BANKING & FINANCE

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The Upside of Tax Reform

With the recently passed Tax Cuts and Jobs Act, now is a good time to look for the opportunities that can positively affect your financial future. While the corporate tax rate is reduced permanently from 35 percent to 21 percent, the individual tax rates are set to sunset (go away) at the end of 2025 unless new legislation is passed making them permanent. From 2018-2025, most Americans will see a reduced tax bill which provides a great opportunity to increase savings. Saving more today avoids the problem of becoming accustomed to these temporary tax savings and allows you to improve your financial future. Proactive financial planning can help to maximize your tax savings, allowing you to save more for retirement and education while planning for potential future tax increases.

LOWER YOUR TAXABLE INCOME/SAVE FOR RETIREMENT

The tax reform dramatically increases the standard deductions from $6,350 to $12,000 for individuals and $12,700 to $24,000 for joint filers but eliminates the personal exemptions and either limits or eliminates itemized deductions. The tax-planning focus shifts from increasing your itemized deductions to lowering your taxable income. Many employees have seen their net paychecks increase due to the tax rates being reduced; use the increase to add to your retirement savings which can also lower your taxable income. You can make pre-tax contributions up to $5,500 (under age 50) or $6,500 (over age 50) into the traditional IRA. Employer retirement plans such as 401(k) and 403(b) plans allow for even greater savings since the pre-tax deferral limits for employees are $18,500 (under age 50) and $24,500 (over age 50).

Qualified Charitable Donations (QCD) provide another opportunity to lower your taxable income. If you donate to a charity on a regular basis and you are older than 70½, consider a QCD. You can send a portion or all of your Required Minimum Distribution (RMD) – up to $100,000 – directly to the charity of your choice. You'll avoid having the RMD treated as income, thereby eliminating any taxes on this distribution from your Traditional IRA.

PLAN PROACTIVELY

Business owners need to prioritize tax planning earlier this year to take advantage of a potential business deduction. Most sole proprietors and partners are taxed at their individual income tax rates. Under the new plan, some of these entities may be able to deduct 20 percent of "qualified business income" as long as their incomes do not exceed certain income thresholds and they abide by other restrictions. This deduction could be significant if a business owner qualifies. Consider meeting with your Certified Public Accountant and Certified Financial Planner™ professional to determine how this deduction will affect you and to see if any changes are necessary to qualify. For example, some business entities may need to analyze how their income is allocated between W2 income and shareholder distributions to take advantage of this deduction. Any tax savings should be used to increase retirement savings through solo 401(k) plans, 401(k) plans, simple IRAs, or SEP IRAs. Employers should consider increasing their employer contributions. All employer contributions are a straight business deduction and avoid all taxes, unlike salary deferrals that are still affected by the payroll tax.

> **Regardless if Congress extends the Tax Cuts and Jobs Act, your financial future can improve dramatically by not living on the tax savings but instead allocating it to retirement savings, education or tax savings in the future.**

SAVE FOR EDUCATION

The child tax credit increases from $1,000 to $2,000 per qualifying child for individuals making less than $200,000 and less than $400,000 for joint filers. Tax credits are more advantageous than deductions since they reduce your actual tax bill versus your taxable income. With the increased income threshold, more families will be able to utilize the child tax credit and substantially decrease their tax bills. The tax savings should be used to contribute to retirement or education savings. The most versatile savings vehicles for education is the 529 College Savings Plan. This plan allows you to contribute after-tax dollars that grow tax-deferred and tax-free if used for qualified education expenses.

HEDGE AGAINST HIGHER TAXES IN THE FUTURE

If you pay fewer taxes this year, consider hedging against higher taxes in the future by establishing a tax-free Roth IRA. Future distributions from Roth IRAs are not subject to state or federal taxes as long as the account is held for five years and the earnings are accessed after 59½ years old. Below are some of the ways to add to a Roth IRA:

If your income falls below the current thresholds of $120,000 for individuals and $189,000 for joint filers, you can make a direct contribution of $5,500 (under age 50) or $6,500 (over age 50).

If your income exceeds these thresholds, you still may be able to contribute to a Roth as part of a 401(k) or 403(b) plan if your plan offers this option.

"Backdoor" contributions allow you to make a nondeductible contribution to a Traditional IRA and immediately convert it to a Roth IRA. The "backdoor" Roth option works best when there are no other IRAs.

Roth conversions are not limited by the income threshold. Roth conversions allow for a portion of your Traditional IRA to be converted to a Roth IRA. Any converted amount is taxable income in the year the conversion takes place.

A Certified Financial Planner™ can help you determine which option is optimal for your circumstances.

Regardless if Congress extends the Tax Cuts and Jobs Act, your financial future can improve dramatically by not living on the tax savings but instead allocating it to retirement, education, and tax savings for the future. Meet with a CFP® professional soon to take advantage of the opportunities available in the current tax environment to improve your financial future.

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