The COMPASS Chronicle

Summer 2019

Highlighting important wealth management issues

How To Give Gifts And Not Trip On The Gift Tax

It may be better to give than to receive, as the old saying goes, but it's also best to avoid the taxes on your generosity. What's also smart is knowing when you have to file a tax form as a gift giver.

You can give one person up to $15,000 yearly without incurring any taxes. In fact, you can give multiple people a gift of up to that amount, and they don't even have to be related to you — your son, your daughter, your best friend, your manicurist, whoever.

So, if you give your favorite niece $25,000, you only owe taxes on the $10,000 above the $15,000 limit. And a gift need not be cash. It could be stock or real estate or cars.

What's more, the limit is per person, not per couple. Your spouse could give that lucky soul the same amount, doubling your household's giving and you're personally still staying under the yearly $15,000 ceiling. Note that only you, the giver, are on the hook to pay any tax, and not the recipient.

The tax stops people from giving all their money and property away during their lifetimes to skirt the estate tax when they die. The good news is that — with a little planning — you don't have to pay the gift tax right away, and maybe never.

In addition to the $15,000 per recipient annual limit, there's a lifetime exclusion amount, $11.4 million in 2019 — this covers *all* your lifetime giving to everybody. With the lifetime exclusion, your estate pays what you gave in excess of that cap.

The lifetime exclusion allows people more freedom to give big gifts. Example: You give your sister $40,000 this year. The extra $25,000 ($40,000 gift minus $15,000 annual exclusion) is taxable. Instead of paying that tax now, you count it against the $11.4 million

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COMPASS Corner

Louis E. Conrad II, CFA®

As COMPASS continues to grow, I am always seeking top talent to support the level of advice and service that our clients have come to expect. I am pleased to announce the hiring of Brian Franford as Associate Wealth Manager. Brian joins COMPASS with wealth management experience at Lincoln Investment and Oppenheimer & Co., subsequent to years in commercial real estate and a master's degree from Columbia University.

Similar to the first quarter, stocks and bonds worldwide continued their advance, despite trade uncertainty. The largest U.S. stocks performed the best, particularly large-cap growth stocks, such as in the technology sector. The Russell 3000 Index, a U.S. stock market proxy, generated a total return of 4.1% for the second quarter and 18.7% through the first six months of 2019. International stocks rose too, with the MSCI EAFE Index, a broad measure of developed market international stocks, gaining 3.7% and 14.0% for the quarter and year-to-date period, respectively.

With the support of the central banks, bonds maintained their rally. The yield on the U.S. 10-Year Treasury began the quarter at 2.40%, but ended at 2.00%, reaching a low of 1.98% late in the quarter. This decline in yields led to appreciation in the Bloomberg Barclays U.S. Aggregate Bond Index, with a total return of 3.1% for the second quarter and 6.1% for the initial six months of 2019.

Give To Charity From An IRA To Lower Your Tax Bill

To keep your tax bill down, if you are over 70½, consider a qualified charitable contribution, which makes donations of up to $100,000 from an Individual Retirement Account (IRA) to a fully deductible charity.

A qualified charitable distribution (QCD) lets you donate from a traditional or inherited IRA, provided you meet the age requirements.

A QCD can help you eliminate, or at least reduce, taxes owed on your required minimum distribution (RMD). That's the amount you are required to take out of your IRA account annually after turning 70½.

Example: Your yearly RMD is $20,000, which counts as taxable income. But if you donate that amount to a charity, it's not counted as income, which may drop you into a lower tax bracket.

Moreover, you don't have to itemize to take this tax deduction. That's good news for Americans no longer itemizing deductions on their returns. To be sure, some taxpayers are hurt by the Tax Cuts and Jobs Act's $10,000 cap on state and local tax deductions, so a qualified charitable distribution can make sense.

You don't have to donate the entire amount to a single charity. You can divvy up a QCD among multiple IRS-eligible charities, within the $100,000 annual limit. You don't have to use 100% of your RMD for the donation, of course, and can keep what you need to pay for your living expenses and donate the rest.

QCDs require careful attention to ensure your donation is made from an individual retirement account — not a 401(k) or 403(b). In addition, you may not make a QCD and also itemize charitable deductions. You must pick one. Plus, the charity must not be a private foundation or a donor-advised fund. These technical details are crucial.

Another QCD tip: Make the contribution straight from your IRA. The RMD money must never be in your personal, non-IRA account. Send your IRA custodian instructions to send the check directly to the charity, with the organization's name on the check. Have the IRA custodian send you documentation that you made the donation.

Finally, be sure to make the donation before you take your RMD. Should you take the RMD first, you can't give the money back to the retirement account and will be ineligible to deduct it.

The QCD is a fairly complex solution to lower taxes and requires the advice of a qualified tax professional. ●

Be Prepared For Tax Policy To Swing Back

For business owners, professionals, and wealthy families, tax rules are about as favorable as they've been in decades, but the tax policy pendulum could swing back again. Be prepared to make some important financial decisions much sooner than had been expected.

For example, the lifetime tax exemption for gifts made in 2019 is $11,400,000, up from $11,180, 000 in 2018. It doubled over the $5.43 million in effect in 2017 and is scheduled to ratchet higher through 2025, as a result of the enactment of the Tax Cuts & Jobs Act (TCJA). In 2026, the exemption reverts back to the level in effect before the TCJA became effective in December 2017.

That means families should have many years before they would be forced to decide whether to make gifts in 2025 to maximize their exemptions from tax in passing their wealth to family members. The 2025 peak in the exemption amount forces a decision about whether to give assets to loved ones while you're still alive or hold onto your assets and give them away after you die. In 2025, you use the $12-million-plus exemption or lose it, and the exemption reverts back to a much lower amount in 2026 and beyond.

However, the tax policy pendulum — a politically charged issue — could swing in the other direction in the months ahead. Business owners, professionals, and other high-net worth individuals may need to make decisions about gifting assets much sooner. There is no assurance that you will have until the end of 2025 to make this important strategic decision about passing on your family wealth.

Point is, if tax policy changes, business owners, professionals and individuals benefiting from strategies enabled under the TCJA may be forced to make decisions about income tax as well as estate and gift tax strategies

Business Owners: Avert Obstacles To Tax Savings

The Tax Cuts and Jobs Act (TCJA) gives business owners new ways to save significantly on federal income taxes, but there are obstacles to getting the full benefits. Here's a primer on tactics to get around some of the barriers.

TCJA permits business owners to deduct 20% of the income passed to them through an S-Corp, LLC, sole proprietorship, and other business forms — excluding C-Corporations.

Section 199A of the tax code makes it harder to qualify for the 20% deduction for businesses that perform services, such as healthcare, law, accounting or consulting. For them, the deduction was phased out above $157,500 for an individual filer and $315,000 for a married couple in 2018, and that will be adjusted for inflation in 2019 (to $160,700 for a single, $321,400 for a couple). The deduction was entirely eliminated for a single-filer on taxable income of more than $207,500 in 2018 and for married taxpayers with more than $415,000 (rising to $210,700 and $421,400 for 2019). Earning more than that means you can't take any 199A deduction whatsoever.

How can service-business owners avoid such impediments? By whittling income down below the thresholds.

As an example, let's take Lisa, a dentist, whose profession is definitely in the service business. Her husband contributes no income, as he is retired. She receives $400,000 in pass-through income from her practice, the profit after she meets all her overhead. Beyond her pass-through income, she pays herself a salary of $150,000. So, her taxable income ($550,000, adding the pass-through and the salary money) exceeds the $410,000 ceiling — with the result that she is not eligible for the 20% deduction.

But Lisa can make moves to lower her reported income. First, she can start her own defined contribution plan for herself and her employees — a receptionist, hygienist, and bookkeeper. That usually means establishing a 401(k) retirement plan in her business qualified under the tax code and it would involve research, services and liability to a business owner as well as added costs.

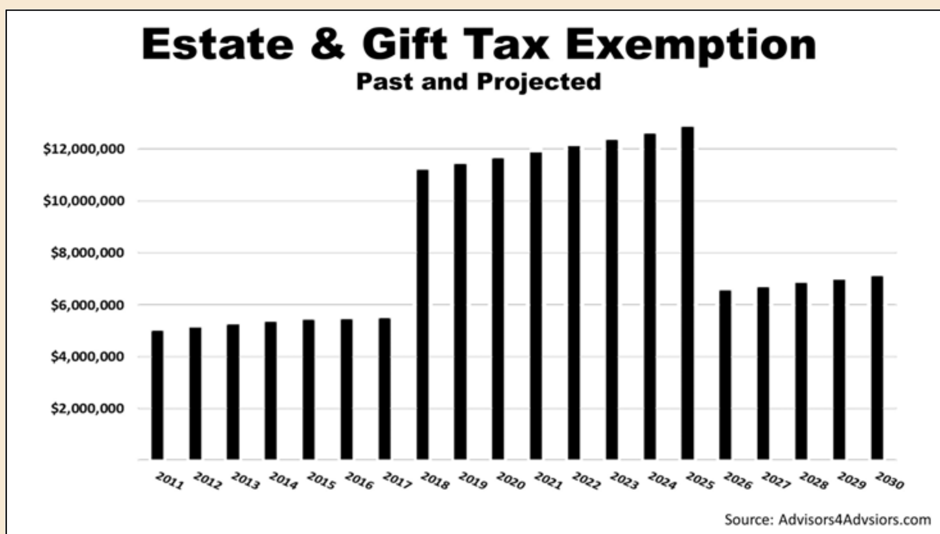
Since Lisa is 55, she can contribute a maximum $25,000 yearly to the plan — the standard $19,000 maximum contribution, plus a $6,000 additional contribution permitted by those over-50 to encourage them to catch-up on retirement savings, and that would reduce her taxable income to $525,000.

Lisa also can open a defined benefit plan for herself and employees. This is a traditional type of pension plan qualified under the tax code to allow participants and their beneficiaries an annual payment for life based on their earnings and life expectancy. In Lisa's case, she can contribute up to $150,000 annually to a defined benefit plan, as that is the average of her past three years' salary. That shaves her taxable income to $375,000, and she now is below the $415,000 ceiling.

Should she wish to pare it further, perhaps to below $315,500 to nab the full 20% pass-through tax deduction, Lisa has additional options: She could make charitable donations or invest in oil and gas ventures that may allow deductions on intangible costs of drilling a well.

For business owners, this is a complex area of tax and financial planning and requires expert advice. Please contact our office with any questions about this specialized advice. ●

much sooner than they might have expected. It's not an issue you want to fall behind on and will require personal and professional tax advice. ●



Time Itemized Deductions To Reduce Taxes

You can't have your cake and eat it, too, but this tax planning strategy lets you have a tax break and repeat it, too.

An old tax tactic, bunching deductions, is used in an entirely new way to minimize your tax bill under the Tax Cuts and Jobs Act (TCJA). By planning to take the new enlarged standard deduction some years and bunching deductions in other years, you may save thousands of dollars in income taxes over two or three years.

The TCJA almost doubled the standard deduction to $12,000 for singles and $24,000 for couples filing jointly in 2018. Trouble is, if you take the standard deduction, you can't itemize other deductions. You no longer can lower your taxable income by itemizing deductions such as charitable donations, medical expenses, mortgage interest, and other miscellaneous expenses.

By bunching, you do both: Last year, you took the enlarged standard deduction. For 2019, you don't. Instead you bunch your deductions and itemize them when you file your taxes for 2019. If your itemized deductions aren't higher than the standard deduction, you take the standard deduction again in 2019 and then itemize in 2020 tax year.

This strategy also helps overcome another downside of the TCJA: It capped deductions on property and state taxes at $10,000 annually. These breaks used to be unlimited, and in some high-tax states exceeded the standard deduction.

By planning to bunch two or three years of charitable donations and other deductions you can control into a single year, your itemized list of deductions every other year could exceed the $24,000 ($12,000 for singles) standard deduction.

For example, a married couple itemizes and claims the maximum property and state income tax deduction of $10,000. They also pay $8,000 in mortgage interest. They'd need to make more than $6,000 of charitable donations to surpass the $24,000 standard deduction threshold. The couple usually gives $4,000 to charity yearly, so they choose to make the gift by combining two years of donations into one tax year. As a result, they can itemize deductions one year and claim $26,000 in deductions. Next year, they take the $24,000 standard deduction.

Planning to benefit by bunching deductions depends on your expected income as well as the specific deductions you can control, but with a little clever planning, you can have your tax break and repeat it, too! ●

How To Give Gifts And Not Trip

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lifetime number. After subtracting that $25,000 from the lifetime exclusion, you have $11.375 million still to go.

It's rare for most Americans to go over the $11.4 million lifetime giving limit. But if you're well-heeled and very generous — your daughter's destination wedding in Corsica costs a bundle — then you can hit it. The gift tax rate ranges from 18% to 40%.

About filing with the IRS: Every year you go over the $15,000 exclusion level, you need to file a Form 709. That way, the government can track who is on the road to reaching the lifetime $11.4 million exclusion.

Some things may not seem to be gifts, but are, and you're required to file the form, like that large sum you blew on your daughter's costly nuptials. Or that $100,000 you just plugged into

your grandchild's 529 college saving plan, which means $85,000 of it is potentially taxable. And if you make an interest-free loan to a friend, the IRS sees it as a gift, too.

Some gifts are tax-free, provided that you give them the right way. Such as gifts for medical or educational expenses. Should you pay someone else's hospital bill, don't give the money to the patient, who then settles the medical tab themselves. You pay the hospital directly. Ditto for education. Instead of giving the money to the student, write the check to the school. Giving to your spouse or a charity is also totally free from the gift tax.

One sure thing about gifts is that they make people happy. Staying within the rules makes the tax man happy, too. It's best to consult a qualified tax professional about this topic, and we are here to help. ●

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