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WEALTH MANAGEMENT, INC.



A Guide To The New Rules On Tax Deductions In 2018

Uncle Sam giveth, and Uncle Sam taketh away. The new federal tax code, which went into effect in 2018 and affects the return you'll file in spring 2019, lowers taxes by expanding some deductions, but restricts or outright eliminates others.

Deductions lower your taxable income so you pay less tax. Here's how deducting items from your income were expanded, restricted, or eliminated.

Tax Planning 2018



Here's a guide to how the new rules expand some deductions, but restrict or eliminate others.

EXPANDED DEDUCTIONS

Standard deduction. The standard deduction is the amount you can subtract from your taxable income if you don't itemize — that is, individually deduct items like mortgage interest, charitable donations, and car loans. Nearly doubling the standard deduction to \$24,000 for joint filers and \$12,000 for singles pushes it up from \$12,700 and \$6,350, respectively. Fewer than half of taxpayers who itemized their 2017 return are expected to itemize their 2018 return. If you file using the standard deduction, preparing your return will be much simpler. If the standard deduction is less than the total of your itemized deductions, you'll still want to file by itemizing, subject to the rules below.

Medical expenses. If you itemize deductions, medical expense deductions

will be more generous. For tax years 2017 and 2018, medical outlays in excess of 7.5% of your adjusted gross income are deductible. Starting in 2019, the threshold rises to the previous level of 10%. Congress is widely expected to consider extending the 7.5% threshold or making it permanent.

Alternative minimum tax. This very unpopular parallel tax system has been reined in and will zap fewer Americans in 2018. The AMT started in 1982 as an effort to reduce loopholes open to ultra-high-income earners, but its net gradually spread and it affected more individuals. In the 1990s, Congress hiked the AMT tax rate, stiffening its cost. Under the AMT, the standard deduction and deductions for state and

local income taxes are lost. With the new law, your exemption — the amount you can subtract from your AMT liability — is much larger. Previously, \$54,300 was exempt for a single-filer and \$84,500 for a married couple filing jointly. Respectively, the exemptions increased by almost a third, to \$70,300 and \$109,400.

Child tax credit. This actually is not a deduction against your income. It's a credit on your tax bill. A credit reduces your tax bill dollar for dollar. The credit for children under age 17 was raised to \$2,000 from \$1,000.

RESTRICTED DEDUCTIONS

State and local taxes. Lawmakers placed a \$10,000 cap per return on deductions for state and local taxes (SALT). Till now, the amount you could

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Good Riddance To The Alternative Minimum Tax

Perhaps the most despised federal levy is the alternative minimum tax, which Congress passed in 1969 to prevent the loophole-savvy ultra-wealthy from shortchanging Uncle Sam.

Over the years, AMT's reach expanded to include households with more than \$200,000 in AGI (adjusted gross income) annually and two-earner couples with children in high-tax states.

Under the new tax law, starting in 2018, the AMT's damage radius is reduced considerably. This alternative tax calculation still requires some individuals to calculate their tax bill twice — under regular rules and then the AMT's, and pay the higher sum. In 2018, though, a fraction of tax-filers will fall into the clutches of the dreaded AMT.

With the tax code rewritten, only about 200,000 tax filers are expected to be required to pay the AMT in 2018, way down from the 5.25 million, according to the Tax Policy Center.

Congress increased income exempt from the AMT calculation. This expands to \$109,400 for joint filers, up from \$84,500, and to \$70,300 for individuals, up from \$54,300.

The happy outcome is that the changes permit many more households making more than \$200,000 to bid the AMT a not-so-fond farewell.

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Giving More To Loved Ones – Tax-Free

While it may be better to give than to receive, as the adage contends, both givers and receivers should be happy with the new tax law. The annual amount you can give someone tax-free has been raised to \$15,000, from \$14,000 in 2017.

Exempting \$15,000 annually from gift tax, over time, transfers a lot of wealth to those you care about during your lifetime, while avoiding the tender mercies of the tax man, and married couples can have double the fun.

Take the example of a husband and wife with three married children and six grandchildren. The husband can give \$15,000 each to his married children and the same amount to their spouses, and also \$15,000 to the half-dozen grandchildren — totaling \$180,000 — and his wife can do the same for the same 12 beneficiaries. The grand total is \$360,000 per year. No federal tax will be levied on these transfers of your wealth to family as well as friends.

In addition, you can give more than the annual exemption caps for college savings. The Tax Cuts and Jobs

Act (TCJA) permits bunching five years of \$15,000 annual gifts into one year, by plugging it into a 529 college savings plan for a child or grandchild. That's \$75,000 in total. Assets in 529 savings plans grow tax-free, if used to pay qualified education expenses.



Gifts made during your lifetime reduce your exemption from tax on your estate. The TCJA more than doubled the estate tax exemption in 2018 from \$5.5 million to \$11.2 million for individuals, and from \$11 million to \$22.4 million for couples. All of these new levels will increase with inflation, though the formula annually adjusting inflation is less

generous than before.

Lifetime gifts can be made directly or through trusts. With a trust, you place the gift of cash, securities, or other assets in an entity set up to make transfer of wealth after you die. The assets in the trust avoid probate court, and makes the transfer faster, less costly, less likely to be contested, and generally more sure-footed. Trusts can influence the values of your progeny by requiring the money you leave to be spent for religious, philosophical, or any variety of educational activities.

A trust also shields assets left to your heirs from lawsuits and business creditors. Should your grandchild get divorced, the trust money is shielded.

The friendlier tax treatment of transfers under the TCJA affects your estate plan and how your assets will be spent after you are gone, but it also may change your plan for gifting during your lifetime. Giving assets during your lifetime can be satisfying because you can witness your impact and influence on the future of your family. ●

New Deduction Rules For Business Owners

If you are a small business owner, Washington, D.C. has changed tax rules to lower your burden but the new rules are fairly complex. Many small businesses, and some that aren't so small, are "pass-through companies," tax-jargon that means the entity's net income isn't taxed at the corporate level but flows straight to their owners' personal returns. That income is taxed at personal income tax rates, as opposed to corporate rates that are generally lower.

The new tax law, though, has a valuable deduction that evens things out for pass-throughs, although the accounting gymnastics make this anything other than simple. "The size of

the deduction varies, depending on the nature of the business activity and the total income of its owner," says Howard Gleckman, a senior fellow at the Tax Policy Center. "It may also depend on how much the business pays its employees and how much property it owns."

Under the new tax law, the top personal rate drops to 37% from 39.6%, with similar reductions in brackets below the highest level. Yet most U.S. businesses are classified as C corporations, which means these companies are taxed separately from their owners. The new tax law lowers the federal tax for C corps to 21%

from 35%.

To balance out the difference, Congress allowed pass-throughs — limited liability companies (LLCs), S corps, partnerships and the like — a 20% deduction on their net income. The effect, for those in the top tax bracket, is to lower an owner's rate to 29.6% from 37%. True, 29.6% is higher than 21%, but owners of C corps, meaning shareholders, pay a tax on dividends they receive, usually 15%. So that comes closer to parity with the pass-throughs.

To prevent those part-time jobs into pass-through entities, lawmakers limited the new rules. So, you can't suddenly

2018 Estate Tax Changes And What May Be Ahead

The tax code overhaul brought a lot of changes, but for the estate tax, the most far-reaching result was what didn't happen. Chiefly, you didn't lose the capital gains break on inherited assets when they are sold.

For tax purposes, the value of an asset, when sold, rises to its current market-value even though it was originally purchased at a lower price. The result is a lighter tax when an heir sells off stocks or other holdings that were part of the bequest.

For a narrow slice of the population, one weighty thing did happen with tax reform: Very wealthy households received a better deal on

how much of their estate is taxable. Their fondest wish did not come true, to be sure, and the new tax law did not kill what is derisively called "the death tax." However, Uncle Sam's claim on inherited mega-money has been shrunk by the new law. Starting in 2018, the exemption for estate tax nearly doubles. The

amount that can be passed along to heirs tax-free rises in 2018 to \$11.2 million from \$5.5 million for individuals, and to \$22.4 million, from \$11 million, for couples.

Above the new thresholds, the Internal Revenue Service expects to collect 40%. However, an important and favorable new wrinkle increases the exclusion annually by the rate of inflation.

The good news — and bad — is that through the end of 2025 is a great time to die, but Congress could modify the just-enacted rules as soon as 2019, particularly with recent changes in the political climate. Left unchanged, this

new part of the tax code is set to expire in 2026.

The number of estates that will pay any tax, according to the Tax Policy Center, is expected to drop from 5,300 in 2017 to 1,700 in 2018.

For heirs, the most important developments are what the House and Senate left alone. Those relate to capital gains and how surviving spouses can structure their own estates, a concept called portability:

Capital gains. The technical term for this untouched provision is a "step-up in basis." Let's say your father dies and you inherit Apple stock that he bought at \$8 per share in 1983,

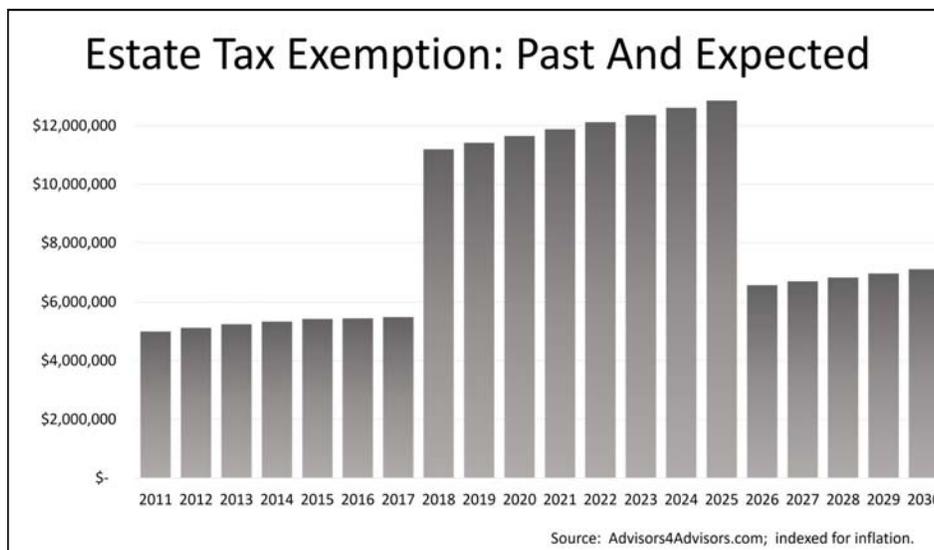
a little after it went public. Today, Apple stock changes hands for around \$172. That kind of appreciation usually means a whopping capital gains bill, should you unload the shares to fund, say, buying a new home. In other words, a 15% tax bite on the price escalation of \$164 for each of

the shares. Thanks to the step-up, the IRS values your Apple shares at \$172, rather than the earlier \$8 per share.

Portability. This is a helpful tax benefit for married couples, which Congress also let stand as is. It permits a surviving spouse to receive the unused part of the estate-tax exemption of the dead spouse.

Example: Dick and Jane have an estate worth millions. Dick dies and leaves \$3 million of it to his children. Remember that the exemption for one person is \$11.2 million. Under the law, Jane can use the leftover \$8.2 million for her estate planning. That's a big deal to her beneficiaries.

The estate tax exemption has been a moving target over the past 20 years. It's important to keep up with the changes. ●



claim you are a consultant and create a sole proprietorship with the intent of grabbing a tax break.

Owners of service businesses — doctors, lawyers, and consultants — are limited in what they can deduct. Service businesses, according to the tax law, may count as their principal asset the "reputation or skill" of the owners and employees, while manufacturers may not.

In addition, Congress inserted income limits on the deductions that affect all pass-throughs, whether or not they're a service business. The 20% deduction is confined to income of \$157,500 for single-filers and \$315,000 for married couples. For service businesses, the deduction is phased out

progressively in excess of those levels and eliminated entirely when total taxable income is \$207,500 for singles or \$415,000 for couples filing jointly.

For other types of businesses, the deductions over those thresholds are limited to the greater of 50% of paid wages or 25% of wages plus 2.5% of the business' tangible depreciable property.

The pass-through rules are a big boon for real estate operators, whose properties usually each are LLCs. Further, if every property in a real estate owner's portfolio, say an office building or a shopping mall, is worth a large amount, the deductions can be sizable. For example, on a shopping mall worth \$5 million, 2.5% of its value is \$125,000. That's quite a deduction. ●

A Bright Outlook For Consumer Spending

Investing prudently requires understanding economic fundamentals. Here's some insight into current economic conditions and the kind of ongoing analysis required to manage wealth prudently for the long term over up and down economic cycles.

The economy is measured quarterly in terms of gross domestic product (GDP), which is the sum of four factors: consumption, investment, government and net exports. Consumer spending is by far most important, accounting for 69% of U.S. economic activity. The key to strong economic growth, then, is a strong American consumer.

In the final quarter of 2017, net exports were a drag on GDP growth. However, net exports are volatile month-to-month and its dips have been followed repeatedly by surges over the past two cycles of the economic expansion and recession that

occurred since January 2002.

Government spending, which includes state and municipal expenditures, has been on the rebound after suffering years of cutbacks in The Great Recession and its aftermath. With real incomes rising since the financial crisis, tax receipts have risen and state and local government spending grew, which has been a positive factor in GDP growth in recent years.

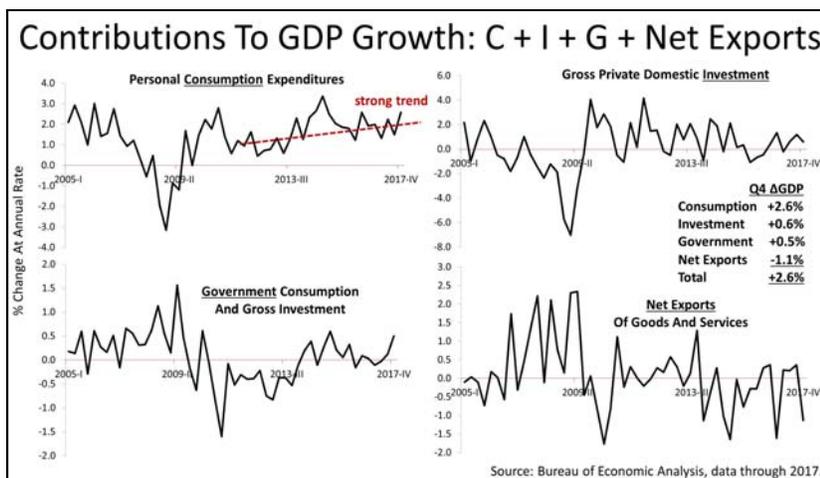
However, business investment and government spending are together not even half as important a factor in growth

of the U.S. economy as consumers. If consumers keep spending, the good times for the U.S. could keep on rolling, and there is some reason for optimism on that score.

Consumer strength rose in closing out the year, according to the most recent data, extending the strong growth trend line (in red) experienced in recent years. In addition, in February, a lower rate of withholding federal taxes on employee paychecks kicked in, and that is putting more money in consumers' pockets to spend. That could show up in GDP

growth figures to be released in early April 2018.

Economic growth shows up in profits of companies and is the key determinant in the value of stocks. Profit expectations at the Standard & Poor's 500 companies grew sharply in the opening quarter of 2018, according to independent economist Fritz Meyer, and the outlook for consumer strength was bright despite an 11.8% correction. ●



Tax Deductions In 2018

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deduct for SALT levies was unlimited. If you live in a place with high state and local taxes and home prices, you're hit hard. If you earn more than \$100,000 in adjusted gross income and live in California, Connecticut, Maryland, New Jersey, New York or Oregon, you're very likely to see a material hike in your annual federal tax liability for at least the next decade.

Mortgage interest. You can continue to deduct this interest for first and second homes. The change: For mortgages dated after Dec. 14, 2017, only the interest on the first \$750,000 of debt is deductible. Before that date, the \$1 million ceiling still applies. In places where home prices and, thus, mortgages, are low, that is not as much of a concern.

In high-price locales, it is.

Home equity interest. You no longer can deduct interest paid on home equity loans, unless it is used to improve the dwelling. Many people use such loans, which are secured by their homes, to pay for college tuition or new cars. If a home equity loan and the mortgage totals more than \$750,000, the amount over that limit can't be deducted.

ELIMINATED DEDUCTIONS

Personal exemption. Exemptions, which lowered your income by \$4,050 per person — usually family members — are gone. For some families with children over 17, who can't take advantage of the expanded tax credit, the elimination of the personal exemption will be a net loss.

Alimony. For divorce and separation agreements made after 2018, alimony payments will no longer be deductible. The deduction is helpful to a paying ex-

spouse who is short on funds.

Casualty and theft losses. If your house burned down or a crook took your wallet, you could deduct the loss not covered by insurance to the extent it exceeded 10% of your income. Under the new law, only casualty losses suffered in a natural disaster declared by the president are deductible.

Job expenses. Continuing education, medical tests and licensing fees previously were write-offs. Not anymore.

Moving expenses. Before, you could deduct these if you moved to start a new job and it was a good distance (that varies by circumstances, but typically meant 50 miles away) from your old home. Now, that is gone, unless you are in the military.

Tax prep. Depending on the complexity of the return, these fees can amount to more than \$500. Uncle Sam no longer will let you deduct them, though. ●