MADISON PARK
CAPITAL ADVISORS

WEEKLY MARKET UPDATE

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Two Words: Tax Reform

Tax reform. Two minutes on Twitter and you'll quickly realize these are two words that are eliciting two things: significant emotions and significant confusion. Two chambers of Congress are now reconciling two contrasting bills.

To continue with the "two" theme – there are two things we know to be true.

1. The tax code is immensely complicated.
2. Few people like paying too much in taxes

Congress set out to address these two truths – aiming to simplify the code and lower tax bills for individuals, families, and business in the USA. Whether their work so far will do so is up for significant debate – but what's not debatable is that their work has led to many questions from concerned clients trying to determine how all of this impacts them personally.

What we do know is that the tax code is not getting significantly simpler. Our friends in the CPA world aren't brushing up their resumes in search of a new career path. Taxes will remain a burden, both in terms of time and money. While we are not tax professionals and we cannot give tax advice, we do keep our finger closely on the pulse of tax reform.

While it is too early to tell you the exact impact (because the final bill is not yet signed), there are a few general themes that we are confident will emerge and should be on your radar. As you can imagine, this blog post can't begin to cover every aspect of the tax code, so we'll instead focus on a few key items as they relate to individual and family returns, especially as it relates to your investments (perhaps we'll save a future newsletter – or even seminar – for the impact on business taxation).

First, let's look at the most talked about tax in the investment world – capital gains. These rates are not changed, including the 3.8% net investment income tax that applies to higher earners. However, more of you may now be subject to 0% capital gains rates, as the underlying marginal tax rates shift. As you may know, those in the lowest two tax brackets currently pay a 0% long-term cap gains rate (this can especially unlock great strategies for new retirees or those in a job transition).

Next, what about deductions? It is likely that the standard deduction will significantly increase – though much of this is paid for by

the elimination of the personal exemption. In addition, the PEASE limitations that limit deductions for high-income earners are likely to go away, helping to increase the value of each dollar deducted (for a select few). Here in Washington, your (crazily high) property taxes will remain deductible, while you say goodbye to the sales tax deduction (buy that new car before year end!). It's not clear yet what will happen to the beloved mortgage interest deduction, but it's fairly safe to say you won't be impacted as it relates to existing mortgages. All in all, itemized deductions are going to become slightly less valuable for many, so we encourage clients to consider accelerating deductions into this tax year where possible (especially for those of you in Oregon, California, and other states subject to a state income tax).

On the income side of things, the new tax brackets are hard to pin down – as there are significant differences between the Senate and House bills. In general, you are likely to find yourself at the same or lower marginal bracket, and will also find your tax bill reduced by lower rates in the lowest brackets. In contrast to the general guidance to accelerate deductions, most clients will find themselves best served by delaying income into next year wherever possible.

Now let's look at qualified retirement accounts. This one is simpler – as there are no changes to 401(k), IRA, and ROTH IRA eligibility and contribution rules (in fact 401(k) limits are increasing to $18,500 for 2018; no changes to IRA limits). Deductions for these contributions remain "above-the-line," meaning you still benefit from them even if you find yourself no longer itemizing deductions.

Lastly, a quick bit on the Alternative Minimum Tax (AMT). It looked likely that this much-maligned tax was soon to be a thing of the past, but I just read that it may re-emerge in a slightly modified form as the reconciliation process continues. Did we mention things won't get much simpler?

Again this is just an introduction (albeit still a long one). Your situation is unique, and we encourage you to engage with us see how your personal financial plan is impacted by pending changes to the tax code. Working alongside your tax professional, we aim to serve you with "tax-aware" investment and financial planning. This is different from "tax-beholden" investing. In other words, we want to make sound tax decisions in the context of sound investment planning, as opposed to letting the tax code dictate the investment decisions. Doing so helps drive better long-term outcomes for your financial picture.

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