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COROMANDEL WEALTH MANAGEMENT

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Reducing your taxes under the new tax law

"The only difference between a tax man and a taxidermist is that the taxidermist leaves the skin."

– *Mark Twain, American author and humorist (1835 - 1910)*

Navigating the Retirement Maze

Last December's hastily passed "2017 Tax Cuts and Jobs Act" mostly escaped the notice of taxpayers, as it applied to future years. Well, the future is here, and time is running out to use the changes to your advantage for 2018. Right after the bill was passed, I wrote a summary of the changes in the tax laws, and the best ways to utilize what little time remained in 2017 to reduce your tax bill that year. Similarly, I'll show you some ways to lessen your 2018 tax liability if you act soon.

Major tax law changes

The differences in the tax law that will most directly impact the average taxpayer in 2018 are:

- Elimination of Personal and Dependent exemptions ($4,100 per person).
- Schedule A changes – Eliminated Miscellaneous Deductions, a $10,000 cap on state and local taxes (SALT), caps on mortgage interest deductibility
- Increased standard deduction – $12,000/$24,000 for single/joint filers
- Marginal tax rates – Still seven brackets, but slightly lower rates and changes to some thresholds
- Alternative Minimum Tax (AMT) limits increased, resulting in a lower likelihood of triggering
- Charitable contribution cash deduction cap raised to 60% of adjusted gross income (AGI)

There are many other changes that won't apply to most taxpayers, including higher rates for the "Kiddie Tax" and a tax break for small businesses. Most of these are scheduled to disappear with the 2026 tax year, though I expect changes even sooner if there is a shift in political party leadership in 2020. Still, we know what the tax laws are for this year, so you should make changes now that could reduce your 2018 tax bill.

Be charitable and save on taxes

The new higher standard deductions will limit the ability of many taxpayers to reduce their taxes through charitable contributions. However, there are ways to work around this, the simplest of which is to aggregate multiple years' worth of charitable donations and contribute to a donor advised fund (DAF). This way, you can claim the full contribution on this year's tax return, and still spread out the donations over multiple years to any qualified charitable organizations.

Another method is to donate appreciated securities and funds that you have held for over a year, either directly to charities or via DAFs. You avoid paying the capital gains tax and can deduct the full value of the donation.

For retirees dealing with the added taxes due to required minimum distributions (RMDs) from their tax-deferred accounts, they can offset their RMDs dollar for dollar with direct contributions from IRAs to charities, called qualified charitable distributions (QCDs). RMDs can add enough income to move you into higher tax brackets, exceed the Medicare IRMMA thresholds, or trigger the Medicare surtax threshold. QCDs can be made by anyone with an IRA who is above the age of 70 ½, and in amounts up to $100,000 a year. (If most of your retirement assets are in 401(k)s, roll them over into an IRA to take advantage of QCDs.) For those with large holdings in appreciated assets (above $1 million) that are thinking charitably, various charitable gift annuities and trusts can save you and your charity recipients many tax dollars over time.

Max out your tax-deferred plans

Tax-deferred savings accounts are a benefit that should be fully utilized. The compounding effect of tax deferral over many years is significant, and maximizing your contributions takes advantage of this. Don't forget that non-working spouses can also contribute to IRAs.

If you have a high deductible health plan, consider setting up a health savings account (HSA). HSAs offer a triple tax advantage: tax deductible contributions, tax deferral, and no tax when withdrawn for qualified medical expenses. Unlike flexible spending accounts (FSAs), where you need to spend the amount contributed by March 15th of the following year, HSAs have no withdrawal requirements, and the longer you leave them untapped, the greater the deferral benefits you accrue.

If you or your children find yourselves in low tax brackets, consider contributing to Roth IRAs or employer retirement plans instead of non-Roth ones. Another option is Roth conversions, which can be used to reduce future tax liabilities. This works best in years of lower income, such as post-retirement but before Social Security and RMDs kick in. I typically recommend doing partial Roth conversions, "filling the bracket" of the current marginal tax rate and not moving into the next higher tax bracket. 529 College Savings Plans are also tax deferred, and should be used for saving for your children's college expenses.

Don't neglect those gains (and losses)

Use realized and unrealized capital gains and losses strategically. If you have the option, follow the rule: "Gains long term, losses short term" to achieve the best tax advantage. (Gains and losses cancel each other out, so this applies to net gains or losses.) Harvest losses to offset capital gains, particularly in higher income years. If losses exceed gains, they can be used to offset up to $3,000 in income each year and the excess carried over to later years. Gains are taxed at a reduced rate, typically 15 percent. If you happen to have a year where your AGI will be within the 12 percent tax bracket ($38,700 for individual, $77,400 for married filing jointly), fill the rest of the bracket with long term capital gains from highly appreciated securities or funds and pay no Federal capital gains tax.

Tax-smart investing

What you invest in, and where it is located, can have a major impact on your tax liabilities. A problem with mutual funds in taxable accounts is that you pay taxes on the capital gains each year even though you haven't sold a single share. Consider using exchange traded funds (ETFs) in taxable accounts, as the gains aren't taken until you sell the shares. If you have mutual funds that are creating this taxable gains problem for you, consider selling the higher basis/lower gains shares to reduce this recurring income, and invest the proceeds in an ETF that holds similar assets.

Tax laws are a moving target, and understanding them and using them to your best advantage is a legitimate way to reduce your tax burden and keep more of what you earn. Or you can choose to pay more taxes than necessary and be what I call "overly patriotic." It's your choice.

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