FOUR WAYS TO MINIMIZE THE NEW SALT LIMITATIONS

State and local taxes have been fully deductible on federal income taxes for over a century. Under the Tax Cuts & Jobs Act (TCJA), that deduction is now limited to $10K. This is a particular problem for those who live in high-tax states. Here's how to cope.

Since the original passage of the income tax in 1913, taxpayers have been allowed to deduct unlimited state and local taxes (SALT), which included sales tax, state income tax and property taxes. Before the TCJA went into effect, homeowners in higher-taxed states were able to deduct state income taxes and property taxes, reducing their tax burden up to 25%. Deductions for SALT have previously been unlimited, which helped to alleviate tax burdens for many property owners and residents of high-tax states or states with a higher cost of living.

The new tax act caps the SALT deduction at $10,000 per year, per return, causing significant frustration for many residents of these high-tax states. Due to the $10,000 limitation, the TCJA has effectively limited the subsidy to those living in higher-tax states. Understanding how this can impact your tax situation is very important.

Furthermore, the SALT limitation disproportionately impacts married couples and is especially so for those who file jointly. Remember, the cap remains at $10,000 per return and not per individual. For married couples who file separately, the allowed deduction must be split between them at $5,000 per individual.

While the SALT limitation can be a significant financial burden to couples, the tax act does provide some relief to families in the form of lower and expanded tax brackets, as well as a generous child tax credit for families with Adjusted Gross Incomes (AGI) up to $400,000.

LOCATION, LOCATION, LOCATION

Seven states account for more than half the value of the SALT deductions: New Jersey, New York, Connecticut, Maryland, Massachusetts, Illinois and California. Of the 50 states, these states charge the highest property taxes and SALT deductions taken by their residents are typically highest as a percentage of income. According to the *New York Times*, New Jersey has the highest property rate in the nation, coming in at 2.40% in 2018, while Connecticut is in the top five at 2.02%. In comparison, Hawaii has the lowest at 0.27%, followed by Alabama at 0.43% and Louisiana at 0.51%.

Any fight to defeat this imposed limitation will be an uphill battle for the governors of these states. Talk about ways to work around the limitation are likely to be unsuccessful as the legalities behind such strategies are uncertain and should not be relied upon.

In fact, the IRS served notice (2018-54) stating, "despite these state efforts to circumvent the new statutory limitation on state and local tax deductions, taxpayers should be mindful that federal law controls the proper characterization of payments for federal income tax purposes."

FOUR WAYS TO COMBAT THE SALT RESTRICTIONS
Given these unwelcome tax restraints, here are four workarounds that may work for your personal situation. As always, you should consult with a tax professional before using any of these strategies.

1. Bunching Works
If you are unable to take the full SALT deduction, consider strategically using other potential deductions, including the reliable method of bunching. This method lumps together two years of charitable (and other) deductions into one single tax year. You can take the standard deduction one year and itemize the following year to make up for some of the lost itemized deductions.

By using this option, you could prepay your mortgage, pay elective medical expenses, pay real estate taxes, and fund your charitable contributions all in one year, and then take the standard deductions the following year. By purposefully planning the timing of your charitable contributions, you may be able to receive a greater tax benefit for the same dollar amount of contributions.

Increase Deductions by Bunching Over Two Years				
	No Bunching (Old Way)		Bunching (New Way)	
	Year 1	Year 2	Year 1	Year 2
Deductions	8,000	8,000	8,000	8,000
Charity	6,000	6,000	0	12,000
Itemize	14,000	14,000	0	20,000
Standard Deduction	12,000	12,000	12,000	12,000
Total Two-Year Deduction	$28,000		$32,000	

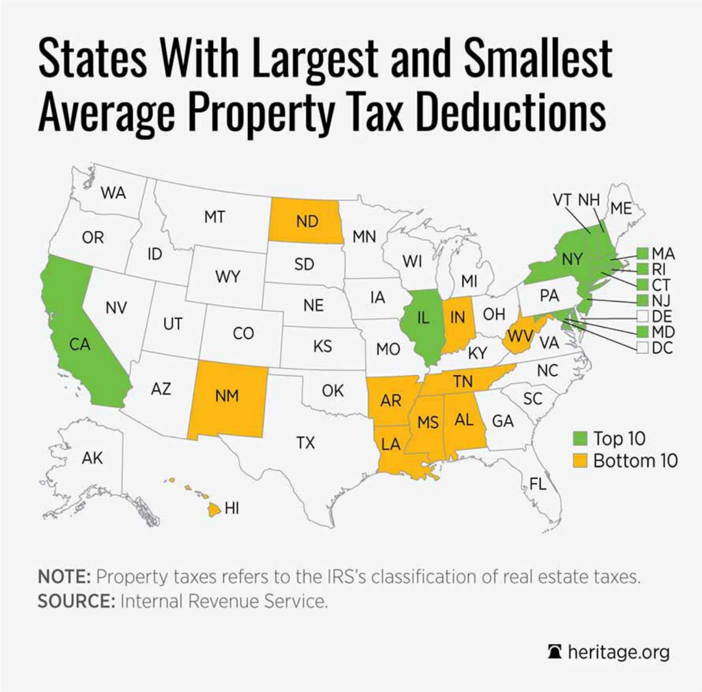
2. Open a Donor-Advised Fund
DAF funds can help you make multiple years' worth of charitable gifts in one tax year, while distributing the gifts later. You can receive an immediate tax deduction when you open and fund the account, despite the gifts being allocated later. This is a win and can be used to offset the loss of SALT deductions.

3. Qualified Charitable Distributions
QCDs are a great option for those age 70½ and older. If you are the owner of an IRA (or beneficiary) over age 70½, a Qualified Charitable Distribution up to $100,000 could be another beneficial way to offset the loss of SALT deductions and reduce your taxable income. The QCD satisfies the Required Minimum Distribution (RMD) and lowers your taxable income, making sense for those who are in a higher tax bracket. You could benefit even further if your spouse is also eligible to use their IRA for the QCD.

Although a deduction for the contribution is not permitted, the transferred amount from the IRA to the charity is excluded from taxable income. This can be most beneficial when looking to avoid Medicare premium surcharges among other things.

4. Should I Stay, or Should I Go?
Relocating or downsizing may need to be considered, especially if you work remotely or are nearing retirement. Some residents of these higher tax states are considering relocation to more tax-friendly states such as Florida, Arizona, South Carolina and Delaware. Yet relocating won't always solve the issue since states with lower property taxes often have higher taxes or costs in

other areas. For instance, Florida's homeowner insurance costs are considerably more, decreasing the benefit received from the lower SALT taxes.



Another option is to simply downsize. A smaller home can help you reduce your personal costs significantly, reduce property taxes, mortgage payments and lower utilities and maintenance expenses. There are typically no hitches to this strategy while relocation could create a bit of turmoil.

FIVE STAR TIP: RELOCATION MUST BE REAL

If you're curious about the relocation strategy, you should be aware that buying a vacation home in a tax-friendly state such as Florida, staying there for a month and claiming it's your primary residence won't work. Relocators will need to show that they have genuinely and fully moved their lives to the new state. State-appointed auditors will go to great lengths to disprove claims of a new home, especially if that new home is conveniently located in a state with low- or no-income taxes.

For instance, Bloomberg has reported that New York's Department of Taxation and Finance is very invested in keeping their wealthy residents paying taxes in New York. The state will go to extreme lengths to determine if a taxpayer has truly moved their main residency or is just trying to dodge the state for the tax savings.

Auditors will test New York residents looking for an out by using a domicile test based on five factors:

1. Other residences owned
2. Where the taxpayer spends most of their time
3. Where their treasured items are kept
4. Where their business is conducted
5. The location of the taxpayer's family

New York residents will also need to meet the "183-day rule" if they plan on moving but keeping a residence in New York state. They must prove they haven't spent more than 183 days per year in New York, and any day where there is no proof can be counted as a day in-state. Even entering the state's boundaries for one hour can make the day count as an in-state day.

State auditors are willing to go after taxpayers by issuing subpoenas for credit card statements, using phone records to track the taxpayer's location, and even confirming where they go for doctor's appointments. So please keep in mind that although a relocation may be a strategic tool for you to use, you need to be legitimately ready and willing to make the move.

WHAT'S NEXT

Although the SALT cap is burdensome, through strategic financial planning, bunching and create charitable giving, some of the impact can be lessened. It's important for you to discuss any strategies you are considering BEFORE enacting on them, so we can help ensure your financial well-being won't be negatively impacted. We can help determine what solutions will best fit your needs.
