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MAY 2018

MORE ABOUT TAX CHANGES

While most taxpayers are now aware of lower federal tax brackets and other changes in the Tax Cuts and Jobs Act of 2017, some may be unaware of less publicized provisions of the new law. These changes feature a little good news, and a bit of bad news.

BAD NEWS

Bad news first. Previously, you could deduct a variety of miscellaneous itemized expenses if they were more than 2% of your adjusted gross income. This provision is gone, which is bad news for people who spend significant money on uniforms, professional development and anything else job-related that employers don't reimburse. Teachers, though, at least get to keep a $250 deduction for classroom and development expenses.

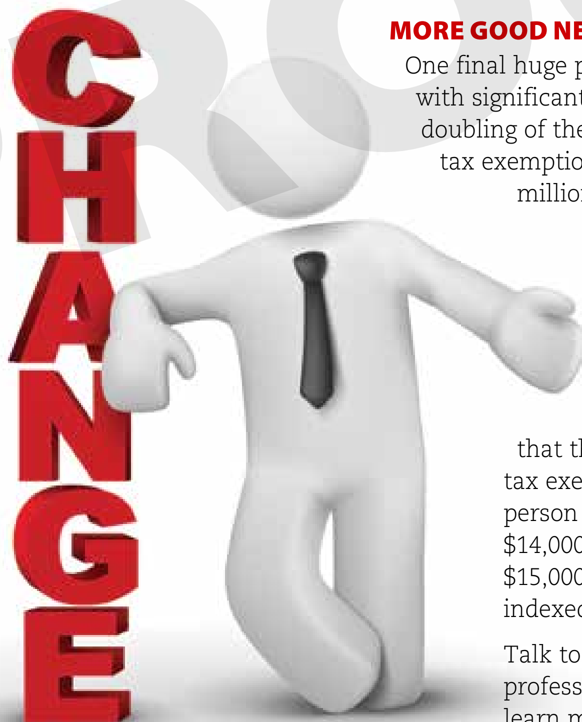
Other deductions that are gone include advisory fees, tax preparation costs and job search expenses. Also significant for homeowners in high-tax states is how much they may deduct annually for state, local, sales and real estate taxes. The limit is $10,000.

GOOD NEWS

If you still itemize, one piece of good news is that starting in 2018, there are no longer income limitations as to who can itemize.

Those taxpayers who want to give more of their income to qualified charities are in luck. The cap on charitable contributions as a percentage of adjusted gross income increased from 50% to 60%.

The Alternative Minimum Tax exemption increased from $84,500 to $109,400 for married taxpayers filing jointly and from $54,300 to $70,300 for single taxpayers. The exemptions also phase out at much higher numbers than before.



MORE GOOD NEWS

One final huge plus for those with significant assets is the doubling of the federal estate tax exemption to $22.4 million for couples and $11.2 million for individuals. While on the subject of estates, also remember that the annual gift tax exemption per person rose from $14,000 in 2017 to $15,000 this year, indexed for inflation.

Talk to your tax professional to learn more.

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529 Plans Expanded

Another change contained in the recent tax bill is the expansion of what constitutes a qualified withdrawal from a 529 plan for education expenses. Previously designed for higher education only, a 529 plan now allows up to $10,000 in tax-advantaged withdrawals per year per beneficiary for qualified grade school (if your state allows) and high school education expenses.

Tax Deferral

While you can't deduct contributions made to a 529 plan on your federal tax return, potential earnings accumulate on a tax-deferred basis. The account owner controls distributions, which incur a tax penalty and income taxes if taken for nonqualified events.

Estate Advantage

A 529 is also a nice estate planning tool. That's because you can make a single-year contribution per person, per beneficiary, of $75,000, free of federal gift tax. You can't make a gift to the same beneficiary for the next four years if you do this.

CUSTODIAL ACCOUNTS

With a recent change in how children's income from savings is taxed, custodial accounts under UGMAs and UTMAs have seeped into talks about saving for college expenses. Here's a look at what these accounts are and whether they can help accomplish your education savings objectives.

WHAT ARE THEY?

The Uniform Gifts to Minors Act (UGMA) and Uniform Transfers to Minors Act (UTMA) accounts are available in most states as alternatives to establishing trusts. Just as gifts to an irrevocable trust can't be reversed, gifts to a UGMA or UTMA account are also final. This means your minor children will immediately own whatever is transferred to these accounts, although you can take withdrawals for the benefit of a child's education and related expenses.

A custodian, which can be a parent, financial institution or advisor, manages either account and anyone can transfer assets to these accounts. You can put virtually anything, including property, into a UTMA account, while a UGMA account accepts only cash, insurance and securities.

TAX TREATMENT

Custodial accounts were once used by parents to transfer assets to children, whose unearned income was taxed at a lower rate than their parents' rate. In recent years this changed, as most custodial accounts' unearned income was taxed at parents' (typically higher) rates.

Now, the tax treatment of a child's unearned income is even more extreme thanks to recent tax law changes. In 2018, children under the age of 19 or full-time students under the age of 24 pay an even higher trusts and estates tax on unearned income – up to 37% on unearned income over $12,500.

In light of these changes, talk to a tax professional to learn if a custodial account or other alternative is best for your situation.

Client PROFILE ••••

Alexa wants to save for her daughters' education, but also wants to control the funds so they don't spend the money for something else when they become adults. Alexa wonders where she can save and maintain control.

Custodial accounts, like those under UGMAs and UTMAs, would not give Alexa the control she seeks when her daughters reach the age of majority in their state, either 18 or 21, and the assets become theirs. Holding assets in a college student's name makes qualifying for financial aid harder than if only the parents' assets were considered.

Two college accounts that would give Alexa more control are 529 plans and Coverdell Education Savings Accounts (ESAs). Both count as parental assets and offer tax-free withdrawals for qualified education expenses. Both would allow Alexa to change beneficiaries if she wanted.

The ESA has annual income qualifications, and time and age restrictions permits only $2,000 per beneficiary per year in contributions. A 529 plan has large contribution limits and no time or age restrictions. For the most flexibility, a 529 plan is probably Alexa's best choice.

Client Profile is based on a hypothetical situation. The solutions discussed here may or may not be appropriate for you.

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YOU'RE RETIRED! NOW WHAT?

You worked a lifetime to build your retirement assets, now how do you take distributions? Any discussion about retirement income usually starts with required minimum distributions, or RMDs.

MIND YOUR RMD

If you contributed to any qualified retirement plans or accounts, including a 401(k) plan and traditional IRA, you must begin taking RMDs by age 70½, with some exceptions. Your plan custodian or advisor should determine your RMD by using uniform life expectancy tables. If you don't take your full RMD, you'll pay a 50% tax on the amount not taken.

TAXABLE OR TAX-DEFERRED?

Once you get your RMD squared away, compare your tax rates on taxable and tax-deferred investments if you need to withdraw additional funds. For the former, capital gains on investments held at least a year and a day aren't taxed (at 15%) until your adjusted gross income reaches $77,200 (married filing jointly). The same couple's income must exceed $479,000 to trigger a 20% tax.

If your ordinary income tax bracket is lower than the capital gains rate, you might consider tapping the tax-deferred accounts rather than realizing taxable gains. If the tax rates are similar, consider letting the tax-deferred potential build-up if your qualified retirement plans continue. Capital gains are realized in the year the investment is sold.

THEN ROTH LAST

After you've tapped your other assets, you might begin spending down a Roth account, which doesn't have RMDs and whose distributions are tax-free.

EASIER TO BECOME A 501(C)(3)

The Internal Revenue Service revised an application and instructions that small charities must use to qualify for tax-exempt status. The IRS requires exemption-seeking applicants with assets under $250,000 and annual receipts under $50,000 to file Form 1023-EZ, Streamlined Application for Recognition of Exemption.

MORE ACCURATE INFORMATION

There are two major changes to the application. One change is a text box added to Part III of the application that requests a brief description of the organization's mission or most significant activities. This change, recommended by the IRS National Taxpayer Advocate, is designed to provide a better understanding of an applicant's most significant activities.

The other change is an addition that involves both the application and worksheet. The application now asks questions about annual gross receipts, total assets and the public charity classification of the applicant.

These changes may reduce the time needed to gain 501(c)(3) status, which typically takes three to six months but can take longer when follow-up is needed.

Q&A

Q: With the new tax law and lower federal income tax rates, does it still pay to open a Roth IRA?

A: A Roth IRA requires no minimum distributions during your lifetime. The new tax laws also didn't alter a Roth IRA's tax-free qualified distributions and potential earnings. Another reason to consider this tax-free retirement savings vehicle is uncertainty. None of us can read a crystal ball, and today's tax breaks could become tomorrow's tax hikes. And remember that most of the new personal tax changes end after 2025, unless they are extended or made permanent.

Q: I read that the new tax cut bill will allow more companies to choose between the cash and accrual methods of accounting. My business generates under $15 million annually. Which is better for me?

A: You and your tax professional should decide which method ultimately works best for you, but generally cash accounting is simpler because you record income when received and expenses when paid. This can, however, make budgeting unpredictable. The accrual method of accounting records your income as you bill it and expenses as they occur, making budgeting a bit more predictable, but accounting a little more complicated. Only businesses generating $25 million or less get to choose between the two methods.

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ClientLine® SHORT BITS

> COMPENSATION GREW BY 2.6% FOR CALENDAR YEAR 2017. That's up from 2.2% in 2016, according to the Bureau of Labor Statistics (BLS). The last two years of wage increases are good news for workers, who saw years of wage stagnation following the Great Recession.

> MORE WORKERS RECEIVE FINANCIAL ADVICE AS AN EMPLOYEE BENEFIT. Again from the Department of Labor's BLS, about one-fifth of private industry workers were offered free or subsidized financial planning services from their employers in 2017. As might be expected, about three times the number of employers with at least 100 employees offered the benefit compared to smaller employers. Information, finance and insurance, and utilities were the three industries most likely to offer it; administrative and waste services, leisure and hospitality, and construction were the least likely.

> CONSUMER DEBT AT RECORD HIGH. One potentially troubling economic sign is that consumer debt hit an all-time high. According to the Federal Reserve Bank of New York's Quarterly Report on Household Debt and Credit, total household debt reached a new peak in the third quarter of 2017 at $12.96 trillion. That's $280 billion above the previous high in the third quarter of 2008. Balances increased by 0.6 percent on mortgages, 1.9 percent on auto loans and 3.1 percent on credit cards.

> INFLATION ROSE 2.1% IN 2017. The reporting, via the BLS's Consumer Price Index for All Urban Consumers (CPI-U), showed an the increase during the 12 months ending December 2017. In 2016, the same index also increased 2.1%, while 2015 showed only a 0.7% rise in inflation.

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