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OnWealth
Financial Advice from Wealth Management Services

Mid-Year Planning: Tax Changes to Factor In

The Tax Cuts and Jobs Act, passed in December of last year, fundamentally changes the federal tax landscape for both individuals and businesses. Many of the provisions in the legislation are permanent, others (including most of the tax cuts that apply to individuals) expire at the end of 2025. Here are some of the significant changes you should factor in to any mid-year tax planning. You should also consider reviewing your situation with a tax professional.

New lower marginal income tax rates

In 2018, there remain seven marginal income tax brackets, but most of the rates have dropped from last year. The new rates are 10%, 12%, 22%, 24%, 32%, 35%, and 37%. Most, but not all, will benefit to some degree from the lower rates. For example, all other things being equal, those filing as single with taxable incomes between approximately $157,000 and $400,000 may actually end up paying tax at a higher top marginal rate than they would have last year. Consider how the new rates will affect you based on your filing status and estimated taxable income.

Higher standard deduction amounts

Standard deduction amounts are nearly double what they were last year, but personal exemptions (the amount, $4,050 in 2017, that you could deduct for yourself, and potentially your spouse and your dependents) are no longer available. Additional standard deduction amounts allowed for the elderly and the blind remain available for those who qualify. If you're single or married without children, the increase in the standard deduction more than makes up for the loss of personal exemption deductions. If you're a family of four or more, though, the math doesn't work out in your favor.

Itemized deductions — good and bad

The overall limit on itemized deductions that applied to higher-income taxpayers is repealed, the income threshold for deducting medical expenses is reduced for 2018, and the income limitations on charitable deductions are eased. That's the good news. The bad news is that the deduction for personal casualty and theft losses is eliminated, except for casualty losses suffered in a federal disaster area, and miscellaneous itemized deductions that would be subject to the 2% AGI threshold, including tax-preparation expenses and unreimbursed employee business expenses, are no longer deductible. Other deductions affected include:

- **State and local taxes** — Individuals are only able to claim an itemized deduction of up to $10,000 ($5,000 if married filing a separate return) for state and local property taxes and state and local income taxes (or sales taxes in lieu of income).
- **Home mortgage interest deduction** — Individuals can deduct mortgage interest on no more than $750,000 ($375,000 for married individuals filing separately) of qualifying mortgage debt. For mortgage debt incurred prior to December 16, 2017, the prior $1 million limit will continue to apply. No deduction is allowed for interest on home equity loans or lines of credit unless the debt is used to buy, build or substantially improve a principal residence or a second home.

Other important changes

- **Child tax credit** — The credit has been doubled to $2,000 per qualifying child, refundability has been expanded, and the credit will now be available to many who didn't qualify in the past based on income; there's also a new nonrefundable $500 credit for dependents who aren't qualified children for purposes of the credit.
- **Alternative minimum tax (AMT)** — The Tax Cuts and Jobs Act significantly narrowed the reach of the AMT by increasing AMT exemption amounts and dramatically increasing the income threshold at which the exemptions begin to phase out.
- **Roth conversion recharacterizations** — In a permanent change that starts this year, Roth conversions can't be "undone" by recharacterizing the conversion as a traditional IRA contribution by the return due date.

June 2018

Shopping for a New or Used Car

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What are the gift and estate tax rules after tax reform?

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Shopping for a New or Used Car

Should you buy a brand-new car or a used one? Consider these factors.

It's time to replace your current car. But should you buy a new car or a used one? Consider the following advantages and disadvantages of each as you shop around for the vehicle that's right for you.

Buying a new car

Advantages. That new-car smell, a clean interior, and the latest technology and safety features...there's no denying the appeal of buying a new car. Aesthetics aside, there is an additional advantage to buying new: starting with a blank slate. You won't need to worry about how the previous driver treated the vehicle. Ownership of a new car comes with the freedom to decide whether to modify the vehicle, how much to drive it, and how much insurance to carry (although your lender may impose some minimum requirements if you take out a loan to buy the car). Bear in mind that there are also state requirements as to how much insurance you need.

The warranty on a new car is typically much better than a used one, offering you greater protection against any defects that may cause your car to malfunction in the first few years of ownership. A new vehicle also comes with benefits like roadside assistance, higher fuel efficiency standards, and the latest safety features. These features help make your car safer to drive, which can provide you with peace of mind.

Disadvantages. The major downside of buying a new car is the hit it will take on your wallet. New cars tend to cost more than used cars for the same make and model, and they also depreciate in value more quickly. In fact, a vehicle loses the majority of its value in the first few years of ownership.

And remember, your new car won't stay new forever. Eventually, the new-car smell will fade, dents and scratches could appear, and the interior will experience wear and tear.

Buying a used car

Advantages. Even if you can afford a new car, buying a used car can be a smart alternative. In addition to saving on the upfront cost, you're also likely to save on insurance because used cars tend to be less expensive to insure than new cars.

Compared to new vehicles, used vehicles tend to depreciate less rapidly. Chances are that a used car's previous owner paid for the bulk of depreciation.

Since most modern cars can go 100,000 miles or more with few mechanical problems, you might not even notice a difference between buying a late-model used car with low mileage and buying a new car.

Disadvantages. A used vehicle comes with many unknowns. You probably won't know why it was traded in or how it was treated by the previous owner. As a result, you may need to be prepared to pay for required maintenance sooner than you would on a new car. You'll want to have a reputable mechanic check out a used vehicle before you buy it. Though you'll have to pay a mechanic for this service, it could end up saving you from paying costly repair bills down the road.

Bear in mind that your choice of models and options is much more limited if you decide to buy a used car. If you have your heart set on a specific kind of car or certain features, this might mean that you'll need to spend a much longer time shopping around.

Additional considerations

Whether you choose to buy a new or used car, make sure you consider the following questions as you go through the car shopping process:

- What do you like and dislike about your current car?
- How will you use the car? Will it be a commuter vehicle that's driven on highways daily, or will it be used less frequently around town?
- Do you need a larger car with a roomy trunk and plenty of seating to accommodate your family, or will a smaller two-door car suit your needs?
- What kinds of features are on your wish list? Do you want a car with the latest technology, or one with a leather interior? Is there a particular body style that you'd favor over another?

If you prefer to trade in your car for a new one every few years, explore leasing as an alternative to buying a new car. Monthly lease payments are generally lower than the payments on a loan to purchase the same vehicle. But leasing a car could mean that you're required to carry more insurance than if you purchase the car. Plus, lease contracts can be confusing, so make sure you know exactly how they work to avoid paying more than you need to.

Buying a car is an important financial decision. Do your research and understand how this purchase will affect you in the short term and the long term to make the most out of your new ride.

Quiz: Can You Answer These Social Security Benefit Questions?

Did you know that 94% of all workers are covered under Social Security?

Source: Social Security Fact Sheet on the Old-Age, Survivors and Disability Insurance Program, July 2017

Most people will receive Social Security benefits at some point in their lifetimes, but how much do you know about this important source of income? Take this quiz to learn more.

Questions

1. Can you receive retirement and disability benefits from Social Security at the same time?

a. Yes

b. No

2. If your ex-spouse receives benefits based on your earnings record, your benefit will be reduced by how much?

a. Reduced by 30%

b. Reduced by 40%

c. Reduced by 50%

d. Your benefit will not be reduced

3. For each year you wait past your full retirement age to collect Social Security, how much will your retirement benefit increase?

a. 6%

b. 7%

c. 8%

4. Monthly Social Security benefits are required to be paid by which of the following methods?

a. Paper check only

b. Paper check, direct deposit, or debit card

c. Direct deposit or debit card

5. Are Social Security benefits subject to income tax withholding?

a. Yes

b. No

6. Once you've begun receiving Social Security retirement benefits, you can withdraw your claim if how much time has elapsed?

a. Less than 12 months since you've been receiving benefits

b. Less than 18 months since you've been receiving benefits

c. Less than 24 months since you've been receiving benefits

Answers

1. b. No. If you receive a disability benefit, it will automatically convert to a retirement benefit once you reach full retirement age.

2. d. Your benefit will not be reduced if your ex-spouse receives Social Security benefits based on your earnings record.

3. c. Starting at full retirement age, you will earn delayed retirement credits that will increase your benefit by 8% per year up to age 70. For example, if your full retirement age is 66, you can earn credits for a maximum of four years. At age 70, your benefit will then be 32% higher than it would have been at full retirement age.

4. c. Since 2013, the Treasury Department has required electronic payment of federal benefits, including Social Security. You can sign up for direct deposit of your benefits into your current bank account or open a low-cost Electronic Transfer Account (ETA) at a participating financial institution. Another option is to sign up for a Direct Express® prepaid debit card. Under this option, your Social Security benefits are deposited directly into your card account, and you can use the card to make purchases, pay expenses, or get cash.

5. b. No. Withholding isn't mandatory, but you may voluntarily ask the Social Security Administration to withhold federal income tax from your benefits when you apply, or later, if you determine you will owe taxes on your Social Security benefits (not everyone does). You may choose to have 7%, 10%, 15%, or 25% of your benefit payment withheld. Ask a tax professional for help with your situation.

6. a. If something unexpected happens and you've been receiving Social Security benefits for less than 12 months after signing up, you can change your mind and withdraw your claim (and reapply at a later date). You're limited to one withdrawal per lifetime, and there are also financial consequences. You must repay all benefits already paid to you or your family members based on your application (anyone affected must consent in writing to the withdrawal), and repay any money previously withheld, including Medicare premiums or income taxes.

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Can I convert my traditional IRA to a Roth IRA in 2018?

If you've been thinking about converting your traditional IRA to a Roth IRA, this year may be an appropriate time to do so. Because federal income tax rates were reduced by the Tax Cuts and Jobs Act passed in December 2017, converting your IRA may now be "cheaper" than in past years.

Anyone can convert a traditional IRA to a Roth IRA in 2018. There are no income limits or restrictions based on tax filing status. You generally have to include the amount you convert in your gross income for the year of conversion, but any nondeductible contributions you've made to your traditional IRA won't be taxed when you convert. (You can also convert SEP IRAs, and SIMPLE IRAs that are at least two years old, to Roth IRAs.)

Converting is easy. You simply notify your existing IRA provider that you want to convert all or part of your traditional IRA to a Roth IRA, and they'll provide you with the necessary paperwork to complete. You can also transfer or roll your traditional IRA assets over to a new IRA provider and complete the conversion there.

If you prefer, you can instead contact the trustee/custodian of your traditional IRA, have the funds in your traditional IRA distributed to you, and then roll those funds over to your new Roth IRA within 60 days of the distribution. The income tax consequences are the same regardless of the method you choose.[1]

The conversion rules can also be used to contribute to a Roth IRA in 2018 if you wouldn't otherwise be able to make a regular annual contribution because of the income limits. (In 2018, you can't contribute to a Roth IRA if you earn $199,000 or more and are married filing jointly, or if you're single and earn $135,000 or more.) You can simply make a nondeductible contribution to a traditional IRA and then convert that traditional IRA to a Roth IRA. (Keep in mind, however, that you'll need to aggregate the value of all your traditional IRAs when you calculate the tax on the conversion.) You can contribute up to $5,500 to all IRAs combined in 2018, or $6,500 if you're 50 or older.

[1] If you choose to receive the funds first and don't transfer the entire amount, a 10% early withdrawal penalty may apply to amounts not converted.

What are the gift and estate tax rules after tax reform?

The Tax Cuts and Jobs Act, signed into law in December 2017, approximately doubled the federal gift and estate tax basic exclusion amount to $11.18 million in 2018 (adjusted for inflation in later years). After 2025, the exclusion is scheduled to revert to its pre-2018 level and be cut approximately in half. Otherwise, federal gift and estate taxes remain the same.

Gift tax. Gifts you make during your lifetime may be subject to federal gift tax. Not all gifts are subject to the tax, however. You can make annual tax-free gifts of up to $15,000 per recipient. Married couples can effectively make annual tax-free gifts of up to $30,000 per recipient. You can also make unlimited tax-free gifts for qualifying expenses paid directly to educational or medical service providers. And you can make deductible transfers to your spouse and to charity. There is a basic exclusion amount that protects a total of up to $11.18 million (in 2018) from gift tax and estate tax. Transfers in excess of the basic exclusion amount are generally taxed at 40%.

Estate tax. Property you own at death is subject to federal estate tax. As with the gift tax, you can make deductible transfers to your spouse and to charity; there is a basic exclusion amount that protects up to $11.18 million (in 2018) from tax, and a tax rate of 40% generally applies to transfers in excess of the basic exclusion amount.

Portability. The estate of a deceased spouse can elect to transfer any unused applicable exclusion amount to his or her surviving spouse (a concept referred to as portability). The surviving spouse can use the unused exclusion of the deceased spouse, along with the surviving spouse's own basic exclusion amount, for federal gift and estate tax purposes. For example, if a spouse died in 2011 and the estate elected to transfer $5 million of the unused exclusion to the surviving spouse, the surviving spouse effectively has an applicable exclusion amount of $16.18 million ($5 million plus $11.18 million) to shelter transfers from federal gift or estate tax in 2018.