HUGHES FINANCIAL SERVICES, LLC

Taximpact

FEBRUARY 2019

in this issue

- TAX CUTS & JOBS ACT LAWS
- 2018 TAX RATE SCHEDULES
- PROACTIVE TAX PLANNING STRATEGIES FOR 2019

Hughes Financial Services, LLC, is an independent Registered Investment Adviser that works closely with individuals and families, helping them to accomplish their unique financial goals and objectives through the allocation of their assets.

We are a fee-based firm that seeks to adhere to the highest fiduciary standards and provide clients with advice that is truly unbiased and has only our clients' best interests in mind.

We offer clients a wealth of comprehensive financial planning expertise in:

- retirement planning
- estate planning
- investment management
- risk management
- tax planning
- education planning

Our advisers hold a variety of professional designations and certifications and are well-versed in a number of financial disciplines. Our combined education and experience allows us to proudly offer you independent financial advice you can trust.

Tax Planning & Tax Risk Management

FILING FOR 2018, PLANNING FOR 2019

The beginning of tax season 2019 was initially in question due to the government shutdown. On January 7th, the Internal Revenue Service (IRS) assured taxpayers they would indeed begin processing tax returns on January 28, 2019. The deadline to file your 2018 tax returns is Monday, April 15th for most U.S. taxpayers (those who live in Maine or Massachusetts have until April 17th to file due to Patriots' Day holiday falling on April 15th and Emancipation Day on April 16th for residents of the District of Columbia).

IRS Commissioner Chuck Rettig said that, despite the government shutdown, **"IRS employees have been hard at work over the past year to implement the biggest tax law changes the nation has seen in more than 30 years."** The IRS recalled furloughed employees to assist in processing tax returns.

Even after the shutdown, one thing that you can always count on is tax season. This year's tax season brings major adjustments for the IRS, taxpayers and tax preparers alike due to the tax law changes and new Form 1040 required to adhere to the rules created by the Tax Cuts and Jobs Act (TCJA).

At Hughes Financial Services, we strongly believe tax planning should always be an essential focus when reviewing your personal financial situation. This report reviews some of the broader changes coming from the Tax Cuts & Jobs Act along with a wide range of tax reduction strategies.

Our goal as financial advisers is to try to point out as many tax savings opportunities and strategies as possible.

We always recommend addressing any strategy with a tax professional to consider how one strategy may affect another and calculate both state and federal income tax consequences. Tax strategies and ideas that have worked in the past might not work now or even be available under today's tax laws.

As you read along, note each tax strategy you think could be beneficial but keep in mind that not all ideas are appropriate for everyone. Always attempt to understand the details before making any decisions — it's always easier to avoid a problem than it is to solve one!

TAX ALERT: Your state income tax laws could be different from federal income tax laws. To view a wide range of tax info and access links to tax forms for all 50 states, go to www.tax.findlaw.com.

2018 TAX RATES & INCOME BRACKETS

There are seven federal income tax brackets in place for 2018. The lowest of the seven tax rates is 10%, while the top tax rate is now 37%. The income that falls into each bracket is scheduled to be adjusted each year for inflation. For 2018, see the charts below to see which bracket you fall into.

TAX TIP: ***Not sure how to file? Ask your tax preparer or review IRS Publication 17, Your Federal Income Tax, which is a complete tax resource.*** It contains helpful information such as whether you need to file a tax return and how to choose your filing status.

2018 TAX TABLES: SINGLE FILERS	
Not over $9,525	10% of taxable income
$9,526 – 38,700	$925.50 + 12% of excess over $9,525
$38,701 – 82,500	$4,453.50 + 22% of excess over $38,700
$82,501 – 157,500	$14,089.50 + 24% of excess over $82,500
$157,501 – 200,000	$32,089.50 + 32% of excess over $157,500
$200,001 – 500,000	$45,689.50 + 35% of excess over $200,000
$500,001 +	$150,689.50 + 37% of excess over $500,000

2018 TAX TABLES: MARRIED FILING JOINTLY	
Not over $19,050	10% of taxable income
$19,051 – 77,400	$1,905 + 12% of excess over $19,050
$77,401 – 165,000	$8,907 + 22% of excess over $77,400
$165,001 – 315,000	$28,179 + 24% of excess over $165,000
$315,001 – 400,000	$64,179 + 32% of excess over $315,000
$400,001 – 600,000	$91,379 + 35% of excess over $400,000
$600,001 +	$161,379 + 37% of excess over $600,000

2018 TAX TABLES: MARRIED FILING SEPARATELY	
Not over $9,525	10% of taxable income
$9,526 – 38,700	$952.50 + 12% of excess over $9,525
$38,701 – 82,500	$4,453.50 + 22% of excess over $38,700
$82,501 – 157,500	$14,089.50 + 24% of excess over $82,500
$157,501 – 200,000	$32,089.50 + 32% of excess over $157,500
$200,001 – 300,000	$45,689.50 + 35% of excess over $200,000
$300,001 +	$80,689.50 + 37% of excess over $300,000

2018 TAX TABLES: HEAD OF HOUSEHOLD	
Not over $13,600	10% of taxable income
$13,601 – 51,800	$1,360 + 12% of excess over $13,600
$51,801 – 82,500	$5,944 + 22% of excess over $51,800
$82,501 – 157,500	$12,698 + 24% of excess over $82,500
$157,501 – 200,000	$30,698 + 32% of excess over $157,500
$200,001 – 500,000	$44,298 + 35% of excess over $200,000
$500,001 +	$149,298 + 37% of excess over $500,000

TAX CUTS & JOBS ACT :UPDATES

Bye-bye Forms 1040A and 1040EZ! For your 2018 tax returns, Form 1040 has been completely redesigned and is now being supplemented with new Schedules 1 through 6. While many taxpayers can file Form 1040 by itself, these additional schedules will be used as needed to complete more complex tax returns. Here are some additional items that 2018 tax filers should review before submitting your returns:

- Tax brackets have been adjusted
- The standard deduction has increased
- The Child Tax Credit has increased
- Some deductions and exemptions are gone
- There are changes to state and local tax (SALT) deductions
- There are new deduction rates for medical expenses
- Capital gains will still impact your income
- There is still a 3.8% Medicare Investment Tax
- Charitable donations are still deductible
- You might still be able to contribute to retirement plans (or take an RMD) if appropriate

NEW TAX LAW DEDUCTION CHANGES

Some deductions and exemptions that were allowed in previous years are now eliminated. In the past, those who used a standard deduction could also include a personal exemption if they were not a dependent. That personal exemption is no longer an option. Also, deductions for interest on home mortgages have been reduced and interest from home equity loans eliminated.

There are also changes to state and local tax deductions. Under the new law, a taxpayer's state and local tax (SALT) deduction is limited to $10,000. This includes both state income and property taxes. This change will have the most impact on taxpayers who live in states with high property taxes and those who pay larger state income tax bills.

If you’re looking to move after you retire, there are several tax articles that suggest it may be more beneficial to move to a tax-friendly state with lower property taxes to reduce your tax liabilities.

2018 STANDARD DEDUCTION AMOUNTS

Most taxpayers claim the standard deduction. For 2018, the standard deduction has almost doubled in size for all filers. Previously set at $6,350 for single tax filers and $12,700 for joint filers, the amounts are now $12,000 for single filers and $24,000 for those filing jointly ($18,000 for head of household filers). If you are filing as a married couple, an additional $1,300 is added to the standard deduction for each person age 65 and older. If you are single and age 65 or older, an additional deduction of $1,600 can be made.

MEDICARE TAXES

3.8% MEDICARE INVESTMENT TAX

This is the sixth year of the net investment income tax of 3.8%, also known as the Medicare surtax. If you earn more than $200,000 as a single or head of household taxpayer, $125,000 as married taxpayers filing separately, or $250,000 as married joint return filers, then this tax applies to either your modified adjusted gross income or net investment income (including interest, dividends, capital gains, rentals, and royalty income), whichever is lower. This 3.8% tax is in addition to capital gains or any other tax you already pay on investment income.

A helpful strategy has been to pay attention to timing, especially if your income fluctuates from year to year or is close to the $200,000 or $250,000 amount. Consider realizing capital gains in years when you are under these limits. The inclusion limits may penalize married couples, so realizing investment gains before you tie the knot may help in some circumstances. This tax makes the use of depreciation, installment sales, and other tax deferment strategies suddenly more attractive.

MEDICARE HEALTH INSURANCE TAX ON WAGES

If you earn more than $200,000 in wages, compensation, and self-employment income ($250,000 if filing jointly, or $125,000 if married and filing separately), the Affordable Care Act also levies a special 0.9% tax on your wages and other earned income. You'll pay this all year long as your employer withholds the additional Medicare Tax from your paycheck. If you're self-employed, be sure to plan for this tax when you calculate your estimated taxes.

If you're employed, there's little you can do to reduce the bite of this tax. Requesting non-cash benefits in lieu of wages won't help — they're included in the taxable amount. If you're self-employed, you may want to take care in timing income and expenses (especially depreciation) to avoid the limit.

CONTRIBUTE TO RETIREMENT ACCOUNTS

IF YOU HAVEN'T ALREADY FUNDED YOUR RETIREMENT ACCOUNT FOR 2018, CONSIDER DOING SO BY APRIL 15, 2019. THIS IS THE DEADLINE FOR TRADITIONAL IRA (DEDUCTIBLE OR NOT) AND ROTH IRA CONTRIBUTIONS.

However, if you have a Keogh or SEP and you get a filing extension to October 15, 2019, you can wait until then to put 2018 contributions into those accounts. To start tax-free compounding as quickly as possible, however, try not to delay in making contributions. Making a deductible contribution will help you lower your tax bill for 2018 and your contributions will compound tax-deferred.

To qualify for the full annual IRA deduction in 2018, you must either: 1) not be eligible to participate in a company retirement plan, or 2) if you are eligible, you must have an adjusted gross income of $63,000 - $73,000 for singles, and from $101,000 - $121,000 for married couples filing jointly. If you are not eligible for a company plan but your spouse is, your traditional IRA contribution is fully deductible if your combined gross income does not exceed $186,000. For 2018, the maximum IRA contribution you can make is $5,500 ($6,500 if you are age 50 or older by the end of the year). For the self-employed, the maximum annual addition to SEPs and Keoghs for 2018 is $55,000.

LIMIT TYPE	2018 LIMIT
Elective deferrals to 401(k), 403(b), 457(b)(2), 457(c)(1)	$18,500
Contributions to defined contribution plans	$55,000
Contributions to SIMPLEs	$12,500
Contributions to traditional IRAs	$5,500
Catch-up contributions to 401(k), 403(b), 457(b)(2), 457(c)(1)	$6,000
Catch-up contributions to SIMPLEs	$3,000
Catch-up contributions to IRAs	$1,000

Although choosing to contribute to a Roth IRA instead of a traditional IRA will not reduce your 2018 tax bill (Roth contributions are not deductible), it could be the better choice because all withdrawals from a Roth can be tax-free in retirement. Withdrawals from a traditional IRA are fully taxable in retirement. To contribute the full $5,500 ($6,500 if you are age 50 or older by the end of 2018) to a Roth IRA, you must earn $120,000 or less a year if you are single or $189,000 if you're married and file a joint return.

The amount you save from making a contribution will vary. If you are in the 22% tax bracket and make a deductible IRA contribution of $5,500, you will save $1,210 in taxes the first year. Over time, future contributions could save you thousands, depending on your contribution, income tax bracket and the number of years you keep the money invested.

If you have any questions on retirement contributions, please call us.

CAPITAL GAINS & LOSSES

WITH DIFFERENT TAX RATES FOR DIFFERENT TYPES OF GAINS AND LOSSES IN YOUR MARKETABLE SECURITIES PORTFOLIO, IT'S A GOOD IDEA TO FAMILIARIZE YOURSELF WITH SOME OF THE RULES.

- Short-term capital losses must first be used to offset short-term capital gains.
- If there are net short-term losses, they can be used to offset net long-term capital gains.
- Long-term capital losses are similarly first applied against long-term capital gains, with any excess applied against short-term capital gains.
- Net long-term capital losses in any rate category are first applied against the highest tax rate long-term capital gains.
- Capital losses that are more than your capital gains can be used to offset up to $3,000 of ordinary income.
- Any remaining unused capital losses can be carried forward and used in the same manner as described above.

TAX TIP: Please remember to look at your 2017 income tax return Schedule D (page 2) to see if you have any capital loss carryover for 2018. This is often overlooked, especially if you are changing tax preparers.

ALWAYS DOUBLE-CHECK YOUR CAPITAL GAINS OR LOSSES. If you sold an asset outside of a qualified account during 2018, you most likely incurred a capital gain or loss. Sales of securities showing the transaction date and sale price are listed on the 1099 generated by the financial institution. However, your 1099 might not show the correct cost basis or realized gain or loss for each sale. You will need to know the full cost basis for each investment sold outside of your qualified accounts, which is usually what you paid for it, but is not always the case.

REQUIRED MINIMUM DISTRIBUTIONS (RMDs)

IF YOU TURNED AGE 70½ DURING 2018, YOU STILL HAVE UNTIL APRIL 1, 2019, TO TAKE OUT YOUR FIRST RMD.

This is a one-time opportunity in case you forgot the first time. The deadline for taking out your RMD in the future will be December 31st of each year. If you do not pay out your RMD by this deadline, you may be subject to a 50% penalty on the amount you were supposed to take out.

TAX TIP: You usually do not have to take out an RMD from your current employer's retirement account as long as you work there and don't own more than 5% of the company. See your plan administrator if you have any questions.

IF YOU HAVE ANY QUESTIONS ABOUT YOUR RMDs, PLEASE CALL US.

INHERITED IRAS

Be careful if you inherit a retirement account from a loved one. In many cases, a decedent's largest asset in their estate is a retirement account. Tax laws for inherited retirement accounts are very complicated, and you must carefully adhere to the requirements to avoid any unnecessary income taxes and penalties. Contact us before receiving any distributions from a retirement account you inherit. Remember – it's easier to avoid a problem than it is to solve one!

- **Inherited retirement accounts, such as an IRA or other qualified plan, are usually 100% taxable upon receipt**
- **No step-up in basis on investments within retirement accounts**
- **Non-spouse beneficiaries usually cannot rollover an inherited IRA to their own IRA; establish an Inherited IRA ("stretch" IRA) instead**
- **Non-spouse beneficiaries of any age can start Required Minimum Distributions (RMDs) the year following the year the owner died and stretch them out over their own lifespan**
- **Stretch IRAs reduce income taxes significantly compared to having all the IRA taxed in one year**
- **It is very important to take the RMD from an inherited IRA each year as penalties for not doing so are very severe – 50% of the amount you did not take**

CHILD AND DEPENDENT CARE CREDIT

Many parents claim the child and dependent care credit each year to help cover the costs of after-school daycare while working yet overlook claiming child care costs during the summer. The key for this deduction is that the camp can only be a day camp, not an overnight camp.

So, if you paid a daycare center, babysitter, summer camp or other care provider to care for a qualifying child under age 13 or a disabled dependent of any age, you may qualify for a tax credit of up to 35% of qualifying expenses of $3,000 for one child or dependent, or up to $6,000 for two or more children.

CHARITABLE GIFTS AND DONATIONS

When preparing your list of charitable gifts, remember to review your checkbook register so you don't leave any out. Make it a priority to always get a receipt for every gift and keep these in a safe place. If your contribution totals more than $250, you'll also need an acknowledgement from the charity documenting the support you provided. Remember that you'll have to itemize to claim charitable deductions, but when filing, the expenses incurred while doing charitable work is often not included on tax returns.

Everyone remembers to count the monetary gifts they make to their favorite charities, but you should count non-cash donations as well. You can't deduct the value of your time spent volunteering, but if you buy supplies for a group, the cost of that material is deductible as an itemized charitable donation. You can also claim a charitable deduction for the use of your vehicle for charitable purposes, such as delivering meals to the homebound in your community or taking your child's Scout troop on an outing. For 2018, the IRS will let you deduct that travel at .14 cents per mile.

INCREASED CHILD TAX CREDIT

For 2018, the maximum child tax credit has doubled to $2,000 per qualifying child, of which $1,400 (up from $1,100) can be claimed for the additional child tax credit. The TCJA also adds a new, non-refundable credit of $500 for dependents other than children. The modified adjusted gross income threshold at which the credit begins to phase out has increased to $200,000 (previously $110,000) for single filers and $400,000 if married filing jointly.

MEDICAL EXPENSE DEDUCTION

The TCJA retroactively made the 7.5% threshold available to any individual taxpayer regardless of age for 2017 and it stays there for 2018. The 10% threshold amount will return in 2019. The tax penalty for not having health insurance after 12/31/18 was also eliminated.

TAX TIP: For 2018, taxpayers can deduct medical expenses that are over 7.5% of their adjusted gross income as opposed to the higher 10% that will return next year.

ROTH IRA CONVERSIONS

A ROTH IRA CONVERSION IS WHEN YOU CONVERT PART OR ALL OF YOUR TRADITIONAL IRA INTO A ROTH IRA. THIS IS A TAXABLE EVENT.

The amount you convert is subject to ordinary income tax. It might also cause your income to increase, thereby subjecting you to the Medicare surtax. However, Roth IRAs grow tax-free and withdrawals are tax-free in the future, a time when tax rates might be higher.

Whether to convert part or all of your traditional IRA to a Roth IRA depends on your situation. It's best to prepare a tax projection and calculate the appropriate amount to convert. Roth IRA conversions are not subject to the pre-age 59½ penalty of 10%.

Many 401(k) plan participants can convert the pre-tax money in their 401(k) plan to a Roth 401(k) plan without leaving the job or reaching age 59½. There are several pros and cons to consider before making this change. **Please call us to see if this makes sense for you.**

DON'T OVERLOOK THESE TAX-SAVING STRATEGIES!

▶ **REINVESTED DIVIDENDS**

This isn't a tax deduction but can save investors a bundle. For an article on overlooked deductions, former IRS commissioner Fred Goldberg told *Kiplinger* magazine that missing this tax break costs taxpayers a lot in overpaid taxes.

Mutual fund dividends can be automatically used to buy extra shares. Each reinvestment increases your tax basis in that fund, which in turn will reduce the taxable capital gain (or increases the tax-saving loss) when you redeem shares. Please keep good records. Forgetting to include reinvested dividends in your basis can result in double taxation of the dividends — once in the year when they were paid out and immediately reinvested and later, when they're included in the proceeds of the sale.

Don't make that costly mistake. **If you're not sure what your basis is, ask the fund or us for help.** Funds often report to investors the tax basis of shares redeemed during the year. Regulators currently require that for the sale of shares purchased, financial institutions must report the basis to investors and the IRS.

▶ **STUDENT LOAN INTEREST PAID BY PARENTS**

Generally, you can deduct interest only if you are legally required to repay the debt. But if parents pay back a child's student loans, the IRS treats the transactions as if the money were given to the child, who then paid the debt. If the child is no longer claimed as a dependent, he or she can deduct up to $2,500 of student-loan interest paid by their parents each year. (Parents can't claim the interest deduction even though they foot the bill because they are not legally liable for the debt.)

▶ **CHARITABLE GIFT MADE FROM IRA**

Individuals at least 70½ years of age can exclude from their gross income qualified charitable distributions from IRAs of up to $100,000 per year. Remember to double check on what counts as a qualified charity distribution before using this tax strategy.

▶ **DON'T FORGET DEDUCTIONS CARRIED OVER FROM PRIOR YEARS** because you exceeded annual limits, such as capital losses, passive losses, charitable contributions and alternative minimum tax credits.

▶ **CHECK YOUR 2017 TAX RETURN** to see if there was a refund from 2017 applied to your 2018 estimated taxes.

▶ **DON'T OVERPAY SOCIAL SECURITY TAXES.** If you received a paycheck from two or more employers and earned more than $128,400 in 2018, you may be able to file a claim on your return for the excess Social Security tax withholding.

▶ **CALCULATE 2019 ESTIMATED TAX PAYMENTS VERY CAREFULLY.** Most computer tax programs automatically assume your income tax liability for the current year is the same as the prior year. This is done in order to avoid paying penalties for underpayment of estimated income taxes. However, in many cases this is not a correct assumption, especially if 2018 was an unusual income tax year due to the sale of a business, unusual capital gains, exercise of stock options, or even winning Powerball!

▶ **DOUBLE CHECK YOUR MATH** where possible and consult a tax preparer before filing.

USE IRS.GOV AS AN ONLINE RESOURCE FOR TAX INFORMATION AND DETAILS

INVESTMENT INCOME

PEOPLE WHO HAD ENOUGH 2018 INCOME TO PAY TAXES AT THE 37% RATE WILL PAY 20% ON NET LONG-TERM CAPITAL GAINS AND QUALIFIED DIVIDENDS.

Long-term capital gains are taxed at more favorable rates compared to ordinary income. One tax strategy is to review investments that have unrealized long-term capital gains and sell enough of the appreciated investments to generate enough long-term capital gains to push you to the top of your federal income tax bracket. This strategy could be helpful if you are in the 0% capital gains bracket and do not have to pay any federal taxes on this gain. Then, you can buy back your investment on the same day, increasing your cost-basis in those investments. If you sell them in the future, the increased cost-basis will help reduce long-term capital gains. You do not have to wait 30 days before you buy back this investment — the 30-day rule only applies to losses.

Note: this non-taxable capital gain for federal income taxes might not apply to your state.

FINAL THOUGHTS

With the passage of the Tax Cuts and Jobs Act, tax brackets, thresholds, and rates changed for many taxpayers in 2018. An essential part of maintaining your overall financial health is trying to keep your tax liability to a minimum. Managing wealth involves careful planning and keeping abreast of any changes that affect investors. We will keep you updated throughout the year on potential tax saving strategies that could be helpful to you. We believe that taking a proactive approach is better than a reactive approach — especially regarding income tax strategies! Remember — if you ever have any questions regarding your investments, please be sure to call us first before making any decisions. We are here to be of service to you and have found that often, there is a simple solution to your question or concern.

PROACTIVE TAX PLANNING STRATEGIES FOR 2019

- **Prepare a 2019 Tax Projection:** Taxpayers already know the 2019 rates and by reviewing their 2018 situation and all 2019 expectations of income, a qualified tax preparer could help you with a tax projection for 2019.
- **New Contribution Limits for Retirement Savings:** For 2019, the contribution limit for employees with 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan increased to $19,000. The limit on annual IRA contributions, last increased in 2013, is up from $5,500 to $6,000. The catch-up contribution limits for those age 50 and over remain unchanged.
- **A Roth IRA Conversion can be Helpful:** A Roth IRA can be beneficial in your overall retirement planning. Investments in a Roth IRA potentially grow tax-free and don't have required minimum distributions during the lifetime of the original owner. Also, Roth IRA assets may pass to your heirs tax-free. Roth conversions are complex and not right for everyone, so please call us to see if this makes sense for your situation.
- **Take Advantage of Annual Exclusion Gifts:** For 2019, the maximum amount of gift tax exemption is $15,000. This means you can give up to that amount to a family member without having to pay a gift tax. Ideas for gifting can include contributing to a working child's (or grandchild's) IRA, or gifting to a 529 plan, which is a tax-sheltered plan for educational expenses.
- **Bunch your Charitable Donations into a Donor Advised Fund (DAF):** Now is the time to explore if it's helpful to your tax situation to deposit cash, appreciated securities or other assets into a Donor Advised Fund and then distribute the money to charities over time. Up to 50% of your adjusted gross income can be deductible if given as donations to typical charities.
- **Look into Health Savings Accounts (HSAs):** In general, to qualify to contribute to a health savings account in 2019, you must have a health insurance policy with a deductible of at least $1,350 for single coverage or $2,700 for family coverage. You can contribute up to $3,500 to an HSA if you have single coverage or up to $7,000 for family coverage in 2019, which is slightly more than the 2018 limits. If you're 55 or older anytime in 2019, you'll be able to contribute an extra $1,000. HSA's can be complex and are not right for everyone, so please call us to explore whether this is a strategy you should use.

2019 TAX BRACKETS: SINGLE FILERS	
10%	$0 – 9,700
12%	$9,701 – 39,475
22%	$39,476 – 84,200
24%	$84,201 – 160,725
32%	$160,726 – 204,100
35%	$204,101 – 510,300
37%	$510,301 +
STANDARD DEDUCTION: $12,200	

2019 TAX BRACKETS: MARRIED FILING JOINTLY	
10%	$0 – 19,400
12%	$19,401 – 78,950
22%	$78,951 – 168,400
24%	$168,401 – 321,450
32%	$321,451 – 408,200
35%	$408,201 – 612,350
37%	$612,351 +
STANDARD DEDUCTION: $24,400	

2201 Cooperative Way, Suite 150 | Herndon, Virgina 20171 | (703) 669-3660 | F (703) 880-4905 | www.h4fs.com