

Tax planning: Income and retirement

Understanding how the tax law affects income and retirement planning

Given the complexity of changes to the tax code in the United States, there is much to consider in determining the impact tax legislation will have on each of us with regard to income and retirement planning.

OVERVIEW

Passed in late 2017, tax-reform legislation made sweeping changes to the tax code in the United States, including changes to individual and corporate income tax rates. Known as the Tax Cuts and Jobs Act, the legislation took effect in 2018, with many of its provisions set to expire on Jan. 1, 2026.

The law includes tax-rate cuts for individuals, corporations and pass-through businesses, and eliminates many individual and business deductions. It increases exemptions for gift and estate taxes; the generation-skipping transfer (GST), which addresses wealth transfer; and the Alternative Minimum Tax (AMT), a supplemental tax affecting high-income earners. It also makes numerous changes affecting multinational businesses.

While the law lowers the tax rates for many income levels, determining the overall impact on you or your family will depend on a variety of other changes in the law, including increases in the standard deductions, the elimination of personal and dependent exemptions, and the limitation or elimination of many personal deductions.

Accordingly, not everyone will experience a lower tax burden.

IMPORTANT TOPICS

- Investment income
- Investment portfolio positioning
- Retirement saving
- Roth IRAs
- Itemized deductions
- Alternative Minimum Tax (AMT)
- Domicile
- Divorce
- The kiddie tax
- Life insurance

Rate	For Unmarried Individuals, Taxable Income Over	For Married Individuals Filing Joint Returns, Taxable Income Over	For Heads of Households, Taxable Income Over	Married Filing Separately
10%	\$0	\$0	\$0	\$0
12%	\$9,525	\$19,050	\$13,600	\$9,525
22%	\$38,700	\$77,400	\$51,800	\$38,700
24%	\$82,500	\$165,000	\$82,500	\$82,500
32%	\$157,500	\$315,000	\$157,500	\$157,500
35%	\$200,000	\$400,000	\$200,000	\$200,000
37%	\$500,000	\$600,000	\$500,000	\$500,000

The chart above shows the tax brackets established by the legislation. The act eliminates the so-called marriage penalty in all but the highest tax brackets, and thus also removes much of the disadvantage of the married-filing-separate status.

INVESTMENT PORTFOLIOS

Preferential rates for investment income: Since the tax rates for long-term capital gains and qualified dividends did not change, you can continue to strategically position investments in accounts to take advantage of preferential tax treatment given to qualified dividends and long-term capital gains. Although the law retains three rates applicable to long-term capital gains and qualified dividends, the points at which these rates begin to change for 2018 are noted in the chart below.

LTCG/QUAL. Div. Tax Rate	Long Term Capital Gain / Qualified Dividend Income					
	Married Filing Joint			Single Filer		
0%	\$0	–	\$77,200	\$0	–	\$38,600
15%	\$77,200	–	\$479,000	\$38,600	–	\$425,800
20%	\$479,000	+		\$425,800	+	

Please note, all changes to the individual tax brackets for ordinary income and long-term capital gains/qualified dividends are set to expire on Jan. 1, 2026. Absent congressional action, the brackets then will revert to those used in 2017, adjusted for inflation.

Ability to choose tax lots: Any time a security is purchased, the new position creates a distinct tax lot, even if you already own shares of the same security. When the position is sold, capital gains or losses are calculated using the tax lot. This allows you to determine the most appropriate tax lot to use for cost-basis purposes on sales or charitable gifts of appreciated marketable securities. This practice remains unchanged, because the first-in, first-out (FIFO) provision that was included in early versions of the tax-reform bill was not part of the final legislation.

Municipal bonds: Although the reduction in the top marginal tax rate from 39.6% to 37% may diminish the appeal of municipal bonds for some investors, those seeking income for their portfolios – especially if you have a higher income – may still find municipals to be a great source of tax-advantaged income and diversification.

Given that some individuals may no longer be able to fully deduct state and local income taxes, municipal bonds may appeal even more to residents of states with higher income tax rates, such as California and New York. The attractiveness of local bonds could improve as high-income taxpayers in these high-tax states look to optimize their tax-equivalent yields on both a federal and state tax basis.

REITs and MLPs: Real estate investment trusts (REITs) and master limited partnerships (MLPs) qualify for the tax reduction associated with small businesses and pass-through entities. People with pass-through businesses should discuss with their tax advisors whether purchasing and holding interests in MLPs and/or REITs in their businesses could produce tax savings.

RETIREMENT SAVING

Retirement plan contributions: If you are paying less income tax, you could have more money to save toward your retirement goals. As a result, you may be able to boost your pre-tax retirement savings and take advantage of an employer match.

Roth IRA conversions: Although re-characterization of a Roth IRA conversion is no longer permitted past 2017, this doesn't mean you shouldn't consider a Roth conversion when it makes sense. For example: You anticipate a lower effective tax rate in retirement or, alternatively, for wealth transfer planning to children or grandchildren.

ITEMIZED DEDUCTIONS

Interest on new home debt: If you are planning to purchase a home, consult with your tax advisor regarding the deductibility of any new or refinanced mortgage indebtedness.

Home equity loans: Interest is still deductible on home equity lines of credit used to buy, build or substantially improve the home that secures the loan. If you have home equity lines of credit used to finance other endeavors, you may want to evaluate repaying them, depending on rates and net cost.

Vacation homes: You may want to discuss with your tax advisor whether it makes sense to convert a vacation home into a rental property and possibly transform the deductibility of interest and taxes.

Medical expenses: If you are considering modifying your home for legitimate medical reasons, including aging, disability or a significant medical procedure, you should act in 2018 to benefit from the temporarily reduced 7.5% adjusted gross income floor before it returns to 10% in 2019. Accelerating a home modification is likely more beneficial for tax purposes than regular medical expenses, given the cost of these modifications. Additionally, costly elective surgeries not covered by insurance also should be accelerated into and paid for in 2018.

Limited casualty and theft-loss: Since theft and some casualty losses are no longer deductible – with some exceptions – and a tax benefit likely will be unavailable from 2018 through 2025, you may wish to reconsider deductible levels on your liability insurance policies.

ALTERNATIVE MINIMUM TAX (AMT)

Goodbye AMT: Given the increased exemption and phase-out thresholds, as well as the elimination or limitation of certain itemized deductions, you may find you are no longer subject to the Alternative Minimum Tax (AMT).

Stock options: Corporate employees with vested and unexercised incentive stock options (ISOs) may benefit for the same reasons noted above. So, you may be able to exercise and hold larger numbers of these options, thus obtaining significant income tax savings by converting more ordinary income into long-term capital gain.

AMT credits: If you have AMT carryovers from 2017, you could find it much easier to recoup them given the higher exemption levels.

DOMICILE

Tax jurisdictions: People have long evaluated the benefits of changing their domicile to a more tax-friendly state, such as Florida, to avoid state income and/or estate taxes. This trend likely will continue, and the deduction limits on mortgage interest and state and local taxes may influence residents of states with high income tax rates, property taxes and property values to relocate to more tax-friendly states.

DIVORCE

Alimony: Since alimony is no longer deductible to the payor spouse, or taxable to the payee spouse, divorce, prenuptial and postnuptial agreements should address these changes, be completed before 2019, if possible, and contemplate the law's potential sunset on Jan. 1, 2026.

Future law changes: If you are seeking a divorce, consult with your legal counsel about including a provision that the divorce agreement can or must be renegotiated if the tax law changes again.

KIDDIE TAX

Kiddie tax: The law affects the determination of the kiddie tax, which prevents parents in high income tax brackets from shifting income to children in lower tax brackets. It generally applies to children under age 18 and full-time students under age 24. Previously, the net unearned income of a child was taxed at the higher of the parent's or child's tax rate. The law simplifies how the tax is calculated, effectively applying the ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child, while the child's earned income is taxed using the individual tax bracket chart. These revised kiddie tax rules are scheduled to expire on Jan. 1, 2026, at which time they will revert back to 2017 law.

LIFE INSURANCE

Time-sensitive review: Life insurance remains valuable in addressing estate liquidity needs, federal and state death taxes, charitable giving and family wealth transfer. Given the tax law's scheduled expiration date of Jan. 1, 2026, planning opportunities should be examined sooner rather than later.

Income replacement: While life insurance is frequently used to further leverage wealth transfers, it may in some cases be just as important for replacing the income of a family provider in the event of a premature death. Though you may no longer see the benefit of transferring wealth through a life insurance policy, given the increase in the estate tax exemption, consult with your tax, legal, financial and insurance advisors before reducing or canceling existing coverage.

Unneeded cash-value policies: One option is to cancel a policy. Another is to surrender it, or sell it back to the insurance company that issued the policy. Another, potentially more practical option, could be a life settlement, in which the policy is sold, often for a higher price, to someone other than the issuing company. Generally, life settlements are available only for insureds age 65 or older. The tax law modified the tax reporting rules for life settlements, making it easier to determine the taxable gain, if any, which should make it more attractive for qualified individuals to dispose of unwanted policies and maximize the sale proceeds.

Kiddie tax

Ordinary Taxable Income			Ordinary Income Tax Rate
\$0	–	\$2,550	10%
\$2,550	–	\$9,150	24%
\$9,150	–	\$12,500	35%
\$12,500	+		37%

Capital Gain Income			Capital Gain Tax Rate
\$0	–	\$2,600	0%
\$2,600	–	\$12,700	15%
\$12,700	+		20%

Let's work together with your tax and legal professionals to determine how the legislation affects you directly.

Asset allocation and diversification do not guarantee a profit nor protect against a loss. While interest on municipal bonds is generally exempt from federal income tax, it may be subject to the federal alternative minimum tax, state or local taxes. In addition, certain municipal bonds (such as Build America Bonds) are issued without a federal tax exemption, which subjects the related interest income to federal income tax.

Rolling from a traditional IRA into a Roth IRA may involve additional taxation. When converted to a Roth, the client pays federal income taxes on the converted amount, but no further taxes in the future. Unless certain criteria are met, Roth IRA owners must be 59½ or older and have held the IRA for five years before tax-free withdrawals are permitted. Additionally, each converted amount is subject to its own five-year holding period. Investors should consult a tax advisor before deciding to do a conversion.

RAYMOND JAMES®

**INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863**

Investment products are: not deposits, not FDIC/NCUA insured, not insured by any government agency, not bank guaranteed, subject to risk and may lose value.
© 2018 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC. © 2018 Raymond James Financial Services, Inc., member FINRA/SIPC.

18-WEALTH-0193 JK/EK 3/18