



1040 News

Q2 2019

Quarterly news & tips for folks in every tax bracket

Introduction:

Congratulations on surviving another tax season. This one was full of surprises. Now is good time to reflect on the Tax Cuts & Jobs Act (TC&JA) in the light of how it affected everyday folks in all tax brackets. Let's focus on the broad themes that 'hit-home' with taxpayers and intentionally neglect most technical details. Work with your tax advisor to understand how these broad themes may or may not affect you moving forward.

Wage Earners:

Everyone with a paycheck was affected by reductions in federal withholding. This is especially true for households with multiple incomes. See page 2 of this newsletter for ideas to adjust your withholding to the desired level.

Families with Children:

The TC&JA was great for most families with children. That's because the Child Tax Credit doubled (\$2000 vs. \$1000) and the income limit for claiming the credit more than doubled (now \$200,000 for single & \$400,000 for married).

Business Owners:

Business owners were big winners with the new tax laws. The Qualified Business Income Deduction was a real game changer. We have written extensively on this topic so see prior issues for details. The only new advice to share on this topic is as follows... The deduction is scheduled to expire on 12/31/25 and there is no guarantee that Congress will not revise it prior to that date. As such, work with your tax advisor to maximize the deduction while it lasts.

Employees:

You can no longer deduct unreimbursed business expenses on your federal tax

return (some states still allow it). Your only recourse is to ask your employer for reimbursement. You may also want to write to your elected officials about this important topic.

Home Owners:

Taxpayers with modest mortgages are not getting the same 'bang for their buck'. These folks should shift how they think about their mortgage. Think about your mortgage as a liability rather than a tax deduction. For example, consider 15 or 20 year loans rather than the conventional 30 year term.

Charitable Givers:

Generous givers with relatively low itemized deductions are also not getting the same amount of tax savings as they did before. In fact, millions of taxpayers got nothing (tax wise) for their charitable giving because the standard deduction is so high (\$12,000 single, \$18,000 HOH, \$24,000 married... more for age 65+).

Practically speaking, what can you do;

- ↳ **Give anyway:** Never let the tax-man change your behavior to something that isn't the right thing to do.
- ↳ **Volunteer more:** The value of your time was never a tax deduction... so you are not losing out on anything.
- ↳ **Gift more:** Gifts were never tax deductible before... so the same principle applies as with volunteering.
- ↳ **Skip a few years:** Save your charity money in an interest earning account over several years and give it all at once. Aside from the tax benefits this system takes less time because you don't have to keep track of giving during the off years.
- ↳ **Wait for the laws to change:** Charitable giving is so popular that politicians will eventually take action. In the meantime, write your elected officials

to request a deduction for charity as an adjustment to income rather than an itemized deduction (with reasonable limits on the amount... such as \$500).

- ↳ **Give directly from an IRA:** Taxpayers older than age 70^{1/2} can give up to \$100,000 per year from an IRA and bypass itemized deductions all together. Younger taxpayers can't do this.
- ↳ **Save more for retirement:** Plan ahead for age 70^{1/2} by increasing your retirement savings. Then retire rich and give your IRA distributions to charity.

Gamblers:

Gambling losses are harder to deduct now because of the increased standard deduction. To partially reduce this burden gamblers should start tracking their wins and losses by session. Detailed records must be kept including the name of the casino, the type of game/wager, and the names of people you were gambling with.

Divorcees:

If your divorce was finalized after 12/31/18 then you will not pay tax on alimony received nor be able to deduct alimony paid. Divorces finalized prior to that date follow the old rules (alimony is taxable income for the recipient and deductible for the payer).

Families with Students:

The Tuition and Fees deduction was never extended by Congress. This deduction was popular for graduate students because it had a higher income threshold than the Lifetime Learning Credit.

Aside from these themes there were other changes that may have affected you. Work with your tax advisor to strategize your taxes

Turn the page for 2nd quarter tax saving tips.

Tax Tips for 2nd Quarter, 2019

Tax season is finally behind us and we can turn our attention to the future rather than dwelling in the past. Lessons from the prior year, however, can guide the way to smooth sailing (tax wise) in 2019.

Did you owe?

More taxpayers had a balance due for tax year 2018, mostly from decreased federal withholding from paychecks due to the Tax Cuts & Jobs Act. If you learned this the hard way then now is the best time to take action so don't owe again.

The typical pay-stub can be confusing. Wages can vary from one pay period to the next. Some deductions are pre-tax while others are post-tax. Rather than getting lost in the weeds, let's focus on basic principles.

Principle #1: Filling out the W4 form is not intuitive. For example, if you are married with four family members (you, spouse, + 2 kids) you probably should **not** claim "married" with 4 allowances. To learn why, read on...

Principle #2: Withholding is blind. It doesn't know how much you (or your spouse if filing jointly) make from other jobs. As such, multiple income households are at greater risk of owing. Practically speaking, you often need to 'trick' your paycheck by selecting "single" on the W4 even when you are actually married.

Principle #3: Trial and error. Rather than over-analyzing your pay-stubs it is often better to make a change and see what happens. For example, if you owed \$3000 on your 2018 return you are looking for about \$250 more withholding per month.

Principle #4: Bonuses and stock options can further complicate matters. After you are paid a bonus or exercise options it pays to take a closer look at your pay-stub to see how much was taken out. If you don't know how much should have been taken out then consult your tax advisor.

Principle #5: Optimization is tough but not impossible. There are online withholding calculators to estimate how much will be taken out based on married vs. single and the number of allowances you claim. The IRS has its own calculator too

(go to IRS.GOV and type "withholding" in the search bar). Keep in mind there are multiple variables and it is easy to get confused. Remember that the goal is to find a workable solution rather than perfection.

Did you make too much?

There are plenty of tax credits and surtaxes that are sensitive to income levels. It might be time to increase your pre-tax deductions (such as your 401k) if you are losing credits or paying surtaxes. Each income threshold is calculated differently, so work with your tax advisor if you are trying to figure out precisely how much extra to contribute. Also keep in mind that there are other limiting factors. With that in mind, here are some of the most common examples:

Do you own a business? The QBI deduction begins to phase out for many businesses starting at a taxable income of \$157,500 (single) and \$315,000 (married).

Do you have kids in college? The American Opportunity Credit (first four years of college) begins to phase out at an income of \$80,000 (single) and \$160,000 (married).

Do you buy health insurance on healthcare.gov or a state run exchange? If you receive a subsidy you will have to pay it all back if you make more than four times the federal poverty level. The federal poverty level starts at \$12,490 (single) and goes up based on the number of people on the tax return. The US Department of Health & Human Services publishes the poverty guidelines on their website (www.aspe.hhs.gov/poverty-guidelines).

Do you have a modest income? The Earned Income Credit phases out at varying income levels between \$15,570 (single with no qualifying children) and \$55,952 (Married with 3+ children).

Do you have a larger income? The Child Tax Credit begins to phase out at \$200,000 (single) and \$400,000 (married). Medicare and investment income surtaxes begin at \$200,000 (single) and \$250,000 (married).

Do you put money in a Roth IRA? You can't directly contribute to a Roth IRA if you make more than \$122,000 (single) or \$193,000 (married).

Do you own rental property? Your ability to deduct rental losses incurred during the current tax year phases out between \$100,000 and \$150,000 of income.

Are you paying off student loans? Your ability to deduct the interest begins to phase out at \$65,000 (single) and \$135,000 (married).

Did you make too little?

Believe it or not there are a few situations where increasing your taxable income helps. This is especially true now that the standard deduction is so large.

Consider selling appreciated investments if your taxable income is below \$38,600 (single) or \$77,200 (married). Below these levels (gains included) you will pay no federal tax on the gain (state tax may apply).

If you didn't earn much (or retired early and not yet collecting Social Security or pension/IRA/401k) you should take advantage of this rare situation. Use this opportunity to convert traditional IRA funds to a Roth. You may be able to do this and pay little to no tax. Plan such conversions carefully with your tax advisor because they cannot be reversed.

Also remember that when your income is low you should avoid taking money out of your Roth IRAs. Try to save your Roth money for retirement years when you are collecting both Social Security and other taxable distributions.

Plan ahead for larger credits.

Now is also a good time to ponder decisions with big credits attached to them.

2019 is the last year for the full 30% tax credit on qualifying **residential solar, small wind, geothermal, and fuel cell** purchases. The credit drops to 26% in 2020.

Adopting children under age 18 may give you a large tax credit (up to a maximum of \$14,080) for the year when the adoption takes place... plus the Child Tax Credit in subsequent years that the child remains your dependent.

Thanks for reading. Look for our next issue in June.