December 2018 Client-Letter

Topics for this month:

Tax Reform and Tax Preparation

8 smart year-end financial planning moves

Tax reform and tax preparation

As a new year approaches, we can reflect on the year that has passed. Personal and professional accomplishments may take center stage. And we may take stock of any disappointments and recalibrate as 2019 approaches.

But in any case, I know it's a busy time. Holiday shopping, holiday parties, community and family events and visits, and much needed year-end cheer may already be on the calendar.

Yet it's not too soon to start thinking about taxes. We may have had discussions about 2017's tax reform, but until we've filed for 2018, it may still feel confusing to many.

Before we jump in, *let me stress that it is my job to assist and help you*. I can't overemphasize this, and I would be happy to review the options that are best suited to your situation. When it comes to tax matters, I also recommend you check with your tax advisor.

Let's get started

Tax reform, officially known as the Tax Cuts and Jobs Act (TCJA) of 2017, was the biggest change in the tax code in over 30 years. The overhaul covered both individual and corporate income taxes. Most will see their tax bill decline a little when they file, but a few folks may see a sharper bite.

I'll touch on some of the changes at a high level.

1. **Tax brackets and tax rates have changed**. The lowest bracket holds at 10% but the top bracket has been lowered from 39.6% to 37%. There have also been modest adjustments to the rates and income levels for taxable income.

Single filers 2018			Single filers 2017	
Taxable income	**Rate**		**Taxable Income**	**Rate**
$0 – $9,525	10%		$0 – $9,325	10%
$9,526 – $38,700	12%		$9,326 – $37,950	15%
$38,701 – $82,500	22%		$37,951 – $91,900	25%
$82,501 – $157,500	24%		$91,901 – $191,650	28%
$157,501 – $200,000	32%		$191,651 – $416,700	33%
$200,001 – $500,000	35%		$416,701 – $418,400	35%
$500,001 or more	37%		$418,401 or more	39.6%

Married filing jointly 2018*			Married filing jointly 2017	
Taxable income	**Rate**		**Taxable Income**	**Rate**
$0 – $19,050	10%		$0 – $18,650	10%
$19,051 – $77,400	12%		$18,651 – $75,900	15%
$77,401 – $165,000	22%		$75,901 – $153,100	25%
$165,001 – $315,000	24%		$153,101 – $233,350	28%
$315,001 – $400,000	32%		$233,351 – $416,700	33%
$400,001 – $600,000	35%		$416,701 – $470,700	35%
$600,001 or more	37%		$470,701 or more	39.6%

*or Qualifying Widow(er)

Source: IRS US Tax Center 2017/18 Federal Tax Rates, Personal Exemptions, and Standard Deductions

2. **The personal exemption has been eliminated; child tax credit increased**. The $4,050 personal exemption taken in 2017 has been eliminated. However, the child tax credit doubles to $2,000 per qualifying child, subject to income limitations.

3. **The increase in the standard deduction will simplify filing for some folks**. The standard deduction will rise from $6,350 to $12,000 for single filers and $12,700 to $24,000 for joint filers.

   The higher standard deduction and increased child tax credit will likely lower tax bills for many lower and middle-income filers. In addition, it simplifies filing every year.

4. **Some itemized deductions have been reduced or eliminated.** State and local income taxes, property taxes, and real estate taxes are capped at $10,000. Anything above can no longer be written off against income.

   All miscellaneous itemized deductions are eliminated, including deductions for unreimbursed employee expenses, tax preparation fees, the deduction for theft, and personal casualty losses, although certain casualty losses in federally declared disaster areas may still be claimed.

The new tax law enhanced the deduction for **charitable contributions** by raising it to 60% of adjusted gross income from 50%.

The law preserved the deduction for unreimbursed medical expenses, temporarily reducing the limitation from 10% to 7.5% of adjusted gross income for tax year 2018 and retroactively for 2017. This floor returns to 10% in 2019.

5. **Changes to the AMT–the alternative minimum tax**. The dreaded AMT is still with us but will snag far fewer taxpayers since the exemption and exemption phase-out have been substantially increased.

   About 5 million taxpayers were expected to pay the AMT under the old law, but only 200,000 are expected to pay the AMT this year.

6. **There's a new 20% deduction for business owners**. The new law gives "pass-through" business owners, such as sole proprietorships, LLCs, partnerships, and S-corps, a 20% deduction on income earned by the business.

   It's a substantial benefit to business owners who aren't classified as C-corps and wouldn't benefit from the reduction in the corporate tax rate to 21% from 35%.

   REITs and MLPs are also eligible for the deduction.

   The deduction is generally available to eligible taxpayers whose 2018 taxable incomes fall below $315,000 for joint returns and $157,500 for other taxpayers.

   There are limitations to the new deduction and some aspects are complex. It is important to check with your tax advisor to see how you may qualify.

The points above are simply a summation of the major changes in 2018. You may see provisions that will benefit you. You may also see potential pitfalls. If you have any questions or concerns, let's have a conversation.

8 smart year-end financial planning moves

1. **Review your income or portfolio strategy**

Are you reaching a milestone in your life such as retirement or a change in your circumstances? Has your tolerance for taking risk changed? If so, this may be just the right time to evaluate your approach.

However, let me caution you about making changes based simply on market performance.

One of my goals has always been to remove the emotional component from the investment plan. Fear and greed do more damage to investment performance than any other factors I can think of. These emotions tell us to load up on stocks when the market is soaring and prods us to sell when volatility surfaces.

2. Take stock of changes in your life

Review insurance and beneficiaries. Let's be sure you are adequately covered. At the same time, it's a good idea to update beneficiaries if the need has arisen.

3. Mind the tax loss deadline

You have until Monday, December 31 to harvest any tax losses and/or offset any capital gains. But be careful. There are distinctions between short- and long-term capital gains, and you must be aware of wash-sale rules (IRS Publication 550) that could disallow a capital loss.

It may be advantageous to time sales in order to maximize tax benefits this year or next. We may also want to book gains and offset any losses.

4. Mutual funds and taxable distributions—be careful

This is best described using an example.

If you buy a mutual fund on December 18 and it pays a dividend and capital gain December 21, you will be responsible for paying taxes on the entire yearly distribution, even though you held the fund for just three days. It's a tax sting that's best avoided because the net asset value hasn't changed.

It's usually a good idea to wait until after the annual distribution to make the purchase.

5. Don't miss the RMD deadline (age 70½ plus)

Required minimum distributions (RMDs) are minimum amounts a retirement plan account owner must withdraw annually, generally starting with the year that he or she reaches 70½ years of age. Some plans may provide exceptions if you are still working.

The first payment can be delayed until April 1 of the year following the year in which you turn 70½. For all subsequent years, including the year in which you were paid the first RMD by April 1, you must take the RMD by December 31.

The RMD rules apply to traditional IRAs, SEP IRAs. Simple IRAs, 401(k), profit-sharing, 403(b), 457(b) or other defined contribution plans. They do not apply to ROTH IRAs.

Don't miss the deadline or you could be subject to **steep** penalties.

6. Contribute to a Roth IRA or traditional IRA

A Roth gives you the potential to earn tax-free growth (not just deferred tax-free growth) and allows for federal-tax-free withdrawals if certain requirements are met.

You may also be eligible to contribute to a traditional IRA, and contributions may be fully or partially deductible, depending on your circumstances. Total contributions for both accounts cannot exceed the prescribed limit.

There are income limits on Roth IRAs and on the deductibility of traditional IRA contributions, but if you qualify, you may contribute $5,500, or $6,500 if you are 50 or older, in total. In 2019, limits will rise to $6,000 and $7000, respectively.

You can make 2018 IRA contributions until April 15, 2018 (Note: state holidays can impact final date).

7. Consider college savings

A limited option, called the Coverdell Education Savings account, did not get axed by the new tax law.

Currently, total contributions for a beneficiary cannot exceed $2,000 in any year and must be made before the beneficiary turns 18.

Any individual (including the designated beneficiary) can contribute to a Coverdell ESA if the individual's modified adjusted gross income for the year is less than $110,000. For individuals filing joint returns, the amount is $220,000.

A 529 plan allows for much higher contribution limits, and earnings are not subject to federal tax when used for the qualified education expenses of the designated beneficiary. Contributions to either accounts are not tax deductible.

8. Wrap up charitable giving

Whether it is cash, stocks or bonds, you can donate to your favorite charity by December 31, potentially offsetting any income.

For any retirees reading this - did you know that you may qualify for what's called a "qualified charitable distribution (QCD)" if you are over 70½ years old? A QCD is an otherwise taxable distribution from an IRA or inherited IRA that is paid directly from the IRA to a qualified charity ("End-Of-Year Contribution and Distribution Planning for Tax-Favored Accounts"–Kitces.com).

This becomes even more valuable in light of tax reform as more taxpayers will no longer be able to itemize, and an RMD that is taken, then donated to a charity, may not provide tax benefits.

Given the increase in the standard deduction and limits on state income and property taxes, annual year-end gifts to your favorite charity may not exceed the higher thresholds. Therefore, you may consider giving an annual gift in early January. Coupled with an annual gift next December, you might reap the tax advantages from itemizing in 2019.

You might also consider a **donor-advised fund**. Once the donation is made, you can generally realize immediate tax benefits, but it is up to the donor when the distribution to a qualified charity may be made.

I hope you've found this letter educational and helpful, but keep in mind that it is not all-encompassing. Once again, before making any decisions that may impact your taxes, please consult with your tax advisor.

As always it is my job to assist you any way I can. If you have any questions or would like to discuss any matters, please give me call at 703-573-7325.

I remain honored and humbled that you have given me the opportunity to serve as your financial advisor.

All the Best,

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