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Tax Benefits of Homeownership After Tax Reform

Protect Your Heirs by Naming a Trust as IRA Beneficiary

What are the gift and estate tax rules after tax reform?

What is the difference between a tax deduction and a tax credit?



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Investment News

Quiz: Financial Facts That Might Surprise You



If you have a penchant for financial trivia, put your knowledge to the test by taking this short quiz. Perhaps some of the answers to these questions will surprise you.

Questions

1. The first organized stock market in New York was founded on Wall Street under what kind of tree?

- a. Maple
- b. Linden
- c. Buttonwood
- d. Elm

2. Who invented the 401(k)?

- a. Congress
- b. Ted Benna
- c. The IRS
- d. Juanita Kreps

3. Which three U.S. bills together account for 81% of the paper currency in circulation?

- a. \$1, \$20, \$100
- b. \$1, \$5, \$20
- c. \$1, \$10, \$20
- d. \$1, \$10, \$100

4. Small businesses comprise what percentage of U.S. businesses?

- a. More than 39%
- b. More than 59%
- c. More than 79%
- d. More than 99%

5. Which U.S. president signed Medicare into law?

- a. President John F. Kennedy
- b. President Lyndon B. Johnson
- c. President Richard M. Nixon
- d. President George W. Bush

Answers

1. c. Buttonwood. On May 17, 1792, 24 New York City stockbrokers and merchants met under a buttonwood tree outside of what is now 68 Wall Street. Their two-sentence brokers' agreement is known as the Buttonwood Agreement.¹

2. b. Ted Benna. A 401(k) is a tax-deferred, employer-sponsored retirement savings plan. Although the name comes from Section 401(k) of the Internal Revenue Code, this type of retirement savings plan was created by Ted Benna in 1979. At the time, he was a co-owner of The Johnson Companies, a small benefits consulting firm.²

3. a. \$1, \$20, \$100. The \$1 bill represents about 29% of the total paper currency in circulation. The \$20 bill represents about 22%, and the \$100 bill represents about 30%.³

4. d. More than 99%. Despite their size, small businesses are a big part of the U.S. economy. According to the U.S. Small Business Administration, small businesses (independent businesses with fewer than 500 employees) comprise 99.9% of all firms and account for 62% of net new jobs.⁴

5. b. President Lyndon B. Johnson. President Kennedy recommended creating a national health insurance program in 1961, but it was President Johnson who signed the Medicare bill into law on July 30, 1965. President Nixon extended Medicare eligibility to certain people under age 65 in 1972, and President Bush expanded Medicare to include prescription drug benefits in 2003.⁵

¹ NYSEData.com

² 401kbenna.com

³ Federal Reserve, Currency in Circulation: Volume, December 2017

⁴ U.S. Small Business Administration, August 2017

⁵ Centers for Medicare & Medicaid Services

Tax Benefits of Homeownership After Tax Reform



Recent tax reform legislation may have reduced the tax benefits of homeownership for some by (1) substantially increasing the standard deduction, (2) lowering the amount of mortgage debt on which interest is deductible, and (3) limiting the amount of state and local taxes that can be deducted. On the other hand, the tax benefits of homeownership may have increased for some because the overall limit on itemized deductions based on adjusted gross income has been suspended. You generally can choose between claiming the standard deduction or itemizing certain deductions (including the deductions for mortgage interest and state and local taxes). These changes are generally effective for 2018 to 2025.

Buying a home can be a major expenditure. Fortunately, federal tax benefits are still available, even after recent tax reform legislation, to help make homeownership more affordable. There may also be tax benefits under state law.

Mortgage interest deduction

One of the most important tax benefits of owning a home is that you may be able to deduct the mortgage interest you pay. If you itemize deductions on your federal income tax return, you can deduct the interest on a loan secured by your home and used to buy, build, or substantially improve your home. For loans incurred before December 16, 2017, up to \$1 million of such "home acquisition debt" (\$500,000 if married filing separately) qualifies for the interest deduction. For loans incurred after December 15, 2017, the limit is \$750,000 (\$375,000 if married filing separately).

This interest deduction is also still available for home equity loans or lines of credit used to buy, build, or substantially improve your home. [Prior to 2018, a separate deduction was available for interest on home equity loans or lines of credit of up to \$100,000 (\$50,000 if married filing separately) used for any other purpose.]

Deduction for real estate property taxes

If you itemize deductions on your federal income tax return, you can generally deduct real estate taxes you pay on property that you own. However, for 2018 to 2025, you can deduct a total of only \$10,000 (\$5,000 if married filing separately) of your state and local taxes each year (including income taxes and real estate taxes). For alternative minimum tax purposes, however, no deduction is allowed for state and local taxes, including property taxes.

Points and closing costs

When you take out a loan to buy a home, or when you refinance an existing loan on your home, you'll probably be charged closing costs. These may include points, as well as attorney's fees, recording fees, title search fees, appraisal fees, and loan or document preparation and processing fees. Points are typically charged to reduce the interest rate for the loan.

When you buy your main home, you may be able to deduct points in full in the year you pay them if you itemize deductions and meet certain requirements. You may even be able to deduct points that the seller pays for you.

Refinanced loans are treated differently. Generally, points that you pay on a refinanced loan are not deductible in full in the year you pay them. Instead, they're deducted ratably

over the life of the loan. In other words, you can deduct a certain portion of the points each year. If the loan is used to make improvements to your principal residence, however, you may be able to deduct the points in full in the year paid.

Otherwise, closing costs are nondeductible. But they can increase the tax basis of your home, which in turn can lower your taxable gain when you sell the property.

Home improvements

Home improvements (unless medically required) are nondeductible. Improvements, though, can increase the tax basis of your home, which in turn can lower your taxable gain when you sell the property.

Capital gain exclusion

If you sell your principal residence at a loss, you can't deduct the loss on your tax return. If you sell your principal residence at a gain, you may be able to exclude some or all of the gain from federal income tax.

Capital gain (or loss) on the sale of your principal residence equals the sale price of your home minus your adjusted basis in the property. Your adjusted basis is typically the cost of the property (i.e., what you paid for it initially) plus amounts paid for capital improvements.

If you meet all requirements, you can exclude from federal income tax up to \$250,000 (\$500,000 if you're married and file a joint return) of any capital gain that results from the sale of your principal residence. Anything over those limits may be subject to tax (at favorable long-term capital gains tax rates). In general, this exclusion can be used only once every two years. To qualify for the exclusion, you must have owned and used the home as your principal residence for a total of two out of the five years before the sale.

What if you fail to meet the two-out-of-five-year rule or you used the capital gain exclusion within the past two years with respect to a different principal residence? You may still be able to exclude part of your gain if your home sale was due to a change in place of employment, health reasons, or certain other unforeseen circumstances. In such a case, exclusion of the gain may be prorated.

Other considerations

It's important to note that special rules apply in a number of circumstances, including situations in which you maintain a home office for tax purposes or otherwise use your home for business or rental purposes.



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Protect Your Heirs by Naming a Trust as IRA Beneficiary



While trusts offer numerous advantages, they incur up-front costs and often have ongoing administrative fees. The use of trusts involves a complex web of tax rules and regulations. You should consider the counsel of an experienced estate planning professional and your legal and tax advisers before implementing such strategies.

Often, tax-qualified retirement accounts such as IRAs make up a significant part of one's estate. Naming beneficiaries of an IRA can be an important part of an estate plan. One option is designating a trust as the IRA beneficiary.

Caution: This discussion applies to traditional IRAs, not to Roth IRAs. Special considerations apply to beneficiary designations for Roth IRAs.

Why use a trust?

Here are the most common reasons for designating a trust as an IRA beneficiary:

- Generally, inherited IRAs are not protected from the IRA beneficiary's creditors. However, IRA funds left to a properly drafted trust may offer considerable protection against the creditors of trust beneficiaries.
- When you designate one or more individuals as beneficiary of your IRA, those beneficiaries are generally free to do whatever they want with the inherited IRA funds, after your death. But if you set up a trust for the benefit of your intended beneficiaries and name that trust as beneficiary of your IRA, you can retain some control over the funds after your death. Your intended beneficiaries will receive distributions according to your wishes as spelled out in the trust document.
- Through use of a trust as IRA beneficiary, you may "stretch" IRA payments over the lifetimes of more than one generation of beneficiaries. Payments to IRA trust beneficiaries must comply with distribution rules depending on the type of IRA plan.

What is a trust?

A trust is a legal entity that you can set up and use to hold property for the benefit of one or more individuals (the trust beneficiaries). Every trust has one or more trustees charged with the responsibility of managing the trust property and distributing trust income and/or principal to the trust beneficiaries according to the terms of the trust agreement. If the trust meets certain requirements, the beneficiaries of the trust can be treated as the designated beneficiaries of your IRA for purposes of calculating the distributions that must be taken following your death.

Special rules apply to trusts as IRA beneficiaries

Certain special requirements must be met in order for an underlying beneficiary of a trust to qualify as a designated beneficiary of an IRA. The beneficiaries of a trust can be designated beneficiaries under the IRS distribution rules only if the following four trust requirements are

met in a timely manner:

- The trust beneficiaries must be individuals clearly identifiable from the trust document as designated beneficiaries as of September 30 following the year of the IRA owner's death.
- The trust must be valid under state law. A trust that would be valid under state law, except for the fact that the trust lacks a trust "corpus" or principal, will qualify.
- The trust must be irrevocable, or by its terms become irrevocable upon the death of the IRA owner.
- The trust document, all amendments, and the list of trust beneficiaries must be provided to the IRA custodian or plan administrator by October 31 following the year of the IRA owner's death. An exception to this rule arises when the sole trust beneficiary is the IRA owner's surviving spouse who is 10 years younger than the IRA owner, and the IRA owner wants to base lifetime required minimum distributions (RMDs) on joint and survivor life expectancy. In this case, trust documentation should be provided before lifetime RMDs begin.

Note: Withdrawals from tax-deferred retirement plans are taxed as ordinary income and may be subject to a 10% federal income tax penalty if withdrawn by the IRA owner prior to age 59½, with certain exceptions as outlined by the IRS.

Disadvantages of naming a trust as IRA beneficiary

If you name your surviving spouse as the trust beneficiary of your IRA rather than naming your spouse as a direct beneficiary, certain post-death options that would otherwise be available to your spouse may be limited or unavailable. Naming your spouse as primary beneficiary of your IRA provides greater options and maximum flexibility in terms of post-death distribution planning.

Setting up a trust can be expensive, and maintaining it from year to year can be burdensome and complicated. So the cost of establishing the trust and the effort involved in properly administering the trust should be weighed against the perceived advantages of using a trust as an IRA beneficiary. In addition, if the trust is not properly drafted, you may be treated as if you died without a designated beneficiary for your IRA. That would likely shorten the payout period for required post-death distributions.



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What are the gift and estate tax rules after tax reform?

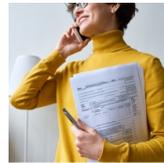
The Tax Cuts and Jobs Act, signed into law in December 2017, approximately doubled the federal gift and estate tax basic exclusion amount to

\$11.18 million in 2018 (adjusted for inflation in later years). After 2025, the exclusion is scheduled to revert to its pre-2018 level and be cut approximately in half. Otherwise, federal gift and estate taxes remain the same.

Gift tax. Gifts you make during your lifetime may be subject to federal gift tax. Not all gifts are subject to the tax, however. You can make annual tax-free gifts of up to \$15,000 per recipient. Married couples can effectively make annual tax-free gifts of up to \$30,000 per recipient. You can also make unlimited tax-free gifts for qualifying expenses paid directly to educational or medical service providers. And you can make deductible transfers to your spouse and to charity. There is a basic exclusion amount that protects a total of up to \$11.18 million (in 2018) from gift tax and estate tax. Transfers in excess of the basic exclusion amount are generally taxed at 40%.

Estate tax. Property you own at death is subject to federal estate tax. As with the gift tax, you can make deductible transfers to your spouse and to charity; there is a basic exclusion amount that protects up to \$11.18 million (in 2018) from tax, and a tax rate of 40% generally applies to transfers in excess of the basic exclusion amount.

Portability. The estate of a deceased spouse can elect to transfer any unused applicable exclusion amount to his or her surviving spouse (a concept referred to as portability). The surviving spouse can use the unused exclusion of the deceased spouse, along with the surviving spouse's own basic exclusion amount, for federal gift and estate tax purposes. For example, if a spouse died in 2011 and the estate elected to transfer \$5 million of the unused exclusion to the surviving spouse, the surviving spouse effectively has an applicable exclusion amount of \$16.18 million (\$5 million plus \$11.18 million) to shelter transfers from federal gift or estate tax in 2018.



What is the difference between a tax deduction and a tax credit?

Tax deductions and credits are terms often used together when talking about taxes.

While you probably know that they can lower your tax liability, you might wonder about the difference between the two.

A tax deduction reduces your taxable income, so when you calculate your tax liability, you're doing so against a lower amount. Essentially, your tax obligation is reduced by an amount equal to your deductions multiplied by your marginal tax rate. For example, if you're in the 22% tax bracket and have \$1,000 in tax deductions, your tax liability will be reduced by \$220 ($\$1,000 \times 0.22 = \220). The reduction would be even greater if you are in a higher tax bracket.

A tax credit, on the other hand, is a dollar-for-dollar reduction of your tax liability. Generally, after you've calculated your federal taxable income and determined how much tax you owe, you subtract the amount of any tax credit for which you are eligible from your tax obligation. For example, a \$500 tax credit will reduce your tax liability by \$500, regardless of your tax bracket.

The Tax Cuts and Jobs Act, signed into law late last year, made significant changes to the individual tax landscape, including changes to several tax deductions and credits.

The legislation roughly doubled existing standard deduction amounts and repealed the deduction for personal exemptions. The higher standard deduction amounts will generally mean that fewer taxpayers will itemize deductions going forward.

The law also made changes to a number of other deductions, such as those for state and local property taxes, home mortgage interest, medical expenses, and charitable contributions.

As for tax credits, the law doubled the child tax credit from \$1,000 to \$2,000 for each qualifying child under the age of 17. In addition, it created a new \$500 nonrefundable credit available for qualifying dependents who are not qualifying children under age 17. The tax law provisions expire after 2025.

For more information on the various tax deductions and credits that are available to you, visit [irs.gov](https://www.irs.gov).



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