DON'T DEFER TAX PLANNING FOR 2018

Between storm damage recovery and pre-existing infrastructure needs, the United States has a lot of rebuilding projects ahead. This means a lot of work for the construction industry, but the bad news is it will cost a lot of money. We believe this makes it unlikely Congress will pass major tax reform by next year. It also gives investors more reason to consider tax-deferred accounts before potential tax reform measures are implemented.

Overview

Perhaps you've had a similar dilemma with your household budget: How do you cut back expenses when your spending must increase? Tax reform, long touted as a hallmark of the Republican party platform, may be difficult to achieve with all the recent expenses the country has encountered.

When Donald Trump was first elected president, there was positive momentum in the stock market in anticipation of his pro-business, pro-tax reduction policies. These days, however, Congress appears to be looking for ways to pass legislation that looks like tax cuts but would actually help increase short-term revenues.

For example, some House Republicans have suggested rolling back the tax-deferred status of 401(k) plans.[1] This would put the 401(k) on the same level as a Roth IRA, only with higher annual contribution limits ($18,000; or $24,000 for those age 50 and up). While that would result in no taxes on distributions during retirement, investors would pay more taxes on income while working. This may reduce the incentive to save with a 401(k), which is extremely important given the retirement income shortfalls many people are facing.

Investment Options & Benefits

Employer-sponsored retirement savings plans include the 401(k), 403(b), 457(b), Simplified Employee Pension (SEP) Plan and Thrift Savings Plan (TSP). These all work very similarly, providing for pretax contributions and tax-deferred growth with taxes due upon distribution. The main difference in plans is which type of employer offers it, as detailed in the table on the next page.[2]

Be aware that most employer-sponsored, tax-deferred plans require minimum distributions every year after age 70 ½. The distribution amount is based on the year-end balance divided by a life-expectancy factor. However, some plans waive mandatory distributions if the employee is still working for the plan sponsor beyond that age.[3]

Simplified Employee Pension (SEP) IRA

The SEP IRA is typically sponsored by a small-business owner. It allows pretax contributions of up to 25 percent of the employee's compensation, or $53,000 — whichever is less. Note that contributions may be made only by the employer, and catch-up contributions are not permitted. However, each employee controls how his or her contributions are invested, just like any other IRA account. Money is taxed at ordinary income rates in the year withdrawn.[4]

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EMPLOYER TAX-DEFERRED RETIREMENT PLANS[5]

	403(b)	457(b)	401(k)	Thrift Savings Plan (TSP)
Offered by	Public schools, hospitals, religious groups	State and local governments	Public or private companies; self-employed	Federal government
2017 contribution limits	$18,000; $24,000 for those age 50 and older	$18,000; might allow catch-up contributions (up to $36,000) for those age 50 and older and/or employees three years from retirement age	$18,000; $24,000 for those age 50 and older	$18,000; $24,000 for those age 50 and older
Taxes on contributions and earnings	Pretax contributions; deferred taxes; earnings grow tax-free	Pretax contributions; deferred taxes; earnings grow tax-free	Pretax contributions (except for a Roth option); deferred taxes; earnings grow tax-free	Pretax contributions (except for a Roth option); deferred taxes; earnings grow tax-free
Taxes on withdrawals after age 59 ½	Taxed at ordinary income rate	Taxed at ordinary income rate	Taxed at ordinary income rate; no tax on a Roth option	Taxed at ordinary income rate; no tax on a Roth option

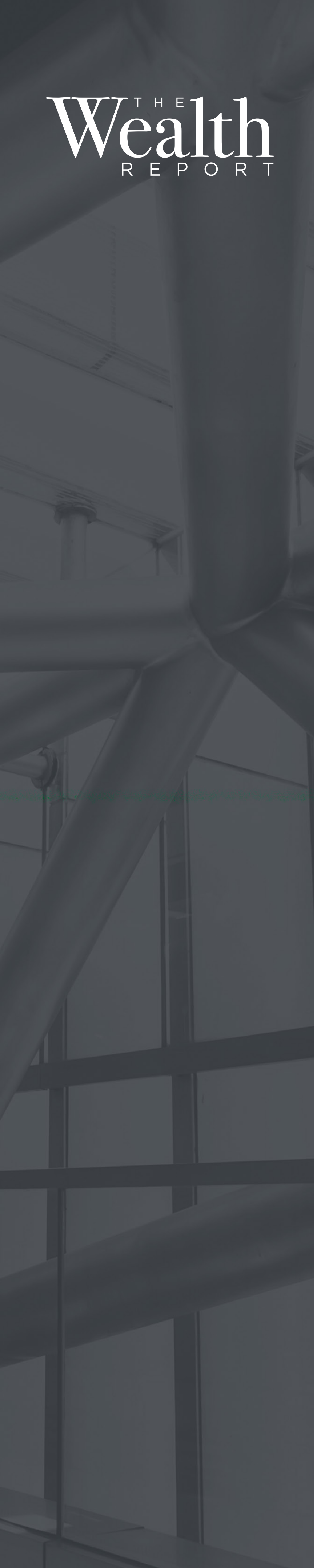
Traditional IRA

While an employer-matched plan may be the first choice, investors can receive tax advantages by investing in a traditional IRA as well. With a traditional IRA, contributions may qualify for a full or partial tax deduction unless the investor (or their spouse) participates in an employer plan or earns more than $72,000 (single; head of household), $119,000 (married filing jointly; qualifying widow/er) or $10,000 if married filing separately. Distributions in retirement are taxed at the owner's income rate.[6]

Roth IRA

A Roth IRA does not allow contributions to be deducted from current income taxes, but it grows tax-free and you can make withdrawals on contributions without penalty after owning the account for only five years. Better yet, you have the option to withdraw contribution amounts at any time without tax consequences, making the Roth IRA a flexible savings option for emergency cash, short- or long-term financial goals. Plus, the Roth IRA does not require minimum distributions at any point.

Note that the total contribution limit for all IRAs combined may not exceed $5,500 a year; $6,500 for account owners over age 50.



Health Savings Account

More and more employers are offering a health savings account (HSA) with a high-deductible health insurance policy; they also are popular among the self-employed. While an HSA initially can be used to help offset health care expenses, it also offers flexibility for retirement savings. First of all, the HSA provides three tax benefits: pretax contributions, tax-deferred growth, and tax- and penalty-free distributions to pay for yours, your spouse's or dependents' medical expenses.

After age 65, you may use HSA funds to pay for Medicare premiums (but not Medigap). Also after age 65, you can withdraw money for any reason without penalty, but the money will be subject to income taxes if not used for qualified medical expenses.

One strategy to help bolster HSA savings is to pay medical expenses out-of-pocket while making annual contributions. This allows the balance to accumulate faster and earnings to grow tax-free. In fact, save the receipts for medical expenses you paid for out-of-pocket to reimburse yourself from the account years later — an option for makeshift tax-free income in retirement.

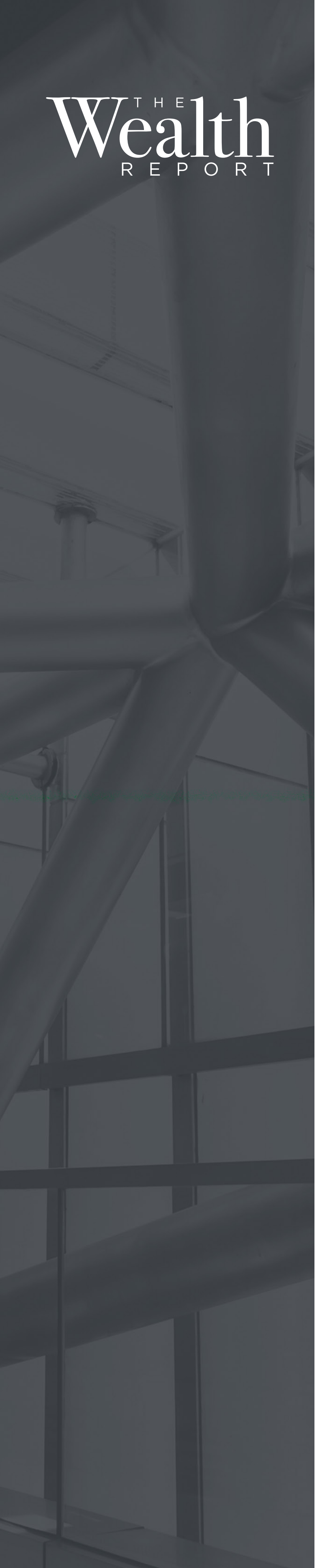
Life Insurance

While many people drop their term life insurance once the kids leave home, permanent life insurance can offer tax-free retirement benefits. In addition to a death benefit, this type of policy offers the ability for the cash value to accumulate on a tax-advantaged basis. This cash value grows and can be withdrawn via tax-free policy loans if you need extra cash. Note that policy loans and withdrawals will reduce the amount of the death benefit, and may cause the policy to lapse. Therefore, it may not be the best option for ongoing supplemental retirement income.

If you do need to use your permanent life policy for income, you may want to consider transferring your cash value to an income annuity, for example, using a strategy called the 1035 exchange. Generally speaking, income annuities are better designed to provide you with retirement income and while the conversion is tax-free, you will have to pay taxes on a portion of the annuity income as you receive it.

Don't wait for tax reform to save aggressively for retirement...

"Consider the adage: 'Don't let the tail wag the dog.' The tail is tax reform, and the dog is your investment strategy." [7]



Final Thoughts

In our opinion, it's usually not a good idea to wait for Congress to pass tax legislation before making investment decisions — much better to act now and tweak later if necessary. Given all that's on the legislative docket now, from disaster recovery to debt limits to mid-term elections, it's nearly impossible to predict the tax treatment for retirement plan contributions and distributions in the near term.

However, don't let that deter you. Develop a strategy based on your needs, your retirement timeline and the appropriate investment plans for your financial situation. As always, it's a good idea to work with a financial advisor to help determine the most appropriate investments and tax-advantaged vehicles to maximize your savings while minimizing your tax burden — both now and when you retire.

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[2] Dayana Yochim. Nerd Wallet. June 29, 2016. "Best Retirement Plans: Choose the Right Plan for You." https://www.nerdwallet.com/blog/investing/best-retirement-plans-for-you/. Accessed Sept. 6, 2017.
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[5] Dayana Yochim. Nerd Wallet. June 29, 2016. "Best Retirement Plans: Choose the Right Plan for You." https://www.nerdwallet.com/blog/investing/best-retirement-plans-for-you/. Accessed Sept. 6, 2017.
[6] IRS. July 27, 2017. "2017 IRA Deduction Limits - Effect of Modified AGI on Deduction if You Are Covered by a Retirement Plan at Work." https://www.irs.gov/retirement-plans/2017-ira-deduction-limits-effect-of-modified-agi-on-deduction-if-you-are-covered-by-a-retirement-plan-at-work. Accessed Sept. 6, 2017.
[7] Robert A. Green. Forbes. Aug. 31, 2017. "Tax Reform Is Uncertain, So Reconsider Your Investment Strategy." https://www.forbes.com/sites/greatspeculations/2017/08/31/tax-reform-is-uncertain-so-reconsider-your-investment-strategy/#12e3f0541eb1. Accessed Sept. 6, 2017.

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