Income Tax Planning Under the New Tax Rules

WELCOME

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Edwin S. Fernandez, CPA/PFS

Financial Advisor

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 CPA's, the largest professional organization for CPA's

Tax Return Preparer Credentials & Qualifications

- **UNLIMITED REPRESENTATION RIGHTS**: Enrolled agents, certified public accountants, and attorneys.
  - **Enrolled Agents** – Licensed by the IRS.
    - Suitability check, must pass a 3 part Special Enrollment Examination,
    - CE - Must complete 72 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 – Rigorous 4 part Uniform CPA Exam – 14 hours
    - College Degree (150 semester and also met experience and good character requirements
    - CE –40 hours each yr. (120 hours every 3 years with 24 hours being live instruction and 4 hours of ethics)
  - **Attorneys** – Licensed by state courts, the District of Columbia or their designees, such as the state bar.
    - Generally, they have earned a degree in law and passed a bar exam.
    - CLE - On-going continuing education and professional character 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

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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

Married Individual Filing Joint Returns & Surviving Spouse

If the amount of wages is:	*The amount of income tax to withhold is:*	
Not over $19,050	10% of taxable income	
Income		**of excess over**
$19,051 - $77,400	$1,905 +12%	$19,050
$77,401 - $165,000	$8,907 +22%	$77,400
$165,001 - $315,000	$28,179 +24%	$165,000
$315,001 - $400,000	$64,179 +32%	$315,000
$400,001 - $600,000	$91,379 +35%	$400,000
$600,001	$161,379 +37%	$600,000

Standard Deduction............$24,000

Single

If the amount of wages is:	*The amount of income tax to withhold is:*	
Not over $9,525	10% of taxable income	
Income		**of excess over**
$9,526 - $38,700	$952.50 +12%	$9,525
$38,701 - $82,500	$4,453.50 +22%	$38,700
$82,501 - $157,500	$14,089.50 +24%	$82,500
$157,501 - $200,000	$32,089.50 +32%	$157,500
$200,001 - $500,000	$45,689.50 +35%	$200,000
$500,001	$150,689.50 +37%	$500,000

Standard Deduction............$12,000

Head of Households

If the amount of wages is:	*The amount of income tax to withhold is:*	
Not over $13,600	10% of taxable income	
Income		**of excess over**
$13,601 - $51,800	$1,360 +12%	$13,600
$51,801- $82,500	$5,944 +22%	$51,800
$82,501 - $157.500	$12,698 +24%	$82,500
$157,501 - $200,000	$30,698 +32%	$157,500
$201,001 - $500,000	$44,298 +35%	$200,000
$500,000	$149,298 +37%	$500,000

Standard Deduction............$18,000

Married Filing Separately

If the amount of wages is:	*The amount of income tax to withhold is:*	
Not over $9,525	10% of taxable income	
Income		**of excess over**
$9,526 - $38,700	$952.50 +12%	$9,525
$38,701 - $82,500	$4,453.50 +22%	$38,700
$82,501 - $157,500	$14,089.50 +24%	$82,500
$157,501 - $200,000	$32,089.50 +32%	$157,500
$200,001 - $300,000	$45,689.50 +35%	$200,000
$300,000	$80,689.50 +37%	$300,000

Standard Deduction............$12,000

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

Rate	Single	Married filing jointly (and surviving spouses)	Heads of household	Married filing separately
0%	Up to $38,600	Up to $77,200	Up to $51,700	Up to $38,600
15%	$38,600-$425,800	$77,200–$479,000	$51,700–$452,400	$38,600-$239,500
20%	Over $425,800	Over $479,000	Over $452,400	Over $239,500

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

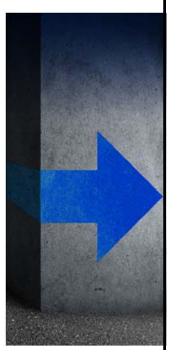
- Penalty to maintain insurance coverage (individual mandate) is repealed for 2019 and forward
- HOWEVER, still in effect for 2017 and 2018
- 2017 penalty:
  - Higher of 2.5% of yearly household income, or
  - $695 per person ($347.50 per child under 18)

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/total 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/refinance
    - 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 are tax-free if the Roth IRA is held for at least five years and the individual is age 59½ or older, making a first-time home purchase (lifetime limit 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 .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

Year of birth	Full retirement age
1943 - 1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

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

Social Security

- When to take Social Security:
  - three choices

Early	Full	Delayed
Decreased	**Basic**	**Increased**

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

Indirect Route	Direct Rollover to IRA or New Plan
You get the check, reinvest yourself • Potential for taxes (20%) and penalties • More work for you • Must roll within 60 days	**"Plan to plan transfer"** • Money stays tax deferred • Easier • Less expensive

Roll to an IRA

Roll over to an IRA

Pros	Cons
• Continue tax deferred growth • Continue contributions • Many investment choices • Access to advice[1] • Consolidate money • Estate planning benefits • No plan restrictions	• No plan-specific investment options • No loans • Must be at least 59½ before taking penalty-free withdrawals[2] • Potential fees

[1] For an additional charge
[2] There are exceptions to this rule if you meet certain 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?

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Thank you