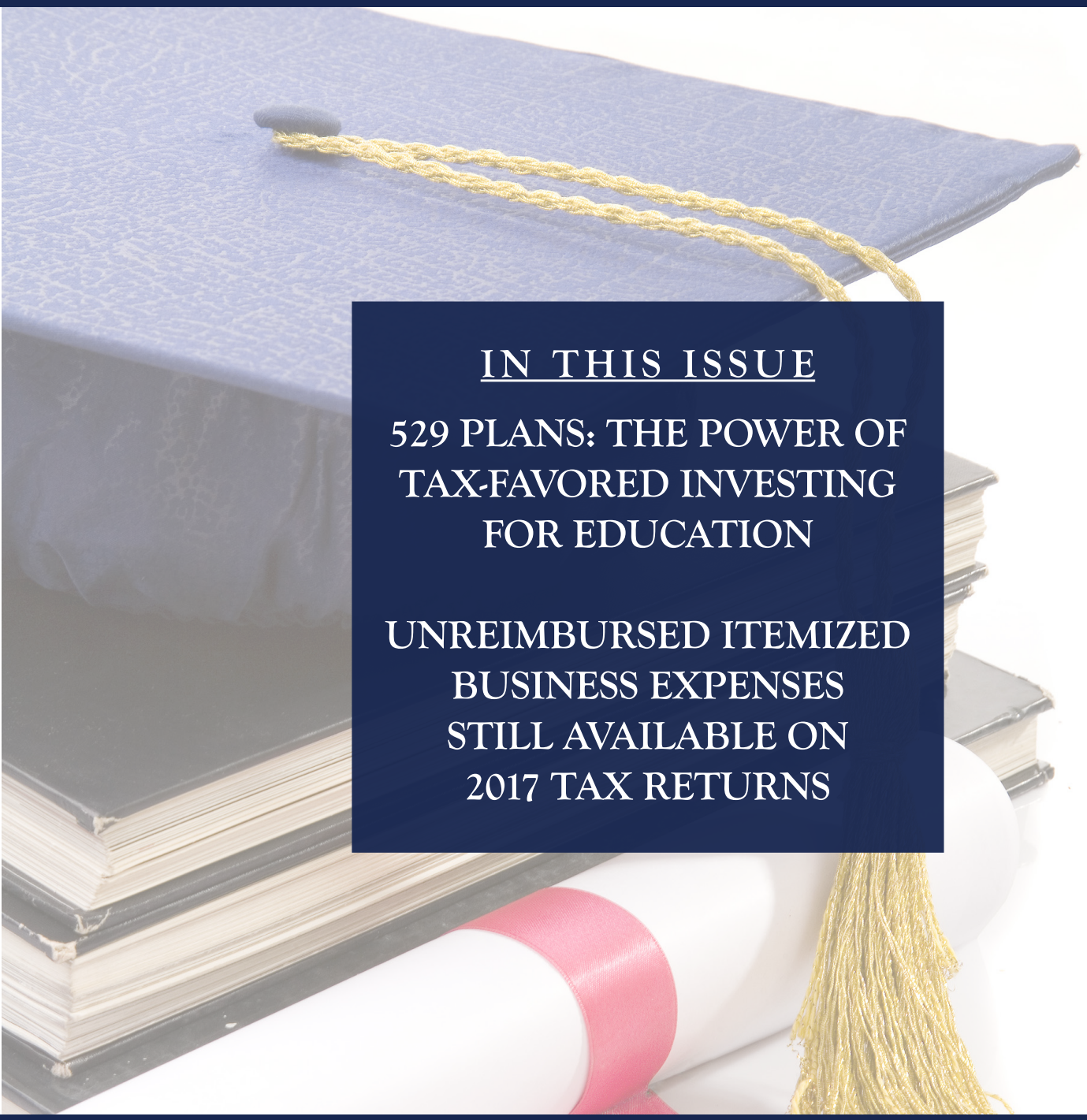
The Siller & Cohen Report

1st Quarter 2018



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529 Plans: The Power of Tax-Favored Investing for Education

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What is a 529 Plan?
A 529 Plan is a tax-advantaged savings plan designed to assist families in saving for education expenses. 529 Plans are operated by a state or educational institution and can be invested based on the investment options offered by that plan. Typically, the owner of the plan chooses how to invest the funds among the options provided.

Costs of Education
As we all know, college and university costs are on the rise, leaving many families struggling to fund their children's education. According to "Saving for College," new parents who have a child today can expect to pay around $275,000 over four years in higher education expenses if that child enrolls in an in-state public university when he or she turns 18 (assuming no scholarships or grants). That number doubles to a little over $550,000 if the child wants to attend a private university (again, assuming no scholarships or grants)[1]. By providing tax-exempt growth, and in some cases, state income tax deductions for contributions, 529 plans assist families in managing these costs.

Additionally, new tax legislation effective for 2018 allows 529 Plan owners to use up to $10,000 per year of 529 plan funds for certain private school K-12 expenses.

Benefits of 529 Plans
- Tax-free growth of investments in the plan (no tax on interest, dividends, or capital gains).
- Tax-free distributions of funds if they are used for "qualified education expenses."
- Of the over 40 states that have an income tax, over 30 of them allow tax-deductible 529 plan contributions.
    - In New York and Connecticut, a married couple may deduct $10,000 from their state income taxes ($5,000 per person).
    - New Jersey does not allow tax-deductible 529 plan contributions.

Limitations and Penalties
529 Plan funds may only be used for "qualified education expenses." You are always free to withdraw your principal investment from your 529 plan without penalty. However, if you withdraw any investment gains for "non-qualified expenses," the IRS may assess the following penalties:

- 10% early withdrawal penalty on the investment gains you take out.
- Income Taxes on the investment gains you take out.

To be safe, before making any withdrawal of 529 funds, you should double-check with your accountant that the transaction is allowed.

Qualified Education Expenses: Eligible uses for 529 Plan funds
Traditionally, 529 Plans were designed to fund higher education expenses, but tax legislation effective for 2018 expanded the allowable uses of 529 plans to include up to $10,000 of certain private school

K-12 expenses. However, while the federal law has changed to allow distributions for K-12 expenses, some states will not follow suit.

Significantly, the New York State Department of Taxation and Finance recently issued a preliminary report stating that it likely will not consider distributions for K-12 private school expenses qualified distributions. This means that New York 529 distributions used to pay for private school will be subject to state and local tax, as well as the recapture of any previous tax benefits or deductions accrued as a result of those distributions. Before using your 529 funds for a K-12 distribution, be sure to check with your CPA what the rules are in your state, and ensure that you will not be subject to state and local taxes or penalties.

The table below summarizes allowable and unallowable distributions for both higher education and K-12 expenses.

Type of Expense	Is this expense qualified for:	
	Higher Education?	K-12?
Tuition and fees	Yes	Yes; up to $10k/ year
Books and supplies	Yes	No
Computers and related equipment and services	Yes	No
Room and board (if enrolled at least half time)	Yes	No
Special needs equipment	Yes	No
Transportation costs	No	No
Health insurance	No	No
Student loan payments	No	No

Beneficiaries

Each 529 Plan has one and only one designated beneficiary. However, this beneficiary can be changed to another member of the family with no tax consequence if the family members are in the same generation. For example, if you have two children, John and Mary, and John earns a full scholarship, the 529 funds intended for him can be rolled into a 529 plan for Mary without incurring taxes.

Funding a 529 Plan

Using what is known as the gift tax annual exclusion, effective for 2018, an individual may contribute $15,000 per year into a 529 Plan without incurring any gift tax, and a married couple may contribute $30,000. These amounts are subject to change based on inflation. Additionally, tax law allows contributors to "front-load" a 529 Plan for up to five years, meaning that rather than deposit $30,000 per year into the plan for five years, a married couple can make an initial deposit of $150,000 when they first establish their 529 Plan. In this case, each spouse would be using five years-worth of their annual exclusions. It is important to note that you are generally required to file Federal and State gift tax returns when front-loading a 529 Plan.

A Planning Concept: Rollovers to a NY State 529 Plan after Front-Loading another State's Plan.
The state of New York allows married couples to deduct a maximum of $10,000 per year from their income tax returns for 529 contributions, but what about couples who front-load their plans? Consider the following example, in which New York City residents, the Jones's, fund a New York State 529 Plan.

- The Jones's make the following deposits, totaling the $150,000 maximum allowable contribution:
    - o $10,000 into a New York 529 Plan
    - o $140,000 into a non-New York 529 Plan
- Each year, the Jones's roll $10,000 from the non-New York plan into the New York Plan.
- This annual transaction qualifies the family for the $10,000 deduction in New York each year.
- The Jones's save $1,073 annually in taxes - $10,000 times 10.73% tax rate (New York City and State tax).
- Over 15 years, the Jones's save $16,095 in taxes. If these tax savings were invested at a 5% net rate of return, they could grow to an amount large enough to cover the last semester of a public in-state university.
- Be sure to confirm this transaction with your CPA before executing it in any state. While this is currently allowable in New York, it is not allowed in all states, and all state laws are subject to change.

Final Thoughts
Since their creation in 1996, 529 Plans have been an effective way for parents and grandparents to save for their children's and grandchildren's education. If you are wondering if a 529 plan may make sense for your family, or if you have any questions about the information presented in this article, don't hesitate to reach out to us. We would be happy to help.

Sources:
1. World's Simplest College Cost Calculator. Retrieved from https://www.savingforcollege.com/calculators/worlds-simplest-college-cost-calculator

2. (2017, August 8). 529 Plans: Questions and Answers. Retrieved from https://www.irs.gov/newsroom/529-plans-questions-and-answers

3. Mert, Martha Kortiak. (2018, January 10). What you can pay for with a 529 plan. Retrieved from http://www savingforcollege.com/articles/what-you-can-pay-for-with-a-529-plan

Unreimbursed Itemized Business Expenses Still Available on 2017 Tax Returns

If you work for a business, you might incur certain expenses that are related to your job. In some cases, those expenses can be substantial. While the tax reform act suspends the deduction for 2% miscellaneous itemized deductions, for tax years 2018 through 2025, it does not change the rules for the 2017 taxable year.

The process of claiming this deduction for employee business expenses might not be simple. You must go through several steps, and you'll need relevant records to substantiate the deduction if you're

challenged by the IRS.

The Broad Look

In general terms, here is an explanation of how to arrive at an employee business expense deduction. First, you need to see how much you have spent on items that are ordinary and necessary for your role at work as an employee. These must be outlays that were not reimbursed in some manner. Therefore, the amounts you hope to deduct must be your actual out-of-pocket costs.

Once you calculate this amount, it is incorporated as a miscellaneous itemized deduction on the appropriate line of Schedule A of your tax return. If you take the standard deduction instead of itemizing on Schedule A, you can't deduct your employee business expenses.

Other costs also go into the category of miscellaneous deductions. They might include tax preparation and investment fees. Once you have a total of miscellaneous items, that amount is deductible on Schedule A to the extent it exceeds 2% of adjusted gross income (AGI).

Example: Al and Bonnie Carson are both employees at different companies. Al has no unreimbursed employee expenses, but Bonnie had $2,500 of such costs in 2017. Together, the Carsons' miscellaneous items total $4,100 for last year.

On their 2017 joint tax return, the Carsons report AGI of $110,500. In this example, 2% of AGI is $2,210. Subtracting $2,210 from $4,100 leaves $1,890, the amount of miscellaneous deductions they can claim on Schedule A.

What's Allowed

The most common unreimbursed miscellaneous deductions may be vehicle costs, overnight travel, and business meals and entertainment. The deduction for business meals and entertainment generally is 50% of their total cost.

Beyond those items, the IRS lists many others as acceptable employee business expenses, from business liability insurance premiums to work-related education. They must have a genuine business purpose and be unreimbursed.

What's Not Allowed

Along with a lengthy list of possible qualified deductions, the IRS also has a list of things that don't belong in this category. Commuting costs are prominent on the do-not-deduct list, which also includes club dues, residential phones, and travel expenses for another individual. If you are going to claim business use of your car here, you'll need good records to show how much the car was used for commuting to and from work versus its use for business trips.

Planning Opportunity

If you are a business owner and file schedule C, your business-related deductions are not impacted by the suspension of itemized employee business expenses for taxable years 2018 through 2025.

Lincoln Financial Advisors does not provide tax or legal advice. You should discuss the issues above with your CPA or tax preparer before taking any action.

What's New At Siller & Cohen: 1st Quarter 2018

Speaking Events:

- Randy Siller, Yona Klein, and Nicholas Strang presented a continuing education program to a regional CPA firm headquartered in Florida, with offices in NYC and Westchester. They presented on a variety of topics, including:

  > Financial planning strategies.

  > Tax Planning and the effects of tax inefficiencies within an investment portfolio.

  > Fixed income, equity, and alternative investment overviews.

  > Economic outlook for 2018, and pressures driving the markets currently and in the future.

- Jeff Cohen was asked to speak at Lincoln Financial Advisors 2018 Spring Forum. He presented on understanding and navigating family dynamics within the financial planning process.

- Randy Siller was asked to speak at Lincoln Financial Advisors 2018 Spring Forum. He made two presentations. He presented on Trust and Estate Planning, specifically ways in which the new tax law affects planning strategies. Additionally, he presented on strategies for generating income in an investment portfolio in today's rising interest rate environment.

Staff Achievements:

- We are proud to announce that Nicholas Strang and Freddie DiFranco have obtained their Life, Accident, and Health Insurance certifications.

Source of data – Yahoo Finance, Morningstar, Wall Street Journal, Bloomberg, Reuters, Dow Jones Newswires, BNP Paribas, U.S. Department of Commerce, The Federal Reserve. Mary Schmich's quote taken from "Advice, like youth, probably just wasted on the young." published in the Chicago Tribune (1997). The performance of an unmanaged index is not indicative of the performance of any particular investment. It is not possible to invest directly in any index. Past performance is no guarantee of future results. This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. Three-year performance data is annualized. Bonds have fixed principal value and yield if held to maturity and the issuer does not enter into default. Bonds have inflation, credit, and interest rate risk. Treasury Inflation Protected Securities (TIPS) have principal values that grow with inflation if held to maturity. High-yield bonds (lower rated or junk bonds) experience higher volatility and increased credit risk when compared to other fixed-income investments. REITs are subject to real estate risks associated with operating and leasing properties. Additional risks include changes in economic conditions, interest rates, property values, and supply and demand, as well as possible environmental liabilities, zoning issues and natural disasters. Stocks can have fluctuating principal and returns based on changing market conditions. The prices of small company stocks generally are more volatile than those of large company stocks. International investing involves special risks not found in domestic investing, including political and social differences and currency fluctuations due to economic decisions. Investing in emerging markets can be riskier than investing in well-established foreign markets.