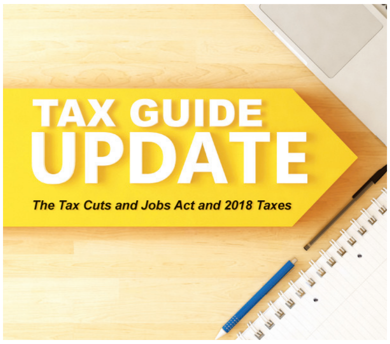
Tax Guide Update: The Tax Cuts and Jobs Act and 2018 Taxes

By AAII Staff

Article Highlights

- Tax rates for individuals in the middle income brackets are three-to-four percentage points lower starting this year.
- A change to how inflation adjustments are calculated could increase the amount of adjusted gross income reported and bump some individuals into a higher tax bracket.
- Contribution limits to retirement savings accounts have not changed, but the ability to undo a Roth IRA conversion has been repealed.



In late December, Congress passed new tax legislation, referred to as the Tax Cuts and Jobs Act (TCJA).

The law made significant changes to both individual and corporate taxes. Almost all of its changes go into effect this tax year (2018). Exceptions impacting 2017 taxes for individual taxpayers are a 7.5% income threshold for deducting medical expenses (it was 10%) and a small (and now expired) window for prepaying property taxes meeting specific requirements. As such, this update will focus on 2018. AAII members seeking information pertaining to their 2017 taxes should refer to "The Individual Investor's Guide to Personal Tax Planning 2017," which was published in the December 2017 *AAII Journal*. The guide has been updated on AAII.com to include in the changes made by the TCJA.

Many of the provisions in the TCJA relating to individual taxpayers are set to expire on December 31, 2025. Unless Congress passes new legislation, the former tax law will go back into effect after that date. This sunset clause was added to many provisions to keep the estimated cost of the legislation below the $1.5 trillion limit. We'll note throughout this guide what specific changes are subject to the sunset provision.

One significant change not receiving much attention is the use of a different measure of inflation. The chained consumer price index (aka chained CPI), will be used to determine inflation adjustments for many breakpoints, limits and deductions in the tax code. The chained CPI factors in potential differences in the choices consumers may make if one item or service rises faster in price than another. For example, if the price of beef rises faster than the price of chicken, consumers—in aggregate—may opt to eat more chicken. By factoring in such assumptions, the chained CPI calculates a slower rate of price increases than the traditional consumer price index.

For taxpayers, the use of chained CPI means the items impacted by it will increase at the slower rate in the future. This could effectively increase the amount of adjusted gross income taxpayers report and bump those near the upper end of their tax brackets into a higher bracket. Put another way, depending on your income and deductions, you could end up paying more in federal taxes than you would have otherwise if Congress had not changed the inflation measure.

What the New Tax Law Has Changed

Here is an overview of the changes impacting many AAII members made by the TCJA.

Income Brackets

Effective in 2018, the tax brackets for individual taxpayers are 10%, 12%, 22%, 24%, 32%, 35% and 37%. The changes from 2017 range between zero percentage points for the bottom tax bracket and the second to highest tax bracket to three-to-four percentage points for the middle brackets. The highest tax bracket has been reduced by 2.6 percentage points.

It's not just the brackets that have changed, but the breakpoints at which each higher tax rate goes into effect have also changed. The income ranges at which the third, fourth and fifth brackets are hit are now higher than what they would have been without the TCJA. Since the tax system is progressive, this change helps to reduce the effective federal tax rate paid by higher income earners, all else being equal. The revised tax brackets and rates are set to expire on December 31, 2025.

Standard Deduction

The standard deduction for married couples has been doubled in value to $24,000. The adjustment for the so-called "marriage penalty" has been maintained with the standard deduction for single taxpayers now set at $12,000. The standard deduction for heads of household is $18,000.

The higher standard deduction limits are set to expire on December 31, 2025. The additional standard deduction for the elderly and the blind ($1,300 for married couples and $1,600 for single taxpayers in 2018) still applies.

Personal Exemption

The personal exemption and its phaseout levels have been suspended through December 31, 2025.

Itemized and Miscellaneous Deductions

The "Pease" limitation on itemized deductions is repealed effective January 1, 2018, through December 31, 2025.

Miscellaneous itemized deductions exceeding 2% of adjusted gross income are no longer deductible. The suspension of the ability to claim such deductions lasts through 2025. This category is large but includes:

- Tax preparation fees such as tax preparation software, tax publications and any fee paid for electronic filing; and
- Investment fees, custodial fees, trust administration fees and other expenses paid for managing your investments that produce taxable income.

Uninsured personal casualties can be deducted only if they are attributable to a federally declared disaster and exceed 10% of adjusted gross income. Losses to theft are no longer deductible. The new rule is in effect from 2018 through 2025.

Most people will no longer be able to deduct qualified moving expenses through 2025. The exception is members of the Armed Forces on active duty who move "pursuant to a military order and incident to a permanent change of station."

State and Local Taxes

The state and local tax (SALT) deduction is now capped at $10,000 per year for married joint filers and for single filers. The cap is $5,000 for married persons filing separate returns. The cap applies to the cumulative total of income and property taxes. Sales taxes can also be deducted, but are still subject to the new cap.

The cap is in effect through the end of 2025. It is not indexed to inflation.

Investments

Capital gains and qualified dividends will continue to be taxed at the 0%, 15% and 20% rates, but the breakpoints have been adjusted. The maximum income for the 0% rate is $77,200 for married joint filers, $38,600 for single and married separate filers and $51,700 for heads of household. The 15% tax rate will apply to married joint filers with incomes up to $479,000, single and married separate filers with incomes up to $425,800 and heads of household with incomes up to $452,400. The brackets are indexed to inflation.

The additional 3.8% net investment income (NII) surtax on capital gains and dividends was not repealed. Married couples filing joint returns with net investment income and modified adjusted gross incomes above $250,000 and single filers with net investment income and modified adjusted gross incomes above $200,000 must pay the NII surtax on capital gains and dividends. Collectibles are eligible for the 3.8% surcharge as well. The $250,000/$200,000 thresholds are not indexed to inflation and were not altered by the TCJA.

Investors will continue to have the ability to specify which lots they are selling, though they must provide notification to their broker in advance of the transaction being executed. Long-term capital gains and qualified dividends are taxed at 15% if incurred for securities held within a taxable account. (There is no capital gains tax or dividend taxes for securities held within a retirement account, such as an IRA. See Robert Carlson's article, "Do's and Don'ts of IRA Investing," in the March 2010 *AAII Journal* for investments that can cause an unexpected tax problem.)

Cryptocurrencies are considered to be a capital asset—like a stock or bond—in the eyes of the IRS if not held as inventory or property for sale to customers. Collectibles, which include gold coins and bars, are taxed at a maximum 28% rate. Funds investing in precious metals, including exchange-traded funds, may also be subject to the collectibles tax rate. Check with the fund company if you have questions about the tax status.

Short-term capital gains are taxed as ordinary income. If you are in the 10% or 12% tax bracket, long-term capital gains and qualified dividends are not taxed.

Roth IRA Conversions

The ability to recharacterize a Roth IRA has been repealed. Effective at the start of 2018, once a traditional IRA has been converted to a Roth IRA, an individual can no longer undo the change.

Health Care

The individual shared responsibility provision of the Affordable Care Act (aka the "individual mandate") requiring adults and children to have minimum essential health coverage has been repealed, effective January 1, 2019.

Medical expenses exceeding 7.5% of adjusted gross income are deductible for 2017 and 2018. The ceiling is set to revert back to 10% on January 1, 2019.

Alternative Minimum Tax

The alternative minimum tax (AMT) was not repealed by the TCJA, but the amount of income exempt from it and the phaseout thresholds were increased. The AMT threshold for married couples filing jointly is $109,400 and $70,300 for single filers in 2018. The phaseout levels are $1 million and $500,000, respectively. These changes are set to expire on December 31, 2025.

Child Tax Credit

The child tax credit has been increased to $2,000 with a new adjusted gross income threshold of $400,000 for married joint filers ($200,000 for all other filers) through December 31, 2025. The credit is refundable up to $1,400. A Social Security number must be provided for each qualifying child the credit is claimed on. See IRS Publication 972 for more information. The refundable portion is indexed to inflation, but not the income phaseout thresholds.

Estate Tax

The estate tax is maintained, but the exclusion limits have been increased significantly. The TCJA doubled the basic exclusion amount from $5 million to $10 million. Adjusted for inflation this means the per spouse exclusion is $11.18 million. The $11.18 million exclusion is portable, meaning that if one spouse passes away, the surviving spouse can claim the exclusion. This characteristic results in a total effective exclusion of $22.36 million in 2018. The large figure will prevent most families from having to pay estate taxes. The exclusion amount remains indexed to inflation, but the higher levels are set to expire after 2025.

The estate tax rate remains 40%. The step-up basis rule applies when an inherited asset is sold: The capital gain resulting from the sale is calculated as the difference between the proceeds at the time of the sale transaction and the value of the assets at the time of the inheritance.

Executors must report the fair value of the property included in the gross estate to both the IRS and to the heirs. Beneficiaries claiming a basis for inherited property above the reported value may be subject to a 20% penalty. *Revised 3/15/2018.*

Kiddie Tax

In 2017, children with investment income above a certain amount may have had part or all of their investment income taxed at their parents' income tax rate.

The "kiddie tax" will continue to apply if the child's total investment income exceeds $2,100 in 2018, but the tax rate is changing. Earnings more than this amount will be taxed at the trust and estate tax rates. Those rates for 2018 are 10% of income up to $2,550, 24% up to $9,150, 35% up to $12,500 and 37% for any income more than $12,500.

The "kiddie tax" applies to children up to age 18 and could apply to children up to age 23—depending on how much earned income they have and whether or not they are full-time students.

Alimony

Alimony and separate maintenance payments will remain deductible by the paying spouse and included in the income of the spouse receiving the payments in 2018.

Stating on January 1, 2019, the paying spouse can no longer deduct such payments, while the payee spouse can no longer report the payments as income. This change applies to previously executed agreements modified after the end of this year that expressly state that the tax law change applies to the modification.

Mortgages and Home Equity Loans

The interest on home equity lines of credit (HELOCs) and second mortgages is still deductible to the extent the loan is used for acquisitions and the cumulative mortgage balance does not exceed $750,000. An example of acquisition indebtedness, according to Greg Rosica (a tax partner at Ernst & Young LLP), would be a HELOC used to pay for the construction of an enclosed patio. Conversely, were the HELOC used to buy patio furniture, the interest would not be deductible.

The $750,000 ceiling is the cumulative amount owed on the first mortgage, the second mortgage and the HELOC. This ceiling was reduced by the TCJA and is not indexed to inflation. The provision does not apply to any indebtedness incurred on or before December 15, 2017. The new rules are set to expire on December 31, 2025.

There are nuances to the ability to deduct mortgage and HELOC interest; consult a tax professional.

What the TCJA Has Not Changed

Here is an overview of the tax provisions not changed by the TCJA.

Social Security

Social Security is taxed at 6.2% for employees and 12.4% for those working in self-employed positions on the first $128,700 of wages.

Retirees younger than full retirement age who have claimed Social Security benefits can earn up to $17,040 in 2018 without having their benefits reduced.

Additional Medicare and Net Investment Income Taxes

Neither the additional Medicare tax nor the net investment income (NII) tax were repealed by the TCJA.

A 0.9% additional Medicare tax applies to wages, compensation and self-employment income above $250,000 for married persons filing jointly and qualifying widows(ers), $200,000 for single persons and heads of household and $125,000 for those who are married but filing separately. The tax applies to wages that are subject to the Medicare tax and does not depend on adjusted gross income. Should the additional tax not be withheld from wages (a situation that could occur for dual-income couples or individuals working more than one job), the tax could be subject to a penalty if not paid with estimated taxes or through additional withholdings (you can request that your employer increase the income tax withholding on your W-4). More information about the additional Medicare tax can be found on the IRS website at www.irs.gov/businesses/small-businesses-self-employed/questions-and-answers-for-the-additional-medicare-tax.

A 3.8% surtax on net investment income (NII) applies to the lesser of net investment income or modified adjusted gross income exceeding $250,000 for married persons filing jointly and qualifying widows(ers), $200,000 for single persons and heads of household and $125,000 for those who are married but filing separately. (These thresholds are not indexed for inflation.)

Investment income subject to the tax includes, but is not limited to, taxable interest, dividends, non-qualified annuities, rents and royalties, capital gains and passive income from partnerships.

Capital gains from the sale of one's primary residence are subject to the tax to the extent that the income exceeds the applicable home sale exclusion ($500,000 for joint filers and $250,000 for single filers). Excluded are tax-exempt interest (e.g., municipal bond interest payments), distributions from individual retirement accounts (IRAs) and distributions from qualified retirement plans [e.g., 401(k) plans]. The IRS has answers to common NII surtax questions at www.irs.gov/uac/Newsroom/Net-Investment-Income-Tax-FAQs.

Flexible and Health Savings Accounts

Flexible savings accounts are maintained. The contribution limit for 2018 is $2,700, and remains indexed to inflation. At the election of their plan sponsors, employees can either carry over unused balances of $500 into the next plan year or take a grace period of up to two and a half months. Dependent care is also eligible for the grace period option, but not the carryover option.

Contributions to a health savings account (HSA) are allowed for those covered by a high-deductible health care plan (HDHP) and not enrolled in Medicare. The minimum annual deductible for self-only coverage is $1,350; it is $2,700 for family coverage. These limits are indexed to inflation.

The maximum limits for annual deductible and other out-of-pocket expenses are $6,650 and $13,300, respectively, in 2018.

HSA contributions cannot exceed $3,450 for individual coverage and $6,850 for family HDHP coverage. See "Health Savings Accounts" in the July 2016 *AAII Journal* for more information about these accounts.

Revised 3/15/2018.

Medical Insurance Premiums

Medical insurance premiums for the self-employed remain deductible and can be used to reduce adjusted gross income on Form 1040.

Retirement Savings

The maximum contribution to individual retirement accounts is $5,500 in 2018. The maximum 401(k) contribution is $18,500, with those age 50 and older eligible to make an additional $6,000 catch-up contribution. For qualified plans, including SEP and Keogh plans, the maximum annual contribution is $55,000 or 25% of your compensation, whichever is less. These limits are indexed to inflation.

Gift Tax

The annual gift tax exclusion is $15,000, and $30,000 for a married couple, in 2018.

Charitable Contributions

Charitable contributions remain tax deductible, but the limitation has been raised from 50% to 60% of adjusted gross income through 2025. You must itemize to claim the deduction. The new, higher standard deduction as well as the new cap on state and local income taxes (discussed on page 8) is expected to lead to fewer taxpayers itemizing.

When making a gift to a charity, you must have an appropriate record of the gift in order to properly support the deduction. In addition, cash contributions of any amount must be supported by a written record, either in the form of a bank record (for example, a cancelled check) or a written receipt from the charity. The record must include the name of the charity, the date and the amount of the contribution.

Qualified charitable distributions (QCDs) remain an option for those who are taking or will start taking required minimum distributions (RMDs) from an individual retirement account. QCDs offset up to $100,000 of RMDs per calendar year. See "The Tax Advantages of Qualified Charitable Distributions From IRAs" by William Reichenstein, Kirsten A. Cook and Harry Harelik in the October 2016 *AAII Journal*.

Education

The law largely, but not completely, left education deductions and credits unchanged.

The maximum Hope Scholarship Credit (the American Opportunity education credit) of $2,500 per year for the first four years of post-secondary education for tuition and related expenses (including books) was made permanent by the Consolidated Appropriations Act of 2016 and can be claimed in 2018.

The Lifetime Learning Credit can be claimed for education expenses beyond the fourth year of post-secondary education and for non-degree courses intended to improve job skills. The maximum credit is $2,000 annually and is subject to income phaseouts.

You can make nondeductible contributions to qualified tuition plans, also known as section 529 plans. (However, the contributions may be deductible from your state income tax, depending on where you live.) These accounts, offered by states or their designees, are maintained solely for the qualified higher education expenses of a beneficiary. Distributions are tax-free, provided that the distributions are used to pay qualified expenses.

The American Tax Relief Act of 2012 (ATRA) made the $2,000 per beneficiary contribution limit to a Coverdell Education Savings Account permanent. The contributions are not deductible, but they grow tax-free in the IRA. Coverdell accounts may be used to fund qualified elementary, secondary and higher education expenses. However, the amount that can be contributed is limited for higher-income taxpayers.

Investment Strategies: 2018 and Beyond

The recently passed Tax Cuts and Jobs Act made more reaching and substantial changes than either the ATRA or the Consolidated Appropriations Act of 2016. Many of the TCJA's changes affecting individual taxpayers are temporary, lasting only through December 31, 2025. The sunset clauses were necessary to keep the estimated cost of the legislation under $1.5 trillion. The expiration dates combined with the projected impact on the federal debt creates uncertainty about how long the reduced tax rates will stay in effect.

Though we cannot predict what

(continued on page 15)

Tax Forecasting Worksheet

This worksheet is designed for estimation purposes only and does not cover all the possible adjustments that may be required to arrive at actual taxable income (for example, Social Security benefits may be taxable in some circumstances) or to compute final income tax liability (for example, lump-sum distribution tax on retirement distributions). It should be adequate for most purposes and is a good starting point for discussions with your tax adviser, who can assist you in making exact calculations.

Go to www.aaii.com/files/PDF/TaxGuide2018/worksheet.pdf for an online worksheet that calculates the math for you.

			2018	2019	
Income					
1.	Salaries per Form W-2				
2.	Non-qualified dividends and interest income				
3.	Net business income (losses)				
4.	Net capital gains and qualified dividend income[a]				
5.	Other gains (losses)				
6.	Passive income (losses) (subject to limitations)				
7.	Other income, including 85% of Social Security benefits, if applicable				
8.	**Total income** (sum of lines 1 – 7)		$	$	
Adjustments					
9.	Keogh contributions				
10.	Deductible IRA contributions				
11.	Moving expenses (active duty military only, subject to limitations)				
12.	Other ____________				
13.	**Adjusted gross income (AGI)** (subtract lines 9 – 12 from line 8)		$	$	
Deductions					
14.	Medical and dental expenses [excess over 7.5% in 2018 (10% in 2019) of line 13; regardless of age] or self-employed health insurance				
	15a. State and local income taxes (or sales taxes)				
	15b. Real estate and property taxes (non-business property)				
15.	Lower of sum of lines 15a and 15b or $10,000	$			$
16.	Home mortgage interest (for acquisition debt only, capped at $750,000)				
17.	Investment interest (limited to investment income)				
18.	Charitable contributions				
19.	Casualty losses (federally declared disasters only)				
20.	**Total deductions** (sum of lines 14 – 19)		$	$	
	OR 20a. Standard deduction,[b] if greater (lines 14 – 19 must all show $0.00)		$	$	
21.	**Regular taxable income** (subtract line 20 from line 13)		$	$	
22.	**Regular tax** (see tax rate tables)[a]				
23.	**Tax credits**				
24.	Regular tax (net) (subtract line 23 from line 22)				
25.	Alternative minimum tax[c]				
26.	Other taxes (self-employment tax, household help, and so forth)				
27.	**Total tax** (sum of lines 24, 25 and 26)				
28.	**Total withholding and estimated tax payments**		$	$	
29.	**Balance due** (refund) (subtract line 28 from line 27)		$	$	

a. *If your taxable income includes net capital gain and qualified dividend income, you may be eligible for a tax rate on that income that is lower than the tax rate that applies to your other income. Refer to IRS Form 1040, Schedule D.*

b. *The standard deduction is not allowed when calculating the alternative minimum tax (AMT).*

c. *Use IRS Form 6251 as a worksheet and review the discussion on AMT in the online version of this article.*

2018 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	9,525	$0 + 10%	$0
9,525	38,700	$952.50 + 12%	$9,525
38,700	82,500	$4,453.50 + 22%	$38,700
82,500	157,500	$14,089.50 + 24%	$82,500
157,500	200,000	$32,089.50 + 32%	$157,500
200,000	500,000	$45,689.50 + 35%	$200,000
500,000	—	$150,689.50 + 37%	$500,000

For Married Taxpayers Filing Joint Returns and Surviving Spouses

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	19,050	$0 + 10%	$0
19,050	77,400	$1,905 + 12%	$19,050
77,400	165,000	$8,907 + 22%	$77,400
165,000	315,000	$28,179 + 24%	$165,000
315,000	400,000	$64,179 + 32%	$315,000
400,000	600,000	$91,379 + 35%	$400,000
600,000	—	$161,379 + 37%	$600,000

For Married Taxpayers Filing Separate Returns

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	9,525	$0 + 10%	$0
9,525	38,700	$952.50 + 12%	$9,525
38,700	82,500	$4,453.50 + 22%	$38,700
82,500	157,500	$14,089.50 + 24%	$82,500
157,500	200,000	$32,089.50 + 32%	$157,500
200,000	300,000	$45,689.50 + 35%	$200,000
300,000	—	$80,689.50 + 37%	$300,000

For Individuals Filing as Head of Household

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	13,600	$0 + 10%	$0
13,600	51,800	$1,360 + 12%	$13,600
51,800	82,500	$5,944 + 22%	$51,800
82,500	157,500	$12,698 + 24%	$82,500
157,500	200,000	$30,698 + 32%	$157,500
200,000	500,000	$44,298 + 35%	$200,000
500,000	—	$149,298 + 37%	$500,000

Capital Gains and Qualified Dividends

	Maximum Taxable Income for Married Filing Jointly		
	Below $77,200	$77,200–$479,000*	Over $479,000*
Short-Term Capital Gains	taxed as income	taxed as income	taxed as income
Long-Term Capital Gains**	0%	15%	20%
Qualified Dividends	0%	15%	20%
Collectibles***	28% maximum	28% maximum	28%
Real Estate Unrealized Gain (Section 1250 Property)	15% maximum	25% maximum	25% maximum

**May also be subject to the 3.8% net investment income (NII) surtax.*
***For investments held longer than one year.*
****Includes art, rugs, jewelry, precious metals or gemstones, stamps or coins, fine wines and antiques.*

Kiddie Tax

Unearned Income of Minor Children (under age 19 and ages 19–23 in certain circumstances)	
First $2,550	10%
$2,550–$9,150	24%
$9,150–$12,500	35%
Over $12,500	37%

Revised 4/25/2018.

2018 Allowable Tax Benefits

Standard Deduction

Under Age 65	
Married, Filing Joint	$24,000
Single	$12,000
Married, Filing Separate	$12,000
Head of Household	$18,000

Additional—Age 65 or Older	
Married (or Qualifying Widow)	$1,300
Single	$1,600

Additional—Blind	
Married (or Qualifying Widow)	$1,300
Single	$1,600

Personal Exemption

$0

Maximum Child Tax Credit

$2,000 per child under age 17 at the end of the year

Standard Mileage Deductions

Business Standard Mileage Rate	54.5 cents
Medical Standard Mileage Rate	18.0 cents
Moving Standard Mileage Rate*	18.0 cents
Charitable Serv Standard Mile Rate	14.0 cents

**active military only, subject to limitations*

Deductible IRA Contribution

If taxpayer and spouse NOT covered by employer-sponsored plan:

If younger than 50	$5,500
If 50 or older	$6,500

Maximum 401(k) Employee Contribution

If younger than 50	$18,500
If 50 or older	$24,500

Self-Employed Medical Insurance Premium Deduction

100%

Annual Gift Tax Exclusion (per person)

$15,000

Estate Tax Exclusion

$11.18 million

2018 Other Tax Items

2018 Social Security Tax Rates

	Employers & Employees	Self-Employed	Wage Limits
Social Security	6.20%	12.40%	$128,700
Medicare	1.45%	2.90%	no limit
Total	7.65%	15.30%	

2018 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 7.5% of AGI
- Uninsured casualities attributable to a federally declared disaster above 10.0% of AGI
- Contributions to qualified charities
- You can itemize state and local income taxes, property taxes and state and local sales taxes up to $10,000

2018 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through witholding or estimated tax payments):

AGI $150,000 or less ($75,000 married filing separate)

- 100% of prior tax liability or
- 90% of current year tax liability

AGI $150,000 or greater ($75,000 married filing separate)

- 110% of prior year tax or
- 90% of current year tax liability

2018 AMT Exemption Amount

Single	$70,300
Married, Filing Joint	$109,400
Married, Filing Separate	$54,700
Head of Household	$70,300

Revised 3/15/2018.

2018 Tax Benefit Phaseout Levels

Personal Exemption—Eliminated Through 2025

	AGI Phaseout Level
Married, Filing Joint	na
Single	na
Married, Filing Separate	na
Head of Household	na

Itemized Deduction (“Pease” Limitation)—Eliminated Through 2025

	AGI Phaseout Level
Married, Filing Joint	na
Single	na
Married, Filing Separate	na
Head of Household	na

IRA Deductibility

For those covered by employer retirement plan [$5,500 maximum contribution per taxpayer; if 50 or older, maximum is $6,500]

	Modified AGI* Phaseout Level
Married, Filing Joint	$101,000
Single	$63,000
Married, Filing Separate	$0**
Head of Household	$63,000
Married, Filing Joint not covered by pension plan, but spouse is	$189,000

Roth IRA Eligibility

Maximum $5,500 nondeductible contribution; if 50 or older, maximum is $6,500

	Modified AGI* Phaseout Level
Married, Filing Joint	$189,000
Single	$120,000
Married, Filing Separate	$0
Head of Household	$120,000

Coverdell Education Account

$2,000 maximum nondeductible contribution per beneficiary; withdrawals are tax-free for qualified education expenses; phaseouts not indexed to inflation

	Modified AGI* Phaseout Levels
Married, Filing Joint	$190,000 to $220,000
Single	$95,000 to $110,000
Married, Filing Separate	$95,000 to $110,000
Head of Household	$95,000 to $110,000

**Modified AGI starts with your AGI (adjusted gross income) and adds back certain tax-exempt amounts including any IRA deductions.*
***$63,000 if strict criteria are met.*

Revised 1/15/2018.

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the politicians in Washington will do, or when they will do it, there are strategies that make sense regardless of the legislative environment. Listed below are traditional tax planning strategies that can help keep your tax bill down. It is important, however, to keep in mind that your goals and risk tolerance, not just the income tax impact of an investment, should drive your investment decisions.

Consider Roth IRA Conversion Opportunities

You have the option of converting all or part of your traditional IRA into a Roth IRA, regardless of your adjusted gross income under existing law. Roth IRAs can provide certain advantages: The converted assets can be withdrawn tax-free at any time, future earnings are also tax-free (with some limitations) and Roth IRA owners are not required to take any minimum distributions in retirement. The downsides, however, are that the conversion amount is taxable in the year it occurs at your marginal tax rate and Roth IRA conversions can no longer be recharacterized.

The lower tax brackets increase the appeal of Roth IRA conversions, especially for those who believe their tax rates will be higher in retirement. Still, taxpayers must carefully weigh the upfront tax costs against the long-term tax advantages. "Retirement Planning Strategies Following the 2017 Tax Act" by William Reichenstein and William Meyer on page 32 of this issue provides an updated look at scenarios justifying a Roth IRA conversion and the scenarios that don't. You may also want to consult a tax adviser.

The new tax law repealed the ability to undo a Roth IRA conversion (a "recharacterization"). Once assets have been converted into a Roth IRA, the conversion is final—even if the value of the amount converted decreases in value after conversion. This change ends the previous flexibility investors had.

You cannot convert required minimum distributions (RMDs) from your traditional IRA for a particular year (including the calendar year in which you reach age 70½) to a Roth IRA. IRS Publication 590-A explains the rules for Roth IRA conversions and Publication 590-B covers the rules for RMDs.

Take Advantage of Lower Marginal Rates

Deferring income that is taxed at higher ordinary tax rates makes sense. Most taxpayers will pay long-term capital gains tax rates of 0% or 15%. For married couples filing jointly with income above $479,000, single filers and married couples filing separately with income above $425,800 and heads of household with incomes above $452,400 in 2018, the long-term capital gains rate is 20%. Short-term capital gains, in contrast, are taxed at ordinary income tax rates and run as high as 37%. The 3.8% net investment income (NII) surtax applies to taxpayers with income above the $250,000/$200,000 thresholds. This tax applies to both short- and long-term capital gains, as well as taxable interest, dividends, non-qualified annuities, rents and royalties and passive income from partnerships. The NII surtax is not indexed to inflation, and the $250,000/$200,000 thresholds are effective for 2018 and beyond.

Similar rules apply to qualified dividends. For married couples filing jointly with income above $479,000, heads of household with incomes above $452,400, and single and married separate filers with income above $425,800 in 2018, dividends are taxed at 20%.

Though tax considerations should never be the primary reason for selling a security, if you have large positions in either gifted or inherited stocks, or stocks received from a sale of a business, you should consider whether it makes sense to sell shares over a period of time to take advantage of the long-term capital gains rates and use the proceeds from selling the stock to diversify your portfolio. This is particularly the case if a large portion of your wealth is concentrated in just a few securities.

The Tax Impact of Investing for and in Retirement

Various parts of the tax code govern how much can be saved for retirement, when withdrawals can be made and how much has to be withdrawn.

There are three big birthdays you should be aware of. At age 50, the maximum amount allowed to be contributed to retirement savings accounts increases ("catch-up contributions"). At age 59½, you can take withdrawals from all retirement accounts without incurring the 10% early withdrawal penalty. Finally, once you reach age 70½, you are no longer eligible to contribute to a traditional IRA and you must begin taking required minimum distributions (RMDs).

The tax code incentivizes savings for retirement. Workers can contribute up to $18,500 in 2018 in a defined-contribution plan [e.g., a 401(k) plan]. A higher limit of $24,500 exists for workers age 50 or older. Taxpayers and spouses not covered by an employer retirement plan can contribute up to $5,500 ($6,500 for those age 50 or older) to a traditional IRA in both 2017 and 2018, though the deductions are subject to income phaseouts. Contributions to a tax-deferred retirement savings account reduce adjusted gross income (and thereby your tax liability) as long as they are within the designated limits. Again, contributions to a traditional IRA can no longer be made starting at age 70½.

Contributions to Roth IRAs and Roth 401(k) plans are not tax-deductible. Like traditional IRAs, up to $5,500 ($6,500 for those age 50 or older) can be contributed to a Roth IRA in both 2017 and 2018. The maximum contribution is subject to income phaseouts starting at $189,000 for married couples filing jointly and $120,000 for single filers in 2018.

Contributions to IRAs and Roth IRAs for the 2017 tax year can be made as late as April 17, 2018. When making a contribution for the previous calendar year, ensure your broker registers the deposit correctly.

Withdrawals from retirement accounts are considered to be taxable income unless taken from a Roth IRA, a Roth 401(k) or similar types of accounts. RMDs are required from most retirement accounts starting at age 70½. (The first RMD can be taken as late as April

1 of the calendar year following the year you turned age 70½, though the second RMD must be taken by December 31 of that same year.) The percentage of retirement savings subject to the RMD increases every year. Roth IRAs are exempt from RMDs, but Roth 401(k) plan savings are not. [A Roth 401(k) can be rolled to a Roth IRA, however.] Those who are still working, contributing to an employer-sponsored retirement plan and own less than 5% of the company they work for can delay the first RMD from a defined-contribution plan until April of the year they retire.

A discussion of all the tax aspects of investing for and in retirement is beyond the scope of this guide. Those seeking greater detail should read IRS Publications 590-A and -B on Individual Retirement Arrangements.

Use Losses Carefully

While tax considerations should not drive your investment decision, you can take advantage of losses in holdings that you would prefer to either sell or reduce from an investment standpoint.

Capital losses first reduce capital gains: Long-term losses reduce long-term gains first, and short-term losses reduce short-term gains first. Any long-term losses left over reduce short-term gains, and vice versa. If you still have losses remaining after offsetting capital gains, you can reduce your "ordinary" income by up to $3,000. Losses not used this year can be carried forward to future years until they are used up. For more information, see "Capital Pains: Rules for Capital Losses" by Julian Block in the September 2010 *AAII Journal*.

When planning, make sure you don't run afoul of the wash-sale rules. If you sell an investment at a loss and then acquire a substantially identical security during the 30-day period prior to or 30-day period following the sale, the loss will be disallowed. If your loss is disallowed by the wash-sale rule, you can increase the cost basis of the new position of the substantially identical security by the amount of the disallowed loss. The holding period for the new position is also adjusted to include the holding period of the position sold at the disallowed loss. You cannot adjust the cost basis or holding period if you acquire the investment in an IRA or Roth IRA, however. For more information, see "Keeping Transactions Clean From the Wash-Sale Rules" by R. Kevin Trout in the December 2014 *AAII Journal*.

Be Aware of Holding Periods for Qualified Dividends

In order to qualify for the reduced 15% (20% for higher earners) tax rate on qualified dividends for common and preferred stocks, a 61-day holding period must be satisfied. Specifically, the stock must be owned for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. (The holding period is more than 90 days out of a 181-day period for preferred stocks with dividends attributable to periods aggregating more than 366 days.) The ex-dividend date is generally one trading day prior to the record date.

Not all dividends are qualified. Qualified dividends are paid by common and preferred stocks. Real estate investment trust (REIT) distributions and master limited partnership (MLP) distributions do not qualify for the discounted taxed rate. Contact the investor relations department of the specific company if you have questions about the tax treatment.

Consider the Impact of Taxes on Mutual Fund Investments

Selecting tax-aware managers of mutual funds may be important to maximizing your aftertax rate of return in your taxable investment portfolio.

You may choose when to sell specific shares of the fund and may, therefore, create long-term versus short-term capital gains, as long as you notify the fund family or your broker in writing with specific instructions. But you don't control the investments within the fund. Should an equity manager fail to extend the holding period on a stock, it could cost you as much as 17% of your gain (37% ordinary rate for short-term capital gains versus the 20% long-term capital gains rate in 2018).

Some mutual fund dividends can be treated as qualified dividends and therefore eligible for the reduced tax rate, while others will not qualify. Dividends paid by stocks held by the fund and passed through to the shareholder are eligible for the qualified dividend tax treatment. However, capital distributions and interest from bonds are not. These payments are reported on Form 1099, which specifies the type of distribution.

Be Careful With Fund Distributions

Investment returns generated by a mutual fund or an exchange-traded fund (ETF) can take the form of dividends, interest or capital gains and losses. Funds are required to distribute dividends, interest and net realized gains to you each year. (However, both mutual fund and ETF managers can use strategies to limit distributions and offset realized capital gains; therefore, it is possible for a fund not to distribute a realized gain for a given year.)

Distributions are taxable whether you take them in cash or reinvest them in fund shares, unless they are income dividends from tax-exempt municipal bond funds or if they are within a tax-sheltered account such as an IRA. (Capital gain, dividend and ordinary income taxes are generally not triggered for funds held in an IRA; rather, withdrawals from a traditional IRA, or similar type of account, are taxed.)

The status of any capital gain or dividend distributed to you by a fund depends on how long the fund owned the securities that produced the gain or dividend—not on how long you owned shares in the fund. The information you will need to determine how your distributions are taxed will be on your fund's Form 1099.

What about losses? A fund's capital losses are never distributed to shareholders, but are used to offset capital gains realized by the fund during the year. Any additional losses are carried forward by the fund to apply against gains realized in the future. The only losses you can claim are those you may have incurred when you redeemed your own shares of a fund.

Because fund distributions are taxed even if they are reinvested, it is important to remember that you should add reinvested income, dividends and capital gains (from both taxable and tax-free funds) to your original cost basis when it comes time to figure gains or losses on any fund shares that are sold. If you do not, you will, in effect, be paying taxes twice on those distributions. (As of January 1, 2012, mutual funds and brokers are required to report the cost basis for mutual fund shares and ETFs bought and sold after that date.)

In addition, consider delaying an investment in a fund if you are investing close to the fund's ex-dividend date. When a distribution is made, it is subject to tax, even if you reinvest it back into the same fund. (The reinvested amount increases your tax basis in the fund, however.)

Most funds commonly make distributions toward the end of the year. Investors must be wary of the distribution date. Generally, you should not invest in a fund shortly before its distribution date, because a portion of your investment will be immediately returned to you with an accompanying tax liability. Most mutual fund and ETF providers should be able to give you a good idea of when their year-end distributions will take place, so calling the fund company prior to investing can be a wise move.

Reconsider Taxable Versus Tax-Free Bonds

Interest from tax-free municipal bonds is generally exempt from federal income taxes, unlike the interest from taxable bonds, which is taxed as income. Like any bond, credit quality matters, as you want to ensure that the issuer will not default. Changing yields can also alter the aftertax yield advantage, making municipal bonds more or less attractive to taxable bonds.

Additionally, private-activity bonds (a type of tax-free bond) could increase your exposure to the alternative minimum tax since their interest income is taxable for purposes of the alternative minimum tax. There are exceptions, including qualified 501(c)(3) bonds, New York Liberty bonds and Gulf Opportunity Zone bonds. Furthermore, the interest on qualified bonds issued in 2009 and 2010 is not subject to the alternative minimum tax.

Interest on advanced refunding bonds issued after December 31, 2017, is taxable.

Check with the bond issuer to find out the bond's tax status.

You should review your bond and money market accounts to make sure that you are earning the highest aftertax return. But don't forget to consider the state tax implications of switching from tax-free to taxable bonds before making any final portfolio decisions.

Consider Increasing Retirement Savings

Increasing retirement savings makes sense from a financial planning standpoint and, depending on your adjusted income, may reduce your tax bill. You have until April 17, 2018, to make an IRA contribution for the 2017 tax year. If your marginal tax rate will be lower in 2018 than in 2017, it may make sense to maximize your 2017 traditional IRA contributions before making a 2018 contribution.

Review Tax Implications of Taxable Versus Tax-Deferred Accounts

The spread between capital gains and ordinary income rates has important implications with respect to your asset allocation between taxable and tax-deferred (retirement) accounts.

For example, from a tax perspective, holding individual stocks in tax-deferred accounts and bonds in taxable accounts could be expensive because the long-term gains resulting from stocks held in tax-deferred plans such as IRAs or 401(k) plans will be taxed at ordinary rates when taken as a distribution. By reversing that structure, taxable bonds and other tax-inefficient assets will be shielded from taxation in the deferred accounts, while equities will enjoy the reduced rates for capital gains in personal accounts.

Tax-free municipal bonds should remain outside of retirement accounts. Individuals should also consider the cost of commissions and taxes, current cash flow needs, and the 0.9% additional Medicare tax and 3.8% NII surtax before making any investment moves between taxable and tax-deferred accounts.

Protect Social Security Benefits

If you are receiving Social Security benefits, you may have to pay taxes on them if your combined income (primarily your adjusted gross income plus any tax-exempt interest income plus half of your Social Security benefits) exceeds certain levels.

To protect your benefits, watch the amount of interest you receive from municipal bonds, since this amount is included in your modified adjusted gross income when determining the Social Security benefit taxability. In addition, you may want to delay discretionary taxable distributions from a retirement plan or IRA.

Conclusion

It is important to remember that taxes are not the key to investment planning. However, many of the provisions in the Tax Cuts and Jobs Act are subject to sunset clauses. These pending expirations, and potentially the federal debt, will force Congress to revisit the tax code in the future. Everyone should consider how the current and possible future changes will affect their overall tax and investment strategies.

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