How Tax Reform Did, And Didn't, Favor Wealthy Clients

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A recent survey found that many aspects of tax reform favor wealthier clients, who will enjoy lower tax rates and easier taxes when inheriting large amounts of money. Other potential beneficiaries of the tax law include homeowners, retirees and itemizers in states with low or no state income tax rates.

Households making about $733,000 and up will see an average tax cut of roughly $50,000; those who make $3.4 million or more next year will enjoy an average tax cut of about $190,000.

Does your average wealthy client see all this?

"Though most taxpayers will benefit from reform, it's especially beneficial to high-income earners," said Abigail Gunderson, CFP and wealth advisor at Tanglewood Total Wealth Management in Houston. "Case in point: A client of mine earns around $500,000 per year, which often placed him in the highest tax bracket. He decided to retire this year. His income for the year is right at $2 million. With the top individual tax rate decreasing from 39.6 to 37 percent, that's an immediate tax savings of at least $36,400."

But not everybody is getting a break on everything, according to Jeff Fosselman, CPA/ CFP and senior wealth advisor at Relative Value Partners in Northbrook, Ill. Many high-net-worth individuals, he said, "own multiple properties or more expensive properties, which result in significantly greater property taxes. The new itemized deduction changes will impact these clients. Also, they'll be impacted by the changes to 2 percent miscellaneous expenses, such as brokerage fees, becoming non-deductible.

"I'm not sure if retirees garner much benefit," Fosselman says, "as they typically won't have mortgages and may be less charitably inclined than those still working."

"There are plenty of 'ifs,'" added Daniel Morris, CPA and senior partner with Morris + D'Angelo CPAs in San Jose, Calif. "[From] a wage earner in a high-tax state, responses are more like 'We got the shaft' to 'blah.' If you're a certain type of investor or small business owner in preferred industries, then overall [you're] happy."

"Our average [high-net-worth] client lives in a state that has high income and real estate taxes," said Gail Rosen, CPA and shareholder with WilkinGuttenplan in Martinsville, N.J. "These clients break even or pay more under the new law. Our clients who are married benefit more than our single clients from the new lower rates—the new laws attempt to fix the marriage penalty."

Gunderson believes the most significant benefit for wealthy clients is the doubling of the estate tax exemption, from $5.6 million to $11.2 million per individual. “Coupled with ‘portability,’ the ability for the surviving spouse to use the deceased spouse’s unused portion of their estate exemption, a married couple can shield as much as $22.4 million of assets and pass this to their heirs free of estate taxes,” she said.

Businesses also did well under reform. “Many small-business owners believe they’re getting a great deal with the decrease in corporate tax rates from 35 to 21 percent,” Gunderson said. “A wealthy client who owns a successful small business changed his firm’s filing status from an S corp to a C corp after 20-plus years. … With the new C corp tax rates, earnings are now taxed at 21 percent, a significant savings to the business owner.”

“The most important provisions are the new tax treatment for pass-through entity income,” Fosselman said. “This is one area I’ve seen individuals’ behavior change in terms of how they structure entities … to take advantage.”

Clients’ expectations about the new law have varied.

“Most of our [high-net-worth] clients thought they were going to pay a lot more tax under the new bill due to the loss of the state tax deduction,” Rosen said. “The ones who break even have been pleasantly surprised.”
