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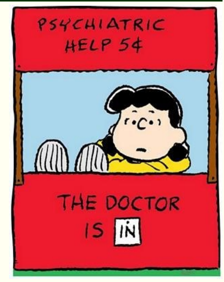
The New Tax Law & A Few Words On The Market



"The hardest thing in the world to understand is the income tax" – Albert Einstein

In my February 2017 newsletter I wrote that "2017 still starts with the old set of tax rules. But, before the year is over we could reasonably expect to see a number of changes."

It almost did not happen, but very late in the year, new tax legislation was enacted by Congress and signed into law by President Trump. The changes will not affect our 2017 tax returns filed this year but significant changes will be and are taking place in 2018. Since I am not a Certified Public Accountant or a tax preparer, my goal as a Certified Financial Planner practitioner is to make you aware of some of the changes that could affect you as a pre-retiree or retiree. If something you read in this newsletter sounds like it might apply to your particular situation, then it behooves you to discuss it with the individuals who will actually be preparing your taxes. The new tax bill is hundreds of pages long and, like most new laws, will face its share of challenges and interpretations as we go along.

It kind of makes you scratch your head a bit, but the first thing to say about the new tax law is that most of its **individual** tax provisions are temporary. The provisions will automatically revert back to the 2017 tax rules in year 2025 unless they are extended by Congress at that time. However, **corporate** tax changes were made permanent. This does not mean that corporate tax rules cannot be changed in the future but they do not have a stated expiration date. It is not within the scope of this newsletter to discuss corporate taxes- my goal is to enlighten my clients on the provisions that might affect them.

In addition to overall lower tax rates in all income brackets, the most notable change for individual taxpayers is that the standard deduction will nearly double in 2018. It will be $24,000 for Married couples, $12,000 for Singles and $18,000 for Household Heads. These new higher standard deductions will likely cause far fewer tax payers to itemize than in the past. Many of the individual deductions we were able to take in the past were either eliminated or pared back; personal exemptions for individual filers and their dependents were repealed.

Miscellaneous deductions subject to the 2%-of-Adjusted Gross Income (AGI) threshold such as IRA and brokerage fees, tax preparation fees, theft losses, employee business expenses, alimony for post-2018 divorce decrees and personal casualty losses (excluding presidentially declared disaster areas) are eliminated as well as write offs for job related moves (except for the military).

Deductions for state and local taxes including sales taxes will now have a combined cap not to exceed $10,000. The home mortgage interest deduction has been reduced to $750,000 on mortgage debt incurred after December 14, 2017. Also, after 2017, the home equity interest deduction for new or existing loans is eliminated.

The write-off for charitable contributions will remain but the Adjusted Gross Income (AGI) limitation on cash donations to qualified charities goes up from 50% to 60%. The popular write-off for medical expenses was kept intact and was actually enhanced by lowering the AGI threshold on Schedule A from 10% to 7.5%.

For each dependent child under age 17, the child tax credit is doubled to $2,000. Lower-income taxpayers have the potential to receive a refundable credit up to $1,400. There is also a new $500 credit for other dependents such as an elderly parent you care for or a disabled adult child. Income phase-outs apply for both.

There are a few other provisions of the new tax code that should be kept in mind. One that may affect pre-retirees under age 65 (as well as others under 65) is the elimination of the Obamacare requirement for individual health care insurance. The current mandate is that individuals either have health insurance, qualify for an exemption or pay a fine. This mandate still applies for 2018 but it will be repealed in 2019.

On the investment/savings fronts, the tax rates (0%, 15% or 20%) on long-term capital gains and qualified dividends did not change; however, income thresholds are now in place for these rates. Taxpayers with taxable income under $38,600 for Singles and under $77,200 for Marrieds will pay a 0% capital gains tax. Single taxpayers from $38,600 to $425,799 and Marrieds from $77,200 to $478,999 will pay a capital gains tax of 15%. The 20% capital gains rate applies to Singles with taxable income beginning at $425,800 and for Marrieds with taxable income beginning at $479,000.

Tax benefits for retirement savings plans remain the same except for changes in how Roth IRA conversions are handled. Unless you convert a Traditional IRA to a Roth IRA, this will not affect you. Roth conversions do not take place very often.

The so called "kiddie tax" has undergone a dramatic change. Unearned income of children under 18 years old will now be taxed as ordinary income and capital gains rates applicable to trusts and estates will apply. Previously, the parent's marginal tax rate applied.

One last item of interest to note in the new tax law is that Congress has raised the estate tax threshold to $22.4 million dollars per couple and the gift tax exclusion for 2018 to $15,000 per donee. The bottom line is that if the net worth of your estate is under $11.2 million dollars, you will not have to pay a federal estate tax and you will not have to worry about gifting. The exclusion amounts do revert back to $5.6 million and $11.2 million on January 1, 2026.

Like the old tax law, the new tax law also contains seven tax brackets; however, there are different tax rates and breakpoints within the brackets. The following tables are the new tax rates for 2018:

Marrieds: If taxable income is	The tax is
Not more than $19,050	10% of taxable income
Over $19,050 but not more than $77,400	$1,905.00 +12% of excess over $19,050
Over $77,400 but not more than $165,000	$8,907.00 +22% of excess over $77,400
Over $165,000 but not more than $315,000	$28,179 +24% of excess over $165,000
Over $315,000 but not more than $400,000	$64,179 +32% of excess over $315,000
Over $400,000 but not more than $600,000	$91,379.00 +35% of excess over $400,000
Over $600,000	$161,379,000 +37% of excess over $600,000
Singles: If taxable income is	**The tax is**
Not more than $9,525	10% of taxable income
Over $9,525 but not more than $38,700	$952.50 +12% of excess over $9,525
Over $38,700 but not more than $82,500	$4, 453.50 +22% of excess over $38,700
Over $82,500 but not more than $157,500	$14,089.50 +24% of excess over $82,500
Over $157,500 but not more than $200,000	$32,089.50 +32% of excess over $157,500
Over $200,000 but not more than $500,000	$45,689.50 +35% of excess over $200,000
Over $500,000	$150,689.50 +37% of excess over $500,000
Household Heads: If taxable income is	**The tax is**
Not more than $13,600	10% of taxable income
Over $13,600 but not more than $51,800	$1,360.00 +12% of excess over $13,600
Over $51,800 but not more than $82,500	$5,944.00 +22% of excess over $51,800
Over $82,500 but not more than $157,500	$12,698.00 +24% of excess over $82,500
Over $157,500 but not more than $200,000	$30,698.00 +32% of excess over $157,500
Over $200,000 but not more than $500,000	$44,298.00 +35% of excess over $200,000
Over $500,000	$149,298.00 +37% of excess over $500,000

Historically, income tax brackets, standard deductions and other economic items have been adjusted annually using the Consumer Price Index as our guideline. Under the new tax law, annual adjustments to these various categories will be tied to a new measure called the Chained Consumer Price Index. While a discussion of the two is beyond the scope of this article, critics of the Chained Consumer Price Index maintain that prices based on the Chained Index will cause annual inflation increases for individuals to be less over time. The net result of the switch to the Chained Index will be the implementation of a hidden tax to help reduce the Federal deficit. Since most of us are not economists, it will be interesting to watch and see if our annual adjustments are less in the future.

In closing, as Albert Einstein said, *"The hardest thing in the world to understand is the income tax."* It is actually not necessary for us to totally understand all of the changes that have taken place in the tax code. The purpose of this article is to alert you to some of the category changes that might affect you. If you can recognize those changes in your own situation, then the next step is to alert your tax preparer who can then provide professional advice.

One final thought. In my January newsletter, I wrote about the lack of volatility and lack of price corrections in the stock market saying the calmness and lack of drawdowns was not likely to be permanent. We did not get too far into February before a 10% correction took place from the January market highs. Unlike the tranquility that has existed for the last several years in markets around the world, corrections and downturns are a normal part of market behavior; we should expect more of them in the future. In my opinion, that is the reason active money management should be a big part of an investment approach for pre-retirees and retirees. Take good care!!!

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