18 Income Tax Strategies for 2018

Updated and revised to reflect changes from The Tax Cuts and Jobs Act

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Strategy # 1

Defined Contribution Plans

IRAs, 401(k)s, 403(b)s, SEP IRAs, and SIMPLE IRAs †

A defined contribution plan is a plan that:

1. An individual benefits from during retirement depending on the contributions made individually to the plan during their working years from earned income (example: an IRA) or
2. A company plan (examples: a 401k, 403b, SIMPLE IRA or SEP IRA plan) that a person has where they work, and they make individual contributions to the plan, plus their company matches up to a certain percentage of their contribution.

The contributions and investment performance of the assets in the plan determine its value. Like a typical savings account, a defined-contribution account contains a specific balance at any given time, which is equal to the market value of the assets accumulated in the account.

Individual IRAs

The maximum contribution for an individual IRA this year is:

- $5,500 per person - OR -
- $6,500 per person if the individual is over the age of 50

The tax deduction depends on the individual's level of income, as well as eligibility and contributions to a company qualified plan (information below on company plans).

Phaseout for deducting IRA contributions (for qualified plan participants)

Married, filing jointly	$101,000 - $121,000 MAGI[1]
Single or head of household	$63,000 - $73,000 MAGI[1]
Married, filing jointly[2]	$189,000 - $199,000 MAGI[1]

[1]Modified adjusted gross income.
[2]Phaseout limit for spouse who is not a participant in a qualified plan.

<u>Note</u>: The following company plans cannot be combined with each other.

Company sponsored 401(k)s

The maximum contribution this year is:

- $18,500 per person.
- Additional $6,000 for individuals whose age is 50+ years

Company sponsored 401(k)s also may include additional employer match and contributions, up to $55,000 total, over one year depending on the individual's income.

Non profit sponsored 403(b)s (examples: schools, churches, etc.)

The maximum contribution this year is:

- $18,500 per person.
- Additional $6,000 for individuals whose age is 50+ years

Non-profit sponsored 403(b)s may also include additional employer match and contributions, up to $55,000 total, over one year depending on that individual's income.

Employer SEP IRAs

The maximum contribution this year is:

- 25% of compensation, or $55,000.

This contribution comes entirely from the employer, not the employee. No catch up provisions are permitted.

Employer SIMPLE IRAs

Individual contribution this year can be up to:

- $12,500
- Additional $3,000 more if the individual is over the age of 50

Plus, there can be up to a 3% match of salary from the employer. Opening deadline is October 1st of current year.

Strategy # 2**

A Defined Benefit Plan

A defined benefit plan provides a fixed, pre-established benefit for employees at retirement. Employees often value the fixed benefit provided by this type of plan. On the employer's side, businesses can generally contribute (and therefore deduct) more each year than in a defined contribution plan. However, defined benefit plans are often more complex, and thus, they can be more costly to establish and maintain than other types of plans.

The maximum that an employer can contribute to a defined benefit plan this year for the benefit of an employee is:

- $220,000

This figure depends on the age of the employee. The older an employee is, the more that can be contributed into a defined benefit plan by the employer.

Defined benefit plans are a great alternative for older, small employers with high incomes that wish to contribute large pre-tax amounts in addition to a defined contribution plan for retirement.

> *Example: an older small business owner with a $400,000 net income may be able to contribute up to $55,000 in a defined contribution plan, plus an additional $220,000 in a defined benefit plan for a total of $275,000.*
> *In an effective tax bracket of 40%, the income tax savings from a combination of the two plans could be $100,000 or more.*

Strategy # 3

Income Timing

Retirement Income

Timing of retirement income includes analyzing expenses and savings and determining if withdrawals from pre taxed retirement accounts can be deferred. This can lower the present years income tax burden on unneeded withdrawals and possibly avoid moving into a higher tax bracket.

Earned Income

Timing of employment income includes analyzing expenses and savings and determining if several weeks to several months of paychecks could go entirely into a defined contribution or defined benefit plan (if available, see Strategy #1). This could lower an income tax burden dramatically and even push you into a lower tax bracket.

Strategy # 4

A Donor Advised Fund

A donor advised fund is like a giving bank account that in high income years is a great way to receive a large charitable deduction when you're not sure which charitable organization you want to give it to yet. You can then give from your donor advised fund to your favorite qualified non profit charity(s) whenever you feel is the best time. This is a great idea for anyone who has had a one time windfall of cash that puts them in a higher tax bracket for the year. Examples include a large oil and gas royalty check, large bonus check, etc. Up to 60% of adjusted gross income may be put into a donor advised fund for a tax deduction.

Strategy #5

Medical Expenses

If possible, try to lump all major health care expenses into this tax year in order to meet itemized deduction limits. In computing regular income taxes, medical expenses are deductible only to the extent that they exceed 7.5% of adjusted gross income.

Strategy # 6

Restructure Passive Income

Example 1: Use of a Real Estate Investment Trust (REIT)[1] that uses cost segregation to rapidly depreciate real estate components with shorter lifespans than brick and mortar like heating and air systems, light fixtures, etc. to offset taxable income

Example 2: Use of sector based investments that can potentially generate ongoing tax efficient income

Example 3: Municipal bonds that generate tax free income (these may still be subject to alternative minimum tax)

[1] Investing in Real Estate Investment Trusts (REIT) involves special risks such as potential illiquidity, as well as devaluation based on adverse economic and regulatory changes. As a result, the values of real estate may

fluctuate resulting in the value at sale being more or less than the original price paid. Real estate is a long-term investment.

Strategy # 7

Donate Required Minimum Distributions (RMDs)

For retirees over 70.5 years old who have to take out a required minimum distribution annually from qualified retirement accounts (IRAs) but do not need it, an RMD can go directly to a qualified charity. By donating a RMD directly from an IRA to a charity instead of taking the RMD and then donating it to Charity the full amount is deductible versus only receiving a tax deduction that may or may not be deductible based on total income and total itemized deductions. Up to $100,000 can go directly to a qualified charity, including the RMD from a qualified plan for retirees over 70.5 years old with the same tax advantages.

Strategy #8

Charitable Gift Annuity

A charitable gift annuity is a way to make a gift to your favorite charity and still receive an income for yourself or others, now or later in the future. It is a contract under which a charity, in return for a transfer of cash or other property, agrees to pay a fixed sum of money for a period measured by one or two lives.

Taxpayers who itemize deductions can claim a charitable deduction for a portion of the original gift. This deduction can result in significant income tax savings. The deduction is equal to the amount of the contribution, less the present value of the payments that will be made to the donor and/or other beneficiary during a lifetime.

Strategy #9

Charitable Remainder Trust

A charitable trust is great for large assets (typically above $1,000,000), with a small cost basis that would generate a large tax burden if sold. It is not good for small charitable gifts.

A charity serves as trustee of the charitable remainder trust and manages or invests the property so that it will produce income. The charity pays the individual (or someone that is named) a portion of the income generated by the trust property for a certain number of years, or for one's whole life. The payment period is specified by the associated individual in the trust document. At the time of death or the end of the time period that is set, the property goes to the charity.

In addition to helping out a favorite charity, several tax advantages are gained from this arrangement. One can take an income tax deduction, spread over five years, for the value of the gift to the charity.

Things begin to get tricky when determining the amount of the deduction. The value of the gift is not simply the value of the property; the IRS deducts from that value the amount of income that is likely to be received from the property.

For example, if $1,000,000 is donated, but the giver expects to receive $500,000 back in income (based on life expectancy, interest rates, and how the trust document is set up), the value of the gift is what is left.

Strategy #10

Charitable Lead Trust

A Charitable Lead Trust is the opposite of a Charitable Remainder Trust in that it generates a potential income stream for a nonprofit organization(s) of choice from assets that are donated. After the income goes to a charity, or charities, for a number of years, the assets eventually are returned back to family members or other beneficiaries.

Strategy #11

Sales & Property Taxes

All state, local, sales, real property and personal property tax is capped at $10,000.

If one is planning on buying a new car in January or February that has a large sales tax associated with it because of the size of the purchase, it may be best to buy it before the end of a high income year.

Strategy #12

Health Savings Account (HSA)

Only an eligible individual may contribute to an HSA. An HSA sponsored by an employer, the employee, or both, may contribute to an HSA. Family members may also make contributions to an HSA on behalf of another family member, as long as that family member is an eligible individual. The maximum contribution for 2018 is:

- $3,400 for individuals - OR -
- $6,750 for families

A $1,000 catch up provision is allowed for individuals age 55 and older not enrolled in Medicare.

Strategy #13

Capital Losses

A widely used strategy for deferring capital gain recognition is tax loss harvesting. Recognizing losses, rather than waiting for a stock to turn around, can have three benefits:

1. Tax losses shelter current capital gains from other equities from tax, and it can effectively defer tax on those gains into the future.
2. Losses in excess of gains can be deducted up to $3,000* annually, sheltering ordinary income derived from salary, interest, and dividends from tax.
3. Losses in excess of gains and the $3,000* limit can be carried over and deducted in future years.

*Married filing jointly - $3,000 limit. Single, or married filing separately - $1,500 limit.

Strategy #14**

Create a Small Business

A small business is a tax favored investment because business losses are deductible in full against earned income. Many home based businesses are started by non-working spouses in order to generate losses against a working spouse's earned income. Small businesses may employ children, and they can be used to shift income to kids without concern for the kiddie tax on unearned income of a child.

Strategy #15

Give Highly Appreciated Stocks Instead Of Cash

Do you give regularly to your church & favorite charities? If you have highly appreciated stock you could gift your highly appreciated stocks instead of giving cash. Do you like owning the stock? After you have given the highly appreciated shares, you could buy new shares of the stock again in a brokerage account with the cash you would have given, and now you raised your basis in the stock for tax purposes, if you want to sell it later.

Strategy # 16

Mortgage Loan Interest

Mortgage loan interest can be deducted on first and second homes up to $750,000 if you itemize your tax deductions.

Strategy # 17

Student Loan Interest Deduction

You can deduct up to $2,500 paid in 2018 toward student loan interest.

Strategy # 18

Self Employed Health Insurance**

You can deduct what you spend on health insurance premiums if you are self employed and do not qualify for any other health insurance plans (for example if a spouse’s employer offers insurance coverage to family members).

† Limitations and Early Withdrawals: Some IRAs have contribution limitations and tax consequences for early withdrawals. For complete details, consult your tax advisor or attorney. Retirement Plans: Distributions from traditional IRAs and employer sponsored retirement plans are taxed as ordinary income and, if taken prior to reaching age 59 ½, may be subject to an additional 10% IRS tax penalty.

As mentioned at the beginning of this report, none of these strategies should be used without first seeking the advice of a Certified Public Accountant (CPA) as tax laws are constantly changing and vary depending on your individual situation. This report is for educational purposes only and is not intended to replace the advice of your personal financial advisor, accountant, CPA, or legal advisor.
For information on comprehensive wealth management that includes many of the tax strategies mentioned, visit www.ciswealth.com or call 830-609-6986 for a phone or office appointment during regular business hours.