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WEALTH MANAGEMENT

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Year-End Tax Planning Tips for 2018

The return most of us will file next April 15 will be our first under the Tax Cuts and Jobs Act (TCJA), the new income tax law that went into effect for 2018. While many of the ins and outs of the new law were thoroughly discussed earlier in the year, when the tax bill was signed into law, it's probably a good time now, near the end of the year, to review some of the major changes and what you can do before New Year's Day to be as prepared as possible.

First, a few big-picture comments. The TCJA leaves in place the same number of tax brackets as before, but rates have been reduced and the top rate is now 37% (down from 39.6%). The standard deduction was increased dramatically—$12,000 for single filers (up from $6,350) and $24,000 for married couples filing jointly (up from $12,700)—but at the same time, many personal itemized deductions have been reduced or eliminated. In theory, nearly doubling the standard deduction should offset most or all of the loss of the itemized deductions. However, taxpayers who have long been accustomed to deducting interest on home equity loans taken for non–home improvement purposes, investment fees and expenses, tax preparation fees, state and local income taxes (SALT), and other items are going to need to adjust to a new way of thinking.

There are a few things you can do between now and the end of the year that could save you some money when you file your return. Let's take a quick look.

Save your medical receipts.
One provision of the TCJA provides a temporary (until the end of 2018) reduction in the threshold for the medical expense deduction, from 10% of adjusted gross income (AGI) to 7.5%. In other words, a taxpayer with AGI of $100,000 would

previously have had to spend $10,000 on medical expenses during the year to reach the threshold for deductibility. This year, the threshold drops to $7,500. For some taxpayers, this could be significant, especially those who may have higher copays for prescription drugs, ongoing therapeutic care, medical equipment costs, and other allowable medical expenses. But if you don't save your receipts, you won't be able to validate the deduction. So, if you think your medical expenses may exceed the lower threshold, start gathering those receipts (or calling your providers to get copies).

Maximize contributions to tax-deferred plans.
The limit for elective contributions to 401Ks went up to $18,500 (from $18,000) for 2018, and that amount is increased by an additional $6,000 for workers age 50 and older. There has never been a better time to reduce your current taxable income and simultaneously build a more secure foundation for your retirement, so make sure you take full advantage.

Contribute to a 529 plan.
This tax-favored savings vehicle for education funding has gotten even better with the TCJA. Deposits to 529 plans grow tax-free, and withdrawals for qualified educational expenses are also exempt from taxation. Many states with income taxes also allow tax benefits for these plans. Formerly, only college expenses were considered qualified withdrawals, but the TCJA allows for tax-free withdrawals to pay for expenses of attending private schools for grades K–12.

The amount you can contribute each year is limited by the gift exclusion limit, and 529 plans are also limited to a single owner and a single beneficiary, but you can own multiple plans—one for each grandchild, if you want. Though the 529 plan might not help reduce your tax bill this year, it's a great way to shield the growth of your funds from taxes and also provide a tax-free benefit for a deserving student.

Utilize the 20% pass-through deduction for small businesses.
Section 199A of the TCJA allows owners of such businesses to deduct up to 20% of the qualified income earned by the business. While there are still a lot of questions surrounding the details of how this will work, the basic outline is that single filers making less than $157,500 total taxable income ($325,000 for married filing jointly) are eligible to deduct 20% of the income passed through from the business. Total taxable income includes the income from the business as well as any investment or interest income and earnings from another source—such as outside employment—minus deductions.

The only other potential catch is whether the business meets the IRS definition of a "specified service trade or business." Because there are uncertainties surrounding this provision, you should consult carefully with your tax advisor. But if your business and income level qualify, this provision could knock significant dollars off your taxable income.

Give your required minimum distribution directly to charity.
This last tip concerns those who have reached age 70 ½ and must begin taking required minimum distributions (RMDs) from their 401Ks, IRAs, and other tax-qualified plans. If you were already planning to make a donation to a charitable cause, why not make the donation directly from your IRA? Known as a qualified charitable donation (QCD), this technique can help you meet your RMD and also reduce your AGI and taxable income. For some retired persons, it can even help reduce the amount of tax they are required to pay on Social Security benefits. Best of all, it doesn't even require an itemized deduction. Depending on your income level, you may be able to transfer as much as $100,000 per year, and QCDs don't affect your new, much higher standard deduction.

You must have the QCD distributed directly from your IRA plan custodian to the charity, and this may require you to discontinue automatic/direct deposit payments of your RMD. In other words, you can't take the money and then donate it to charity; it must come directly from your IRA custodian. Also, if you are receiving your RMD in monthly installments, you will need to make arrangements for your custodian to split the payments in two parts: the QCD, which will go directly to the charity; and your remaining RMD portion, paid to you. You will also be responsible for informing your tax preparer that you have directed the QCD in order to be certain that the transaction is accurately reported and your taxable income is correctly reduced.

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