Tax Report

QUARTER 4 2018

The Tax Cuts and Jobs Act (TCJA) of 2017 is the most significant alteration to the tax code in 30 years and will impact nearly every taxpayer in 2018.

In 2017, there were seven tax brackets ranging from 10% to 39.6% and 0% to 20% brackets on capital gains. For 2018, there will continue to be seven tax brackets but with lower rates ranging from 10% to 37%. For capital gains, there will still be 0% to 20% brackets, but coming in at different points.

Here are some other ways the new tax laws may affect you:

- Tax rates will likely drop by 2–4%.
- Four out of five taxpayers can expect a tax reduction with an estimated average savings of $1,600.
- The highest tax bracket will be lowered from 39.6% to 37%.
- Higher income earners will see more of a reduction than lower earners. *(Sources: Tax Cuts and Jobs Act; IRS-Rev. Proc. 2017-58; Tax Policy Center)*

FEDERAL INCOME TAX BRACKETS (SINGLE)

2017		2018	
10%	$0–$9,525	10%	$0–$9,525
15%	$9,526–$38,700	12%	$9,526–$38,700
25%	$38,701–$93,700	22%	$38,701–$$82,500
28%	$93,701–$195,450	24%	$82,501–$157,500
33%	$195,451–$424,950	32%	$157,501–$20,000
35%	$424,951–$426,700	35%	$200,001–$500,000
39.6%	Over $426,700	37%	Over $500,000

FEDERAL INCOME TAX BRACKETS (MARRIED FILING JOINTLY)

2017		2018	
10%	$0–$19,050	10%	$0–$19,050
15%	$19,051–$77,400	12%	$19,051–$77,400
25%	$77,401–$156,150	22%	$77,401–$165,000
28%	$156,151–$237,950	24%	$165,001–$315,000
33%	$237,951–$424,950	32%	$315,011–$400,000
35%	$424,951–$480,050	35%	$400,001–$600,000
39.6%	Over $480,050	37%	Over $600,000

TCJA HIGHLIGHTS

Key policy highlights that could impact most investors:

- ✓ Kept seven tax brackets, but reduced the rates
- ✓ Increased standard deductions and eliminated others
- ✓ Created state and local tax (SALT) limitations
- ✓ Doubled the Child Tax Credit and changed a range of family tax issues on children, schooling, marriage, retirement, and estate planning
- ✓ Mortgage interest rate deductions available for new mortgages decreased
- ✓ Alternative Minimum Tax (AMT) increased
- ✓ Medical expense deductions were modified
- ✓ Eliminated the Affordable Care Act's individual mandate penalty tax
- ✓ Lowered corporate tax rates; businesses and small business owners face several rule changes
- ✓ Pass-through income will be taxed differently
- ✓ Estate taxes remained but exemption levels doubled

COMPARISON OF MARRIED FILING JOINTLY RATES

The table to the right shows a quick comparison of the pre-tax bill rates that were scheduled versus the new tax rates after the TCJA.

As you can see, most rates are down, with the lower brackets and the $237,951 to $315,000 range being the big winners rate-wise.

Not taking the use of deductions into account, taxes paid on income should go down for most people.

Be sure you're having the right amount withheld, especially if you purposefully plan for a rebate each year. The IRS believes that further changes will be made to the tables for 2019.

TAX PLANNING STRATEGY
To be sure you're having the right amount withheld, use the withholding calculator at irs.gov.

Per Notice 1036, the IRS will be updating the withholding calculator to help taxpayers determine their withholdings. The calculator should be ready by the end of February and can be found at irs.gov. Taxpayers are encouraged to use the calculator to adjust their withholding once it is released. 90% of taxpayers will see more money in their paychecks in February. *(Source: IRS Press Release IR-2018-05)*

MARRIED FILING JOINTLY RATES

INCOME RANGE	SCHEDULED 2018 RATE	TCJA RATE
$1–$19,050	10%	10%
$19,051–$77,400	15%	12%
$77,401–$156,150	25%	22%
$156,150–$165,000	28%	22%
$165,001–$237,950	28%	24%
$237,951–$315,000	33%	24%
$315,001–$400,000	33%	32%
$400,001–$424,950	33%	35%
$424,951–$480,050	35%	35%
$480,051–$600,000	39.6%	35%
Over $600,000	39.6%	37%

STANDARD DEDUCTIONS

FILING STATUS	2017	2018
Single	$6,350	$12,000
Married Filing Jointly or Qualifying Widows and Widowers	$12,700	$24,000
Married Filing Separately	$6,350	$12,000
Head of Household	$9,350	$18,000

EXEMPTIONS & DEDUCTIONS

New tax tables reflect the repeal of personal exemptions, changes in tax brackets, and the increase in the standard deduction.

According to the Tax Foundation, 68.5% of households took a standard deduction in 2016. In 2018, it is predicted that over 90% of Americans will be taking the higher standard deduction, according to the Treasury Department. According to *Kiplinger's*, 38 million of the 45 million taxpayers "would be better off" with taking the higher standard deduction, rather than itemizing.

The additional standard deduction for taxpayers 65 and older still applies.

TAX PLANNING STRATEGY
Take the standard deduction one year and then itemize your "bunched" deductions for the next year.

The new tax law eliminates the personal exemption of $4,050, which means the large increase in the standard deduction won't be that large for some families.

New deduction amounts will sunset in 2025. *(Sources: U.S. Treasury; the Tax Foundation, Tax Cuts and Jobs Act of 2017; IRS-Rev. Proc. 2017-58; IRS Schedule A (Form 1040))*

Exemptions

Most exemptions were completely repealed at the end of 2017 and were instead consolidated into the standard deduction.

The Child Tax Credit was expanded and a new family tax credit was designed to offset the loss for families.

Itemized Miscellaneous Deductions

You will no longer be able to deduct moving expenses, home office expenses, investment fees, tax preparation fees, professional dues, or casualty loss (in most instances). (*Sources: Tax Cuts and Jobs Act; IRS-Rev. Proc. 2017-58)*

Mortgage Interest Deduction

The mortgage interest rate deduction was reduced from $1 million to $750,000 (or $375,000 for married filing separately). Existing loans will

be grandfathered up to the original amount but not to exceed $1 million.

Home equity loans are no longer deductible, unless used in connection with home acquisition or improvement. *Sources: Forbes, Realtors Predict Tax Bill Will Cause Housing Prices to Drop in Every State, December 2017, The Tax Foundation, "2018 Facts and Figures, Tax Cuts and Jobs Act")*

Medical Expenses

Medical expense tax deductions were expanded for 2017 and 2018 by setting the deduction threshold to 7.5% of AGI for all taxpayers.

In 2019, the floor increases back to 10% of AGI before medical expenses can be deducted. If possible, incur elective medical and dental expenses before December 31, 2018 while the lower limitation applies. *(Sources: Tax Cuts and Jobs Act; IRS-Rev. Proc. 2017-58, Tax Cuts and Jobs Act; IRS Publication 502)*

TAX PLANNING STRATEGY

Incur medical and dental expenses before the end of the year for lower deductions.

Donations to Charitable Organizations

Cash contributions to public charities are deductible up to 60% of AGI (from 50%). Here are some strategies for increasing your deductions:

- Contribute highly appreciated securities to charities.
- Consider contributing to a donor-advised fund.
- Consider a Qualified Charitable Distribution (QCD).

Please seek tax and legal advice when exploring these strategies. If you are considering donating to a QCD, here are some important points to remember:

- Contributions are limited to the amount that is taxed as ordinary income.
- Funds must come out of the IRA by the Required Minimum Distribution (RMD) deadline.
- The annual limit on QCDs from all IRAs cannot exceed $100,000 per individual.

While Roth IRAs do not require RMDs, a QCD may be taken from a Roth IRA under certain conditions. Only earnings on a Roth can be used to satisfy a QCD that have not been in the Roth for five years. *(Sources: Tax Cuts and Jobs Act; Tax Policy Center T170336; IRS Publication 526)*

Alternative Minimum Tax

The increased standard deduction means many households won't itemize deductions *and* won't get hit with the Alternative Minimum Tax (AMT). That may mean more money in pockets of high earners. And those who still owe AMT may end up owing less than previous years.

If you're hit with AMT, you will pay your regular lower tax plus the AMT difference. In the past, that has applied to a lot of people. But now you're less likely to pay the alternative minimum tax.

Incentive stock options may trigger AMT liability, but exercising options over a series of different tax years may help. Seek advice from a tax professional. *(Sources: IRS Topic Number 556, Tax Cuts and Jobs Act; IRS-Rev. Proc. 2017-58, The Tax Foundation)*

TAX PLANNING STRATEGY

Exercise options over different tax to help avoid AMT.

ALTERNATIVE MINIMUM TAX

INCOME RANGE	2017	2018
Single or Head of Household	$54,300	$70,300
Single or Head of Household (Beginning of Phaseout)	$120,700	$500,000
Married Filing Jointly	$84,500	$109,400
Married Filing Jointly (Beginning of Phaseout)	$160,900	$1,000,000

CHILD & FAMILY TAX CREDITS

Child & Family Tax Credits Double

The credit won't phase out until a single filer's income is $200,000 or $400,000 for married couples filing jointly. *(Source: Tax Cuts and Jobs Act)*

Maximize After-Tax Returns

Higher tax bracket payers could deduct their retirement account investment fees from their retirement accounts, essentially paying the fees with cheaper pre-tax dollars, potentially saving money.

You may also consider mutual funds* as they can provide a tax advantage because fees are netted against the fund's taxable income, but always consider after-tax benefits.

TAX PLANNING STRATEGY
Investing in mutual funds can provide a tax advantage.

Be sure to consult a professional tax advisor regarding your specific situation.

Education Provisions

With Section 529 plans, distributions of up to $10,000 may be used for "qualified expenses" for elementary school and high school.

Forgiveness of student loan debt will not be taxable income to the student on account of the student's death or total disability.

As with other investments, there are generally fees and expenses associated with participation in a 529 plan. There is also a risk that these plans may lose money or not perform well enough to cover college costs as anticipated.

Most states offer their own 529 programs, which may provide advantages and benefits exclusively for their residents. The tax implications can vary significantly from state to state. *(Source: Tax Cuts and Jobs Act; IRS Newsroom, "529 Plans")*

Taxes & Home Ownership

Since the modern introduction of the federal income tax in 1913, national, state, county, school, and municipal taxes could be deducted to avoid being taxed twice on the same income and to promote home ownership.

In 2017, the deductible was unlimited, but in 2018 it is limited to $10,000 for all state, local, property, and sales taxes.

Divorce

For divorces after 2018, alimony is no longer a deductible expense for the payer, nor is it considered income to the payee. Previously, both were allowed.

Before finalizing, be sure to review the full cost of your divorce. Ensure your divorce attorney or mediator understands the new tax treatment for alimony, consider property settlements in lieu of alimony, and seek advice from a tax professional. *(Sources: Tax Cuts and Jobs Act; IRS Publication 1819)*

TAX PLANNING STRATEGY
Review the full cost of your divorce before finalizing.

CHILD & FAMILY TAX CREDITS

	2017	2018
Credit for Children	$1,000	$2,000
Credit for Other Family Members	$0	$500
Beginning of Phaseout	$110,000	$400,000
Refundable Amount (Credit for Children Only)	$1,000	$1,400

HEALTH CARE MANDATE

The tax bill removed the individual mandate by eliminating the penalty for not having coverage. This goes into effect January 1, 2019.

CHANGES FOR BUSINESS ENTITIES

Corporate tax rates went from a scale of 15 to 35% to a 21% flat tax rate.

The U.S. has had some of the highest corporate taxes in the world. Now, corporate taxes will be the lowest since 1939. The belief is that lower taxes could spur increased business investment.

Corporate income over $10 million was previously taxed at the marginal rate of 35%, but will now be taxed at 21%. In truth, the effective tax rate was much lower than 35% according to Goldman Sachs.

CORPORATE TAX RATES

TAXABLE INCOME	2017	2018
$0–$50,000	15%	21%
$50,001–$75,000	25%	21%
$75,001–$10,000,00	34%	21%
Over $10,000,000	35%	21%

**Investing in mutual funds is subject to risk and loss of principal. There is no assurance or certainty that any investment strategy will be successful in meeting its objectives.*

Corporate AMT

The corporate AMT has been eliminated and the changes are permanent. Previously, the corporate AMT was 20%. This is another incentive that makes the U.S. more attractive for foreign companies to invest.

Multinational companies, such as Nike or Microsoft, were taxed on their foreign income when they brought profits to the U.S. As a result, those companies wouldn't bring that income to the U.S., but would invest the funds internationally. Because of the new act, those companies won't be taxed on foreign profit and may investment more heavily in the U.S.

New Business Pass-Through Rate

A pass-through is when individual business owners pay taxes on their firm's income on their personal income tax return. Roughly 92% of private businesses in the U.S. are organized as pass-throughs. This includes sole proprietorships, partnerships, limited liability companies, and S corporations.

Prior to the new tax law, small business owners usually paid taxes based on their individual tax rates up to 39.6%. Now, owners will be allowed to take a 20% deduction for qualified business income (QBI) and these individuals will only be taxed on 80% of their pass-through income. Combined with the new 37% top individual rate, the top tax rate for eligible pass-through business income is 29.6%. Most small businesses will see at least modest relief from their taxes.

This provision has many complications incuding a phase-out starting at $157,500 (single) and $315,000–$415,000 (married filing jointly) of taxable income.

The deduction phases out for highly compensated professionals, such as dentists, lawyers, and investment managers, beginning at incomes of $157,500 for singles and $315,000 for joint filers. The deduction is unavailable when total income reaches $207,500 or $415,000 for single filers or married filing jointly, respectively.

A couple with a small business that has less than $315,000 of total income could pay $20,000 less in taxes.

Owners of service-based businesses, such as law or dental practices, are not eligible for the tax break above the income phase out limits. Owners of engineering, architectural, and real estate firms are excluded from this provision. Non-service firms can still get the exclusion, but the amount of the exclusion may be less than 20% depending on more limits.

This deduction will end after 2025. If you have a pass-through corporation, we encourage you to see a CPA for specific details. *(Sources: Tax Cuts and Jobs Act; IRS-Rev. Proc. 2017-58, The Tax Foundation, "2018 Facts and Figures")*

Depreciation for Small Businesses

Changes to bonus deprecation and Section 179 give businesses more options for expensing property and equipment. The cap on expensing business assets will rise from $500,000 to $1 million.

Businesses should be asking themselves, "What business equipment purchases or business improvements are we contemplating that could now receive a more generous depreciation?"

Seek accounting and legal advice for this one. *(Source: Tax Cuts and Jobs Act)*

ESTATE PLANNING & GST TAXES

The House GOP legislation proposed a total repeal of estate taxes. While the tax act does not quite go that far, it does double the unified estate and gift tax exemption amounts from their current levels, which raises the scheduled 2018 exemption of $5.6 million into an $11.2 million individual estate tax exemption and a $22.4 million exemption for married couples if you pass away after December 31, 2017.

But it wasn't that long ago that people with estates under $1 million had to worry about the estate tax. So wills and trusts may have formula clauses tied to the amount of the exclusion, which could now result in unintended estate dispositions. Many of these estate plans should be reviewed in light of the tax act.

Step-up in basis remains, as does the top 40% tax rate on gifts and estates, as well as the existing rules on generation skipping taxes.

Federal estate tax is not the only reason for estate planning. State taxes apply in many situations. There are family circumstances to consider in determining how much to leave beneficiaries and in what manner. Trusts

ESTATE & GST TAXES

- ✓ Doubles the basic exclusion amount and GST exemption
- ✓ Retains the form 1014(a) basis adjustment ("step-up")

are important to control the disposition of assets even if estate taxes are no longer a factor. For people under $22.4 million of assets, which is most of them (99.92%), it is still important that their estates are distributed to the right beneficiaries, the right way. This higher exemption amount will sunset December 31, 2025 and return to the current amount. *(Sources: Tax Cuts and Jobs Act; IRS-Rev. Proc. 2017-58)*

Re-examine Wills, Trusts, & Estate Plans

Only eight per 10,000 estates are expected to owe tax. Check your wills and trusts with your estate planning attorney to ensure formulas still applicable. Some estates under exemption levels may no longer need life insurance policies to pay federal estate taxes.

Remember, you may still owe state-level estate taxes. Does your will protect your spouse and children with a flexible trust? Are your aging relatives protected with a robust revocable trust? While many people like simple wills, a simplified document may not cover all your needs or have the flexibility to address evolving laws.

You may have signed a will many years ago when the exemption amount was significantly lower. Because Congress has changed the estate tax many times, it's worth reviewing your documents.

Roth Conversions Got Trickier

Roth IRAs are a retirement account for post-tax income up to a specified amount each year. All withdrawals after 59 ½ are tax-free if the five-year holding period has passed. Unlike IRAs, there is no Required Minimum Distribution (RMD) for Roth IRAs.

A Roth can be a very powerful tool to help save for retirement. In fact, now more than ever may be a good time to convert your pre-tax dollars in your traditional IRA to a Roth IRA, since your tax bracket may have fallen due to the change in income brackets.

Roth recharacterization can *not* be used to unwind a Roth conversion you cannot change the Roth back to an IRA. Ever. Once it is converted, there are no more do-overs, which is why you'll likely want to do conversions in October or later.

Still, Roths remain a great retirement planning tool. Making smaller conversions over different tax years may eliminate doing a large conversion in one year and the possible difficulties connected with tight cash flow near the tax filing date, or if the market pulls back, decreasing the value of the account. Roth IRAs are still an attractive retirement account for many reasons, including the ability to take qualified tax-free withdrawals and the availability to make contributions at any age, as long as you have earned income. In addition, a taxpayer can avoid Required Minimum Distributions (RMDs) with a Roth IRA, which is a huge benefit.

With the new conversion restriction:

- Consider smaller conversions over several tax years
- Consider future cash flow carefully and your ability to pay the tax bill when it comes due
- Consider the potential for market slide when deciding whether to convert
- Consider timing the conversion for later in the year.
- Seek advice from tax and investment professionals

(Sources: IRS Publication 590-A; IRS Notice 2017-64)

ADDITIONAL TAX PLANNING STRATEGIES

- ✓ Maximize retirement plan contributions
- ✓ Tax loss or gains harvesting
- ✓ Tax-exempt strategies
- ✓ Tax-advantaged strategies

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WE REVIEW CHANGES WITH OUR CLIENTS FREQUENTLY

One of our main focuses as a financial advisory practice is to review changes for our clients on an ongoing basis.

Considering the economy and markets isn't enough. As your wealth manager, we also need to understand how your lives may be changing. Perhaps, one of your children is marrying or a new grandchild is on the way. Maybe an illness or a death has changed your family's circumstances. Maybe you've decided to pursue a new career or start a business. No matter what is happening—big changes or small ones—these events play an important role in your finances and the strategies we pursue to help you make the most of your money. So, please, let us know what's changing in your life. It's one reason coming in and sitting down with your advisor for a review at least annually is so important.

Regarding the new tax law:

- Seek professional help from your financial advisor and tax advisor — for our clients tax planning is part of our regular reviews and we've been especially diligent during this past year.
- Ensure that you understand how all the new rules impact you.
- Start building your tax and investment review plan now.

As our clients know, our role as your advisor is to maintain non-emotional objectivity, avoid knee-jerk reactions, and assist you in making decisions that are always in your best interest. Remember, we will be here for you!