pennsylvania, which allows a maximum of $511,758.
    B. For a female accountholder born in 2017, ABLE account maintenance fees of $30–$60 per year will result in a total lifetime loss of over $5,000.
    C. Michigan's ABLE program charges a $45 annual maintenance fee plus a program management fee of 0.5 percent of the average daily net assets in the account.
    D. The Virginia ABLE account website provides printable gift certificates with six themes, including happy birthday and happy holidays.

22. According to the authors, all of the following are questions financial planners should ask when analyzing ABLE options on behalf of their clients **EXCEPT:**
    A. Does the state ABLE program being considered offer the degree of investment risk that most benefits the client?
    B. How will participation in this state's ABLE program impact the client's eligibility for Medicare?
    C. What are the state account balance limits?
    D. Is the client eligible for a state income tax credit for ABLE account use?

Regulatory Changes Impacting Partnerships: An Opportunity for Financial Professionals

23. All of the following statements about the recently issued proposed partnership regulations are correct **EXCEPT:**
    A. The proposed regulations were issued pursuant to changes introduced into law by the Bipartisan Budget Act of 2015, as amended by the Protecting Americans for Tax Hikes Act.
    B. With the new rules, the IRS seeks to deal with partnership adjustments in a more efficient manner.
    C. The new rule opens up the possibility for financial service professionals to serve as the partnership tax representative for partnership clients.
    D. Under the new rules, a partnership can have up to three designated partnership representatives for a given tax year.

24. All of the following statements about the eligibility requirements for a partnership representative are correct **EXCEPT:**
    A. The partnership representative must have availability to meet in person with the IRS in the United States in a reasonable manner.
    B. If the partnership representative is an individual, he or she must be a CPA with at least 5 years' experience as a partner in an accounting firm.
    C. The partnership representative must have a U.S. taxpayer identification number.
    D. Under the definition of "person" in Internal Revenue Code Section 7701(a)(1), the partnership representative can be a corporation.

25. Which statement(s) about the revocation of a partnership representative designation is (are) correct?
    I. For the revocation to be valid it must be signed by two general partners for the year at issue.
    II. The IRS will treat a revocation as effective 45 days after receipt.
    A. I only C. Both I and II
    B. II only D. Neither I nor II

Income-Shifting Strategies for Those with Children

26. All of the following statements about the kiddie tax are correct **EXCEPT**:
    A. The kiddie tax rule was designed to address situations in which parents shifted unreasonable amounts of income to their children in order to lower the parent's tax liability.
    B. The kiddie tax strategy allows parents to shift unearned income of up to $2,100 to their child without it being taxed at the parents' marginal tax rate.
    C. The kiddie tax rules define earned income as wages and royalties resulting from services and work performed; unearned income is all other types of income.
    D. The kiddie tax is imposed on both earned and unearned income of children under the age of 18.

27. Which statement(s) about taxation of a child's unearned income under the Tax Cuts and Jobs Act of 2017 (TCJA) is (are) correct?
    I. Under the TCJA, taxable income of a child attributable to net unearned income is subject to tax brackets applicable to trusts and estates.
    II. Changes resulting from the TCJA negatively impact the amount of unearned income an individual can shelter.
    A. I only C. Both I and II
    B. II only D. Neither I nor II

28. What is the deduction amount allowed for interest paid on federal student loans?
    A. The greater of $2,500 or the amount actually paid.
    B. $2,500
    C. The lesser of $2,500 or the amount actually paid.
    D. $2,100

29. All of the following statements about employment of a child as an income-shifting strategy are correct **EXCEPT**:
    A. This strategy is advantageous for both the parent and the child because the child earns work experience and the parent enjoys tax advantages.
    B. To be eligible for tax benefits for the employment of a child, the parent must be a sole proprietor or the partner in a partnership, and the wages must be reasonable.
    C. The IRS allows parents to deduct wages paid to their children as a business expense as long as the compensation does not exceed $5,000.
    D. Wages paid for services by a child under the age of 18 who is employed by his mother or father are exempt from FICA tax.

30. All the following statements regarding the use of family limited partnerships for tax planning purposes are correct **EXCEPT**:
    A. The family limited partnership strategy provides the benefits of shifting and allocating income to children and other family members while minimizing tax liability for the family as a whole.
    B. In the case *Estate of Murphy v. United States,* the Tax Court held that the family limited partnership created by Charles Murphy had no legitimate nontax purpose.
    C. Strict IRS requirements make a family limited partnership difficult to establish.
    D. The IRS issued proposed regulations in 2016 designed to prevent the undervaluation of transferred interests in partnerships.