

Key Thoughts on the Tax Cuts and Jobs Act

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–Debra Taylor, CPA/PFS, Esq.

The Tax Cuts and Jobs Act has made major changes to the tax code. It's important that you understand these changes to best plan your tax strategy going forward.

The Tax Cuts and Jobs Act has brought the biggest tax overhaul in 30 years and has left many with questions. It's important that you understand how the elimination of deductions, compression of tax rates, and brand-new benefits for certain taxpayers will affect your tax strategy. According to the Tax Foundation, most taxpayers saw a reduction in tax rates, but for many lower income taxpayers, that tax cut was so little it may hardly even be noticed. And if you live in a high-tax state or you rely heavily on deductions, you are likely to see a tax increase.

Every taxpayer needs to assess their individual situation. Here are some initial thoughts and areas to be discussing with your financial advisor. Of course, any advice below is subject to your specific tax situation, with consideration to your state of residence and AMT, among other things.

Missing SALT

The SALT deduction previously allowed taxpayers to deduct state and local taxes to avoid being taxed on the same income twice. Reduction of the SALT deductions will be most acutely felt in the states where those deductions make up the greatest percentage of income:

California, Connecticut, Maryland, Oregon, New Jersey, and New York, according to the Tax Foundation. If you live in one of these states, you should talk to your financial advisor about your overall financial plan, as the elimination could affect cash flow and the value of your home.

Previously, a typical couple with two homes in one of these high-tax states was able to lower their ultimate tax burden by 25%. Now, their tax burden has actually increased, and these folks may want to consider tax-friendly states such as Texas, Arizona, or Florida.

If you are committed to living in a high-tax state and are unable to move or declare residency anywhere else, there are a few tax-smart moves that could help your situation.

Consider bunching deductions— take the standard deduction one year and itemize the next. By employing this tried-and-true strategy, you may be able to take the most advantage of some of those lost itemized deductions. For instance, you may claim the standard deduction in one year, and then prepay your real estate taxes and mortgage payment and fund your charitable contributions the next year, which will enable you to take the full advantage of your deductions.

Goodbye to miscellaneous itemized deductions

The elimination of the deductibility of miscellaneous itemized deductions for tax preparation fees, investment fees, moving expenses, and employee expenses means we should reconsider how and when we pay expenses. Confirm whether your employer is unable to absorb those business or moving expenses that you may currently be paying out of pocket, or perhaps consider cutting back in those areas.

If you donate to charity

Charitable contributions are another area that will be impacted by the tax law changes. Due to the expansion of the standard deduction to \$24,800 per couple, it is likely that fewer people will itemize deductions going forward. In the past, about 30% of taxpayers currently itemized, but it is estimated that fewer than 10% will itemize in the future as a result of the new Tax Act, particularly if you live in states with little to no income or real estate tax.

If you take the standard deduction rather than itemizing, you cannot deduct charitable contributions. What you can consider, however, is opening a donor-advised fund and prefunding it with several years of donations. Once you fund the account, you can then take one large up-front deduction, potentially itemize that year on your tax return, and then spread the distributions to the charities in future years when you are using the standard deduction. Essentially, it allows taxpayers to separate the act of donating from the actual year of deduction, which is a newish concept but may make sense under the new law.

And if you are age 70½ or over, don't forget the Qualified Charitable Deduction (QCD) which allows a taxpayer to donate his RMD directly to charity up to \$100,000 per year, essentially decreasing their AGI.

If you own a pass-through business entity (lucky you, I think)

Everyone who owns a small business and has pass-through income should be asking what they can do to

take advantage of the new 20% deduction aimed at pass-through business owners. By taking advantage of the qualified business deduction, a couple with a small business that has less than \$326,600 of income could pay almost \$20,000 less in taxes. However, higher-earning doctors, lawyers, accountants and investment managers could have net tax increases despite lower tax rates, as they will lose most of their state and local tax deductions.

If you have large amounts of pass-through income, reconsider whether you should change your business entity to a C corporation to take advantage of the new 21% top tax rate. Service firms that are looking to expand or who have cash flow they don't need to pay out should look hard at becoming a C corporation.

Careful with Roths (but we still love 'em)

Previously, if you made a Roth conversion you had the ability to undo the conversion by October 15th of the following year. This was done through a Roth recharacterization. The Tax Cuts and Jobs Act has eliminated the Roth recharacterization, meaning there will be no opportunity for a redo on Roth conversions going forward.

This means that if you perform conversions in the future, they will require additional thought. You should discuss a conversion with your financial advisor before taking any action to make sure it is the best move.

Paying the tuition bills?

The final tax bill also expands the use of Section 529 Plans allowing the distribution of \$10,000 per year to cover the cost of K-12 expenses and can provide planning opportunities for families wanting to pay for private or religious or home school expenses through the use of the preferred vehicle. This allows for additional flexibility and is just another reason that you should consider Section 529 Plans for all types of educational funding.

If you are getting divorced

Beginning in 2019, the tax bill changes the treatment of alimony in one important way. Under the Tax Cuts and Jobs Act, alimony is no longer treated as deductible for the payor, nor is it treated as income for the payee for divorces finalized after 2018. Due to this important change, divorcing spouses may consider property settlements over alimony in the future. In addition, the new Tax Act may decrease the transfer of payments or property from one spouse to another, if there is no income tax deduction available to the payor spouse. Obviously, the non-deductibility of alimony needs to be considered in all property settlements and divorce negotiations going forward.

Not so simple

Although the Tax Act was publicized as a way to simplify taxes, it will be anything but. You should talk with your financial advisor if any of the changes described above apply to your situation.

Debra Taylor, CPA/PFS, Esq., CDFA, writes on tax and retirement planning for Horseshmouth, an Independent organization providing unbiased insight into the critical issues facing financial advisors and their clients.