



Focus on Financial Freedom

Maintaining Your Financial Health

Mid-Year Planning: Tax Changes to Factor In



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The overall limit on itemized deductions that applied to higher-income taxpayers is repealed, the income threshold for deducting medical expenses is reduced for 2018, and the income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

Dolan Financial Services

Charlene K. Dolan, CFP® AIF®
Danielle S. Holmes, CRPC® AIF®
108 Main St., Amesbury, MA
978-388-3468
978-465-3468
plan@dolanfinancialservices.com
DolanFinancialServices.com

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A Parent-Child Conversation About College Costs



A weighty decision

Most teens are not financially experienced enough to drive a \$100,000 or \$200,000 decision, especially one that has the potential to impact them for most or all of their 20s or longer. So parent guidance is critical.

If you're the parent of a high school student who's looking ahead to college, it's important to have a grown-up conversation with your child about college costs. A frank discussion can help both of you get on the same page, optimize the college search process, and avoid getting blindsided by large college bills.

An initial conversation: a, b, and c

As a parent, you need to take the lead in this conversation because most 16-, 17-, and 18-year-olds are not financially experienced enough to drive a \$100,000 or \$200,000 decision. One approach is to start off saying something like: "We will have saved 'a' when it's time for you to start college, and after that we should be able to contribute 'b' each year, and we expect you to contribute 'c' each year." That will give you a baseline of affordability when you start targeting colleges.

A more in-depth conversation: borrow x, pay back y

Once you start looking at colleges, you'll see that prices vary, sometimes significantly. If a college costs more than $a + b + c$ above, you'll have to fill the gap. The best way to try and do this is with college grants or scholarships (more on that in a minute). Absent grant aid, you'll need to consider loans. And here is where you should have a more detailed conversation with your child in which you say: "If you borrow 'x' you will need to pay back 'y' each month after graduation." Otherwise, random loan figures probably won't mean much to a teenager.

You can use an online calculator to show your child *exactly* what different loan amounts will cost each month over a standard 10-year repayment term. For example, if College 1 will require your child to borrow a total of \$16,000 at 5%, that will cost \$170 each month for 10 years. If College 2 requires \$24,000 in loans, that will cost \$255 each month. A loan amount of \$36,000 for College 3 will cost \$382 per month, and \$50,000 for College 4 will cost \$530 a month, and so on. The idea is to take an abstract loan amount and translate it into a month-to-month reality.

But don't stop there. Put that monthly loan payment into a larger context by reminding your child about other financial obligations he or she will have after college, such as a cell phone bill, food, rent, utilities, car insurance. For example, you might say: "If you attend College 3 and have a student loan payment of \$382 every month, you'll also need to budget \$40 a month for your phone, \$75 for car insurance, \$400 for food..." and so on. The goal is to help your child understand the cost of real-world expenses and

the long-term financial impact of choosing a more expensive college that will require more loans.

Even with a detailed discussion, though, many teenagers may not be able to grasp how their future lives will be impacted by student loans. Ultimately, it's up to you — as a parent — to help your child avoid going into too much debt. How much is too much? The answer is different for every family. One frequently stated guideline is for students to borrow no more than what they expect to earn in their first year out of college. But this amount may be too high if assumptions about future earnings don't pan out.

To build in room for the unexpected, a safer approach might be to borrow no more than the federal government's Direct Loan limit, which is currently a total of \$27,000 for four years of college (\$5,500 freshman year, \$6,500 sophomore year, and \$7,500 junior and senior years). Federal loans are generally preferable to private loans because they come with an income-based repayment option down the road that links a borrower's monthly payment to earned income if certain requirements are met. Whatever loan amount you settle on as being within your range, before committing to a college, your child should understand the total amount of borrowing required and the resulting monthly payment after graduation. In this way, you and your child can make an informed financial decision.

If there's any silver lining here, it's that parents believe their children may get more out of college when they are at least partly responsible for its costs, as opposed to having a blank check mentality. Being on the hook financially, even for just a small amount, may encourage your child to choose courses carefully, hit the books sufficiently, and live more frugally. Later, if you have the resources, you can always help your child repay his or her student loans.

Target the right colleges

To reduce the need to borrow, spend time researching colleges that offer grants to students whose academic profile your child matches. Colleges differ in their aid generosity. You can use a net price calculator — available on every college website — to get an estimate of how much grant aid your child can expect at different colleges. For example, one college may have a sticker price of \$62,000 but might routinely offer \$30,000 in grant aid, resulting in an out-of-pocket cost of \$32,000. Another college might cost \$40,000 but offer only \$5,000 in grant aid, resulting in a higher \$35,000 out-of-pocket cost.



Managing Money When You Marry: Financial Tips for Newlyweds



According to a survey by the American Psychological Association, 62% of Americans are stressed about money.¹

The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased.

Getting married is an exciting time for a couple. However, along with this excitement come many challenges. One such challenge is how to manage your finances together. The key to success is to communicate with your partner and come up with a financial plan that you both agree on, since the financial decisions you make now can have a lasting impact on your finances in the future.

Map out your financial future together

Your first step should be to discuss your common financial goals. Where do you see yourself next year? What about five years from now? Together, make a list of your short- and long-term financial goals. Short-term goals are ones that can be achieved in less than five years (e.g., saving for a down payment on a home or new car). Long-term goals usually take more than five years to achieve (e.g., paying off college loans, saving for retirement). Next, determine which financial goals are most important to both of you so together you can focus your energy on them.

Prepare a budget

A budget is an important part of managing 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. Start by listing your current monthly income. In addition to your regular salary and wages, be sure to include other types of income, such as dividends and interest. Next, add up all of your expenses. It helps to divide expenses into two categories: fixed (e.g., housing, food, transportation, student loan payments) and discretionary (e.g., entertainment, vacations). Ideally, you should be spending less than you earn. If not, you need to review your expenses and look for ways to cut down on your spending.

Consider combining bank accounts

You'll also need to decide whether you and your spouse should combine bank accounts or keep them separate. While maintaining a joint account does have its advantages (e.g., easier record keeping and lower maintenance fees), it is sometimes difficult to keep track of the flow of money when two individuals have access to a single account. Fortunately, online banking makes it easier to know exactly what is in your account at all times. If you choose to keep separate accounts, you might consider opening a joint checking account to pay for common household expenses.

Resolve outstanding credit/debt issues

Having good credit is an important part of any sound financial plan, so this would be a good time to identify any potential credit or debt problems you or your spouse may have and try to resolve them now rather than later. Order copies of your credit reports and review them together. You are entitled to a free copy of your credit report from each of the three major credit reporting agencies once every 12 months (visit annualcreditreport.com for more information). For the most part, you are not responsible for your spouse's past credit problems, but they can prevent you from getting credit together as a married couple. Even if you've always had good credit, you may be turned down for credit cards or loans that you apply for together if your spouse has a bad credit history. As a result, if one of you had credit issues, you might consider keeping your credit separate until your credit situation improves.

Evaluate your employee and retirement benefits

If you and your spouse have separate health insurance coverage through an employer, you'll want to do a cost-benefit analysis of each plan to determine whether you should keep your health coverage separate. Compare each plan's deductible, copayment, and benefits as well as the premium for one family plan against the cost of two single plans. In addition, if you and your spouse participate in an employer-sponsored retirement plan, you should be aware of each plan's investment options, matching contributions, and loan provisions. Review each plan carefully and determine which one provides the better benefits. If you can afford to, contribute the maximum amount possible to your respective plans.

Assess your life and disability insurance needs

While the need for life and disability insurance may not have seemed necessary when you were both single, as a married couple you may find that you are financially dependent on each other. Having life and disability plans in place will help ensure that your financial needs will be taken care of if either of you dies or becomes disabled. If you already have insurance, you should reevaluate the adequacy of your coverage and update your beneficiary designations.

¹ "Stress in America," American Psychological Association, 2017



Dolan Financial Services

Charlene K. Dolan, CFP® AIF®

Danielle S. Holmes, CRPC®
AIF®

108 Main St., Amesbury, MA

978-388-3468

978-465-3468

plan@dolanfinancialservices.com

DolanFinancialServices.com

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Commonwealth does not provide legal or tax advice. Please consult with a legal or tax professional regarding your individual situation.



Can I undo my Roth IRA conversion in 2018?

The answer is: It depends.

When you convert a traditional IRA to a Roth IRA, you include the value of your traditional IRA, reduced by any

nondeductible contributions you've made, in your income for federal tax purposes in the year of the conversion. For conversions prior to 2018, if you subsequently decided to "recharacterize" or undo the conversion for any reason — e.g., the value of your IRA assets declined after the conversion, resulting in a bad tax deal — the IRS would permit you to do so, provided the recharacterization took place in a timely fashion.

For example, assume you converted a fully taxable traditional IRA worth \$50,000 to a Roth IRA in 2016. You would have been required to include \$50,000 in income on your 2016 federal income tax return. But shortly after the conversion, the value of your Roth IRA declined to \$40,000. Suddenly you were faced with the proposition of paying taxes on \$50,000, while your Roth IRA was worth only \$40,000.

Fortunately, you had until your tax return due date (including extensions) to undo all or part of a conversion. So in this example, you would

have had until October 15, 2017, to recharacterize the conversion.

Unfortunately, the Tax Cuts and Jobs Act passed in 2017 eliminated the option to recharacterize a Roth conversion, with one exception: If you converted your Roth IRA in 2017 and have since changed your mind, you have until your filing deadline, including extensions (or until October 15, 2018), to recharacterize.

When you recharacterize, you need to withdraw the amount you originally converted, plus any earnings, out of the Roth IRA and transfer it back to a traditional IRA.

If you already paid your taxes for 2017, you'll need to file an amended return to obtain a refund for any taxes paid on the conversion. An amended return can generally be filed as late as three years after the original return was filed.

Undoing a Roth conversion can be complicated, so it's probably a good idea to consult your tax professional before taking action.



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.

