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Trust UPDATE

November 2018

Year-end tax planning

It's a whole new ball game this year.

The Tax Cuts and Jobs Act enacted in December 2017 is going to change tax planning for many, many taxpayers this year.

• ***Fewer itemizers,*** as the rough doubling of the standard deduction is expected to allow up to 90% of taxpayers to give up tracking their deductions. What's more, many deductions have been eliminated entirely, and the deduction for state and local taxes is capped at $10,000. Unless your total deductions come to more than $12,000 for singles, $24,000 for marrieds filing jointly, the standard deduction will be the way to go.

• ***Fewer taxpayers caught by the alternative minimum tax*** (AMT), as the AMT exemption has been significantly increased. See the table below for details. If you've been snared in past years by the AMT, you already know what it's like to lose 100% of your deductions for state and local taxes. If you're excused from the AMT this year, you may now be able to take advantage of that deduction again.

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New boundaries

The AMT will snare fewer people in 2018, and the break points on tax rates for long-term capital gains are higher.	AMT exemption	Tax rate on Long-term Capital Gains: 0% tax rate if taxable income is less than	Tax rate on Long-term Capital Gains: 15% tax rate if taxable income is less than
Married filing jointly or surviving spouses	$109,400	$77,200	$479,000
Married filing separately	$54,700	$38,600	$239,500
Single	$70,300	$38,600	$425,000
Head of household	$70,300	$51,700	$452,000

Source: Internal Revenue Code; M.A. Co.

Taxpayers with taxable income above the break points pay a 20% tax on net capital gains and dividend income.

• ***Complicated portfolio planning,*** given the change in break points for the tax on long-term capital gains and the wild ride in this year's stock markets. See the table on page 1 for new tax rates. On page 3, we discuss the importance of identifying which lot of stocks you wish to sell, should selling be part of your year-end planning.

Avoid short-term gains

The tax rate on a capital gain from the sale of an asset held for more than a year is generally about half of that on the sale of something held for a year or less. This can create a quandary. Should an investor lock in a gain while the price is high, or risk a market downturn by waiting until the longer holding period is satisfied? No doubt, in today's volatile financial markets, this call is often not an easy one to make. Still, a bias toward longer-term holding periods will lead to better overall tax results.

Use tax-deferred accounts wisely

There is a temptation to hold appreciating assets, such as stocks, in a tax-deferred account, such as a traditional IRA. Years of tax-free compounding are certainly attractive. On the other hand, all distributions from the traditional IRA will be taxed as ordinary income. There is no preferential tax rate for long-term holdings. What's more, the basis step-up at death doesn't apply to assets in retirement accounts. Accordingly, the better result for some investors will come from owning their appreciating assets in a taxable account, and investing their IRAs in bonds and other income-oriented choices.

The zero tax on some capital gains

Taxpayers in the lowest tax bracket pay no tax at all on their capital gains. Should the taxpayer experience a year of falling into that low bracket, it's a great time to harvest gains at no tax cost. The more likely scenario for an affluent family is in the realm of gifts. A grandparent who would like to give $15,000 to a grandchild, perhaps to help with higher-education expenses, would be well advised to instead give the grandchild appreciated securities. Assuming that the grandchild has only nominal income, the stocks may be sold without any tax drag on the proceeds.

Convert to a Roth IRA

Conversion of a traditional IRA to a Roth IRA is a taxable event, and the tax can be substantial. However, with the Roth IRA all future income and capital appreciation have the potential of being fully tax free. Should a taxpayer find himself or herself in a lower bracket than usual , it well may be a good time to consider such a conversion.

See your tax advisors before making any final decision. ☐

A capsule guide to our services for investors

Our services are, in essence, powerful financial planning tools built upon important investment management components. One of the great strengths of trust planning is the ability to tailor the plan to respond flexibly to current and future financial needs.

Portfolio supervision. Serious investing is a full-time job. Our investment advisory and investment management services put experienced investment professionals on your side. The officer assigned to your account will work with you to establish an investment strategy suited to your personal goals and circumstances. Asset allocation planning will be employed to optimize your portfolio, reducing investment risk through a process of disciplined diversification.

Lifetime financial management. The next step in comprehensive financial protection employs a *revocable living trust.* We begin by developing an investment policy for the trust based upon your requirements. We will implement that plan, providing continuous portfolio supervision and distributing or reinvesting trust income as directed. As trustee, we can move beyond the investment sphere, arranging to pay household bills and taxes on your behalf. A revocable trust provides financial protection in the event of incapacity, and it has important estate planning advantages as well.

IRA rollovers. Anyone who will receive a lump sum distribution from an employer's retirement plan would be well advised to take a careful look at an IRA rollover for the funds. A rollover preserves valuable tax privileges and can enhance your retirement capital. Taxable withdrawals may begin without penalty at age 59½, and a program of minimum withdrawals must begin at age 70½. With their tax-deferred nature, IRA rollovers present somewhat unusual investment issues, which should be resolved in the context of a full review of financial resources.

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Which block to sell?

As the year comes to a close, portfolio review is appropriate, and rebalancing may be called for in some cases to correct asset allocation drift. That may mean selling some stocks. Selling stock shouldn't be a tax-driven decision, but tax consequences do need to be taken into consideration. If you've purchased shares of a company over a number of years and have decided to lighten your holdings, your choice of which lot to sell could make a big difference on your tax bill. There have been suggestions in Congress to remove this flexibility from investors, but to date it has been preserved.

Here's a simplified example.

Mary and John own 40,000 shares of a hypothetical company that we'll call XYZ Corp. They purchased the shares at various times over the past ten years, in four transactions of 10,000 shares each. Here is a summary of their position:

XYZ stock	Held for	Cost/share	Purchase price
Block 1	10 years	$5	$50,000
Block 2	5 years	$10	$100,000
Block 3	3 years	$15	$150,000
Block 4	6 months	$10	$100,000

Now let's assume that Mary and John have decided to sell one block of 10,000 and the current price is $12. They can have a gain or a loss, depending upon which block they choose to sell, and the gain can be long term or short term. This table summarizes their potential tax liability if they are in the 35% tax bracket for ordinary income and 20% for capital gains:

XYZ stock	Gain (loss)	Tax rate	Tax due (tax savings)
Block 1	$70,000	20%	$14,000
Block 2	$20,000	20%	$4,000
Block 3	($30,000)	20%	($6,000)
Block 4	$20,000	35%	$7,000

Should the couple choose to sell Block 3, they will realize a long-term capital loss of $30,000, which may be netted against long-term gains for a potential tax savings of $6,000. The worst result would be first in, first out, selling Block 1 and triggering a large tax bill, but that is the approach required by IRS Regulations if the taxpayer fails to identify the proper lot to be sold.

Tax planning for real portfolios is more complicated than this simplified example. As you can see, excellent records are an essential prerequisite for informed decision making. ☐

Biggest bump in seven years

The last time that the Social Security cost-of-living adjustment was over 3% was in 2012. The increase for 2019 comes close, at 2.8%, following on the heels of the 2.0% increase we had in 2018. The increased income flows to some 67 million Americans.

All the other thresholds will be going up as well. Covered earnings will be boosted from $128,400 in 2018 to $132,900 in 2019. The average monthly benefit for all retired workers will be $1,461, and for an aged couple (both receiving benefits) the average will be $2,448. The maximum benefit at full retirement age will be $2,861 per month.

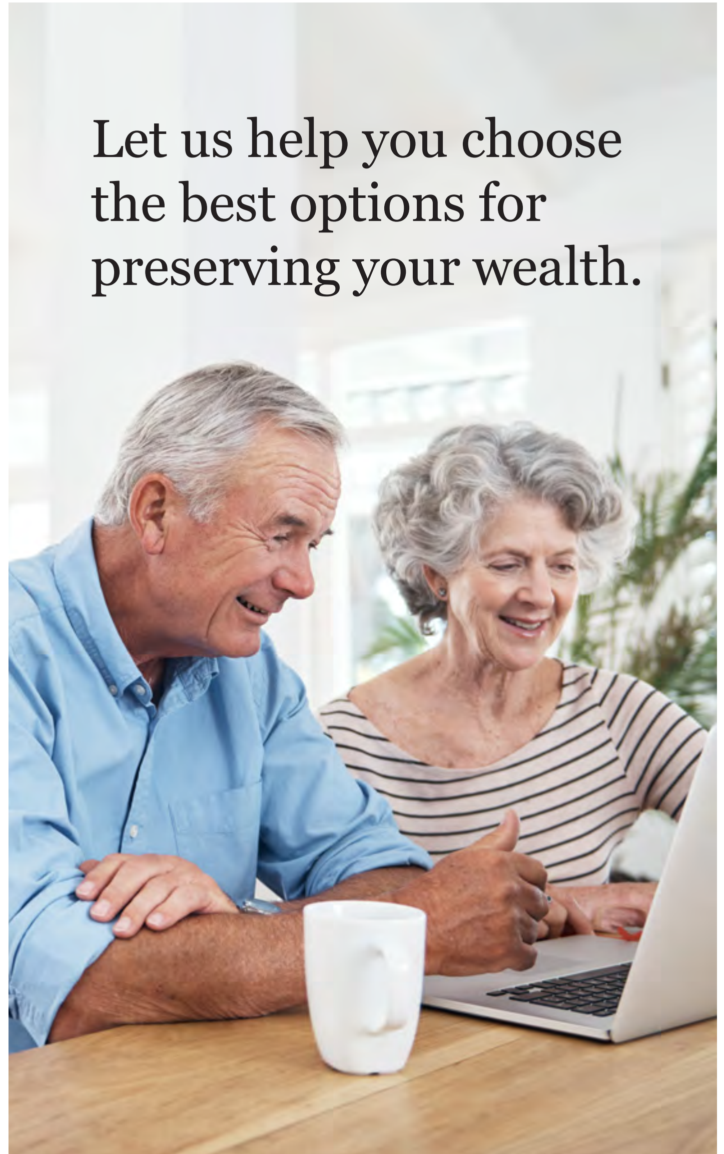
If you were born in 1953, you will reach your full retirement age of 66 in 2019. Those born in 1954 also have 66 as their full retirement age. The phase-in to a full retirement age of 67 begins with those born in 1955, and those who were born in 1960 and later years must wait until age 67 for full retirement benefits. Early retirement is still permitted at age 62, subject to a permanent actuarial reduction in benefits.

Those who retire before their full retirement age are subject to an earnings test—if you are not really retired, you probably should not be claiming the benefits. For those who are ages 62 through 65, the amount exempt from the earnings test is $17,640 in 2019. One dollar in benefits will be withheld for every two dollars above the limit. Only earned income is taken into account—dividends, interest, and capital gains are ignored in this calculation. In the year that one reaches full retirement age, the limit jumps to $46,920, and the lost benefit is one dollar for every three over the limit. Note that the earnings test no longer applies once one reaches full retirement age.

Social Security benefits are subject to income tax for higher-income retirees. For married couples filing jointly, "higher income" means combined income of more than $32,000. From $32,000 to $44,000 of combined income, half of the benefits are taxed, and above $44,000 85% are taxed. "Combined income" has a special meaning in this context. To determine combined income, start with your adjusted gross income, add in nontaxable interest (such as municipal bond interest), and then add in half of the Social Security benefits.

For singles, the bracket for 50% benefit taxation is $25,000 to $34,000, and, above $34,000, benefits are 85% taxable.

You can arrange for your income taxes to be withheld from your benefits if you wish. ☐



Utilizing life insurance, revocable living trusts, investment management accounts and more products, our Trust Division has a variety of options to help you preserve your assets for the next generation.

For more information, call (870) 793–4441.