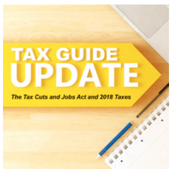
The March 2018 AAII Journal is Now Available Online

Feature Article »

Tax Guide Update: The Tax Cuts and Jobs Act and 2018 Taxes

by AAII Staff



A comprehensive overview of the changes affecting most individual investors, including tax rates, deductions and exemptions.

AAII InvestoGraphic »

The Cost of Panicking

by AAII Staff

Getting out of the market due to fear over falling prices has a lasting, negative impact on your wealth.

Mutual Funds »

The Top Mutual Funds Over Five Years: Tech Takeover

by Jaclyn N. McClellan

Technology funds lead this year’s list of the top funds, though two non-sector funds are also on the top-10 list.

Financial Planning »

Retirement Planning Strategies Following the 2017 Tax Act

by William Reichenstein and William Meyer

The lower tax rates and higher standard deductions make taking advantage of Roth IRAs more attractive now.

Departments »

Briefly Noted

Current news items of interest to individual investors.

- A Simple Way to Fund Retirement
- Dividends Impact Consumption More Than Capital Gains Do
- Trends in Individual Retirement Accounts
- “Sell in May” Has Weakened as a Strategy

Letters »

Members comment on comparing mutual funds and ETFs and basing risk level on portfolio size.

Editor’s Note »

Charles Rotblut, CFA
AAII Journal Editor

As promised, this month's issue contains an update to our tax guide. The update specifically applies to the 2018 tax year and incorporates the changes made by the Tax Cuts and Jobs Act (TCJA). The changes in the bill have little impact on 2017 taxes, though the medical expenses tax deduction was reset back to 7.5% of adjusted gross income for 2017 and 2018. This deduction will revert back to 10% in 2019 if Congress doesn't act. If you are using tax software or tax guides, be sure to check for any updates.

After looking at the new law closely (I have the actual legislation on my PC), I can tell you that many of the provisions affecting individual taxpayers are temporary. There are also parts of the law whose implications are not completely settled or otherwise could be determined in tax court.

I'll share a few examples. As of press time in mid-February, the Internal Revenue Service (IRS) was still working on new W-4 forms and a new Form W-4 calculator. Interest on home equity lines of credit (HELOCs) is now only deductible if used for acquisition debt, such as building an enclosed patio. You cannot deduct interest on HELOC debt used to buy spiffy new furniture for your patio, however. Where a gray area exists is if only part of your roof needs to be repaired. Your accountant may be able to provide an opinion, but a firm line in the sand does not currently seem to exist. The SALT (state and local tax) deduction is another question mark. The law appears to allow for a combination of state and local income taxes, property taxes and sales taxes to be counted toward the $10,000 cap. Guidance from the IRS on this subject has yet to be released. Again, your accountant or tax professional may have a firm opinion on this.

The big uncertainty, of course, is how long do these tax cuts stay in place? Nobody knows for sure. Should the TCJA fail to bring the economic growth that its proponents believe it will, the country's debt will rise. Add in the recent two-year budget deal, and it's easy to see why the debt hawks are not happy. There are paths to reducing the federal debt, but they require politicians to break from their ideologies and be willing to (at least partially) sacrifice their sacred cows. Unfortunately, we still seem to be moving further away from much-needed constructive bipartisanship.

Given this, it can be prudent to make hay while the sun shines. Use any additional cash you receive from the TCJA to boost your savings if you do not absolutely need it for current expenditures and/or to pay down debt. Alternatively, consider moving more money into Roth-type accounts. Doing so can make a lot of sense if you think you will be at the same or a higher tax bracket in the future. Roth IRA conversions are taxable events, so be sure you don't convert so much that it inadvertently bumps you into a higher tax bracket. If you are currently enrolled in Medicare or will be within the next two years, be sure to also consider the potential impact the conversion will have on your premiums. William Reichenstein and William Meyer discuss the advantages of Roth IRA conversions.

Those of you eligible to contribute to a traditional IRA also have a short window of opportunity to take advantage of tax arbitrage given the reduced tax brackets in 2018, as I discussed in the February 15, 2018, AAII Investor Update. Make a deductible contribution to a traditional IRA effective for the 2017 tax year. (You have until April 17 to do this.) Then convert the amount to a Roth IRA for the 2018 tax year. This will give you the IRA contribution deduction at the higher 2017 tax rates and the ability to pay taxes on the Roth IRA conversion at the lower 2018 tax rates.

Wishing you prosperity,

Charles Rotblut, CFA
Editor, *AAII Journal*
@CharlesRAAII