WEALTH PERSPECTIVES

# The one tax tip you need for 2019 (and beyond)

**Key takeaways**

- Tax rules routinely change, foiling best-laid strategies. Monitor vigilantly and maintain flexibility.
- Diversifying your tax strategies to hedge against tax-rule changes is prudent — as the fallout from 2018 tax reform has shown.
- High net worth clients have unique tax planning opportunities available to diversify their tax strategies.

You know how diversification can protect your investment strategy from curveballs thrown by financial markets. But what about your tax strategy?

If there's one thing to learn from the sweeping tax reforms of 2018, it's that tax rules change, so tax strategies must be flexible. Despite what many taxpayers believe, tax rules are not "permanent." The only way to protect yourself from the changing vagaries of the taxing authority is to diversify your approach.

Do not "put all your eggs in one (tax-strategy) basket," says Jeff Brooks, wealth strategist at

Capital Group. “We just don’t know what will end up becoming the law and how that law will be interpreted and enforced by the Internal Revenue Service.”

Diversifying your tax strategies takes a well-thought-out plan and consultation with a tax professional. The value of such work will become clear in April when the realities of the many tax changes that kicked in during 2018 hit home.

Changes made by the Tax Cuts and Jobs Act of 2017 serve as valuable and practical lessons of the need for flexibility. “‘Permanent tax laws’ means they are permanent until Congress changes them,” Brooks says.

**Tax diversification rule #1: Be tax flexible.**

Tax strategies may work well in one year, but can falter when tax rules change. Flexible strategies allow clients to shift where it makes sense. 2018 presents a number of useful examples of the importance of this.

- **Manage standard deduction changes.** Perhaps the most significant change for many taxpayers in the 2018 tax year is the near doubling of the standard income tax deduction. For married couples, the deduction jumps from $12,700 to $24,000, and for single filers it goes from $6,350 to $12,000. This major change means a vast majority of taxpayers will not itemize, Brooks says, which puts strategies that relied on itemization in question. This change rewrites the effectiveness of any tax strategy that revolves around itemized deductions.

**Standard deductions for 2018 are much higher**

| | 2017 STANDARD DEDUCTION | 2018 STANDARD DEDUCTION |
|---|---|---|
| Individual | $6,350 | $12,000 |
| Married Couple | $12,700 | $24,000 |

Source: Capital Group

***An approach to consider:*** Make sure tax strategies can be altered to fit tax-law changes, especially when it comes to deductions. For instance, you might want to craft a tax plan so expenses that previously were deducted annually are now “bunched” into a single tax year, Brooks says. You might take the standard deduction in one year, and then accumulate deductible expenses so you can itemize for next year. “If I have deductions I spread over a number of years and would not be in a situation where I could itemize, why don’t I try to force them into one year?” he says.

One technique that works well for the charitably inclined is a donor-advised fund (or DAF). A DAF is a centrally managed collection of individually directed charitable accounts. It allows one to irrevocably donate cash, stock or other assets like real estate and take a deduction in the year of the gift to the DAF, presumably in excess of the standard deduction limit. But you don’t have to release all the funds to charity at once. “I can keep making gifts year after year from the donor-advised fund, but I get the deduction in the year of my gift to the fund,” Brooks says.

- **HNW tip: Position for new opportunities.** It’s important to refresh tax strategies to take advantage of new structures. For instance, high net worth clients might avail themselves of Qualified Opportunity Funds (QOFs), a tax incentive created in 2017. QOFs allow investors to postpone and possibly eliminate taxes resulting from the realization of gains on the sale of capital assets. As long as sale proceeds are invested in QOFs (which, in turn, invest in Qualified Opportunity Zones, areas identified by the states as being in need of economic development), taxation of the capital gains are postponed. Over time the tax basis in the sold property is adjusted, reducing or eliminating the tax generated by the sale, Brooks says.

**Tax diversification rule #2: Update estate-planning strategies.**

The estate tax planning process should never be described as “set it and forget it.” It may be tempting to consult with an estate-planning attorney, create a will and/or trust, put it in a safety deposit box and forget about it. But changes to estate-planning laws are common and they can be significant when they do occur. Plans built on current rules can be rendered ineffective after subsequent legislative changes are made.

- **The new paradigm: basis planning.** 2018 is a dramatic example. Basics remain the same: Lifetime gifts carry cost basis to the recipient. Estate assets receive a “step up in basis” to date of death value at owner’s death. But the gift and estate tax exemption amounts have doubled in 2018 to $11.2 million per individual ($22.4 for a married couple). The result? Now it’s prudent for taxpayers to use the much higher exemption amount to keep appreciated assets in their estates, Brooks says. When they die, they can then bequeath appreciated assets to beneficiaries. That way, the basis is stepped up to value at the time of death. “Now the argument is switched for many more taxpayers who are now saying, ‘No gifts. I want that property included in my estate,’” he says.
- **HNW tip: Pay education and medical costs directly.** For ultra-wealthy taxpayers, the $11.2 million lifetime exception may still be too low. One strategy to consider to increase the tax-free gifting ceiling is paying loved ones’ education and medical expenses, Brooks says. Most commonly used for children or grandchildren, these payments may be made for anyone. These payments have a powerful benefit and do not apply to the annual exclusion or lifetime exemption if payment is made directly to the provider. Gifts to newly created and tax-advantaged ABLE accounts are another way to fund lasting care for others with special needs.

**Tax diversification rule #3: Use the rules to your advantage.**

While all tax laws are subject to change, some have withstood the test of time, Brooks says. Including long-standing statutory structures (those spelled out in the Internal Revenue Code) can offer some level of durability to a tax plan. “These are rules that have been on the books for years,” Brooks says. “If you build something around these, you might have more faith they’re going to be remain available for years to come.”

Certain “split-interest trusts” such as grantor-retained annuity trusts, charitable remainder trusts, charitable lead trusts and qualified personal residence trusts are structures that have endured and might give investors more faith in their longevity. Consider them not only for their tax benefits but also for the protection they might offer from other tax provisions being changed.

**Tax diversification rule #4: Prepare to negotiate based on tax changes.**

Knowing a change is coming is essential when negotiating the terms of an agreement that will carry forward into future tax years. Good tax counsel should stay abreast of such changes, but it's important to be vigilant and know to bring them up in the negotiation process.

Again, 2018 serves up an important reminder of the importance of this. Prior to 2018, alimony paid was deductible by the payer and was reported as income by the recipient.

All that changes in 2019. As of January 1, alimony payments are no longer deductible. You are now effectively paying alimony with after-tax dollars. "When negotiating or renegotiating a divorce decree, be certain that it properly reflects the economic consequences of this change in the law," Brooks says. The payment amount should reflect the new tax treatment of alimony or support payments.

**Diversification pays.**

Diversification of tax strategies allows taxpayers to create plans that accommodate changes to the law. The most recent changes have allowed more taxpayers to focus less on minimizing taxes and more on creating strategic goals to meet current cash flow requirements as well as legacy goals. "The changes imposed by the Tax Cuts and Jobs Act have allowed more people to refocus on the true purpose of charitable and non-charitable giving, rather than simply the creation of a tax deduction," Brooks says.

And above all, it's a reminder of the importance of advisors looking for tax issues, but also seeking counsel. "We always encourage our clients to seek tax counsel," Brooks says. "Good counsel will raise the fact that laws can and do change over time."

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