Financial Services Advisory

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New Ways To Influence The Next Generation

The Tax Cuts And Jobs Act of 2018 (TCJA) gives you more good reasons to help your children, grandchildren, great nieces and nephews. Any amount you give to a 529 account that's used to pay for qualified expenses for college as well as private or religious schooling before college is deductible. With tax reform eliminating all or a large chunk of state income-tax deductions for many individuals in 2018, giving to a 529 lightens your state income-tax load while perhaps changing a life of a family member or friend and influencing their values.

If a child in your family is affected by autism, ADHD, opioids, or any other modern maladies, you have new ways to benefit from the privilege of helping children with special needs.

The average annual rate of college inflation was double the overall inflation rate for the past decade, according to College Board data, and 529 assets hit $279 billion in 2016, according to College Savings Plan Network — up almost 160% from 10 years earlier, as parents tried to keep pace with rising college costs.

Enacted two decades ago, Section 529 plans have become popular because contributions grow tax-free and withdrawals for tuition, books, room and board are also tax-free. No limits are imposed on contributions, but your 529 may not exceed the estimated cost of a beneficiary's education expenses.

Many states let you deduct 529 contributions from state income tax, and some also allow deductions made to out-of-state 529 plans. Almost all states offer 529s and permit out-of-state residents to invest. Here's how the new tax overhaul encourages 529 savings:

Savings on state income tax lowers federal liability. To the horror of high-tax states, federal deductions for state income, property and sales tax were limited for 2018, and annually through 2026, with a $10,000 limitation. Still, 41 states have an income tax and New Hampshire and Tennessee tax dividends and other investment income, and about three dozen states allow deductions for 529 contributions. Your gifts to 529s lower your income subject to federal as well as state income tax, easing the pain of losing the federal deduction for state

(Continued on page 4)

The New Tax Law Gives Roth Converters A Little Less Wiggle Room

Retirement savers, give thanks! The recently passed tax plan doesn't harm you — much. Congress, for instance, did not lower maximum contributions for tax-deferred plans, like traditional 401(k)s and individual retirement accounts. Nor did Congress tinker with moving your money from a traditional plan into a Roth, where you pay the taxes up front and appreciation grows tax-free and your withdrawals won't ever be taxed.

With one small exception. Until Congress changed the law right before the holidays, some people who did a Roth conversion could decide they wanted to un-do it, which the tax experts call a recharacterization. Not anymore.

Backing out of a Roth conversion was a convenient deal. Maybe at year's end, you discovered that other unanticipated deductions, income or market conditions made the conversion look like a boneheaded idea. Maybe it turned out you lacked the money you thought you'd have to pay the Roth tax. Maybe the stock mutual fund you converted had slid since you moved the fund into a Roth IRA. Why pay taxes on higher-cost stock when you can make the conversion disappear – and maybe later convert at the lower level?

Under the new law, for tax year 2018, you can't have that flexibility anymore. Once you make the switch, you are stuck with your choice. The good news: if you want to recharacterize a 2017 Roth conversion, you have until Oct. 15, 2018 to do it.

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Giving More To Loved Ones – Tax-Free

While it may be better to give than to receive, as the adage contends, both givers and receivers should be happy with the new tax law. The annual amount you can give someone tax-free has been raised to $15,000, from $14,000 in 2017.

Exempting $15,000 annually from gift tax, over time, transfers a lot of wealth to those you care about during your lifetime, while avoiding the tender mercies of the tax man, and married couples can have double the fun.

Take the example of a husband and wife with three married children and six grandchildren. The husband can give $15,000 each to his married children and the same amount to their spouses, and also $15,000 to the half-dozen grandchildren — totaling $180,000 — and his wife can do the same for the same 12 beneficiaries. The grand total is $360,000 per year. No federal tax will be levied on these transfers of your wealth to family as well as friends.

In addition, you can give more than the annual exemption caps for college savings. The Tax Cuts and Jobs Act (TCJA) permits bunching five years of $15,000 annual gifts into one year, by plugging it into a 529 college savings plan for a child or grandchild. That's $75,000 in total. Assets in 529 savings plans grow tax-free, if used to pay qualified education expenses.

Gifts made during your lifetime reduce your exemption from tax on your estate. The TCJA more than doubled the estate tax exemption in 2018 from $5.5 million to $11.2 million for individuals, and from $11 million to $22.4 million for couples. All of these new levels will increase with inflation, though the formula annually adjusting inflation is less generous than before.

Lifetime gifts can be made directly or through trusts. With a trust, you place the gift of cash, securities, or other assets in an entity set up to make the transfer of wealth after you die. The assets in the trust avoid probate court, and makes the transfer faster, less costly, less likely to be contested, and generally more sure-footed. Trusts can influence the values of your progeny by requiring the money you leave to be spent for religious, philosophical, or any variety of educational activities.

A trust also shields assets left to your heirs from lawsuits and business creditors. Should your grandchild get divorced, the trust money is shielded.

The friendlier tax treatment of transfers under the TCJA affects your estate plan and how your assets will be spent after you are gone, but it also may change your plan for gifting during your lifetime. Give us a call for help putting together the right gifting strategy for you and your family. ●

Your Alma Mater Or Your Family?

The new tax law doubles what you can leave loved ones' tax free when you die and that's really bad for your alma mater. Tax breaks for donations to your alma mater may no longer make the grade with you. Here's why:

Estate Tax Exemption Rises. The Tax Cuts And Jobs Act (TCJA) doubles a married couple's estate's tax-exemption to $22 million. Alums now want to maximize their exemptions by leaving $22 million to their children, nieces, nephews and other loved ones before even thinking about a donation to favorite old schools.

Larger Standard Deduction. The TCJA upped the standard deduction from $13,000 to $24,000 for married couples and most Americans no longer will itemize deductions. But that also means you no longer may deduct college donations. Younger alumni will never get into the habit of contributing to their alma mater, disrupting the finance of U.S. educational institutions.

Athletic Deduction Nixed. Before the TCJA, many colleges targeted contributions from alumni who might qualify for good seats at games. The old law allowed donors to deduct 80% of such gifts. Now, the deduction is zero.

Taxing Endowments. Under the new tax code, schools with endowments of $500,000 per student or more and 500 students or more face a 1.4% levy on income. Only a small number of schools are subject to this new tax, but it is a consideration in making college donations.

The Plus Side. The TCJA is not entirely bad for all education-minded donors. Some plusses:

- If you itemize, you may now deduct up to 60% of your adjusted gross income on donations to qualified charities, including your old school. That's up from 50%.
- You can "bunch" donations you pledge to give over several years. The

A Guide To The New Rules On Tax Deductions In 2018

Uncle Sam giveth, and Uncle Sam taketh away. The new federal tax code, which went into effect in 2018 and affects the return you'll file in spring 2019, lowers taxes by expanding some deductions, but restricts or outright eliminates others.

Deductions lower your taxable income so you pay less tax. Here's how deducting items from your income were expanded, restricted, or eliminated.

EXPANDED DEDUCTIONS

Standard deduction. The standard deduction is the amount you can subtract from your taxable income if you don't itemize — that is, individually deduct items like mortgage interest, charitable donations, and car loans. Nearly doubling the standard deduction to $24,000 for joint filers and $12,000 for singles pushes it up from $12,700 and $6,350, respectively. Fewer than half of taxpayers who itemized their 2017 return are expected to itemize their 2018 return. If you file using the standard deduction, preparing your return will be much simpler. If the standard deduction is less than the total of your itemized deductions, you'll still want to file by itemizing, subject to the rules below.

Medical expenses. If you itemize deductions, medical expense deductions will be more generous. For tax years 2017 and 2018, medical outlays in excess of 7.5% of your adjusted gross income are deductible. Starting in 2019, the threshold rises to the previous level of 10%. Congress is widely expected to consider extending the 7.5% threshold or making it permanent.

Alternative minimum tax. This very unpopular parallel tax system has been reined in and will zap fewer Americans in 2018. The AMT started in 1982 as an effort to reduce loopholes open to ultra-high-income earners, but its net gradually spread and it affected more individuals. In the 1990s, Congress hiked the AMT tax rate, stiffening its cost. Under the AMT, the standard deduction and deductions for state and local income taxes are lost. With the new law, your exemption — the amount you can subtract from your AMT liability — is much larger. Previously, $54,300 was exempt for a single-filer and $84,500 for a married couple filing jointly. Respectively, the exemptions increased by almost a third, to $70,300 and $109,400.

Child tax credit. This actually is not a deduction against your income. It's a credit on your tax bill. A credit reduces your tax bill dollar for dollar. The credit for children under age 17 was raised to $2,000 from $1,000.

RESTRICTED DEDUCTIONS

State and local taxes. Lawmakers placed a $10,000 cap per return on deductions for state and local taxes (SALT). Till now, the amount you could deduct for SALT levies was unlimited. If you live in a place with high state and local taxes and home prices, you're hit hard. If you earn more than $100,000 in adjusted gross income and live in California, Connecticut, Maryland, New Jersey, New York or Oregon, you're very likely to see a material hike in your annual federal tax liability for at least the next decade.

Mortgage interest. You can continue to deduct this interest for first and second homes. The change: For mortgages dated after Dec. 14, 2017, only the interest on the first $750,000 of debt is deductible. Before that date, the $1 million ceiling still applies. In places where home prices and, thus, mortgages, are low, that is not as much of a concern. In high-price locales, it is.

Home equity interest. You no longer can deduct interest paid on home equity loans, unless it is used to improve the dwelling. Many people use such loans, which are secured by their homes, to pay for college tuition or new cars. If a home equity loan and the mortgage totals more than $750,000, the amount over that limit can't be deducted.

ELIMINATED DEDUCTIONS

Personal exemption. Exemptions, which lowered your income by $4,050 per person — usually family members — are gone. For some families with children over 17, who can't take advantage of the expanded tax credit, the elimination of the personal exemption will be a net loss.

Alimony. For divorce and separation agreements made after 2018, alimony payments will no longer be deductible. The deduction is helpful to a paying ex-spouse who is short on funds.

Casualty and theft losses. If your house burned down or a crook took your wallet, you could deduct the loss not covered by insurance to the extent it exceeded 10% of your income. Under the new law, only casualty losses suffered in a natural disaster declared by the president are deductible.

Job expenses. Continuing education, medical tests and licensing fees previously were write-offs. Not anymore.

Moving expenses. Before, you could deduct these if you moved to start a new job and it was a good distance (that varies by circumstances, but typically meant 50 miles away) from your old home. Now, that is gone, unless you are in the military.

We are happy to work with you and your CPA to make sure you are prepared for the new tax law changes. ●

deduction can exceed the write off under the standard deduction.

- You can contribute via a donor-advised fund, which entitles you to a large immediate deduction on annual donations you pledge to make over a period of years. If you suddenly strike it rich, this is a great way to go.

Old Ivy has been around since before the income tax and has managed to flourish, but the new economics of supporting education is disrupting the finances of major educational institutions and the effects are yet to be felt. If you have questions about donating money to a school or your priorities in planning your estate, please contact us. ●

This Is Not Your Parents' Interest Rate Cycle

If you're a pre-retiree, your returns on fixed income investments may be much lower than your parents' portfolio.

If you're over 70, you were invested during four decades marked by strong fixed income returns. From the astronomical highs of the late 1980s, rates climbed down before finally bottoming in 2017, and two generations of retirement investors enjoyed bull market returns in bonds annually for years. The next generation of retirees face an entirely different fixed income investing environment.

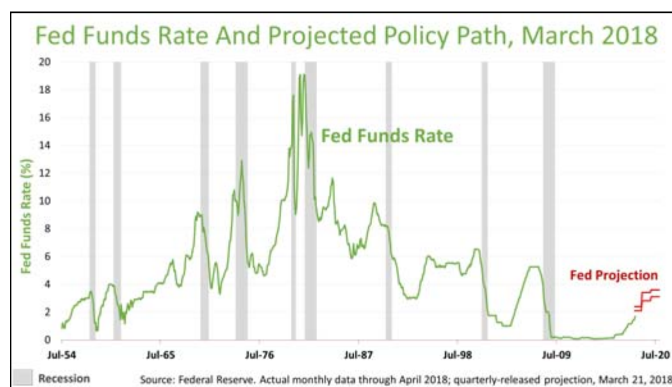
Past performance is not a guarantee of your future results. Source: Online Data Robert Shiller. Data through December 2017.

The last 50 years were an aberration when viewed from the perspective of the past 171 years. The rise in rates of the 1970s and 80s and the unwinding of that anomaly is behind us now, and history indicates the next decades could be characterized by 10-year U.S. Treasury bond rates of about 4%. That may be the new normal.

Past performance is not a guarantee of your future results, but we are nonetheless grateful to Robert Shiller, an economics professor at Yale University and Nobel Laurate in Economics, for sharing this historical data online. It shows that, over in the long arc of U.S. financial history, nothing like the last 50 years ever happened before the 1970s. If interest rates revert to their long-term mean, a 4% 10-year U.S. Treasury bond is a likely path in the decades ahead.

The yield on a 10-year U.S. Treasury bond, in the grand sweep of history, averaged about 4% annually. That's normal. Mortgage rates of the 70s, 80s, or 90s were abnormal. The new normal may be a 2% inflation rate and a 10-year bond yield of 4%. That's what the Federal Reserve Board of Governors expected in the second quarter of 2018.

The point is, this is not your parents' retirement savings environment. Economic fundamentals are different. If you learned about investing from your parents or invest based on what's worked in the past, the future may not be much like the recent past but instead like the distant past. We are happy to continue this conversation and answer any questions you may have about the changing interest rate environment. ●



Source: Federal Reserve. Actual monthly data through April 2018; quarterly-released projection, March 21, 2018.

Influence The Next Generation

(Continued from page 1)

and local taxes.

Paying for private school tuition. 529s to pay for kindergarten through 12th grade are now permitted, but you must check to see if your state allows you to deduct 529s used to pay for private schools.

Consider financial aid. A 529 might hurt a child's chances for financial aid at private high school. However, 529s do not penalize an applicant for Federal Student Aid (FAFSA) for college.

Children with special needs. This bolsters a federal tax break for those who become blind or disabled before age 26. It also covers education for modern maladies, like ADHD and autism. Enacted in 2014, ABLE accounts make gifts to individuals with special needs eligible for tax-free growth in 529 accounts. The 529 accounts are not figured into eligibility for Medicaid, Social Security income or Supplement Security Income (SSI) payments.

Deduct up to $15,000 a year by giving to an ABLE account from a 529. Spouses get twice as much benefit. Withdrawals are tax-free for qualified expenses, like employment training, housing, fighting autism, ADHD and overcoming disabilities.

If you have the privilege to be able to help the next generation and want to finance religious school, military training, or help a child with special needs, this is a loophole for you. Please let us know if we can assist you with making this happen. ●

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