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Be Prepared For Tax Policy To Swing Back

For business owners, professionals, and wealthy families, tax rules are about as favorable as they've been in decades, but the tax policy pendulum could swing back again. Be prepared to make some important financial decisions much sooner than had been expected.

For example, the lifetime tax exemption for gifts made in 2019 and 2020 are $11.4 million and $11.58 million, respectively, up from $11.18 million in 2018. It more than doubled from the $5.43 million exemption in effect in 2017 and is scheduled to ratchet higher through 2025, as a result of the enactment of the Tax Cuts & Jobs Act (TCJA). In 2026, the exemption reverts back to the level in effect before the TCJA became effective in December 2018.

That means families should have many years before they would be forced to decide whether to make gifts in 2025 to maximize their exemptions from tax in passing their wealth to family members. The 2025 peak in the exemption amount forces a decision about whether to give assets to loved ones while you're still alive or hold onto your assets and give them away after you die. In 2025, you use the $12-million-plus exemption or lose it, and the exemption reverts back to a much lower amount in 2026 and beyond.

However, the tax policy pendulum — a politically charged issue — could swing in the other direction in the months ahead. Business owners, professionals, and other high-net worth individuals may need to make decisions about gifting assets much sooner. There is no assurance that you will have until the end of 2025 to make this important

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Five Key Factors In Funding A Child's Education

The Tax Cuts And Jobs Act (TCJA) changed funding a child's education significantly. Here are five factors to consider.

1. You can now pay tuition for kindergarten through 12th grade at private, public or religious schools with money saved in tax-advantaged 529 college savings accounts.

2. Families can now take tax-free withdrawals from a 529 plan to pay for up to $10,000 of K-12 tuition. While contributions are not tax deductible at the federal level, earnings grow free of federal income tax on withdrawals used for qualified school expenses.

3. You are not limited to 529 plans sponsored by your state and can choose from a long list of 529s sponsored by other states.

4. The TCJA axed taxes on alimony payments, so custodial parents should have an easier time qualifying for need-based aid.

5. The TCJA also eliminated tax deductions for interest on home equity loans and lines of credit. These are major sources of education funding and losing their deductibility may require a change in your college funding plan.

Education tax breaks were boosted overall by the TCJA, but to tax efficiently navigate these waters, we encourage you to see the guidance of a tax professional. We are here to answer questions and create a strategic approach.

Warm regards,
The Gerstein Tax Service Client Team

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, up from $14,000 back 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. *(See our article on page 1 for more on 529 plans).*

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. The estate tax exemption increased to $11.4 million and $11.58 million for individuals for 2019 and 2020, and $22.8 million and $23.16 million for families.

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 the 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 your beneficiaries actions with the money you leave by requiring it to be spent for philosophical or a 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. ●

5 Retirement Mistakes You Can Fix

To err is human, but some mistakes are worse than others, and slip-ups that occur while you're planning for retirement can come back to haunt you financially.

But it may not be too late for you to fix some common mistakes. Here are five prime examples:

1. Saving too little. It seems obvious, but not setting aside enough money could become a big problem if you underestimate the amount you'll need to live on—all the more likely as life expectancies continue to rise. So if your employer offers a 401(k) plan with matching contributions, try to take full advantage of it, even though your take-home pay will be reduced by deferrals. And you can supplement these savings with IRA contributions.

2. Starting too late. From the start of your career there are many financial priorities competing for a share of your salary. You may be saving to buy a home or to put your kids through school. Yet while early contributions to a retirement plan can produce outsized benefits, you may be able to make up for lost time if you put as much as the law allows into your retirement savings. For 2019, the maximum 401(k) deferral is $19,000 or $25,000 if you're age 50 or over. These numbers increase to $19,500 and $26,000 for 2020. For both 2019 and 2020, the IRA limit is $6,000 or $7,000 if age 50 or over. You also might decide to work a few years longer than you'd originally planned. That can boost your savings while reducing the length of your retirement.

3. Ignoring taxes. Taxes are an essential part of the retirement planning equation. When you take money out of your retirement plans you'll likely owe federal and state income tax on those distributions. Part of your Social Security benefits also is subject to taxation. And your tax rate during retirement might be higher than you expect if you don't get some of the deductions you were able to

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Education Tax Credits Primer

The American Opportunity Credit (for college students) and the Lifetime Learning Credit — for undergrad, graduate and vocational students — are the two education tax credits available from the federal government. Students can claim either of the two credits for schooling costs, or their parents can — provided they don't opt for married filing separately.

Even if you paid education costs with a student loan, you are eligible to take these credits. You can claim both benefits on the same return but not for the same student or the same expenses.

The benefits aren't huge, but a tax credit reduces your tax bill dollar for dollar, making it much more valuable than a mere deduction. Some key details about the two credits:

American Opportunity Tax Credit (AOTC)

Worth up to $2,500, you can take the AOTC credit if you paid at least that much in undergrad education expenses in 2019: tuition, fees, books and equipment. Expenses not included in the qualifying formula: transportation, living and medical expenses.

With a credit, should you owe $4,000 in taxes, then you need to pay just $1,500 to Uncle Sam.

What's more, this benefit is better for college students than the lifetime credit because it is refundable. Meaning, if the amount of the AOTC exceeds the tax you owe, then up to 40% of the credit (to a maximum of $1,000) will be refunded to you.

You can claim the credit for up to four years. Parents take the credit if they ponied up for a student's education costs and the student is listed on their tax return as a dependent.

It does have income limits: To get the full credit, your modified adjusted gross income (MAGI) must be $80,000 or less, and $160,000 if you're married filing jointly. You get a reduced benefit if the MAGI is up to $90,000, or $180,000. Above those top levels, you get zilch.

MAGI is the total of your household's adjusted gross income — income minus deductions — with any tax-exempt interest income added back.

Lifetime Learning Credit (LLC)

This one is worth a little less, $2,000, and there's no ceiling on the number of years you can take the LLC. That's why it makes great sense for a grad student, who faces years of course work. Ditto for someone who goes back to school to develop new aptitudes, even if the person took the AOTC in previous years.

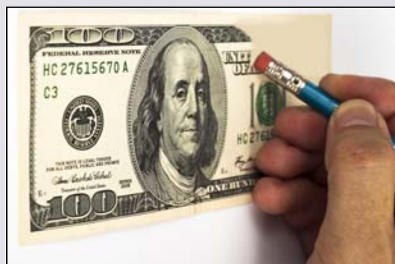
Like the AOTC, the LLC also doesn't cover living expenses, medical care or transit, but does allow you to claim supplies and books that the school requires.

The MAGI ceilings are a little lower than with the AOTC. Namely, $57,000 for singles and $114,000 for marrieds for the full benefit, and $67,000 and $134,000 for the reduced credit. Another downside: The LLC doesn't have a refundable feature.

The real cost of education has risen for decades, and these two federal tax credits are a single instrument in a strategy to pay for private school or college costs. For information about other tax breaks and advice on strategically planning to finance education, call our office, as tax planning is highly dependent on your personal situation. ●

claim while you were working. Factoring in taxes when you plan for retirement will help you create a more realistic scenario.

4. Not diversifying your investments. While you've undoubtedly heard about the benefits of spreading your investment dollars across many kinds of holdings, it's often tempting to stick with investments that have been doing well for you. But there's no guarantee that gains on a particular stock or fund will continue, and creating a diversified portfolio can help reduce the risk that you'll be hurt by losses in one or two investments. Just keep in mind that diversification doesn't provide guaranteed protection, especially in declining markets.



5. Ending retirement planning when you retire. Even after you retire you'll have important decisions to make. You'll need to make sure your portfolio stays diversified, and you'll likely need to allocate some money to stocks or other investments that may help you keep pace with rising costs.

Maybe the biggest overall mistake you can make is assuming you know it all. Reach out for expert assistance to avoid the common traps. ●

Lending Money? Watch Your Tax Step

Doug Burnside is in a quandary. His daughter, Megan, needs money to get a new business venture going. But Doug can't afford to give her the money outright and she has had trouble getting a loan from a bank.

What can be done? One idea is for Doug to lend his daughter the cash. Megan can repay Doug, with interest, if the business succeeds. Everyone wins.

But this kind of intra-family loan brings several potential tax pitfalls. As long as the loan is for $10,000 or less, there won't be a problem. However, if the borrowed amount is larger and he doesn't charge the going rate of interest, the IRS will "impute" interest for him, based on its own assumptions. He'll end up being treated as if he had charged his daughter interest, even though he hadn't, and he'll owe tax on that "phantom income" that he didn't receive.

In such cases, if the loan is for $100,000 or less, the interest you will be considered to have received annually for tax purposes is limited to the amount of your child's net investment income for the year. And if that amount doesn't exceed $1,000, you can avoid taxable interest income on the intra-family loan. But the IRS may still intercede if it suspects that you're trying to dodge the tax liability.

How do you figure out what the "going rate" for interest is? It depends on several factors, including the type of loan, its length, and the interest rates in your local area. You might be able to charge slightly less than a local bank would get, but you can't go overboard.

What happens if Megan's business fails and she can't pay Doug back? The IRS could determine that the "loan" was always meant to be a gift. To avoid that problem, it's best to have an attorney draft a formal loan document. It should include the usual terms that would be found in a bank loan. For instance, the document will usually indicate:

- The amount of the loan;
- The time allowed for repayment;
- The interest rate structure;
- A description of the collateral securing the loan.

Finally, have the loan document witnessed and notarized. This is the best proof you can have if the IRS ever challenges the deal. Also, keep records showing repayments to demonstrate that the arrangement is a bona fide loan. ●

Be Prepared For Tax Policy

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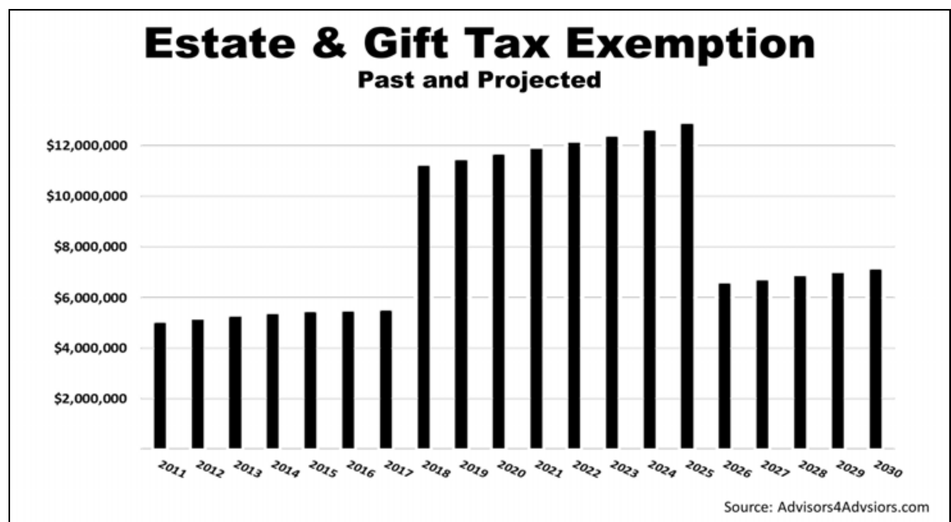
strategic decision about passing on your family wealth.

Point is, if tax policy changes, business owners, professionals and individuals benefiting from strategies enabled under the TCJA, may be forced to make decisions about income tax as well as estate and gift tax strategies much sooner than they might have expected. It's not an issue you want to fall behind on and will require personal and professional tax advice.

2025 is supposed to be the date when you use or lose the large estate and gift tax exemption on family wealth transfers. If everything went along as scheduled under the current law, you wouldn't hit that use it or lose it moment until the end of 2025! However, if tax policy were to shift in 2020 or 2021 — which is a real possibility — then you could be on the precipice of paying millions in estate and gift tax much sooner than expected. ●



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