Wealth Planning **Update**

Seven steps to effective 2018 tax planning

How the Tax Cuts and Jobs Act may affect your 2018 income tax.

It's the time of year again to consider steps you can take to potentially reduce your income tax liability. The Tax Cuts and Jobs Act (TCJA) reduced the highest tax rate from 39.6% to 37%, but that does not necessarily mean you'll be in a lower bracket. If you're a middle or upper bracket taxpayer, particularly a single filer or head of household, you may be pushed into a higher bracket. As in years past, it may be important to consider ways to reduce your taxable income and accelerate deductions.

In addition to new tax brackets, the TCJA contains other provisions that are likely to impact your financial plan. The seven steps below can help you understand some of those provisions, better manage your tax liability, and initiate conversations with your tax and financial professionals.

① Evaluate withholding and estimated tax payments

If you have not yet done so, ask your tax professional to calculate whether the money you've paid in taxes so far this year is in line with your expected tax liability. If it's not, you still have time to adjust the amount withheld from your paychecks or your final quarterly estimated tax payment. If your 2018 liability will be higher than it was in 2017, increasing your withholding or estimated payments may help you avoid a penalty. If not, reducing them will help you avoid paying excess tax.

② Look for ways to maximize deductions

The TCJA increased the standard deduction to $24,000 for married couples and to $12,000 for those who file as single. You will no longer be in a position to itemize if your deductions do not exceed these higher levels. While this may make tax filing easier, it could also mean lower overall deductions. However, with a little planning, you might still be able to itemize in certain years. Here's an example:

Suppose you have $22,000 of itemized deductions this year, including $4,000 in charitable contributions that you plan to make at year end. Instead of making the charitable contributions in 2018, you could bunch two years' worth of contributions into 2019 so you're eligible to itemize in that year. The table below summarizes the potential benefit.

	With bunched contributions	Without bunched contributions
2018	$24,000 standardized deduction	$24,000 standardized deduction
2019	$26,000 itemized deductions	$24,000 standardized deduction
Total	**$50,000 total deductions**	**$48,000 total deductions**

The impact would be even greater if you bunched several years' worth of contributions into one year. If you're worried about providing a steady stream of donations to charitable organizations, ask your financial professional about setting up a donor advised fund (DAF). You would make a lump-sum contribution into the DAF and then dictate when and to whom the funds are disbursed over time. Likewise, you may be able to fund multi-year charitable contributions using the qualified charitable distribution (QCD) rule with required minimum distributions from your IRA. If you're 70½ or older, ask your financial professional about this way to reduce your adjustable gross income.

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③ Break down your mortgage debt

The TCJA eliminated the deduction for home equity interest (unless used to buy, build or substantially improve a residence) and reduced the maximum mortgage interest deduction. You can now deduct interest on only up to $750,000 of mortgage debt ($1,000,000 if the debt was outstanding before December 16, 2017). Since you can deduct mortgage acquisition debt that you incurred to buy, build or substantially improve your primary or secondary residence, for 2018, you'll want to consider what your debt is made up of and identify the portion used to buy, build or improve your home.

You may also want to consider:

- Consolidating non-qualifying debt into qualifying debt
- Restructuring debt that doesn't qualify into investment debt, which might qualify as investment interest

④ Take advantage of tax-favored health care plans

If you belong to a high-deductible health insurance plan, you may be able to take advantage of a health savings account (HSA) that allows you to contribute pre-tax up to $3,450 for self-only coverage ($4,450 if you're 55 or older) and up to $6,900/$7,900 for family coverage. Money socked away in an HSA does not have to be used up each year, as it does in a flexible spending account, and the earnings grow tax-free.

Note that the TCJA allows you to deduct unreimbursed medical expenses above 7.5% of your adjusted gross income, but that rate will rise to 10% in 2019. Therefore, it may make sense to pay all medical expenses for 2018 before the end of the year, especially if you will meet the deduction floor this year but not next, or if you won't be able to itemize next year.

The moral of the story: see your tax professional early as there is much to consider.

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⑤ Maximize contributions to your retirement plans

Most contributions to retirement plans are made with pre-tax dollars, so maximizing those pre-tax contributions will increase your retirement savings and decrease your taxable income. You have until the end of 2018 to contribute up to $18,500 to an employer plan ($24,500 if you're age 50 or older) and until April 17, 2019 to contribute up to $5,500 to an IRA ($6,500 if you're age 50 or older).

If you don't already have an IRA, speak with your financial professional about the benefits of contributing to a traditional IRA and then converting it to a Roth IRA. An immediate conversion will have little or no tax impact.

⑥ Look for tax-loss selling opportunities

The markets have been rising for the longest period in history. If you've sold securities this year for a gain, consider selling others that would produce a loss if you don't expect them to come back.

You can offset the gains with the losses and reduce your taxable income. If you have more losses than gains, you can offset up to $3,000 of ordinary income and carry over extra losses to offset income next year.

⑦ Leverage expanded uses for 529 plans

Another way to set aside tax-advantaged dollars that grow tax-free is in a 529 education savings account. The TCJA extended the use of 529 plans beyond college expenses to allow up to $10,000 per year, per beneficiary to be used for elementary or secondary school tuition. You can open an account for a child, grandchild, or anyone else who might need the money for education. If the beneficiary is not old enough to benefit from the plan yet, opening an account now allows more time for the money to grow. You can even open it in your own name and change the beneficiary later on.

The annual gift exclusion rules allow you to contribute up to $15,000 to each beneficiary per year ($30,000 if you and your spouse contribute). And, you can make up to five years' of contributions at once if you don't make other annual exclusion gifts over those years.

Four more considerations for business owners

If you own a business, there are a few more tax-related steps you can take.

1. Start a tax-qualified retirement plan

There are many options available, and each has its pros and cons. Some have to be established before year end but others give you until the tax-filing deadline of next year. A retirement plan can provide valuable business deductions starting this year if you act quickly. It also offers the opportunity for you to start growing tax-advantaged retirement savings. Talk to your tax professional to determine which plan is right for your business.

2. Find out if you're eligible for a new 20% deduction

One of the most intricate and wide-ranging pieces of the TCJA is IRC Sec. 199A, which allows an additional deduction to eligible pass-through business owners of up to 20% of business income. This complex provision is not available to all pass-through entities and is limited in scope. As this is an entirely new provision, ensure adequate advance planning with your tax professional to learn if you qualify and to maximize the benefits.

3. Consider buying new business assets

Under the bonus depreciation rules, business owners can now write off the entire cost of qualifying purchases under changes enacted with the TCJA. Last year, the bonus limit was 50%. In addition, the IRC Sec. 179 deduction limit was increased to $1 million, subject to phase out after $2.5 million of purchases.

4. Don't forget the R&D credit

This credit is available for businesses for specified research and development expenses, including those for qualified software development. It's also available to business owners of pass-through companies and can be used to offset up to $250,000 in payroll taxes per year for 5 years for qualifying new or small businesses. As the rules for claiming and documenting this tax credit can be complex, you should discuss this with your tax professional.

Should you be concerned about the estate tax?

With the increase in the lifetime exemption from $5.49 million per person to $11.18 million, many estates that were exposed to a potential estate tax may no longer be. However, if your estate is valued over $11.18 million (or you're married with a combined estate over $22.36 million), here are some ideas to consider:

- **You could use some of the additional lifetime exemption given to you before the amount reverts back to original levels in 2026.** If you do that, make sure to leave yourself enough to live on.
- **An option is to remove assets from your estate and freeze their values using a Spousal Lifetime Access Trust (SLAT).** In a SLAT one spouse sets aside assets for the benefit of the couple's children and, as long as the spouses remain married, the spouse can access it if needed. To insure equality, each spouse can set up a SLAT for the other, as long as they are sufficiently nonreciprocal to avoid IRS scrutiny.
- **If you have an older estate plan that uses a formula, it could be booby-trapped due to the increase in the lifetime exemption amount.** See your tax professional about a possible rework.

To be sure, the provisions of the TCJA are a primary concern when it comes to 2018 tax planning. That said, the framework for tax reform 2.0 is already in the works. Aside from making some of the temporary provisions of the TCJA permanent, the next generation of tax reform may include expanded family, schooling, and retirement savings rules, more write-offs of startup costs for small businesses, and other incentives for business and economic growth. As you work with your tax and financial professionals, these new proposals could prove important. The moral of the story: see your tax professional early as there is much to consider.

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