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Special Interest Articles:

College Planning Basics

By Christopher W. Beale, CFP®

As college students end their winter break and head back for spring semester, I thought it would be a good time to review some college planning basics.

I tell clients there's no "magic bullet" for accomplishing the college savings goal. Paying for college for your children usually incorporates several strategies including:

- Saving money in a college fund
- Scholarships and Grants
- Loans by parents and/or students
- Re-directing current income from parents or students during the college years.

In most cases, the best vehicle to save for college is 529 savings accounts. 529 refers to the section of the Internal Revenue Service code which allows for tax preferential treatment of college savings accounts. 529 plans are typically owned by the parent with the child as beneficiary.

There are many benefits to investing in a 529 account. The main benefit is that money saved for college is money that will not have to be borrowed for college. Compound interest doesn't care if you're earning it or paying it. You are much better earning compound interest in a 529 account than paying compound interest on a student loan. According to the College Board, 60% of all college Bachelor degree recipients have borrowed to pay for their education. While the average loan amount is $28,400, I have seen students graduate with loan amounts in excess of $100,000. That's like having the mortgage without owning the house.

There are tax benefits to investing in 529 plans. While contributions are not federally tax-deductible, some states like Connecticut can offer a deduction or tax credit for contributions made to state sponsored 529 plans. The compound earnings discussed above grow tax-free. Withdrawals for qualified higher education expenses (**QHEE**) are tax-free. The new 2018 tax law allows for distributions of $10,000 per year to cover the cost of K-12 expenses. The ability for families to pay for private or religious primary and secondary school expenses is just another reason that families should be using 529 savings plans for all types of educational funding.

(Continued on page 2)

2018 Tax Law Changes and You

By Christopher M. Lee, CFP®

As many of you are aware, we had sweeping Federal tax law changes for the first time in 30 years that will have both positive and negative effects on many of you. Please note that these changes are not uncommon and usually do happen every 30 years, with the last two coming in 1981 under President Reagan and before that, in 1945 under President Truman.

In this article we will discuss, as Clint Eastwood would say, "The good, the bad, and the ugly" of the bill and how it may affect you. *Please note that this article is not meant to be a comprehensive guide to every caveat of the law, but it does cover the high points and makes it obvious how important good financial and tax planning will be (as it was in the past and will continue to be in the future)!* First though, let's talk about some of the things that did not change:

(*Continued on page 3*)

College Planning Basics

(Continued from page 1)

In order to have the distributions to qualify as tax-free, they must be used for QHEE at an eligible institution. Qualified higher education expenses include:

- Tuition
- Mandatory fees
- Required textbooks, supplies and equipment
- If used primarily by the beneficiary during the time the beneficiary is enrolled at an eligible educational institution, the following are included:
    - Computer or peripheral equipment
    - Computer software
    - Internet access and related services
- Room and Board during any academic period which the student is enrolled at least half-time in a degree, certificate or other program that leads to a recognized educational credential awarded by an eligible educational institution. If the student lives off campus, the amount of this expense is considered a QHEE, but is limited to the cost of on-campus housing.
- Special needs services for student with special needs

Two common pitfalls I've seen with 529 distributions that can cause them to be taxable. First, paying a student loan is not considered a qualified higher educational expense. Second, is not matching the year the distribution is taken with the year the QHEE is used. If the college bill for the spring semester is due in January, take the distribution in January, not December of the previous year.

The tax penalty for non-qualified distributions are taxes and penalties due for earnings or growth, but not on your contributions (which were made after tax).

529 plans where the parent is the owner and the student is the beneficiary, are viewed more favorably for potential financial aid than money held in an account in the student's name only. FAFSA (Free Application for Federal Student Aid) generally counts 20% of any student owned assets as being available to pay for college. FAFSA counts 5.64% of parent owned assets as available for paying for college. For example, if your child has $10,000 in a bank account in their name, 20% or $2000 would be deemed available to pay for school. This means $2000 less in potential financial aid. If the same $10,000 is in a parent owned 529, the reduction in financial aid would only be $564.

I would like to make one final important and personal appeal. Prior to sending your children off to college, understand that they are now young adults. As young adults over the age of 18, they gain certain legal rights which excludes your ability to access or assist in certain aspects of your child's life. If you want to be continued to be involved in your child's educational life, the Family Educational Rights and Privacy Act (FERPA) requires that students age 18 or older provide written consent before educational records such as grades, transcripts and disciplinary records can be shared with parents. Colleges typically provide FERPA consent forms for students to sign.

A financial power of attorney allows the parents to help manage the child's finances. If, for instance, a student has a car accident or illness, leaving them either temporarily or permanently unable to make financial decisions, this document allows the parents to avoid an expensive court process of being appointed the guardian for the student.

(Continued on page 3)

"Education is the ability to listen to almost anything without losing your temper or your self-control"

-Robert Frost: American Poet

College Planning Basics

(*Continued from page 2*)

Finally and more importantly, parents should also have a health care power of attorney and HIPPA authorization on behalf of their children. As some of you know, our youngest son Michael contracted viral meningitis one week prior to final exams last April. Abby and I flew to North Carolina and spent a week in the hospital with Michael in Greensboro while Michael was diagnosed, treated and started his recovery from this awful disease. (Thank you Bob and Donna in Greensboro for all your guidance and support during this very difficult time). The health care power of attorney gives parents the ability to make health care decisions for their children. Luckily, Mike never lost consciousness and allowed us this ability. Had he been unconscious or in a coma, this would not have been the case! HIPPA authorization allows doctors to speak to parents about a child's medical condition. While the child may be concerned with privacy, I recommend full parental access to the student's health records which could be especially valuable in situations that can't be anticipated.

Mike has fully recovered and was able to complete his classes and finish his final exams when he returned to High Point University last fall. I wanted to share this very difficult ordeal because of the lesson it provided to Abby and I, and the opportunity to share that lesson with all of you. Whether you're sending them off to preschool or sending them to grad-school, a little planning can save you time, money and grief!

"Investment in knowledge pays the best interest"

-Benjamin Franklin: Author, Politician, Scientist, Inventor and Diplomat

2018 Tax Law Changes and You

(*Continued from page 1*)

UNCHANGED

Tax rates on dividends and capital gains remain unchanged. For capital gains and qualified dividends, that means a maximum tax rate of 15% for taxpayers in the lower tax brackets. For those in the highest tax bracket, the tax rate is 23.8%, including the 3.8% Net Investment Income Tax, associated with the Patient Protection and Affordable Care Act.

Tax benefits to retirement accounts, such as 401(k)s and IRAs, stand. Most of these did not change, the only notable difference is taking away the availability to re-characterize a conversion once you have converted funds from a traditional IRA to a Roth IRA. Please note that since this availability to re-characterize came out in 1997, our office has done less than a dozen of these, so chances are it will not affect you.

Keeps the deductions for charitable contributions, retirement savings, and student loan interest.

Tax-lot selling rules stay the same. Investors are still able to determine the most appropriate tax lot to use for cost-basis purposes on investment sales. This preserves an important planning tool for advisors and you as investors.

Alternative Minimum Tax. It keeps the tax, but it increases the exemption from $54,300 to $70,300 for singles and from $84,500 to $109,400 for joint. The exemptions phase out at $500,000 for singles and $1 million for joint.

THE GOOD

Reduced Rates. Tax rates/brackets have come down for some taxpayers as seen on the comparison graph below:

(*Continued on page 4*)

2018 Tax Law Changes and You

(Continued from page 3)

Tax brackets for married taxpayers filing jointly

Current law		Final plan	
10%	$0–$18,650	10%	$0–$19,050
15%	$18,651–$75,900	12%	$19,051–$77,400
25%	$75,901–$153,100	22%	$77,401–$165,000
28%	$153,101–$233,350	24%	$165,001–$315,000
33%	$233,351–$416,700	32%	$315,001–$400,000
35%	$416,701–$470,700	35%	$400,001–$600,000
39.6%	$470,701 or more	37%	$600,000 or more
Standard deduction:	$12,700	Standard deduction:	$24,000
Personal Exemption:	$8,100	Personal Exemption:	Eliminated

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Tax brackets for single filers

Current law		Final plan	
10%	$0–$9,325	10%	$0–$9,525
15%	$9,326–$37,950	12%	$9,526–$38,700
25%	$37,951–$91,900	22%	$38,701–$82,500
28%	$91,901–$191,650	24%	$82,501–$157,500
33%	$191,651–$416,700	32%	$157,501–$200,000
35%	$416,701–$418,400	35%	$200,001–$500,000
39.6%	$418,401 or more	37%	$500,001 or more
Standard deduction:	$6,350	Standard deduction:	$12,000
Personal Exemption:	$4,050	Personal Exemption:	Eliminated

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Lower Corporate Tax Rates. This should benefit you as an investor, as this decrease in corporate tax rates from 35% to a more competitive rate (globally) of 21%. The anticipation of this benefit was one of the main catalysts that helped push the stock markets higher in 2017.

Tax breaks for business owners who qualify for pass-through income. Many businesses are pass-through entities, so the effect could be large and swift. Business owners might consider converting from a C corporation structure to S corporation or partnership to take advantage of the pass-through tax preference. There is complexity, though, that might curtail this option for those this pertains to, so it's important to consult your tax professional.

529s get more useful. (Please see Chris Beale's article on this in the newsletter)

(*Continued on page 5*)

"Nothing in life is to be feared, it is only to be understood. Now is the time to understand more, so that we may fear less."

-Marie Currie: French Physicist and Chemist, 2x Noble Prize Winner

2018 Tax Law Changes and You

(Continued from page 4)

"I have lived by one crucial principle since I was 24 years old. I don't blame or complain about things like the economy, the government, taxes, employees, gas prices, or any of the external things that I don't have control over. The only thing I have control over is my response to these things."

-Jack Canfield: Author of Chicken Soup for the Soul

The Act increases the Child Tax Credit from $1,000 to $2,000. Even parents who don't earn enough to pay taxes can claim the credit up to $1,400. It increases the income level from $110,000 to $400,000 for married tax filers.

It doubles the standard deduction. A single filer's deduction increases from $6,350 to $12,000. The deduction for Married and Joint Filers increases from $12,700 to $24,000. Roughly 30% of taxpayers itemize now so that number will likely be far smaller following the tax changes. So this may be a benefit to some, but may hurt others which we will discuss below.

THE BAD

Elimination of the Miscellaneous Itemized Deductions. In the past, these were deductible only to the extent they exceed 2% of a taxpayer's adjusted gross income. These deductions included unreimbursed job expenses, tax preparation fees, investment management expenses (as most of you pay with New England Capital), and gambling losses to name a few.

Mortgage interest on large loans. It limits the deduction on mortgage interest to the first $750,000 of a new mortgage/ loan taken out in 2018. If you purchased your home before 1/1/18 you are grandfathered in.

Alimony. Those paying alimony can no longer deduct it, while those receiving it can. The new rules won't affect anyone who divorces or signs a separation agreement before 2019.

THE UGLY

The cap on state income tax deductions and property tax. Taxpayers can deduct up to a maximum of $10,000 in state and local taxes. They must choose between property taxes and income or sales taxes. This will harm taxpayers in high-tax states like Connecticut, New York, New Jersey and California.

Interest on home equity lines. Home equity lines of credit can no longer be deducted. This applies to everyone – even existing lines of credit – no one is grandfathered in!

Personal Exemptions. It eliminates personal exemptions. Before the Act, taxpayers subtracted $4,150 from income for each person claimed.

Some of you may consider this good and others of you bad, but the Act repeals the Obamacare tax on those without health insurance in 2019. Without the mandate, the Congressional Budget Office estimates 13 million people would drop their plans. The government would save $338 billion by not having to pay their subsidies. But health care costs will rise because fewer people will get the preventive care needed to avoid expensive emergency room visits.

As with any tax plan there are winners and losers and some of this will take time to see some of the benefits. Historically, even minor changes in the tax code take a fair amount of time to fully understand and to strategize for. Given the scope of this legislation, accountants, tax attorneys, and financial advisors will be digesting the changes and coming up with tax strategies for quite some time.

An Important Note: These changes will not impact the tax return that you file this coming April covering the tax year 2017. They take effect January 1, 2018.

Sources:

https://taxfoundation.org/conference-report-tax-cuts-and-jobs-act/

https://www.thecapitalideas.com/articles/2018-tax-reforms-mean-for-investors?cid=sm_tw_12385

New England Capital News

- Happy Silver Anniversary! – Chris Lee recently celebrated his 25th Anniversary working at New England Capital.

- We have a new face at New England Capital! Chrissy Shingler recently joined us and is a great addition to our team! She will be working as a Para-planner, assisting us in meetings and also with customer service. Please make sure you say "Hi" to her when you are in the office or call.

Important Tax Document Information

- If you have a retirement account (IRA, SIMPLE, Roth, SEP) and took money out last year, the 1099-R should be mailed from your custodian (Schwab/Fidelity/National Advisors Trust) by the end of January.

- If you have a non-retirement accounts at Fidelity, Schwab or National Advisors Trust, you will not be receiving your 1099 until the third week of February.

- Please note that any management fees that may be deductible are included on the 1099 Composite from Fidelity, Schwab or National Advisors Trust.

- Please note that we cannot speak to your tax preparer or accountant regarding your accounts without your prior authorization.

- Matt and Ann will be available to assist you with any questions or issues regarding tax documents this tax season. Please email mattsczurek@newenglandcapital.com or annocone@newenglandcapital.com