10 Best Income Tax Planning Ideas for 2018 After Tax Reform

Belfint Briefing

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Tax Cuts and Jobs Act – Quick Overview

- Lowered tax brackets – top bracket in 2018 = 37%
- Eliminated personal and dependent exemptions
- Doubled Standard deduction
- Limits state and local tax deductions to $10,000
- Retains 0%, 15%, 20% capital gains tax rates
- Retains 3.8% net investment income tax
- Retains, but expands exemptions from Alternative Minimum Tax
- Doubles child credit and permits credit for other family members
- Eliminates "miscellaneous" itemized deductions subject to 2% of AGI floor

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Tax Cuts and Jobs Act – Quick Overview – Continued

- Limits mortgage/HELOC interest deduction
- Changes how certain losses can be claimed
- Provides for a 20% deduction on certain business income
- Change to "Kiddie tax" calculation
- Individual provisions of tax act effective 2018-2025

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The Goal – Keep Adjusted Gross Income Low

- Impacts deductible medical expenses otherwise subject to 7 ½ percent of AGI floor
- Impacts taxability of social security benefits
- Impacts future Medicare Part B and D premiums
- Impacts available amount of special rental real estate passive loss deduction
- Impacts new 20% qualified business income deduction

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#1 Qualified Business Income Deduction

- 20% of income from S corporations, partnerships, self-employment income, and real estate trade/businesses
- Certain wage/asset limits may apply if taxable income is greater than $315,000 (MFJ) or $157,500 for others
- Limited for professional service type business income
- Effectively reduces top tax rate from 37% to 29.6%
- Planning

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#2 IRA -to- Charity Transfers (Qualified Contribution Deduction)

- Many taxpayers will now be claiming the standard deduction
- QCD can be claimed in addition to standard deduction
- Must be at least 70 ½
- Max = $100,000 per person in a year to charity
- Must be made directly from IRA to charity, although a check payable to charity but delivered by taxpayer is fine
- COUNTS TOWARDS REQUIRED MINIMUM DISTRIBUTION!
- KEEPS AGI LOW!
  - Impact on taxable portion of SSA benefits
  - Impact on future Medicare Part B and D premiums
  - Impacts medical deduction if itemizing
  - Impacts rental real estate loss deduction calculation

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#3 Charitable Contributions

- Tax act increased limit on cash contributions to 60% of AGI (2018-2025)
- Bunching strategy
- Contributing appreciated securities rather than cash
- Offsets higher income such as large bonuses or sale of assets
- Donor Advised Fund – allows a 100% upfront deduction and you can decide later who gets the funds
- Charitable Remainder Trusts – Continues a stream of income for life with remainder to charity
    - Annuity trusts
    - Unitrusts
    - Pooled income funds

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#3 Charitable Contributions – Continued

- Gift annuity
- Life insurance
- Real estate
- Stock of closely held business

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#4 Itemized Deduction vs. Standard Deduction

- 2018 Standard Deduction:
  - $24,000 for joint filers
  - $18,000 for head of household
  - $12,000 for single and married filing separately
- The additional standard deduction for being age 65 and/or blind unchanged

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#4 Itemized Deduction vs. Standard Deduction - Continued

- The following changes could eliminate itemizing deductions:
  - State/local tax limitation of $10,000
  - No miscellaneous itemized deductions
  - New limit on mortgage interest deduction (new mortgages limited to $750,000)
  - Home equity loan interest no longer deduction (except for home acquisitions, construction, and renovations)
- Consider “bunching” deductions – itemize in year 1 and claim standard deduction in year 2 (Specifically medical and charitable)

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#5 Funding Retirement Plans and IRAs

- Traditional IRA contributions may be deductible
- Roth IRA contributions:
  - Future withdrawals are tax-free if conditions are met
  - Excellent estate planning tool
- Fully fund employer sponsored plans, including 401(k), 403(b), Roth accounts
  - 2018 limit is $18,500 (2019 limit is $19,000)
  - If age 50+ – an additional $6,000
- Establish and fund self-employment retirement plans
  - Various options
  - Contribution not due until business return is actually filed

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#6 Roth Conversions

- No income limit to convert
- Taxes paid in year of conversion
- Do not have to convert entire amount in single year
- Cannot re-characterize beginning in 2018
- Good strategy in years when conversion recognition can be offset by
  - Low tax bracket
  - Other losses
  - Large itemized deductions

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#6 Roth Conversions – Continued

- Distributions generally tax-free and penalty-free if not withdrawn in the first 5 years after conversion and age 59 ½
  - Reduces AGI (as opposed to traditional IRA)
  - No RMD requirement at 70 ½
  - Heirs can inherit tax-free distributions
  - Upfront taxes paid will reduce exposure to estate taxes

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#7 Losses

- Capital Losses – Limited to $3,000 per year
  - Harvest losses at yearend to offset gains
  - Unlimited carryover of excess losses
- Passive Losses – generally limited to passive income
  - Unused PALs carried forward
  - Sale of passive actively (i.e. rental real estate) frees up unused passive losses related to activity and possibly other PAL's
- Casualty Losses – new tax law generally eliminates this deduction other than losses from federally declared disasters

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#8 Divorce & Separation

- TCJA – alimony will no longer be deductible or includable in income for agreements signed or modified after December 31, 2018
- Deduction/income inclusion still in place for pre-2019 agreements

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#9 Estimated Tax Payments

- TCJA required a re-work of Form W-4
- Many individuals now find themselves over or under withheld
- Penalty for underpayment of tax unless one of two tests are met
  - 90% of current tax liability test
  - 100% of prior year's tax liability test (110% if prior year's AGI > $150,000)
- Run yearend projection to see where you stand
- If Under withheld:
  - Have additional FWT taken from remaining pay checks
  - Take a distribution from IRA and withhold taxes. Then return all funds within 60 days to IRA (including amount withheld)
    - Beware of multiple rollover rules

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#10 Planning with Children/Grandchildren

- Put the kids on payroll in the family business
- Annual gift exclusion in 2018 is $15,000 per donor to each donee
- Election to contribute up to 5 times limit ($75,000) in a single year to 529 plan
    - Earnings withdrawn for qualified education expenses are tax-free
    - New law permits tax-free withdrawals for tuition payments (only) up to $10,000 each year per beneficiary
- New law changes Kiddie-tax calculation
    - Prior law-unearned income taxed at parent's marginal rate
    - Beginning in 2018 – net unearned income taxed using trust tax rates – reaches 37% on income > $12,500

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