

## Tax Changes and Planning Considerations in 2018 and Beyond

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On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act, a sweeping \$1.5 trillion tax-cut package that fundamentally changes the individual and business tax landscape. While many of the provisions in the new legislation are permanent, others (including most of the tax cuts that apply to individuals) will expire in eight years. Some of the major changes included in the legislation that affect individuals and businesses are summarized below; unless otherwise noted, the provisions are effective for tax years 2018 through 2025. This newsletter also highlights some potential tax and retirement planning strategies that could be considered based on the new tax laws.

### Tax Cuts and Jobs Act: Impact on Individuals

#### Individual Income Tax Rates

The legislation replaces most of the seven current marginal income tax brackets (10%, 15%, 25%, 28%, 33%, 35%, and 39.6%) with corresponding lower rates: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. In general, marginal tax rates would fall at all levels; however, there are some noticeable exceptions especially for singles. The exceptions would be income for couples between \$400,000 and \$424,950 (and singles between \$200,000 and \$424,950),

where the marginal rate would increase from 33% to 35% in 2018. Also, singles with income between \$157,500 and \$195,450 will have an increase from 28% to 32%. The legislation also establishes new marginal income tax brackets for estates and trusts, and replaces existing “kiddie tax” provisions (under which a child’s unearned income is taxed at his or her parents’ tax rate) by effectively taxing a child’s unearned income using the estate and trust rates.

**Standard Deduction and Personal Exemptions** - The legislation roughly doubles existing standard deduction amounts, but eliminates the deduction for personal exemptions. Additional standard deduction amounts allowed for the elderly and the blind are not affected by the legislation and will remain available for those who qualify.

#### Itemized Deductions (if not taking the Standard Deduction)

The overall limit on itemized deductions that applied to higher-income taxpayers (commonly known as the “Pease limitation”) is repealed, and the following changes are made to individual deductions:

- State and local taxes — Individuals are only able to claim an itemized deduction of up to \$10,000 (\$5,000 if married filing a separate return) for state and local prop-

“ The Tax Cuts and Jobs Act... fundamentally changes the individual and business tax landscape. ”

#### 2018 Standard Deduction Amounts

Filing Status	Before Tax Cuts and Jobs Act	After Tax Cuts and Jobs Act
Single or Married Filing Separately	\$6,500	\$12,000 (+\$1,600 if over 65 for single, +\$1,300 for Married Filing Separately)
Head of Household	\$9,550	\$18,000 (+\$1,600 if over 65)
Married Filing Jointly	\$13,000	\$24,000 (+\$1,300 per person over 65)

erty taxes and state and local income taxes (or sales taxes in lieu of income).

- Home mortgage interest deduction — Individuals can deduct mortgage interest on no more than \$750,000 (\$375,000 for married individuals filing separately) of qualifying mortgage debt. For mortgage debt incurred prior to December 16, 2017, the prior \$1 million limit will continue to apply. No deduction is allowed for interest on home equity indebtedness, however, it might be possible that a deduction could apply if the home equity loan or HELOC (home equity line of credit) was used for home improvements. **With rising interest rates occurring within HELOCs, and such interest not likely to be deducted in the future, the advantages of using a HELOC are more limited.**
- Medical expenses — The adjusted gross income (AGI) threshold for deducting unreimbursed medical expenses is retroactively reduced from 10% to 7.5% for tax years 2017 and 2018, after which it returns to 10%.
- Charitable contributions — The top adjusted gross income (AGI) limitation percentage that applies to deducting certain cash gifts is increased from 50% to 60%.
- Casualty and theft losses — The deduction for personal casualty and theft losses is eliminated, except for casualty losses suffered in a federal disaster area.
- Miscellaneous itemized deductions — Miscellaneous itemized deductions that would be subject to the 2% AGI threshold, including tax-preparation expenses, investment expenses, and unreimbursed employee business expenses, are no longer deductible.

### Child Tax Credit

The child tax credit is doubled from \$1,000 to \$2,000 for each qualifying child under the age of 17. The maximum amount of the credit that may be refunded is \$1,400 per qualifying child, and the earned income threshold for refundability falls from \$3,000 to \$2,500 (allowing those with lower earned incomes to receive more of the refundable credit). The income level at which the credit begins to phase out is significantly increased to \$400,000 for married couples filing jointly and \$200,000 for all other filers. The credit will not be allowed unless a Social Security number is provided for each qualifying child.

A new \$500 nonrefundable credit is available for qualifying dependents that are not qualifying children under age 17.

### Alternative Minimum Tax (AMT)

The AMT is essentially a separate parallel federal income tax system with its own rates and rules. For example, the AMT effectively disallows a number of itemized deductions, as well as the standard deduction. The legislation significantly narrows the application of AMT by increasing the AMT exemption amounts and dramatically increasing the income threshold at which the exemptions begin to phase out.

### Other Noteworthy Changes

- Long-term Capital Gains and Qualified Dividend tax rates (e.g., 0%, 15%, 20%) no longer follow the new tax brackets

for regular income tax purposes, and are tied to the brackets in 2017. Net Investment Income taxes (e.g., 3.8%) still apply at same income level as 2017. See Investment Taxes section in insert for bracket levels. .

- The Affordable Care Act individual responsibility payment (the penalty for failing to have adequate health insurance coverage) is permanently repealed starting in 2019. For those buying their own insurance through an exchange, a Premium Tax Credit (often referred to as a subsidy) will still apply for those with lower incomes.
- Application of the federal estate and gift tax is narrowed by doubling the estate and gift tax exemption amount to about \$11.2 million in 2018, with inflation adjustments in following years. It's important to know that exemption levels revert back to prior levels in 2026, unless further legislation is passed. Also, certain states that have their own estate and/or inheritance taxes may or may not change their exemption levels from 2017.
- In a permanent change that starts in 2018, Roth conversions cannot be reversed.
- For divorce or separation agreements executed after December 31, 2018 (or modified after that date to specifically apply this provision), alimony and separate maintenance payments are not deductible by the paying spouse, and are not included in the income of the recipient. This is also a permanent change.

## Tax Cuts and Jobs Act: Impact on Businesses

### Corporate Tax Rates

- Instead of the previous graduated corporate tax structure with four rate brackets (15%, 25%, 34%, and 35%), the new legislation establishes a single flat corporate rate of 21%.
- The Act reduces the dividends-received deduction (corporations are allowed a deduction for dividends received from other domestic corporations) from 70% to 50%. If the corporation owns 20% or more of the company paying the dividend, the percentage is now 65%, down from 80%.
- The Act permanently repeals the corporate alternative minimum tax (AMT).

### Pass-through Business Income Deduction

Individuals who receive business income from pass-through entities (e.g., sole proprietors, partnerships, LLC's, S-corps) generally report that business income on their individual income tax returns, paying tax at individual rates. For tax years 2018 through 2025, a new deduction (in addition to either the Standard Deduction or Itemized Deductions) is available equal to 20% of qualified business income from such pass-through entities.

For those with taxable incomes exceeding certain thresholds, the deduction may be limited or phased out altogether, depending on two broad factors:

- The deduction is generally limited to the greater of 50% of the W-2 wages reported by the business, or 25% of the W-2 wages plus 2.5% of the value of qualifying depreciable property held and used by the business to produce income.

- The deduction is not allowed for certain businesses that involve the performance of services in fields including health, law, accounting, actuarial science, performing arts, consulting, athletics, and financial services.

For those with taxable incomes not exceeding \$157,500 (\$315,000 if married filing jointly), neither of the two factors above will apply (i.e., the full deduction amount can be claimed). Those with taxable incomes between \$157,500 and \$207,500 (between \$315,000 and \$415,000 if married filing jointly) may be able to claim a partial deduction.

### *“Bonus” Depreciation Through 2022*

Business owners and landlords may now deduct up to 100% of the cost of tangible property new and used (e.g., equipment, furniture, computers, appliances, etc.).

### *Internal Revenue Code (IRC) Section 179 Expensing*

Small businesses (now including landlords) may elect under IRC Section 179 to expense the cost of qualified property, rather than recover such costs through depreciation deductions. The Tax Cuts and Jobs Act increases the maximum amount that can be expensed in 2018 from \$520,000 to \$1,000,000, and the threshold at which the maximum deduction begins to phase out from \$2,070,000 to \$2,500,000. Both the \$1,000,000 and \$2,500,000 amounts will be increased to reflect inflation in years after 2018. The new law also expands the range of property eligible for expensing.

## **Potential Strategies for Individuals**

### *Retirement Savings Strategies*

The new rules do not call for changes to existing retirement savings incentives, preserving the favorable tax treatment and contributions limits for 401(k) type plans, IRAs, and other retirement savings accounts. On average, the tax changes will have minimal effect on one's overall taxes, thus contributing to any plan/account that reduces taxable income will continue to be a great retirement and tax saving strategy especially while in middle to higher tax brackets. Maximum 401(k) type plan employee contributions have gone up \$500 to \$18,500 (\$24,500 if age 50 or older). Health Savings Accounts (HSAs), which are a great savings and tax tool for those with high deductible health insurance plans, have maximum 2018 contributions going up to \$3,450 for a self only plan and \$6,900 for a family plan, with each plan maximum increased by \$1,000 if age 55 or older. Along with making contributions to retirement accounts that reduce current taxes, one should also make contributions, when possible, to Roth type accounts where future gains and withdrawals are normally not taxed. Finally, having an outside investment account continues to have its own long-term benefits, and building this up for use during certain years can provide maximum tax planning opportunities.

### *Bracket Management*

In addition to maximizing retirement plan contributions during high-income years to reduce taxes, the new tax brackets

continue to provide opportunity to implement tax and retirement planning strategies during low taxable income years as well. Although a low income year can occur at any time through working years, a possible significant reduction in taxable income can occur between full (or partial) retirement and when taking Social Security (often 66 or later to maximize benefits) and required minimum distributions (RMDs) from IRA/401k type accounts (starting at age 70 ½). For example, if temporarily in the 12% marginal tax bracket, and expected to be in the next higher bracket of 22% later on (or back in the 25% bracket in 2026 based on current laws), one should consider several strategies to fill up the lower tax bracket, thus maximizing long-term benefits.

**Roth Conversions** - Converting traditional IRA and qualified 401(k) funds to a Roth IRA can be a great long term move while in a lower tax bracket, as investment holdings and future growth in a Roth IRA are not taxed upon qualified withdrawals both for the owner and any beneficiary, whereas withdrawals would be fully taxed if held in a traditional IRA or 401(k) type account. You have to report the conversion as a taxable distribution in the year converted, but this distribution is being taxed at a low rate as compared to a potentially higher tax rate when distributions are taken later on from a traditional IRA or 401(k). Married couples each having sizable traditional IRA and 401(k) type accounts with each other as beneficiary, might benefit even more with ROTH IRA conversions as required distributions from taxable retirement accounts could put the surviving spouse in an even higher tax bracket due to the compressed brackets when going from married to single. If you also believe marginal tax rates will go back to prior rates in 2026 as law currently states, or rates could go even higher to address the deficit and/or continue government programs such as Social Security and Medicare/Medicaid, then Roth Conversions (and contributions to Roth accounts) become even more beneficial.

**Realizing Long-Term Capital Gains at 0%** - This strategy continues to exist for those in a lower tax bracket (e.g., 2018 taxable income expected below \$77,200 married and \$38,600 single) where tax payers with investments outside retirement accounts having long-term gains can sell such investments and potentially realize gains at a 0% federal tax rate. One could then reinvest the proceeds to set a new higher cost basis, saving taxes if the investment is sold later on. If such investments with gains were not realized at 0% but instead sold while in a higher tax bracket, a capital gains tax rates of 15% or higher on the capital gain would apply.

Unique situations where filling up a lower bracket might not be advised

1. If one is paying for health insurance through an exchange and able to qualify for a government subsidy due to being in a low-income bracket.
2. If already collecting Social Security and less than 85% of such benefit is being taxed, which may be possible if in a low bracket.

### *Deduction Lumping*

With the Standard Deduction essentially doubling, and potential itemized deductions being capped or eliminated, many more tax filers will now take a higher Standard Deduction. If the Standard Deduction is not much higher than allowed Itemized deductions, then there may be an opportunity to strategically bunch certain itemized deductions in a given tax year to exceed the Standard Deduction, thus providing a higher tax benefit for that particular year. For example, if one's total taxes (state, local, real estate, and personal property) are expected to be less than the maximum \$10,000, then one might see if there is a way to vary the timing of the amounts paid such that one year is higher than another. For those having substantial medical cost which would be higher than 7.5% of adjusted gross income in 2018 (greater than 10% of AGI in years beyond 2018) it might be possible to time payment of big expenses into one year to get a tax break, however, this strategy will only apply to a small group of taxpayers. For self-employed taxpayers having a net profit, you will still be able to report medical insurance premiums (including Medicare payments) as an adjustment to income (front page of your 1040 tax return and not an itemized deduction), which will continue to provide a tax break.

**Donor Advised Fund** - Probably the best deduction lumping strategy for those that are charitably minded is through the use of a Donor Advised Fund where a large contribution is made to the charitable fund in select years, getting the higher deduction in the year of funding even though actual money is going to charities, via grants, in later years at your choosing. If one has appreciated investments held longer than a year in a non-retirement investment account, then those securities can be transferred to a Donor Advised Fund and no capital gains (and related taxes) will ever be reported if sold, thus providing a potential double tax break. Growth and dividend distributions from investments held in a Donor Advised Fund are also tax free, however, keep in mind that investment holdings cannot be transferred back to you for your own use. For much more information on Donor Advised Funds, including the Schwab offering, please contact our office.

### *Charitable Option at Age 70 ½*

Another option for charitably inclined individuals 70 ½ and older

is to give to charities through a Qualified Charitable Distribution (QCD). In the year one turns 70 ½, required minimum distributions (RMDs) must come out from traditional IRA accounts and are fully taxable. A QCD, available when one turns 70 ½, is a direct transfer of funds from an IRA account payable to a qualified charity. The QCD counts toward the RMD for the year; however, the amount transferred is not taxable. This strategy is optimized in years when the Standard Deduction is higher than the total of itemized deductions that normally would include the charitable gift.

### *529 College Savings Plans*

529 Plans now are more flexible in that \$10,000 per year in such plans can be used for education expenses for grades K-12, in addition to college and post-graduate study. It is important to know that states that allow state income tax deductions on contributions may or may not allow such deductions if funds are used for K-12 expenses. At this writing, there are two separate bills being considered by Colorado state legislature, one allowing a deduction and another disallowing it.

### *Summary*

For a more detailed review of some of the strategies discussed, please see the case study in a past Financial Intelligence newsletter, "Retirement Planning part 2" found under the Resources tab in our website, Peakam.com. Even though the tax brackets and savings calculations will have changed somewhat, the overall strategies presented could still apply today.

As certain sections of the new tax laws become more clear and defined by the IRS, there will continue to be other opportunities to plan for the future. For example, the pass-through business income deduction is an area where more clarity needs to exist before strategies could be implemented to maximize this possible deduction. Working with your tax professional will be very important in understanding the impact of any tax planning strategies that may be relevant to your unique situation. As always, we look forward to working with you to implement financial planning strategies that best meet your long-term financial goals.

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# Key Numbers 2018

Tax reference numbers at a glance.



## Income Tax (2018 tax rate tables)

Taxable income	Tax due	plus	% of income*
<b>Single</b>			
Up to \$9,525	\$0	+	10%
\$9,525 to \$38,700	\$952.50	+	12%
\$38,700 to \$82,500	\$4,453.50	+	22%
\$82,500 to \$157,500	\$14,089.50	+	24%
\$157,500 to \$200,000	\$32,089.50	+	32%
\$200,000 to \$500,000	\$45,689.50	+	35%
Over \$500,000	\$150,689.50	+	37%
<b>Married filing jointly</b>			
Up to \$19,050	\$0	+	10%
\$19,050 to \$77,400	\$1,905.00	+	12%
\$77,400 to \$165,000	\$8,907.00	+	22%
\$165,000 to \$315,000	\$28,179.00	+	24%
\$315,000 to \$400,000	\$64,179.00	+	32%
\$400,000 to \$600,000	\$91,379.00	+	35%
Over \$600,000	\$161,379.00	+	37%
<b>Married filing separately</b>			
Up to \$9,525	\$0	+	10%
\$9,525 to \$38,700	\$952.50	+	12%
\$38,700 to \$82,500	\$4,453.50	+	22%
\$82,500 to \$157,500	\$14,089.50	+	24%
\$157,500 to \$200,000	\$32,089.50	+	32%
\$200,000 to \$300,000	\$45,689.50	+	35%
Over \$300,000	\$80,689.50	+	37%
<b>Head of household</b>			
Up to \$13,600	\$0	+	10%
\$13,600 to \$51,800	\$1,360.00	+	12%
\$51,800 to \$82,500	\$5,944.00	+	22%
\$82,500 to \$157,500	\$12,698.00	+	24%
\$157,500 to \$200,000	\$30,698.00	+	32%
\$200,000 to \$500,000	\$44,298.00	+	35%
Over \$500,000	\$149,298.00	+	37%

\*The percentage applies to each dollar of taxable income within the range until the next income threshold is reached.



## Standard Deduction

Single	\$12,000	<b>Additional deduction for blind or aged (over age 65)</b>	
Married filing jointly	\$24,000		
Married filing separately	\$12,000		
Head of household	\$18,000		
Dependent*	\$1,050*		
		Single or head of household	\$1,600
		Married filing jointly or separately	\$1,300

\* Dependent standard deduction is the greater of \$1,050 or \$350 plus earned income.



## Alternative Minimum Tax (AMT)

	Maximum exemption amount	Exemption phaseout threshold
Single or head of household	\$70,300	\$500,000
Married filing jointly	\$109,400	\$1,000,000
Married filing separately	\$54,700	\$500,000
	26% rate applies to AMT income up to \$191,500*	
	28% rate applies to AMT income over \$191,500*	

\*\$95,750 if married filing separately.



## Education Credits and Deductions

MAGI phaseout ranges	Single or head of household	Married filing jointly
Lifetime Learning credit ( <b>\$2,000 max</b> )	\$57,000 to \$67,000	\$114,000 to \$134,000
American Opportunity credit ( <b>\$2,500 max</b> )	\$80,000 to \$90,000	\$160,000 to \$180,000
Education loan interest deduction ( <b>\$2,500 max</b> )	\$65,000 to \$80,000	\$135,000 to \$165,000
U.S. Savings bond interest exclusion for higher-education expenses	\$79,700 to \$94,700	\$119,550 to \$149,550



## Estate Planning

Annual gift tax exclusion	\$15,000
Noncitizen spouse annual gift tax exclusion	\$152,000
Top gift, estate, and GST tax rate	40%
Gift tax and estate tax applicable exclusion amount	\$11,200,000 + DSUEA*
Generation-skipping transfer (GST) tax exemption	\$11,200,000**

\* Basic exclusion amount plus deceased spousal unused exclusion amount (exclusion is portable); may be adjusted by the IRS.

\*\*The GST tax exemption is not portable; may be adjusted by the IRS.

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## Retirement Planning

Employee contribution limits to employer plans*	
401(k) plans, 403(b) plans, 457(b) plans, and SAR-SEPs (includes Roth contributions to these plans)	\$18,500
Annual catch-up contribution (age 50+)	\$6,000
SIMPLE 401(k) and SIMPLE IRA plans	\$12,500
Annual catch-up contribution (age 50+)	\$3,000
IRA contribution limits**	
Traditional and Roth IRAs (combined)	\$5,500
Annual catch-up contribution (age 50+)	\$1,000

\* Lesser of these limits or 100% of participant's compensation.

\*\* Lesser of these limits or 100% of earned income.

MAGI phaseout limits for deductible contributions to a traditional IRA (affects taxpayers covered by an employer-sponsored retirement plan)	
Single or head of household	\$63,000 to \$73,000
Married filing jointly when the spouse who makes the contribution is covered by a workplace plan	\$101,000 to \$121,000
Married filing jointly when the spouse who makes the contribution is not covered by a workplace plan but the other spouse is covered	\$189,000 to \$199,000
Married filing separately	Up to \$10,000

MAGI phaseout limits to contribute to a Roth IRA	
Single or head of household	\$120,000 to \$135,000
Married filing jointly	\$189,000 to \$199,000
Married filing separately	Up to \$10,000



## Social Security/Medicare

Tax rate on earnings	
FICA tax – Employee	
Social Security (OASDI) portion	6.2%
Medicare (HI) portion	1.45%*
FICA tax – Employer (OASDI & HI)	
	7.65%
FICA tax – Self-employed	
Social Security (OASDI) portion	12.4%
Medicare (HI) portion	2.9%*
Additional employee Medicare payroll tax/ self-employment tax on earnings in excess of specific limits*	0.9%*
Maximum taxable earnings	
Social Security (OASDI only)	\$128,400
Medicare (HI only)	No limit

\* Additional Medicare tax is assessed on earnings in excess of \$200,000 (single filer), \$250,000 (married filing jointly), or \$125,000 (married filing separately).



## Standard Mileage Rates

Business purposes	54.5¢ per mile
Medical purposes	18¢ per mile
Charitable purposes	14¢ per mile
Moving purposes	18¢ per mile



## Investment Taxes

Single filer	Married filing jointly	Married filing separately	Head of household	Tax rate
Long-term capital gain & qualified dividend tax (taxable income thresholds)				
Up to \$38,600	Up to \$77,200	Up to \$38,600	Up to \$51,700	0%
\$38,601 up to \$425,800	\$77,201 up to \$479,000	\$38,601 up to \$239,500	\$51,701 up to \$452,400	15%
More than \$425,800	More than \$479,000	More than \$239,500	More than \$452,400	20%
Net investment income tax (MAGI thresholds)				
Over \$200,000	Over \$250,000	Over \$125,000	Over \$200,000	3.8%*

\*The 3.8% net investment income tax (also referred to as the unearned income Medicare contribution tax) applies to the lesser of (a) net investment income or (b) modified adjusted gross income (MAGI) exceeding the above thresholds. It does not apply to municipal bond interest or qualified retirement plan/IRA withdrawals.

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