Now That The Dust Has Settled…Smart Tax Moves In 2018

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Now that the dust has settled, here are some smart tax moves to lower your taxes and/or avoid higher taxes/penalties in 2018. These steps may be especially helpful if you live in high property and high income tax states (e.g. New Jersey, New York, California) since state and local tax deductions are capped. Unfortunately all these changes mean you'll need more time and energy to stay on top of your taxes.

Here are 4 strategies to *lower* taxes and/or avoid *higher* taxes/penalties:

1. <u>Bunch Up Charitable Donations With A Charitable Trust.</u> Charitable trusts can be set up at brokerage houses very easily. (note: I happen to use Fidelity, which requires a $5,000 minimum to set up). For example, you decide to defer $12,000 in 2018 and you plan on distributing these funds in 2018 and 2019. You benefit from the charitable deduction of $12,000 in 2018 if you itemize above the standard $12,000 (single filer) or $24,000 deduction for married couples filing jointly. Perhaps you anticipate having fewer deductions in 2019, so you plan on using the standard deduction next year. This advice also works for out-of-pocket medical deductions if your expenses exceed $7,500. Note: even better than deferring **dollars** to charity, donate **investments** that have appreciated significantly to avoid long-term capital gains tax.

Example: Sara wants to donate to charity by gifting a mutual fund she purchased in 2010 for $3,500. The current value is $12,000. If she sells this position outright, she pays 15%

long-term capital gains tax on the $8,500 gain (= $1,275 of taxes). This reduces her $12,000 donation to $10,725, net of tax. If Sara donates her $12,000 position directly to her charitable trust, she deducts the full amount of $12,0000 in 2018.

2. Pay Down Your Home Equity Loan ASAP If You Don't Use the $ to "Buy, Build or Substantially Improve" Your Home. In the "good old days" (through the end of last year), you could take out a home equity loan to help pay e.g. for college and the interest was tax-deductible. That's no longer the case!
3. If You Use 529 Plan Assets To Cover K-12 (New IRS Provision), Make Sure It's OK With Your State! Some states automatically follow federal IRS codes while other states may consider withdrawing 529 dollars for pre-college education a "non-qualified distribution" and charge you penalties. The best way to proceed is to call your 529 Plan and ask them if withdrawals are penalty-free in your state of residence.
4. The Old Rule of Thumb Recommending Withdrawal of Taxable Assets Before Tax-Deferred Assets May Be Out the Window. The general rule of thumb for many tax payers was 1) withdraw assets first from taxable accounts and 2) let your tax-deferred accounts grow since you'll pay lower income taxes when you're retired. Now it makes good tax sense to take a mixture of taxable *and* tax-deferred withdrawals to cover retirement expenses – especially if you defer Social Security until age 70. Federal income tax rates in 2018 are lower for many tax-payers but they could be higher after age 70 ½ if Required Minimum Distributions (RMDs) from tax-deferred accounts bump up your overall ordinary income into higher tax brackets.

Example: Seth and Susan are both 68, married and retired. Both will postpone Social Security until they turn 70. After consulting their advisor and CPA, they decide to withdraw

$60,000 from Seth’s IRA in 2018. They expect their ordinary income to remain below $77,200 so they pay 0% long-term capital gains tax on taxable investments they plan to sell to cover the balance of living expenses. As long as Seth and Susan don’t breach $77,400 of taxable income in 2018, their top federal tax bracket is 12%.

In conclusion, you may need to spend even more time thinking about taxes in 2018 – and taxes are not everyone’s cup of tea. *The current tax overhaul is pushing the federal deficit ever higher so it’s prudent to bulk up on retirement savings.* Our grandchildren may have to boost taxes significantly in the coming decades. In addition, a rising budget deficit may end up eating into entitlements like Social Security and Medicare.