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Robert G. Elliott's Financial News

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New Tax Act Makes Sweeping Changes to Individual Taxes

The 2017 Act made the most significant changes to the U.S. tax code in over 30 years, impacting virtually every individual and business. Due to political constraints and Senate budget rules, most of the individual provisions become effective in 2018, but revert to prior law before 2025. While there are numerous provisions impacting individuals, some of the most significant include:

• **Individual Income Tax Rates** – While there are still seven tax brackets for individuals, the ordinary income tax rates have decreased to 10%, 12%, 22%, 24%, 32%, 35%, and 37% (compared to 10%, 15%, 25%, 28%, 33%, 35%, and 39.6% under prior law) and the income brackets have widened. In future years, income levels will be indexed for inflation using a chained consumer price index (CPI). The IRS estimates that taxpayers will start to see the effects of these reductions in their paychecks as early as February 2018. The Tax Foundation estimates that the 2017 Act will increase the after-tax incomes of all taxpayer groups in 2018 by 0.8% to 2.2% (Source: Preliminary Details and Analysis of the Tax Cuts and Jobs Act, December 2017).

• **Qualified Dividends and Capital Gains** – The tax rates on net capital gains and qualified dividends remain, but the brackets for the different tax rates are indexed for inflation using the chained CPI-U.

• **Chained CPI-U** – As mentioned above, the income levels subject to taxation as well as many other provisions in the 2017 Act are adjusted for inflation using a chained CPI-U rather than the CPI-U, which had been used in the past. Typically, chained CPI-U grows

at a slower rate than regular CPI-U, since it considers substitute purchases in reaction to changes in relative prices. Many feel that CPI-U overstates increases in the cost of living because it doesn't account for the fact that consumers adjust their buying patterns when prices increase, instead of simply buying the same item at a higher price.

• **Standard Deduction** – The standard deduction nearly doubled to $24,000 for married couples filing jointly, $18,000 for head of household filers, and $12,000 for single individuals, indexed for inflation using the chained CPI-U. Under prior law, the 2018 standard deduction was $13,000 for married couples filing jointly, $9,550 for heads of households, and $6,500 for single filers. This change simplifies tax filing by reducing the number of individuals who itemize deductions 50%. Approximately nine out of 10 taxpayers will simply claim the new standard deduction starting in 2018 (Source: The Heritage Foundation, December 19, 2017).

• **Personal Exemption Deduction** – The deduction for personal exemptions and the personal exemption phaseout has been eliminated through 2025.

• **Child Tax Credit** – The 2017 Act increases the child tax credit from $1,000 to $2,000 per qualifying child, with up to $1,400 being refundable. The adjusted gross income phaseout thresholds are increased to $400,000 for married couples filing jointly (up from $110,000) and $200,000 for all other filers (up from $75,000 for single filers and $55,000 for married individuals filing separately), which is not indexed for inflation. A $500 nonrefundable credit is also available for qualifying dependents other than qualifying children.

• **State and Local Tax Deduction** – Deductions for state and local taxes, including income taxes and property taxes, are limited to $10,000 ($5,000 for married individuals filing separately). Sales taxes can be claimed as an alternative to state and local income taxes. Prepayment of state and local income taxes in 2017 for a future year is disallowed.

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New Tax Act...

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• **Mortgage Interest Deduction** – The mortgage interest deduction is limited to interest $750,000 of acquisition debt ($375,000 for married individuals filing separately). If the debt was incurred prior to December 15, 2017, the prior limitation of $1 million remains ($500,000 for married taxpayers filing separately). Taxpayers can still include mortgage interest on second homes within the lower dollar caps. Interest on home-equity loans is no longer tax deductible.

• **Charitable Contribution Deduction** – The 50% limitation of contributions to public charities and certain private foundations has been increased to 60% of the taxpayer's contribution base. Contributions exceeding the 60% maximum can be carried forward and deducted for up to five years.

• **Medical Expense Deduction** – For tax years beginning after December 31, 2016, and ending before January 1, 2019, medical expenses in excess of 7.5% of adjusted gross income (AGI) for all taxpayers can be deducted (down from 10% of AGI for all taxpayers except those over age 65).

• **Personal Casualty and Theft Loss Deduction** – Itemized deductions for personal casualty losses, including those from fire, storms, shipwrecks, other casualties, and thefts, are suspended, except for personal casualty losses incurred in a federally declared disaster.

• **Alimony Deduction** – For divorce agreements entered into after December 31, 2018, alimony and separate maintenance payments are not deductible by the paying spouse and not included in income of the spouse receiving the payments.

• **Miscellaneous Itemized Deductions** – The deduction for miscellaneous itemized deductions in excess of 2% of AGI is suspended.

• **Limitation on Itemized Deductions** – Under prior law, itemized deductions for higher income taxpayers were limited (known as the Pease limitation). For taxpayers who exceeded the threshold amount, itemized deductions were reduced by 3% of the AGI exceeded the threshold. Under the 2017 Act, the Pease limitation is suspended.

• **Affordable Care Payment** – The individual shared responsibility payment required under the Affordable Care Act (also known as Obamacare) is permanently reduced to zero, effective for months beginning after December 31, 2018. However, both the 3.8% net investment income tax and the 0.9% addition Medicare tax, which were enacted as part of Obamacare, remain in effect.

• **Kiddie Tax** – A child's earned income is now taxed at the rates for single individuals and net unearned income is taxed based on the brackets for trusts and estates (see the article "Estate and Gift Tax Exclusion Doubled" for more details on those rates). Under prior law, the child's net unearned income was taxed at the parents' rate if that rate was higher than the child's tax rate, while the remainder of the child's income (earned income plus unearned income up to $2,100 in 2018 less the child's standard deduction) was taxed at the child's rate.

• **Section 529 Funds** – The definition of qualified higher education expenses that can use Section 529 account funds has been expanded to include tuition at an elementary or secondary public, private, or religious school, up to $10,000 per year limit.

• **Recharacterization of IRA Contributions** – Under prior law, both regular contributions and conversion contributions to a Roth IRA could be recharacterized as having been made to a traditional IRA. The 2017 Act no longer allows recharacterization of conversion contributions to a Roth IRA, although the other recharacterizations are available.

• **Alternative Minimum Tax (AMT)** – The AMT is a separate tax calculation meant to prevent high-income taxpayers from avoiding tax liability by using exclusions, deductions, and credits to reduce income. If the AMT tax is higher than the regular tax, the larger amount is owed. When computing the AMT, only income above an AMT exemption amount is considered. Under the 2017 Act, the exemption amount has been increased to

- $109,400 for married taxpayers filing jointly and surviving spouses (up from $86,200)
- $70,300 for single taxpayers (up from $55,400)
- $54,700 for married taxpayers filing separately (up from $43,100)

These exemption amounts are reduced (not below zero) to 25% of the amount by which the taxpayer's income exceeds the phaseout amounts:

- $1 million for married taxpayers filing jointly and surviving spouses
- $500,000 for all other taxpayers

All amounts will be adjusted for inflation based on the chained CPI-U.

Encourage Your Child to Fund an IRA

Once your child starts working, help him/her develop good savings habits by encouraging him/her to fund an IRA. Even if your child only contributes for a few years, an IRA can provide significant funds for retirement.

Your child must have earned income to contribute to an IRA and may only contribute the lesser of earned income or the maximum IRA contribution. The maximum limit is $5,500 in 2017.

Assume your 16-year-old daughter starts working part-time. If she contributes $2,000 to an IRA from the ages 16 to 22, she will contribute $14,000 over seven years. With no further contributions, the IRA could potentially grow to $527,437 on a tax-deferred or tax-free basis by age 65. That assumes earnings of 8% compounded annually, but does not include any income taxes that might be due.

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Encourage Your Child...

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If your child continues $2,000 IRA contributions until age 65, he/she would make total contributions of $98,000 and may accumulate investments of $1,145,540. *(These examples are provided for illustrative purposes only and are not intended to project the performance of a specific investment vehicle).*

Although most children will be eligible to contribute to both a traditional deductible IRA and a Roth IRA, you should probably encourage your child to fund a Roth IRA, which has several advantages:

• **Roth IRAs are more flexible.** Your child can withdraw all or part of his/her contributions at any time without paying federal income taxes or penalties. Thus, if your child later decides to use contributions for college, a car, a down payment on a home, or for some other purpose, contributions can be withdrawn with no tax consequences.

• **Earnings accumulate tax free, plus qualified distributions can be withdrawn tax free.** A qualified distribution is one made at least five years after the first contribution and after age 59 ½. There are also certain circumstances where earnings can be withdrawn without paying income taxes and/or the 10% federal income tax penalty. If your child allows the funds to grown until at least age 59 ½ , all contributions and earnings can be withdrawn without paying any federal income taxes.

• **A traditional deductible IRA offers little tax benefit to a child.** When your child first starts working, he/she will typically pay a low marginal tax rate on his/her income. So even though the Roth IRA contribution is not tax deductible, your child typically receives little or no tax benefit from deducting the traditional IRA contribution anyway.

If you can't convince your child to use his/her own money to fund the IRA, consider reimbursing him/her as part of your annual gift tax exclusion for any IRA contributions.

Municipal Bonds

We offer the following bonds subject to prior sale or change in price as of February 28, 2018.

Ref No	Issuer	Maturity Date	Coupon	Yield to Maturity	Yield to Call	Call Date	Rating	Price
1	Met Govt Nashville & Davidson Vanderbilt Univ	07/01/47	4.000	3.906	3.790	07/01/27	A3	101.633
2	McNairy Cnty TN	06/01/47	3.375	3.589	3.589	06/01/26	AA	96.140
3	Wilson Cnty TN School & Publc Impt	04/01/32	3.000	3.100	3.100	04/01/23	AA+	98.864
4	Knox Cnty TN Ref	06/01/28	2.250	2.720	2.720	06/01/25	Aa1	95.819
5	Johnson City TN	06/01/25	5.000	2.320	2.320	N/A	Aa2	117.779

Callable at 100% beginning of the call date above and every call date thereafter with 30 days notice.

In addition to the bonds listed, we have several other corporate bonds available. If you are looking for a specific bond or maturity, please feel free to contact me with your requests.

We are also interested in buying corporate bonds. If you have bonds for sale, please call me for a bid and details on how you can convert your present bonds to cash or alternative investments.

Finally, new bonds are coming to market every day. If you give me a call, I will be more than happy to go over current market offerings and conditions with you.

Although the information and statistics are not guaranteed, they have been obtained from reliable sources and are believed to be accurate. All put/call information may not be displayed and Wiley Bros.-Aintree Capital assumes no responsibility for such undisclosed features or omissions. All are subject to market conditions and/or prior sale.

Personal Note

As many of you know my wife, Cassie, and I are empty-nesters. Tate, our youngest daughter, recently started her freshman year in college. So far, so good as she is having a great experience while still deciding her future course of study. She entered college thinking about psychology and education as possible majors, but now is taking some classes in economics and seems to be enjoying that field. As a former Econ major myself I am trying not to push her too hard in a specific direction, but I am stressing the fact that having a business background may help her get a degree that ultimately lands her a job. Moving her off of my and Cassie's payroll in four years is the main goal! Our oldest daughter, Sarah, is in her last semester in college. She is finishing her degree in bio-medical engineering and is starting to feel some trepidation as she moves from "student" to "adult with a job". I believe a person can be of two minds as when they graduate college. On the one hand, I remember well the desire to become independent, but on the other hand there was some concern about what comes after the diploma is handed out. For Sarah, her mom and I are proud parents and there is NO TREPIDATION for us having her off of our "payroll!" I am sure she will excel in whatever endeavor she chooses to pursue next.

Being of two minds is also how I feel about the run in the stock market over the past nine years. On the one hand, things are good. The economy is doing well and unemployment is near 4%. The banking system has healed and appears well capitalized. Public policy, tax policy, and regulation have become less onerous for business. The U.S. recovery has now morphed into a worldwide recovery, something rarely seen. In addition, there is a technology revolution going on which will probably last a couple decades and remake the way goods and services are delivered worldwide.

On the other hand, valuations in the stock market are elevated. We are at the top range of the market cap to GDP ratio. Enthusiasm is clearly on the rise as mutual fund managers are holding the lowest percentage of cash on record and NYSE margin levels are also at record highs. The recent tax bill caused the stock market to run up 7% in January and, despite a brief correction in February, the Dow Jones Industrial Average remains close to 26,000. Complacency in the market is high and 2017 was the first year in history where the market declined no more than 3% for the entire year. That being said, I believe caution is in order.

What to do? If you have needs for cash within a couple of years, raise it now. This is also a good time to make charitable gifts of appreciated securities. Within your portfolio, know what you own so you do not make an emotional decision to "get out" based on some commentator inciting investors to "do something" during the next stock market decline. This "in/out" thinking undermines the deeper logic that wealth in a capitalistic world is created through business ownership. When you own shares in a company (either through a stock or mutual fund) you own a business. Over time it is the long-term growth in intrinsic value of those businesses that matters. Taking this long view, investing is more of an enterprise to be run over decades, not months. To own these businesses over many years you will notice that they will have lower prices when fear about the current state of the economy is rampant (such as during the last recession in 2008-2009) and higher when investors are enthusiastic about the economy, such as now.

As always, I encourage my clients to be cautious in the short-term, but optimistic over the long-term. We will definitely experience more volatility in the stock market in 2018 than we did in 2017, in fact we already have! But, we are not going to make investment decisions based on any story lines or "crystal ball" gazing's. Instead, we'll continue to remember that markets are large complex institutions that react with uncertainty on a daily basis, but measure value over long periods of time. (As an aside, I started in the investment business in 1992 when the DOW was trading around 3,000 and is now around 26,000.) We will continue to remember why we invest, which is to help our clients reach specific goals they've set for themselves. And we'll continue to stick to our long-term strategies which are designed to look beyond the current headlines. On the one hand, be prepared for short-term volatility in the market this year, but on the other hand maintain an optimistic long-term view.

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