‘TIS THE SEASON

Year-End Financial Planning 2018

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It is that time of year again for SevenBridge and our clients to work together to execute on several time-sensitive planning items generally due to annual IRS deadlines and current market conditions.

Funding tax-advantaged accounts

There are several commonly-used accounts that require action by a stated deadline in order to comply with tax rules to achieve the planned tax savings or deferral. For example, individual IRA accounts (Traditional and Roth) are required to be funded by April 15, 2019. Similarly, health savings accounts (HSA's) for those with high deductible health insurance plans, have the same deadline. In Pennsylvania, college savings accounts (529's), are required to be funded during the calendar year to qualify for the state tax deduction in the current tax year.

Gifting and the advancement of donor-advised funds

Gifting within the family: Each year, the IRS identifies a "gift tax exclusion" amount. For 2018, the exclusion is $15,000. This means that each taxpayer can gift $15,000 to another individual without paying taxes or filing a gift tax return on that gift. Gifts of larger amounts are required to be reported to the IRS via Form 709, a gift tax return, where lifetime gifts are accumulated and considered to determine whether tax is owed. One strategy to effectively execute gifts larger than the annual exclusion amount, is to spread gifts out over several tax years. Let's say that a married couple intends to gift their newly-wed daughter and son-in-law $50,000 as a wedding gift. If the gift is spread out over two tax years $25,000 in each calendar year, the same gifting goal is achieved with no additional tax consequences or filings to the donor.

Gifting to others: In December 2017, the Tax Cuts and Jobs Act (TJCA) was enacted by our federal legislators. As a result of this tax law change, there were no significant changes to the deductibility of donations to qualified charities. However, there was a doubling of the standard deduction that will increase the number of taxpayers who elect the standard deduction vs. itemizing deductions (including charitable gifts.) If you plan to itemize deductions for your 2018 tax return, there is no significant change for you. For those taxpayers who can benefit from the increased standard deduction, one strategy is to concentrate or "bunch" several years-worth of planned giving into a single year. Using this strategy will allow the taxpayer to make donations large enough to flip into an itemized deductions election for that year. The benefit is that 100% of those donations will be tax deductible (up to certain limits of adjusted gross income.) A downside to this strategy is the loss of liquidity in the year the donations are made, so careful planning should be considered.

Donor-advised funds are one vehicle that taxpayers should consider when meeting their charitable giving goals. One example of how these funds work is that a client can transfer appreciated securities with large capital gains into the donor-advised fund. In the year that the securities are transferred, the taxpayer will be able to deduct 100% of the fair market value of securities transferred and will also avoid capital gains taxes. Then, donations are made from the donor-advised fund based on a schedule chosen by the donor. In this way, a donor can achieve tax savings while spreading out the gifts over multiple years. An additional benefit is that any investments held in a donor-advised fund can grow tax free prior to the donation. There is no further financial benefit to the donor, except that the charity will receive larger check.

Another option is gifting to a charity directly from your Traditional or Rollover IRA accounts (does not apply to Roth IRA accounts.) If you are over 70 ½, you are required by the tax code to take annual required minimum distributions. Instead of taking these distributions and paying ordinary income tax, an individual can gift up to $100,000 each year to a qualified charity without paying any income tax on the transfer. In addition, these transfers count toward your required minimum distributions for the year. Be mindful that you must transfer the funds directly to the charity and you may not first take the distribution yourself and then gift the funds. When it comes to a charitable giving plan, consult with your financial advisor so that you can move forward confidently knowing that you achieved the largest possible benefit to your chosen charity while maximizing any tax advantages for you and your family.

Tax Loss Harvesting expected to be popular in 2018

Tax loss harvesting is a classic strategy to maximize total return in taxable accounts. The market 's volatility that was experienced in October and into November, has plenty of economists and financial advisors arguing that we are at or nearing the end of the economic expansion phase that began at the end of the Great Recession about 10 years ago. When experiencing these periods in the past, it is common for some portfolio managers to favor profit-taking in order to implement an updated investment plan for a new phase in the economic cycle. In this environment, it will be common for those same portfolio managers to search for opportunities to sell investments with unrealized losses in order to offset some of the capital gains experienced from profit-taking over the past few months. This activity is known in financial planning as "tax loss harvesting."

It is important to remember that selling investments for the purpose of reducing capital gains taxes can be a worthwhile strategy, but an advisor should also ensure that the strategy does not result in an investment portfolio that deviates from the client's long-term investment plan. In addition, wash sale rules should be considered to ensure that the IRS allows the intended treatment of capital losses.

We hope that this has helped to inform you of the most common year-end financial planning opportunities. For a complete, comprehensive discussion, please contact us.
Happy Holidays and happy financial planning!

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