Advanced Planning
Banking

Lending opportunities in light of the new tax legislation

When and how you choose to use both sides of your personal or business balance sheet are important decisions.

In today's world, pursuing your life's goals is being challenged in new ways. Which makes now the perfect time to review your goals in terms of "Advice. Beyond investing." Because when we collaborate on what matters most to you, we can create a plan tailored for you.

On December 22, 2017, President Trump signed the new tax bill into law. With new legislation comes new opportunities. The following changes may lead some clients to reconsider how they are using their personal balance sheet—or that of their business—to efficiently manage their taxes. Whether financing businesses or equipment, considering purchasing a new home or refinancing or improving a current one, clients may wish to consider the following strategies and discuss them with their tax or legal advisor.

Considerations for business owners

Accelerated depreciation on equipment—Qualified property (new or used) acquired and placed in service after September 27, 2017 may be immediately depreciated 100%. This is a significant expansion of the previous "bonus depreciation" rules, which allowed depreciation of 50% of the cost of the asset in the first year, and the balance over a specified time period depending on the class of asset being depreciated. This new benefit is phased down, 20% per year, for property placed in service during the years 2023 – 2026, after which it sunsets entirely. Property placed in service in 2027 or later is subject to the old depreciation rules. (Some property is subject to the same phasedown but over the years 2024 – 2027).

Business interest expense—For tax years beginning January 1, 2018, business interest is deductible only up to the sum of:

- Business interest income
- 30 percent of adjusted taxable income (with a depreciation addback until 2022), and
- Floor plan financing interest (which only applies to sellers of motor vehicles)

With a carry forward for the unused deduction. Importantly, small businesses (average annual gross receipts not exceeding $25 million) are *not* subject to the new limits, nor are real estate developers, construction companies, real estate management/leasing companies, or farming businesses).

UBS can give you access to strategic borrowing solutions you may not have considered.

Whether you are considering purchasing business aircraft to take advantage of the accelerated depreciation rules or continuing to expand your working ranch, UBS can give you access to strategic borrowing solutions you may not have considered. Through our referral partnerships with industry leading lenders, clients have access to small business, commercial real estate, aviation and agricultural financing. Small business, commercial real estate, aviation and agricultural financing is provided by third-party firms and not by UBS Financial Services Inc. or its affiliates ("UBS").

Small businesses are financed more frequently with personal and family savings than by any other means.[1] **Business owners also can tap UBS Credit Lines** to access liquidity quickly using personal or business assets held at UBS as loan collateral, including the ability to borrow in the business's name. Offered by UBS Bank USA, Security Backed Loans offer a convenient, simple and many times less costly solution compared to traditional business loans, enabling business owners to purchase equipment, covering expenses or helping owners simply feel more secure when cash flow is tight.

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Considerations for individual borrowers

New mortgage interest rules—The mortgage interest deduction has been limited under the Act. Taxpayers can deduct interest on mortgage debt up to $750,000 (in the aggregate) of acquisition indebtedness for a newly acquired principal or second home. Existing mortgages are grandfathered up to the prior $1 million limit (with some transition relief for principal residences in contract).[2]

The 2018 plan does not change the approach to home acquisition financing for construction-to-permanent homes, nor the ability for clients to take advantage of a "technical refinance" (an approach that enables the client to purchase the home in cash or with a credit line, and then replenish proceeds used to purchase the home with a traditional mortgage). In both these instances, the same $750,000 maximum of acquisition indebtedness will apply.

Refinancing—If mortgage debt incurred on or before December 15, 2017 is refinanced, the refinanced debt will also be grandfathered into the $1 million limit up to the amount of the original mortgage outstanding at the time of the refinancing. The new law also disallows application of the mortgage interest deduction to indebtedness after expiration of the original term.

For example, a married couple has 20 years remaining on their 30-year loan. They had an original mortgage balance of $1 million and currently have $800,000 outstanding. Should they take a cash-out refinance of their property, they can only take the deduction for $800,000 mortgage amount (the grandfathered limit amount) for the next 20 years.

UBS Bank USA continues to offers a wide range of sophisticated home financing solutions for clients purchasing new homes or refinancing existing ones. Your dedicated UBS Wealth Management Banker understands the changing environment and your local market, and is committed to working with you and your Financial Advisor to help find the best mortgage option to complement your overall wealth management strategy.[3]

For example, Interest Only Adjustable Rate Mortgage (ARM) options may enable clients to maximize the tax deductible portions of their monthly mortgage payment. An ARM is a home loan whose interest rate changes periodically in relation to an index. Rates charged during the initial periods are generally lower than fixed-rate mortgages, and for Interest-Only (I/O) options, the client pays only interest for the first 10 years of the mortgage, compared to a traditional mortgage where both principal and interest are repaid with every monthly payment. An interest only adjustable rate mortgage offers the potential for a reduced monthly payment and the ability to maximize cash flow. You may benefit from an interest only option if you have a short-term horizon for either the ownership of your home or the payoff of your mortgage as this option allows the flexibility of a lower payment for the first 10 years.

Additionally, since there are no prepayment penalties, you can prepay at any point without incurring a cost. Consult your CPA on the benefits of mortgage tax deductions.

Home equity—Interest on home equity loans, Home Equity Lines Of Credit (HELOC) and second mortgages is now only deductible if the proceeds of such loan (i) are used to make substantial improvements to the home, or in the case of second mortgages used for acquisition, construction or other substantial improvements; and (ii) combined with other acquisition indebtedness, does not in the aggregate exceed the $750,000 limit referenced above. Interest on loan proceeds secured by a residence used for any other purpose is no longer deductible.

Clients should consult with their tax advisors regarding the deductibility of mortgage indebtedness.

Note that the new mortgage interest deductibility rules for individuals are effective for the 2018 through 2025 tax years—like most other individual deductions, these provisions sunset on December 31, 2025.

Borrowing against your home has traditionally been a good way to unlock liquidity, but may be less attractive under the new tax law.
Due to the restrictions on the deductibility of HELOCs as described above, Securities Backed Loan may be a more attractive alternative. Here are some reasons why:

- Rate—Both HELOCS and SBLs are generally variable rate, with a base rate (Prime in the case of HELOCs, and 30-Day LIBOR for Variable SBLs) plus a spread. With interest rates based on approval amounts, borrowing costs may be materially lower for clients.
- Fees—SBLs cost nothing to set up and have no unused balance fee. HELOCs often have origination fees. In some jurisdictions, they even require you to pay mortgage taxes on the full amount of the HELOC even if it's never used.
- Ease—SBLs feature a streamlined application and timely decisions, usually within a few days. HELOCs usually require an appraisal, as well as a liquidity and income analysis of the borrower, translating into several weeks' time to establish.
- Credit rating—SBLs are not reported to credit bureaus as an existing liability whereas HELOCs often are.

Capital gains on the sale of a home—The rules on the ability to exclude capital gain on the sale of a principal residence stay the same. An individual may exclude up to $250,000 of gain on the sale of a principal residence ($500,000 for married filing jointly) provided the home has been their principal residence for two out of the last five years.

Investment interest expense—Investment interest expense may still be deducted against net investment income under the new tax law. This deduction is separate from other investment expenses categorized as miscellaneous itemized deductions, which are no longer deductible under the law. This means that margin interest is still deductible against net investment income.

When and how you choose to use both sides of your personal or business balance sheet are important decisions—decisions that should be revisited in the context of changes in the new tax law. Your UBS Financial Advisor can help you review your existing liabilities or cashflow needs to help you evaluate various financing options to explore. Start the conversation by completing a "Personal Liability Review."

The **Advanced Planning Group** of UBS provides comprehensive planning, advice, and education to ultra high net worth individuals and families. The team consists of professionals with advanced degrees, extensive planning experience, and various areas of expertise. Through our publications, the Advanced Planning Group features the intellectual capital of UBS in wealth planning, estate tax, and philanthropy and evaluates how changes in the legislative and tax landscape might impact our clients' planning.

See important notes and disclosures on the next page

[1] Small Business Administration Office of Advocacy. "Frequently Asked questions about small business."
[2] $375,000 for married couples filing separately for new acquisitions; and $500,000 for married couples filing separately for grandfathered mortgages. Code Sections 163(h)(3)(F)(i)(II) and (III).
[3] UBS Wealth Management Bankers are employees of UBS Bank USA. UBS Financial Advisors are employees of UBS Financial Services Inc.

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Equal Opportunity Lender. Equal Housing Lender.

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Credit Lines are "non-purpose" loans and may not be used directly or indirectly to purchase, trade or carry securities or to repay debt (a) used to purchase, trade or carry securities or (b) to any affiliate of UBS Bank USA. Additional limitations and availability may vary by state. Prepayments of UBS Fixed Credit Lines will be subject to an administrative fee and may result in a prepayment fee. Neither UBS Financial Services Inc. nor UBS Bank USA provide legal or tax advice. You should consult your legal and tax advisors regarding the legal and tax implications of borrowing using securities as collateral for a loan. For a full discussion of the risks associated with borrowing using securities as collateral, you should review the Loan Disclosure Statement that will be included in your application package. Securities backed financing involves special risks (including, without limitation, being subject to a margin call if certain collateral value requirements are not met) and is not suitable for everyone.

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