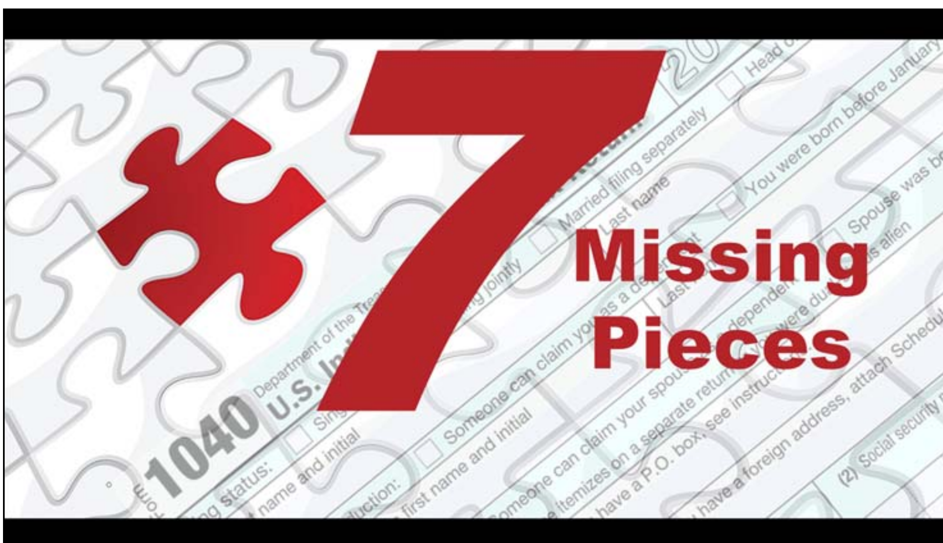
The COMPASS Chronicle

Spring 2019

Highlighting important wealth management issues

7 Tax Breaks Eliminated Or Curtailed

The Tax Cuts and Jobs Act became effective in 2018 and delivered lots of good news, such as curbing of the alternative minimum tax and lowering tax brackets. However, in filing your federal return for the first time under the new rules, be aware that these seven popular tax breaks disappeared or were curtailed.



Personal exemptions. This longstanding break was axed, and for many it won't be missed because of a near-doubling of the standard deduction to $12,000 for individuals, $18,000 for heads of household and $24,000 for joint filers. The personal exemption was $4,056. This was not technically a deduction, which you subtract from your taxable income; as an exemption, it was a dollar-for-dollar reduction of your tax bill. For a single parent with, say, three children—who would get the standard deduction of $18,000—the personal exemption might have been a better deal unless the standard deduction didn't put the parent in a lower tax bracket. Partly offsetting the loss of the personal exemption is the increase of the child tax credit to $2,000 from $1,000.

Unlimited home equity loan interest deduction. Through 2017, you could deduct interest on a loan you took out to buy a boat, fund a vacation or for any endeavor not related to real estate. No more. Now, the loan must be connected to home improvement. What's more, the total of the mortgage and the home equity loan can't be more than $750,000.

Unrestricted state and local tax (SALT) deductions. This is a big deal for residents of states like New York and California, which have both high property taxes and hefty state income taxes. Before the TCJA, these levies could be deducted from a federal

(Continued on page 4)

COMPASS Corner

Louis E. Conrad II, CFA®

I am pleased to announce that I was selected as a 2019 Five Star Wealth Manager as announced in the February issue of *Boston* magazine. The selection is based on ten objective criteria, including a favorable regulatory review, client retention rates, and education and professional designations. Approximately 16% of the Boston area's wealth managers who were under consideration were selected as a Five Star Wealth Manager. This is the sixth time I have been honored to be selected.

Following a disappointing fourth quarter, stocks rebounded worldwide. In fact, U.S. stocks enjoyed their best quarter in 10 years with the Russell 3000 Index, a broad measure of U.S. stocks, generating a return of more than 14%. International stocks rebounded too, but lagged the return of U.S. stocks. The MSCI EAFE Index, a proxy for international equities, gained 10%. Emerging market stocks experienced similar gains.

Bonds continued to rally, extending their winning streak to five months. The yield on the 10-year U.S. Treasury peaked at 3.26% in November, but has declined steadily since, finishing the first quarter at 2.40%. A deceleration in economic growth among the world's major economies resulted in lower bond yields. The price of bonds moves inversely to interest rates, so the decline in rates led to a gain of 2.9% in the Bloomberg Barclays U.S. Aggregate Bond Index during the first quarter.

Sun Starts Setting On Solar Tax Credit From Uncle Sam

The sun is shining on the tax credit for solar power but this federal tax credit that lightens your tax burden significantly starts sunsetting in 2020.

The good news is that the cost of solar panels and equipment is dropping, down about 6.5% in 2018, and putting in solar panels can cut your utility bills by a lot. The bad news is the upfront cost isn't cheap — an average of $13,188 in 2018, according to EnergySage, a marketplace for solar equipment.

Luckily, federal tax credits can cut your cost. That $13,188 upfront cost is after taking the tax credit. Far more valuable than a deduction against your taxable income, a credit reduces your tax dollar for dollar. But you better hurry to beat the phase-out of the credits.

Currently, the tax credit reduces the net cost of a solar system in residential and commercial properties by 30%. In 2020, that drops to 26%, and drops again in 2021 to 22%. The credit then zeroes out in 2022. The break for commercial use does remain, but only at 10%.

One small saving grace is that some states, local governments, and utilities also offer rebates and other tax incentives that can further lower the solar system costs. In the meantime, while the credit lasts, qualifying expenses include the panels themselves, the wiring to connect them to your home electrical system, and the cost of the labor in the installation.

If you don't have a big enough tax liability to use the full credit to cut your tax bill, the amount left over can be carried forward to the next tax year. The home served by solar power does not have to be your principal residence, and no limit is placed on the dollar amount of your credit, which is good if you own a large home.

A caveat: Should you rent out your home for part of the year, you have to reduce the credit for the time you're not present. In an example from TurboTax, if you live in the house for just three months, your credit is one quarter of the amount you'd benefit by had you lived in the place year-round: So, for a system costing $10,000, the 30% credit is $3,000, but you as a part-time resident and landlord get only $750. Rent out the house for the entire year, and you get zilch.

Certainly, some systems cost more than others. For instance, if you have a rectangular south-facing roof, your installation is simple. Yet if the roof is broken up by dormers, skylights and multiple levels, putting in a system is trickier, and more expensive. Nonetheless, whatever you end up paying, the shiniest deals are available now, so you may want to act before the sun starts to set on solar tax credits from Uncle Sam. ●

The New Math Of Renting Out A Vacation Home

If you've ever thought about becoming a landlord, here's an update on recent tax breaks that changed the equation for weighing whether to rent a property or be the sole tenant throughout the year.

If you bought a home in 2018, only the first $750,000 of the mortgage interest is deductible, down from $1 million under the old rules. But a rental property is not subject to these limits.

While the math of renting out your place may not have worked before, you may want to look at it again. Your mortgage could be several million dollars, but you'd still be able to deduct *all* of the interest on it — just as you did before the new law. If you live in the residence for part of the year and rent it out for the rest, you're entitled to a partial break.

Another advantage for rental property owners is that you can now deduct only $10,000 in state and local income tax and

As A Final Act of Love, Plan Thoughtfully

"Everybody wants to go to heaven," according to a classic blues song, "but nobody wants to die." Nor does anyone like to think about dying. And that must be why some people don't put much thought into estate planning, much the less in drawing a schematic for distributing one's earthly possessions to those you love the most.

But this is important. It's something you want to do diligently. It's something you want to get right.

Your heirs and the executor of your estate — the person you choose to oversee that your wishes are carried out — will remember you kindly for your clarity of purpose; it's good for all involved. Otherwise, you risk setting off a family feud. Resolving not to leave your property open to legal dispute, here are three key rules for further planning your estate:

Name Beneficiaries Correctly. Putting someone's name in your will may not be enough, of course. It's wise to name who gets what in documents filed with your insurer, annuity provider and retirement fund sponsor, usually for individual retirement accounts. To be clear, if you want your daughter to get your ABC Stock 500 fund, naming her in the will does no good. It must be on file with a custodian. Moreover, listing multiple beneficiaries of real estate often is an invitation to a quarrel. What if you give your home to your three children? Maybe one wants to keep it for old time's sake, and the other two want to unload it and pocket the money. Or perhaps they all want to sell but can't agree on a broker or a fair selling price. In the meantime, they would need to chip in to maintain the house, which can cause further disputes.

Keep Estate Plans Current. Years or decades may pass between when an estate plan is devised and your death. Lots can change. Like spouses. If you divorced and never updated your will afterward, your ex could end up inheriting your worldly possessions. And what about your nephew, who was so delightful as a kid but grew up to be someone you don't really want to help financially. What's more, the tax laws could have changed, and old plans may be totally out of sync with current rules. Reviewing your will annually makes sense.

Provide Vital Information. Another problem is not furnishing your executor and heirs with a thorough up-to-date list of accounts and how to get access to them. Account titles, user names, and passwords — along with security questions — must be stored. Encrypting and saving this information is best. Writing it down and storing it in a safe deposit box is next best. However, not everything should be stored digitally. Mortgage documents, the deed to your home, your last mortgage payment and paperwork on your car are best kept in a safety deposit box, which requires a key and a photo I.D. to access. So, remember to arrange access for your executor with the bank. In leaving an item of sentimental value, consider who among your heirs would most appreciate its significance. Your Facebook, Instagram and Amazon account can be managed from the grave using online services such as Mylennium. It's wise to have a master list with all user names and passwords for financial holdings. This can be in your safe deposit box or in a secure place in your home. Trouble is, keys tend to get lost. Encrypting it and storing it online or on secure media you keep in your home is better.

Nobody wants to die but if you want to go to heaven, making your final wishes easy on loved ones is a thoughtful final act to help get you there. ●

property tax annually on a home if you are not renting it out. But if you rent out a property for at least 15 days a year, you can take a deduction on part of the property taxes paid.

A homeowner who pays $12,000 in property levies annually, for example, may deduct only the first $10,000. Renting out that property for three months qualifies you for a deduction on 25% of property taxes paid, or $3,000, and you could separately deduct the other $9,000 in property taxes paid.

Rental property owners also get a break on making home improvements. Under tax reform, landlords may immediately deduct capital spending on equipment and machinery. Gone is the requirement to take the break over many years. If you install a new kitchen in a rental property, for instance, it's deductible all at once.

Becoming a landlord is fraught with issues beyond finances, chief among them: privacy. Letting others invade your personal space literally is no small decision and a very personal one. However, the economics of renting out a vacation home have changed, and you may want to reconsider your options.

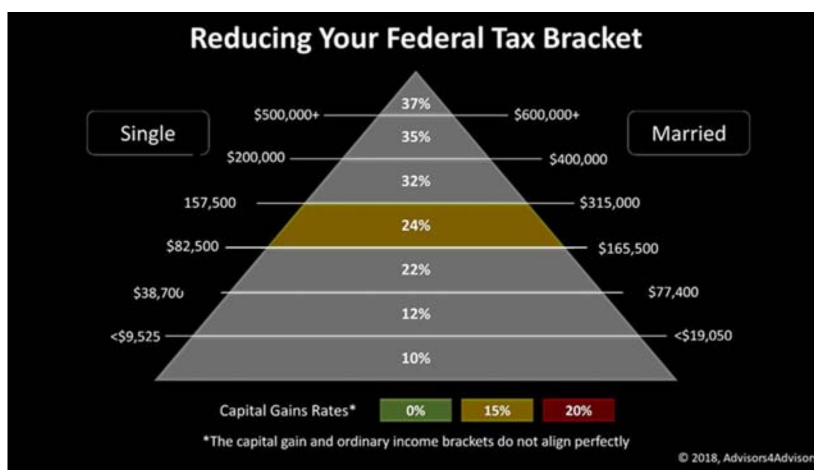
In the era of Airbnb, deciding to rent a vacation home requires advice from a professional who understands the strategic tax and financial planning as well as your personal situation. Please give us a call if you have any questions. ●

High Income Earners & Roth Conversion

Roth IRAs are tax-free, making them popular, but a married couple is ineligible to contribute to a Roth if they earned more than $199,000 of modified adjusted gross income in 2018 ($135,000, if single). A "backdoor" around this limit enables you to convert traditional IRA assets into tax-free Roth IRA accounts, even if you're over the income limit. Here's a strategic approach for maximizing the backdoor route to get tax-free Roth treatment with the least amount of conversion-tax.

When you convert a traditional IRA to a Roth account, you are required to pay tax on the income withdrawn from your traditional IRA. If you do not have the cash on hand to pay the extra income tax you'll owe next April 15, you probably should forget about converting now; withdrawing a larger sum to pay for the income taxes is a risky financial bet and is generally unwise.

If you have the cash on hand to pay the extra income tax you'll owe in the year you draw from your traditional IRA to make the conversion to the Roth, your next move is maximizing your tax bracket. For instance, if your taxable income is $177,500 after making a $100,000 withdrawal from the traditional IRA, consider lowering the amount you convert to avoid pushing you into the 32% bracket. Reducing a $130,000 contribution to a Roth by $30,000 lowers your maximum tax bracket to 24%, for example, giving you the maximum benefit of the 24% bracket.



Because of the stock market's performance in 2018, you may be able to convert a traditional IRA to a Roth with little or no tax taxes. If you funded a deferred compensation plan or traditional IRA with after-tax income in late 2017 or 2018, its fair market value may be lower now than the amount you contributed, and you could convert that traditional IRA account to a Roth tax-free!

To be clear, if you made after-tax contributions to an IRA in 2017 or 2018 and it's shown little or no appreciation, consider converting that IRA to a tax-free Roth IRA, and because you will owe little or no additional income tax on the conversion and — unlike the traditional IRA — the Roth will create tax-free income upon withdrawal.

If you made after-tax IRA contributions to a traditional IRA in 2017 or 2018, or if you want to evaluate a Roth IRA conversion, please contact our office because this is a technical tax topic that requires specialized tax advice. ●

7 Tax Breaks Eliminated

(Continued from page 1)

return, no matter how lofty they were. For the 2018 tax year, however, the so-called SALT write-offs are capped at $10,000. In California, the average SALT deduction had been $20,000.

Unreimbursed employee expenses deduction. It used to be that you could deduct any job-related payment from your own wallet that was above 2% of adjusted gross income, provided that your employer didn't pay you back. That deduction is gone.

Moving expense deduction. Under the old law, you could deduct moving costs if the relocation was job-related. It had to be 50 miles farther from your previous home than the distance between the old place and the old job. The new law restricts moving deductions to people in the military.

Unlimited natural disaster deductions. 2018 was a bad year for natural disasters, with hurricanes and wildfires wrecking lives and destroying homes. You used to be able to deduct a portion of the damages. Now, that is allowed only if you live in an area that's designated as a presidential disaster zone.

Alimony deduction. In the past, if you were the alimony payer, you could deduct the payment from your federal taxes. But for those getting divorced in 2019, that can no longer happen. The old rules still apply to divorces prior to this year.

With April 17, 2019 filing deadline fast approaching and this being the first return to be filed under the new rules under eliminating or curtailing these deductions, we are here to answer any questions about how these changes affect your personal situation. ●

COMPASS Wealth Management 290 Baker Avenue, Suite N101, Concord, MA 01742-2193 P (978) 254-7040 F (978) 254-7039 www.compassinvest.com

While the information contained in this newsletter relies on sources believed to be reliable, accuracy cannot be guaranteed. Unless otherwise noted, all information and opinions are as of the date of transmittal, and are subject to change without notice. This newsletter is intended for general informational purposes only and it does not discuss all aspects that may apply to your situation. Please consult with a qualified professional. COMPASS Wealth Management, LLC is a registered investment advisor with the appropriate regulatory authorities. For additional details on the services that COMPASS offers, we encourage you to review Parts 2A and 2B of our Form ADV, which is provided on request.

©2019 API