

Why Every Planner Needs to Understand the New Tax Laws

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SIGNED INTO LAW within the last year, the Tax Cuts and Jobs Act is still hot off the presses, and the changes are seismic. Never has it been so important for financial planners to incorporate a review of their client's tax return into the planning process. Almost every recommendation made has the potential to swing tax results for better or worse; and being strategic is critical as the nuances of the TCJA become more familiar.

Alimony is changing. Under the old laws, the payor of alimony could deduct payments from their income tax return. Recipients would in turn report that income on their tax return. This income was treated like earned income for the purpose of contributing to an IRA.

Starting in 2019, alimony payments are no longer deductible by the payor or treated as income by the recipient. Any divorces prior to 2019 will be grandfathered under the old rules. This is a hit for your client who is not only paying alimony, but also paying tax on the income that they're not keeping. In turn, recipients get a tax break but without earnings, they lose the ability to contribute to an IRA.

Earnings on children's accounts

are impacted. These earnings will be taxed at trust tax rates. This could be a good story for 529 plans. Under the new rules, \$10,000 per year can be applied to private school expenses prior to college. Remember, trust taxes are very aggressive at 37 percent if over \$12,500. Could it be better to pay a 10 percent penalty on earnings not used for education if there is enough time for the tax deferred growth to outpace the high tax rates, even with the penalty?

Be thoughtful about timing conversions of Roth IRA funds. The opportunity to recharacterize a Roth conversion is no longer available. None of us have a crystal ball, but timing will be more of a consideration going forward.

Sunset provisions are imbedded in these new laws. Many of the reductions are set to expire in 2025. Think about when your client is proactively recognizing income. Suppose you have a retired client who is over age 59½ and they are living off savings while letting their tax-deferred retirement accounts amass. Instead, it may be prudent to recognize some of that income along the way, filling up tax buckets at lower rates, or possibly converting some of those funds into Roth IRAs before tax rates go up again.

Fewer taxpayers will itemize deductions. The standard deduction will be almost double, making this a difficult threshold to overcome. For loans starting in 2018, the mortgage interest deduction is now limited to financing up to \$750,000 and only home equity loan interest used to improve the home is deductible. In addition, real estate

taxes are included in the \$10,000 limitation of tax deductions along with state and local income taxes. This is not true of rental property. All taxes on property held for business purposes is still fully deductible. Being strategic may be more important and ownership decisions may require more thought.

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Deductions for charitable donations may no longer benefit those not itemizing. Be aware that anyone receiving a required minimum distribution can divert all or a portion of that distribution directly to the charity. That portion of the RMD is not reported as income. This also reduces income for the purpose of calculating taxable Social Security and other deductions related to income. This should be a routine recommendation for any charitably inclined person age 70½ or older receiving a required minimum distribution.

For those needing to repay a 401(k) loan due to leaving an employer, they now have up until the filing due date of the tax return instead of just 60 days to replace the funds before they become taxable, often subject to a 10 percent penalty. This gives planners and their clients more time to find an option for

full or partial repayment.

Another win, more of our clients will now receive a child tax credit. This opportunity used to phase out at only \$110,000, but that has increased to \$400,000. On the other hand, exemptions are gone. This credit along with a new family credit for other family members are designed to offset this. AMT is also all but gone for most taxpayers because the phaseout has been increased to \$1 million.

The biggest tax change requiring understanding and strategic positioning is the introduction of the qualified business income deduction. This is a new deduction available to our business owners that, depending on the type of business they are in, may be reduced or unavailable due to the amount of taxable income shown on their tax return. This credit is subject to phaseouts based on taxable income. These phaseouts start at \$315,000 for married taxpayers and shut out the deduction for service business owners at \$415,000. The single business owners have phaseouts that start at \$157,000 through \$315,000. Any client with a business may be impacted, from the sole proprietor selling at home parties to the client who is a professional or owner of a startup.

Investment earnings, distributions from plans, exercising stock options, the timing of triggering Social Security, and non-qualified deferred compensation payments are a few of the critical components that may make the difference between receiving or forgoing this deduction. Poor strategy could be a costly mistake for the taxpayer. Thoughtful recommendations on contribution amounts to retirement plans and tax-favored portfolios can result in significant tax savings.

Only with understanding of this not-so-simple tax simplification will it be possible to guide our clients with strategies that will produce the best tax outcomes possible. ■

LEARN MORE

For a review of how the TCJA is impacting planners and clients, see the following *Journal* articles at FPAJournal.org:

2018 Tax Planning Opportunities under the Tax Cuts and Jobs Act, by *Randy Gardner and Leslie Daff*, provides information on itemized deductions, state and local tax deductions, education planning, and more.

Tax Reform Changes Affect Planners and their Business Clients, by *Julie Welch and Randy Gardner*, offers guidance on the TCJA provisions that planners need to know to run their businesses and possibly pass on to their business clients.

2018 Is an Important Planning Year in Divorce Situations, by *Randy Gardner and Julie Welch*, explains the important tax planning implications for clients in the midst of a divorce, contemplating a divorce, or needing to modify documents from a prior divorce.

Understanding Taxation of Dependent Children's Income after Tax Reform, by *Randy Gardner and Julie Welch*, details the changes to the way dependent children's earned and unearned income are taxed for the years 2018 to 2025.

How to Use the TCJA to Build Your Business, by *Evan T. Beach*, offers suggestions for how planners can educate clients and prospects on tax reform.

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