Ten income and estate tax planning strategies for 2018

Key tax facts for 2018

Highest marginal tax rates	37% on ordinary income (taxable income exceeding $500,000 for single filers and $600,000 for couples), 20% on capital gains and dividends applied on taxable income exceeding $425,800 ($479,000 for couples)
Medicare investment income surtax	3.8% surtax on net investment income (e.g., interest, capital gains, dividends, rental income, royalties, income from non-qualified annuities, "passive" business income) affecting taxpayers with more than $200,000 in modified adjusted gross income ($250,000 for couples)
Additional Medicare payroll tax	Extra tax of 0.9% on salary and wages as Medicare payroll tax increases from 1.45% to 2.35% on earnings above $200,000 ($250,000 for couples)
Personal exemptions	Repealed
Child tax credit (CTC)	Increased from $1,000 to $2,000 for "qualifying children" under 17 years old at the end of the year. An additional $500 tax credit applies to other qualified dependents who are not qualifying children (e.g., dependent child age 17 or over). The tax credit is phased out as income exceeds $200,000 (individuals) or $400,000 (couples)
Estate/gift tax exemption	$11.2 million
Annual gift tax exclusion amount	$15,000

Significant changes to tax deductions for 2018

Standard deduction	Nearly doubled to $12,000 (individuals) and $24,000 (couples)
Mortgage interest	Interest on home equity lines of credit (HELOC) deductible in certain cases where proceeds are utilized to acquire or improve a property
State and local taxes	Capped at $10,000 in aggregate
Medical expenses	Expanded for 2017 and 2018 with a 7.5% AGI threshold (10% thereafter)
Miscellaneous 2% deductions	Repealed
Charitable contributions	Deduction for cash gifted to public charities increased to 60% of AGI (from 50%)
Student loan interest	Deduction still available
Moving expenses	Available to members of the armed services only
Personal casualty losses	Available only if federal disaster is declared
Pease rule	Repealed, no income phaseout of itemized deductions

Visit putnamwealthmanagement.com for the latest tax and financial planning ideas from Putnam.

Not FDIC insured | May lose value | No bank guarantee

Ten tax-smart strategies to consider in 2018

1. **Invest in municipal bonds to generate tax-free income**

   Even with reduced tax rates, municipal bonds may still be attractive on a relative tax basis for higher-income taxpayers , especially those who find themselves subject to the 3.8% surtax on net investment income. The tax equivalent yield, i.e., the yield an investor would require in a taxable bond investment to equal the yield of a comparable tax-free municipal bond, is higher for those taxpayers.

2. **Utilize strategies to reduce or avoid taxable income**

   Contributing to a retirement plan or IRA, funding a flexible spending account (FSA), or deferring compensation income can reduce adjusted gross income (AGI) and prevent a taxpayer from reaching key income thresholds that may result in a higher tax bill. Conversely, be mindful of transactions, such as the sale of a highly appreciated asset, which may increase your overall income above thresholds for the 3.8% surtax, impact taxability of Social Security benefits, or result in higher Medicare premiums.

3. **Consider Roth IRA/401(k) contributions or conversions**

   A thoughtful strategy utilizing Roth accounts can be an effective way to hedge against the threat of facing higher taxes in the future. Younger investors or taxpayers in lower tax brackets should consider using Roth accounts to create a source of tax-free income in retirement. It is virtually impossible to predict tax rates in the future or to have a good idea of what your personal tax circumstances will look like years from now. Like all income from retirement accounts, Roth income is not subject to the new 3.8% surtax and is also not included in the calculation for the $200,000 income threshold ($250,000 for couples) to determine if the surtax applies. IRA owners considering a conversion to a Roth IRA should carefully evaluate that transaction since the option to recharacterize, or un-do, a Roth IRA conversion is no longer available.

4. **Maximize deductions in years when itemizing**

   With the large increase in the standard deduction and the scaleback of many popular deductions, fewer taxpayers will choose to itemize on their tax return going forward. Some taxpayers may benefit by alternating between claiming the standard deduction some years and itemizing deductions other years. If possible, it would make sense to "lump" as many deductions into those years when itemizing. For example, taxpayers may want to consider making a substantial charitable contribution during a tax year when itemizing instead of making regular, annual gifts. In addition, with the repeal of the "Pease rule," there are no phaseouts on itemized deductions at higher income levels.

5. **Be mindful of irrevocable trusts and taxes**

   Because of the low income threshold ($12,500 for 2018), which will subject income retained within an irrevocable trust to the highest marginal tax rates and the 3.8% Medicare surtax, trustees may want to reconsider investment choices inside of the trust (municipal bonds, life insurance, etc.). Or, maybe trustees should consider (if possible) distributing more income out of the trust to beneficiaries who may be in lower income tax brackets.

6. **Review estate planning documents and strategies**

   The increase in the lifetime exclusion amount for gifts and estates (projected at $11.2 million per individual in 2018) may have unintended consequences for some individuals and families with wealth under that threshold. They may think that they do not have to plan for their estate. However, taxes are just one facet of estate planning. It is still critical to plan for an orderly transfer of assets or for unforeseen circumstances such as incapacitation. Strategies to consider include proper beneficiary designations on retirement accounts and insurance contracts, wills, powers of attorney, health-care directives, and revocable trusts.

7. **Plan for potential state estate taxes**

   While much attention is focused on the federal estate tax, certain residents need to know that many states have estate or inheritance taxes. There are a number of states that are “decoupled” from the federal estate tax system. This means the state applies different tax rates or exemption amounts. A taxpayer may have net worth comfortably below the $11,200,000 exemption amount for federal estate taxes, but may be well above the exemption amount for his or her particular state. It is important to consult with an attorney on specific state law and potential options to mitigate state estate or inheritance taxes.

8. **Develop a strategy for low cost-basis assets**

   Ensure stepped-up cost basis is maintained when property is transferred at death. For example, careful consideration should be made around lifetime gifts that may jeopardize a step-up in cost basis on property at death. When property is gifted, the party receiving the gift generally assumes the original cost basis. Additionally, certain trust provisions may be utilized to ensure that property receives a step-up in cost basis at death.

9. **Expand use of 529 accounts for education savings**

   529 college savings plans retain existing tax advantages. Account earnings are free of federal income tax, and a special gift tax exclusion allows you to make five years’ worth of gifts to a single beneficiary in one year without triggering the federal gift tax. Qualified education expenses were expanded in recent years to include laptops, computers and related technology. The new tax law allows families to use up to $10,000 annually for K–12 tuition.

10. **Consider the charitable rollover option if you are a retiree**

    Retired IRA owners (age 70½ and older) may benefit from directing charitable gifts tax free from their IRA. Since even more retirees will claim the higher standard deduction, they will not benefit tax-wise from making those charitable gifts unless they itemize deductions. Account owners are limited to donating $100,000 annually, which can include the required minimum distribution (RMD), and the proceeds must be sent directly to qualified charity.

Consult a qualified tax or legal professional and your financial advisor to discuss these types of strategies to prepare for the risk of higher taxes in the future. Personal circumstances vary widely so it is critical to work with a professional who has knowledge of your specific goals and situation.

While all bonds have risks, municipal bonds may have a higher level of credit risk as compared with government bonds and CDs. Capital gains, if any, are taxable for federal and, in most cases, state purposes. Income from federally tax-exempt funds may be subject to state and local taxes.

This material is for informational and educational purposes only. It is not a recommendation of any specific investment product, strategy, or decision, and is not intended to suggest taking or refraining from any course of action. It is not intended to address the needs, circumstances, and objectives of any specific investor. Putnam, which earns fees when clients select its products and services, is not offering impartial advice in a fiduciary capacity in providing this sales and marketing material. This information is not meant as tax or legal advice. Investors should consult a professional advisor before making investment and financial decisions and for more information on tax rules and other laws, which are complex and subject to change.

Putnam Retail Management

Putnam Investments | 100 Federal Street | Boston, MA 02110 | putnam.com

II922 312993 9/18