



Phase 3 Newsletter

Weathering any Financial Season

Mid-Year Planning: Tax Changes to Factor In



The Tax Cuts and Jobs Act, passed in December of last year, fundamentally changes the federal tax landscape for both individuals and businesses. Many of the provisions in the legislation are permanent, others (including most of the tax cuts that apply to individuals) expire at the end of 2025. Here are some of the significant changes you should factor in to any mid-year tax planning. You should also consider reviewing your situation with a tax professional.

New lower marginal income tax rates

In 2018, there remain seven marginal income tax brackets, but most of the rates have dropped from last year. The new rates are 10%, 12%, 22%, 24%, 32%, 35%, and 37%. Most, but not all, will benefit to some degree from the lower rates. For example, all other things being equal, those filing as single with taxable incomes between approximately \$157,000 and \$400,000 may actually end up paying tax at a higher top marginal rate than they would have last year. Consider how the new rates will affect you based on your filing status and estimated taxable income.

Higher standard deduction amounts

Standard deduction amounts are nearly double what they were last year, but personal exemptions (the amount, \$4,050 in 2017, that you could deduct for yourself, and potentially your spouse and your dependents) are no longer available. Additional standard deduction amounts allowed for the elderly and the blind remain available for those who qualify. If you're single or married without children, the increase in the standard deduction more than makes up for the loss of personal exemption deductions. If you're a family of four or more, though, the math doesn't work out in your favor.

Itemized deductions — good and bad

The overall limit on itemized deductions that applied to higher-income taxpayers is repealed, the income threshold for deducting medical expenses is reduced for 2018, and the income

limitations on charitable deductions are eased. That's the good news. The bad news is that the deduction for personal casualty and theft losses is eliminated, except for casualty losses suffered in a federal disaster area, and miscellaneous itemized deductions that would be subject to the 2% AGI threshold, including tax-preparation expenses and unreimbursed employee business expenses, are no longer deductible. Other deductions affected include:

- **State and local taxes** — Individuals are only able to claim an itemized deduction of up to \$10,000 (\$5,000 if married filing a separate return) for state and local property taxes and state and local income taxes (or sales taxes in lieu of income).
- **Home mortgage interest deduction** — Individuals can deduct mortgage interest on no more than \$750,000 (\$375,000 for married individuals filing separately) of qualifying mortgage debt. For mortgage debt incurred prior to December 16, 2017, the prior \$1 million limit will continue to apply. No deduction is allowed for interest on home equity loans or lines of credit unless the debt is used to buy, build or substantially improve a principal residence or a second home.

Other important changes

- **Child tax credit** — The credit has been doubled to \$2,000 per qualifying child, refundability has been expanded, and the credit will now be available to many who didn't qualify in the past based on income; there's also a new nonrefundable \$500 credit for dependents who aren't qualified children for purposes of the credit.
- **Alternative minimum tax (AMT)** — The Tax Cuts and Jobs Act significantly narrowed the reach of the AMT by increasing AMT exemption amounts and dramatically increasing the income threshold at which the exemptions begin to phase out.
- **Roth conversion recharacterizations** — In a permanent change that starts this year, Roth conversions can't be "undone" by recharacterizing the conversion as a traditional IRA contribution by the return due date.

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"Time famine" is the feeling of being overwhelmed by the demands of work and life. Also known as time scarcity and time stress, this pressure is a "critical factor" in the rising rates of obesity.

Source: "Buying Time Promotes Happiness," PNAS, July 24, 2017

Investing to Save Time Boosts Happiness Returns

The more money you make, the more valuable you perceive your time to be — and the more time-strapped you may feel, according to University of British Columbia psychology professor Elizabeth Dunn.¹ So wouldn't it stand to reason that if you use some of your hard-earned money to buy yourself more time — for example, by paying someone to clean your house or mow your lawn — you might achieve a greater level of happiness? Indeed, that was the primary finding in a series of studies by Professor Dunn and other researchers published in the Proceedings of the National Academy of Sciences (PNAS).²

The discovery

The study's authors surveyed 6,000 individuals at diverse income levels in multiple countries, including the United States, Canada, the Netherlands, and Denmark. The surveys queried participants about whether they spent money on a monthly basis to hire others to take care of unpleasant or time-consuming daily tasks or chores — such as cleaning, yard work, cooking, and errand-running — and if so, how much they spent. Respondents were also asked to rate their "satisfaction with life" and report demographic information, such as their income level and whether they were married and had children.

Researchers found that across all national samples, 28.2% of respondents spent an average of about \$148 per month to outsource disliked tasks, while in the United States, 50% of respondents spent an average of \$80 to \$99 on services that save time. Across all studies, those who spent money to outsource disliked tasks and/or save time had a stronger life satisfaction rating. Findings were consistent across income spectrums; in fact, in the United States, researchers found a stronger correlation among the less-affluent respondents. The authors noted, however, that their studies did not include enough people at the lowest end of the income spectrum to attribute similar findings to this group.

Of course, correlation does not necessarily indicate causality, so the researchers designed a follow-up experiment to further test their hypothesis.

In this experiment, researchers gave a group of 40 adults \$80 each to spend over the course of two weekends. During the first weekend, they were to spend \$40 on something that would save them time, such as ordering groceries online and having them delivered. On the second weekend, they were directed to spend \$40 on a nice material purchase, such as clothes, board games, or a bottle of wine. On

average, those who spent money to save time reported better moods at the end of the day than those who purchased material goods. And according to the researchers, over time, the effect of regular mood boosts can add up to greater overall satisfaction with life.

In a third study, researchers asked respondents how they would spend an extra \$40. Just 2% indicated they would use the unexpected bonus to invest in time-saving services.

Perhaps most surprising of all the findings? Researchers polled 800 millionaires from the Netherlands about whether they spent money to save time. Despite the fact that these individuals could readily afford to hire others to take care of time-consuming tasks, only about half of them reported doing so on a monthly basis. Researchers surmise that the reason might be because such individuals feel guilty or don't want to be perceived as lazy for outsourcing chores they can easily do themselves.

The lesson

"If you have a lot of money and a lot of nice stuff, but you're spending your time doing things that you dislike, then your minute-to-minute happiness and overall happiness is likely to be pretty low," said Dunn in an interview about the research.³ In the PNAS report, the study's authors contend that this may be especially true for women:

"Within many cultures, women may feel obligated to complete household tasks themselves, working a 'second-shift' at home, even when they can afford to pay someone to help. In recent decades, women have made gains, such as improved access to education, but their life satisfaction has declined; increasing uptake of time-saving services may provide a pathway toward reducing the harmful effects of women's second shift."

The bottom line? If you can afford it, don't shy away from spending money to save time. Doing so is an investment that provides immeasurable returns in the form of overall well-being.

¹ "What Is Your Time Really Worth?" Elizabeth Dunn, TEDx Colorado Springs, December 1, 2014

² "Buying Time Promotes Happiness," PNAS, July 24, 2017

³ "A Psychology Expert Says Spending Your Money on This Can Boost Your Happiness," CNBC, November 10, 2017



529 plan assets surpass \$300 billion mark

As of September 2017, assets in 529 plans totaled \$306 billion.

Source: Strategic Insight, 529 College Savings & ABLE, 3Q 2017 529 Data Highlights

Note

Investors should carefully consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. Specific information is available in each plan's official statement. Keep in mind that there is the risk that 529 plan investments may not perform well enough to cover costs as anticipated. Also consider whether your state offers any 529 plan state tax benefits and whether they are contingent on joining your own state's 529 plan. Other state benefits may include financial aid, scholarship funds, and protection from creditors.

College Saving: How Does a 529 Plan Compare to a Roth IRA?

529 plans were created 22 years ago, in 1996, to give people a tax-advantaged way to save for college. Roth IRAs were created a year later, in 1997, to give people a tax-advantaged way to save for retirement. But a funny thing happened along the way — some parents adapted the Roth IRA as a college savings tool.

Tax benefits and use of funds

Roth IRAs and 529 plans have a similar tax modus operandi. Both are funded with after-tax dollars, contributions accumulate tax deferred, and qualified distributions are tax-free. But in order for a 529 plan distribution to be tax-free, the funds *must* be used for college or K-12 education expenses. By contrast, a qualified Roth distribution can be used for anything — retirement, college, travel, home remodeling, and so on.

In order for a distribution from a Roth IRA to be tax-free (i.e., a qualified distribution), a five-year holding period must be met *and* one of the following must be satisfied: The distribution must be made (1) after age 59½, (2) due to a qualifying disability, (3) to pay certain first-time homebuyer expenses, or (4) by your beneficiary after your death.

For purposes of this discussion, it's the first condition that matters: whether you will be 59½ or older when your child is in college. If the answer is yes (and you've met the five-year holding requirement), then your distribution will be qualified and you can use your Roth dollars to pay for college with no tax implications or penalties. If your child ends up getting a grant or scholarship, or if overall college costs are less than you expected, you can put those Roth dollars toward something else.

But what if you'll be younger than 59½ when your child is in college? Can you still use Roth dollars? You can, but your distribution will not be qualified. This means that the earnings portion of your distribution (but not the contributions portion) will be subject to income tax. (Note: Just because the earnings portion is subject to income tax, however, doesn't mean you'll necessarily have to pay it. Nonqualified distributions from a Roth IRA draw out contributions first and then earnings, so you could theoretically withdraw up to the amount of your contributions and not owe income tax.)

Also, if you use Roth dollars to pay for college, the 10% early withdrawal penalty that normally applies to distributions before age 59½ is waived. So the bottom line is, if you'll be younger than 59½ when your child is in college and you use Roth dollars to pay college expenses, you might owe income tax (on the earnings portion of the distribution), but you

won't owe a penalty.

If 529 plan funds are used for any other purpose besides the beneficiary's qualified education expenses, the earnings portion of the distribution is subject to income tax *and* a 10% federal tax penalty.

Financial aid treatment

At college time, retirement assets aren't counted by the federal or college financial aid formulas. So Roth IRA balances will not affect financial aid in any way. (Note: Though the aid formulas don't ask for retirement plan *balances*, they typically do ask how much you *contributed* to your retirement accounts in the past year, and colleges may expect you to apply some of those funds to college.)

By contrast, 529 plans do count as an asset under both federal and college aid formulas. (Note: Only parent-owned 529 accounts count as an asset. Grandparent-owned 529 accounts do not, but withdrawals from these accounts are counted as student income.)

Investment choices

With a Roth IRA, your investment choices are virtually unlimited — you can hold mutual funds, individual stocks and bonds, exchange-traded funds, and REITs, to name a few.

With a 529 plan, you are limited to the investment options offered by the plan, which are typically a range of static and age-based mutual fund portfolios that vary in their level of risk. If you're unhappy with the market performance of the options you've chosen, under federal law you can change the investment options for your *existing* contributions only twice per calendar year (though you can generally change the investment options on your *future* contributions at any time).

Eligibility and contribution amounts

Unfortunately, not everyone is eligible to contribute to a Roth IRA. For example, your income must be below a certain threshold to make the maximum annual contribution of \$5,500 (or \$6,500 for individuals age 50 and older).

By contrast, anyone can contribute to a 529 plan; there are no restrictions based on income. Another significant advantage is that lifetime contribution limits are high, typically \$300,000 and up. And 529 plan rules allow for large lump-sum, tax-free gifts if certain conditions are met — \$75,000 for single filers and \$150,000 for married joint filers in 2018, which is equal to five years' worth of the \$15,000 annual gift tax exclusion.

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Can I convert my traditional IRA to a Roth IRA in 2018?

If you've been thinking about converting your traditional IRA to a Roth IRA, this year may be an appropriate time to do so. Because federal income tax rates were reduced by the Tax Cuts and Jobs Act passed in December 2017, converting your IRA may now be "cheaper" than in past years.

Anyone can convert a traditional IRA to a Roth IRA in 2018. There are no income limits or restrictions based on tax filing status. You generally have to include the amount you convert in your gross income for the year of conversion, but any nondeductible contributions you've made to your traditional IRA won't be taxed when you convert. (You can also convert SEP IRAs, and SIMPLE IRAs that are at least two years old, to Roth IRAs.)

Converting is easy. You simply notify your existing IRA provider that you want to convert all or part of your traditional IRA to a Roth IRA, and they'll provide you with the necessary paperwork to complete. You can also transfer or roll your traditional IRA assets over to a new IRA provider and complete the conversion there.

If you prefer, you can instead contact the trustee/custodian of your traditional IRA, have the funds in your traditional IRA distributed to you, and then roll those funds over to your new Roth IRA within 60 days of the distribution. The income tax consequences are the same regardless of the method you choose.¹

The conversion rules can also be used to contribute to a Roth IRA in 2018 if you wouldn't otherwise be able to make a regular annual contribution because of the income limits. (In 2018, you can't contribute to a Roth IRA if you earn \$199,000 or more and are married filing jointly, or if you're single and earn \$135,000 or more.) You can simply make a nondeductible contribution to a traditional IRA and then convert that traditional IRA to a Roth IRA. (Keep in mind, however, that you'll need to aggregate the value of all your traditional IRAs when you calculate the tax on the conversion.) You can contribute up to \$5,500 to all IRAs combined in 2018, or \$6,500 if you're 50 or older.

¹ If you choose to receive the funds first and don't transfer the entire amount, a 10% early withdrawal penalty may apply to amounts not converted.



What are some tips for creating a budget and sticking to it?

It's a common problem for many individuals — wondering exactly where your paycheck goes each month. After paying expenses, such as your mortgage, utilities, and credit card bills, you may find little left to put toward anything else.

Creating a budget is the first key to successfully manage your finances. Knowing exactly how you are spending your money each month can set you on a more clear path to pursue your financial goals. If you become sidetracked when it comes to your finances, consider these tips for creating a budget and staying on the right path.

Examine your financial goals. Start out by making a list of your short-term goals (e.g., new car, vacation) and long-term goals (e.g., your child's college education, retirement) and prioritize them. Consider how much you will need to save and how long it will take to reach each goal.

Identify your current monthly income and expenses. Add up all of your income. In addition to your regular salary and wages, be sure to include other types of income, such as

dividends, interest, and child support. Next, add up all of your expenses. Sometimes it helps to divide expenses into two categories: fixed (e.g., housing, food, transportation) and discretionary (e.g., entertainment, vacations). Don't forget to factor in any financial goals you would like to pursue.

Evaluate your budget. Once you've added your income and expenses, compare the two totals. Ideally, you should be spending less than you earn. If this is the case, you're on the right track, and you'll need to look at how well you use your extra income toward achieving your financial goals. On the other hand, if you are spending more than you earn, you should make some adjustments to your budget. Look for ways to increase your income or reduce your expenses, or both.

Monitor your budget. Finally, you should monitor your budget periodically and make changes when necessary. Keep in mind that any budget that is too rigid is likely to fail. Keep your budget flexible as your changing circumstances demand.