Income Tax Planning Under the New Tax Rules

WELCOME

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CPA/PFS
- Received the most comprehensive financial planning professional certification available, the Personal Financial Specialist credential.
- Every CPA/PFS is first and foremost a CPA.
- Every CPA/PFS has a duty to approach financial planning objectively and without bias; intent on upholding our client’s best interest.
- Every CPA/PFS is a part of the American Institute of CPAs, the largest professional organization for CPAs.

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- **UNLIMITED REPRESENTATION RIGHTS**: Enrolled agents, certified public accountants, and attorneys.
  - Enrolled Agent: Licensed by the IRS.
  - Scholarship exam, pass a 3 part Special Enrolment Exam.
  - CPA: Must complete 15 hours every 3 years.
- Certified Public Accountants: Licensed by state boards of accountancy, the District of Columbia, and U.S. territories.
  - Passed the Uniform CPA Examination.
  - Receive a part Uniform CPA Exam.
- Attorneys: Licensed by state courts, the District of Columbia or their designees.
  - Generally, they have a law degree and passed a bar exam.
  - Cel: On-going continuing education and professional development standards.
- **LIMITED REPRESENTATION RIGHTS**: Unlicensed Preparer:
  - Not regulated, no oversight, not bound by ethics rules.
  - Annual Filing Season Program – Encourages CE.
  - PTIN Holders – Authorized to prepare returns, not authority to represent before IRS.

Income Tax Planning Under the New Tax Rules
- **What changed?**
  - Tax brackets
  - Itemized Deductions
  - 20% Passthrough Deduction
  - ACA Impact
  - AMT Changes
  - Changes in Retirement Planning
  - Estate & Gift Tax Changes
  - Education Benefit Changes
  - Other Changes
- **Strategies to reduce Income**
- **Retirement – ERB & Social Security**
- **Tax Implications of Moving $**
### Many Changes!

- Generally effective after 12/31/17
- Most changes are temporary
  - Sunset after 2025
- Guidance is needed
- Future legislation?
- State conformity to changes?

### 2018 Tax Table

#### The Basics
- No more dependent exemption
- Higher child tax credit ($2,000)
  - New $500 non-child dependent credit
- Increase in standard deduction
- Individual AMT not repealed
  - But exemption amounts have increased
Dividend & Capital Gains Rates Unchanged

<table>
<thead>
<tr>
<th>Rate</th>
<th>Single</th>
<th>Married filing jointly (and surviving spouses)</th>
<th>Heads of household</th>
<th>Married filing separately</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>Up to $38,600</td>
<td>Up to $77,200</td>
<td>Up to $51,700</td>
<td>Up to $38,600</td>
</tr>
<tr>
<td>15%</td>
<td>$38,600-$425,800</td>
<td>$77,200-$479,000</td>
<td>$51,700-$452,400</td>
<td>$38,600-$239,500</td>
</tr>
<tr>
<td>20%</td>
<td>Over $425,800</td>
<td>Over $479,000</td>
<td>Over $452,400</td>
<td>Over $239,500</td>
</tr>
</tbody>
</table>

Itemized Deduction Changes

- Repeal of the overall limitation on itemized deductions
- Medical deduction threshold is 7.5% for 2017 & 2018
  - Reverts to 10% starting in 2019
- Mortgage interest limited to $750k of debt
  - Debt prior to 12/15/17 is grandfathered
- Home equity interest no longer deductible
- State and local tax deduction is limited to $10k ($5k if MFS)
- Misc. deductions subject to 2% threshold no longer deductible

Misc. itemized deductions subject to 2% AGI

- Unreimbursed employee expenses
- Tax prep fees
- Hobby expenses
- Investment fees/expenses
- Legal fees related to producing income
- Safe deposit fee
- Gambling losses (in excess of winnings)

…are no longer deductible
Expired provisions (at the end of 2016)

- Exclusion of discharge of indebtedness on principal residence
- Deduction of mortgage insurance premiums
- Above-the-line deduction for qualified tuition and fees
- Credits for qualified energy property

20% pass-through deduction

- 20% of qualified business income
- Qualified business income definitions
  - Qualified trade/business income
    - Not a specified trade/business
      - Trade/business involving performance of services
    - Does not include investment income
    - Does not include reasonable compensation paid from S corporation or guaranteed payments paid to a partner
  - Phase-out limitation

Affordable Care Act impact

- Penalty to maintain insurance coverage (individual mandate) is repealed for 2019 and forward
- HOWEVER, still in effect for 2017 and 2018
- 2017 penalty:
  - Higher of 2.5% of yearly household income, or
  - $695 per person ($347.50 per child under 18)
Impact on the net investment income tax (NIIT)

- No change to NIIT itself, but......
- Investment fees and state income tax (amount attributable to investment income) reduce investment income to lower amount subject to NIIT
- Since investment fees are no longer deductible and state income tax is limited to $10k, this will likely cause an increase in the amount subject to NIIT

Alternative minimum tax (AMT) changes

- Alternative tax system that parallels the regular federal tax (with different rates and rules for deductions)
- Increase in exemption amount
- Due to limit on state/local tax deduction and repeal of miscellaneous deductions, impact should be less

Changes to retirement planning

- Ability to recharacterize a Roth conversion to a traditional IRA is removed after 2017
- Extension of rollover period for plan loan offsets
Estate and gift taxes changes

- 2018 estate tax exemption: $11.2 million
- 2018 gift tax annual exclusion: $15,000
- Estate planning is more than minimizing estate taxes.
  - Updating documents – Beneficiaries, Wills, Trusts, Estate Plans, Powers of Attorney, Healthcare Directives, etc.
  - Repurposing insurance
  - Privacy
  - Asset protection

Education tax benefit changes

- Sec 529 plan distributions for private school tuition
- Sec 529 plan assets can transfer to ABLE accounts for family members
- Student loan forgiveness will not be taxable income to student upon death/totals disability

Other individual changes to note

- Casualty losses: only from federally-declared disasters
- Alimony: deduction/inclusion repealed for divorces executed after 12/31/18
- Moving expenses deduction repealed
- Kiddie tax now at trusts/estate tax rates
Charitable contribution changes

- AGI limitation increased to 60% for cash contributions (from 50%)
- No 80% deduction for right to purchase athletic tickets
- Exception to contemporaneous written acknowledgement requirement is repealed (must be obtained now for any contribution of $250 or more)

State and local tax issues

- Total deduction limit of $10k ($5k if MFS)
  - Combination of income/sales and state/local property taxes
- Exceptions
  - Tax imposed at entity level
  - Property taxes for residential rental property/business property
- Prepayment of 2018 state income taxes in 2017
- Prepayment of 2018 real estate taxes in 2017

Planning Now to Avoid Underpayment Penalties

- Estimated tax payments/withholding
Proposed changes not included in final bill (but were in either House or Senate bill) include ...

- Additional standard deduction for elderly and blind
- $250 above-the-line teacher deduction is not changed
- Exclusion for employer-provided dependent care assistance
- Exclusion for adoption assistance programs
- Reduction of capital gain rates/changes to taxation of interest income
- Sec. 121 exclusion of gain on sale of principal residence
- Required use of FIFO to determine basis of stock dispositions
- Charitable driving remains at 14 cents/mile (rather than actual)
- Consolidation and modification of education provisions not included (only change is to expand 529 plans)
- Plug-in electric vehicle credit (Sec. 30D)

Depreciation changes

- Additional first year/bonus depreciation- 100% for property acquired after 9/27/17
- Phase down schedule for years after 2022
- Now allowed for new and used property
- Qualified improvement property no longer qualifies
- Luxury auto limits – (note that additional $8k depreciation has been extended for 2017)
- Increases to Sec. 179 ($1M and threshold $2.5M)
- SUV limitation remains at $25,000
- Limits are indexed for inflation
- Expansion for certain real property (roofs, HVAC)
- Allows residential rental property

Planning Tips

Requires rethinking and planning in many areas

- Choice of entity for business ventures
- Charitable giving planning
- Estate/gift planning with temporary increased exemption
- Stock option and restricted stock exercise planning
- Interplay of Sec. 199A with remaining rules such as NIIT, passive activity loss limits
Planning Opportunities

- Complexity = possible savings opportunities
- Consider evaluating tax structure
- A CPA can provide financial planning services

Make It Less Taxing

- 403(b)
- 457(b)
- Student Loan
- IRA
- Alimony

Section 125 Cafeteria Plan
- Premium only Plan
- Flexible Spending Account
- Medical Reimbursement Account
- Dependent Care

Make it Less Taxing

- 403(b)/457(b)/401(k):
  - $18,500 + $6,000 for 50 and over
  - May coordinate 403(b) & 457(b) at UNM
  - $37,000 max EE deferral under age 50
  - $49,000 max EE deferral over age 50
- IRA:
  - $5,500 + $1,000 for 50 and over
- Roth IRA:
  - Income limits on contributing, but anyone can convert funds to a Roth
Strategies to Reduce Income (cont.)

- Itemized Deductions:
  - Medical > $
    - Insurance premiums
    - Long-term care premiums
    - Medical expenses
    - Medical Mileage - .10/mile
    - Prescriptions
  - Taxes – Limited to $10K
    - State & local
    - Real estate
    - Personal property taxes
    - Other taxes – foreign taxes

Strategies to Reduce Income (cont.)

- Itemized Deductions (cont.):
  - Interest
    - Home mortgage interest
    - HELOC - $100k
    - Points paid on purchase/finance
    - Investment interest
  - Gifts to Charity
    - Gifts by cash or check
    - Gifts other than cash or check
    - Charitable remainder trust

Make it Less Taxing

Roth IRA

- Contribute after-tax
- Savings grow tax-deferred
- Earnings may be withdrawn tax-free if requirement met

Any distributions taken from the IRA, per tax law of the Roth IRA, are held for at least five years, and the individual is age 59½ or older making at first time home purchase (limit first of $10,000 per taxpayer), is disabled or dies.
What To Expect In Retirement

- ERB Pension
  - # of Years of SVC X 5 Years Consecutive Highest Avg. Comp. X 0.0235
  - Three options
    - A - Full Pension, no reduction, no continuation of benefit to beneficiary
    - B - Reduced pension, beneficiary receives the same benefit upon death of member
    - C - Reduced pension, beneficiary receives 50% of member benefit upon death of member
    - D - Pension Maximization

What To Expect In Retirement

- Pension Maximization
  - Fund your pension benefit yourself!
  - Lifespan of spouse may be shorter than yours
  - May extend benefits to other family members
  - Usually funded with a permanent type of insurance
    - Whole Life
    - Universal Life
    - Variable Universal Life
  - Not suitable for everyone - Health issues, Spouse is young, etc.

What To Expect From ERB

- When am I eligible to retire
  - Old Rules – 25/75 – Started contributing to ERB prior to July 1, 2010
  - New Rules – 30/80 - Started contributing to ERB after to July 1, 2010
- What can I expect
  - 25 years ~ 59% of Avg 5 Cons. Yrs Highest Comp
  - 30 years ~ 69% of Avg 5 Cons. Yrs Highest Comp
How Much Will I Need?

- Most experts indicate its at least

80%

Social Security

Age to receive full Social Security benefits

<table>
<thead>
<tr>
<th>Year of birth</th>
<th>Full retirement age</th>
</tr>
</thead>
<tbody>
<tr>
<td>1943 - 1954</td>
<td>65</td>
</tr>
<tr>
<td>1955</td>
<td>66 and 2 months</td>
</tr>
<tr>
<td>1956</td>
<td>66 and 4 months</td>
</tr>
<tr>
<td>1957</td>
<td>66 and 6 months</td>
</tr>
<tr>
<td>1958</td>
<td>66 and 8 months</td>
</tr>
<tr>
<td>1959</td>
<td>66 and 10 months</td>
</tr>
<tr>
<td>1960 and later</td>
<td>67</td>
</tr>
</tbody>
</table>

Social Security

- How Social Security calculates your benefit:
  - Lifetime earnings
  - Average earnings during the 35 years you earned the most
  - Your age
- Maximum Benefit for 2018 - $2,788/mo
**Social Security**

- Early Retirement = 62

*Reduced* benefit

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**Social Security**

- When to take Social Security:
  - three choices

1. Early Decreased
2. Full Basic
3. Delayed Increased

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**Get down to basics**

- Delayed Retirement = 70

*Income amount will be permanently increased*
How is Social Security Taxed

- You will pay tax on 85% of SS Benefits if you:
  - file a federal tax return as an "individual" and your combined income* is
    - between $25,000 and $34,000, you may have to pay income tax on up to 50 percent of your benefits.
    - more than $34,000, up to 85 percent of your benefits may be taxable.
  - file a joint return, and you and your spouse have a combined income* that is
    - between $32,000 and $44,000, you may have to pay income tax on up to 50 percent of your benefits.
    - more than $44,000, up to 85 percent of your benefits may be taxable.
  - are married and file a separate tax return, you will pay taxes on your benefits as your base amount = 0.

Combined income = AGI + Non-taxable Interest + ½ of SS Benefits

Tax Rules on Retirement Plans

- Must be 59 & ½ for no penalty (55 & separated from employment)
- Required Minimum Distribution – 70 & ½
- Rollovers – Typically not taxed
- Distributions out of 403(b) require mandatory 20% federal withholding
- Distributions out of IRA's no mandatory withholding

Taxation of Retirement Income

- Taxability of Retirement Assets
  - Pension – Generally 100%
  - Qualified Plans – 403(b), 457, 401(k), IRA, SEP IRA, Simple IRA, Keogh – 100% Taxable
  - Roth – Non-taxable
  - Social Security
    - Single or Head of Household – Modified AGI in excess of $25,000 - up to 85% of benefits will be taxable
    - Married Filing Jointly – Modified AGI in excess of $32,000 – Up to 85% of benefits will be taxable
    - Married Filing Separately – Modified AGI in excess of $0 – Up to 85% of benefits may be taxable
Roll to New Plan

How to roll to a new plan

<table>
<thead>
<tr>
<th>Indirect Route</th>
<th>Direct Rollover to IRA or New Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>You get the check, reinvest yourself</td>
<td>“Plan to plan transfer”</td>
</tr>
<tr>
<td>• Potential for taxes (20%) and penalties</td>
<td>• Money stays tax deferred</td>
</tr>
<tr>
<td>• More work for you</td>
<td>• Easier</td>
</tr>
<tr>
<td>• Must roll within 60 days</td>
<td>• Less expensive</td>
</tr>
</tbody>
</table>

Roll to an IRA

Roll over to an IRA

<table>
<thead>
<tr>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Continue tax deferred growth</td>
<td>• No plan-specific investment options</td>
</tr>
<tr>
<td>• Continue contributions</td>
<td>• No loans</td>
</tr>
<tr>
<td>• Many investment choices</td>
<td>• Must be at least 59½ before taking penalty-free withdrawals²</td>
</tr>
<tr>
<td>• Access to advice¹</td>
<td>• Potential fees</td>
</tr>
<tr>
<td>• Consolidate money</td>
<td></td>
</tr>
<tr>
<td>• Estate planning benefits</td>
<td></td>
</tr>
<tr>
<td>• No plan restrictions</td>
<td></td>
</tr>
</tbody>
</table>

¹For an additional charge. ²See our investments for the rule of any non-rollover conditions (known as 72(t) withdrawals).

Roll to a New Plan

• Important:
Roll within 60 days to avoid taxes and penalties
Roll to an IRA

• Pay taxes **now or later?**
• Roth = **tax-free** growth

Leave Money in Plan

• Eligible for distributions without penalty
  • Age 59 & ½
  • Age 55 & separated from employment
• Must take RMD’s by age 70 & ½
  • RMD’s calculated separately from IRA’s or other qualified plans
• Loan provision available before & after employment

Tools & Links

Use the following link:
http://www.fernandezfinancial.com/financial-calc#incomeSection

• Federal income tax estimator
• Should I adjust my payroll withholdings?
• Should I itemize or take standard deduction?
• 2017 tax refund estimator
  https://www.irs.gov/
Questions?

Contact Edwin S. Fernandez, CPA/PFS
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Thank you