CALAMOS®
WEALTH
MANAGEMENT

FAMILY MATTERS

Insights on key topics—
through a multi-generational lens.

TOPIC:

RETIREMENT & TAX PLANNING AS TAX-FILING DATE APPROACHES

Although the calendar has turned to the New Year, some retirement-account tax-planning strategies remain available in advance of filing tax returns for 2018 income. Also, since 2018 is the first full year affected by the recent tax reform, the Tax Cuts and Jobs Act (TCJA), there are important new factors to plan for.

In this installment of Family Matters, we are pleased to offer insights from New York-based Gary Weissman, CPA, of Wolf Weissman CPA's, P.C. and Calamos Wealth Management senior wealth advisor Geoffrey Sargeant.

We created the *Family Matters* insight series to spark ideas and spur conversation among family members on a wide range of important financial topics. They're purposely written as a primer for more in-depth discussions with your Calamos Wealth Management advisor on how the matters presented will apply to you and your family's unique situation. We hope you find that the multi-generational lens by which topics are presented promotes pass-along readership to multiple family members. Your Calamos Wealth Management advisor is available to all members of your family to provide guidance on matters you care about most.

For Jack Riley and wife Anne, getting ready for taxes this year is more complicated than usual. Jack, 60, is one year into business on his own, having sold his stake in a manufacturer's rep business to his former partners. Jack's not ready to retire "for real"—that's about five years down the road—but he is pleased to be shifting gears. For 2018, Jack's income consists of $100,000 from his former partners—the buy-out funds, which will total $500,000 over five years—plus another $125,000 from a few long-held accounts that Jack negotiated to keep when he left the partnership.

Now that Jack's a one-man show, he's looking forward to being on the road for pleasure more often than business. That includes summer adventures with his wife, Anne, also 60—who, as a middle school teacher, has summers off. Looking further down the road, Jack and Anne have big plans for retirement in five years. They want to save as aggressively as possible. Now that it's 2019, they're getting ready to file their 2018 taxes—and realize there's lots to think about.

Revving Up Retirement Contributions

In past years, Jack had contributed to a 401(k) he and his partners had established. Now on his own, he meant to figure out the best retirement plan strategy for his 2018 sole-proprietorship income—but didn't get around to it before year-end. Now that 2018 is over, what can he do to gain tax advantages for his 2018 income and set himself up for success going forward?

Also, Anne wonders whether she should increase her annual contribution to her school district's 403(b) plan. She's been contributing up to the employer-match level but has the option to set aside much more.

""Jack and Anne can benefit from a team-based approach to their retirement and tax planning," says Gary P. Weissman, CPA, of Wolf Weissman CPA's, P.C. in New York City. "With aggressive retirement goals and a newly formed business, not to mention changing tax laws, they need comprehensive financial and tax planning expertise."

Assuming the couple has enough liquidity to accommodate significantly increased retirement contributions, a natural first place to start is Anne's 403(b) account. "By increasing her contributions to the annual maximum of $19,000 plus a $6,000 catch-up contribution (since she is over age 50), Anne can channel a significant portion of her salary into retirement accounts over the next five years," says Weissman. "Unlike IRAs, in which 2018 filers can contribute until April 15th, 2019, 403(b) and 401(k) contributions can't be made retroactively after year-end and before filing your taxes, so this would apply to Anne's 2019 income, not 2018."

Fortunately, in Jack's case, there is an opportunity to address 2018 income even though the calendar has turned to 2019. Because he owns his own business, he could put aside even more money—with a SEP (Simplified Employment Pension) IRA as the most likely fit.

"For Jack, the obvious first thing to consider is a Traditional IRA," says Geoffrey Sargeant, Senior Wealth Advisor with Calamos Wealth Management. "But in this case, the $5,500 contribution limit for IRAs, even when combined with a catch-up contribution of $1,000, doesn't put much of a dent in the need. With relatively high income and a strong desire to put away as much as possible over the next five years, Jack should consider other options."

"In Jack's case, given that his needs for cash are significantly lower than his income, a SEP may be ideal because it will allow him to sock away a drastically larger amount than IRAs and, furthermore,

even more than he'd been able to with the 401(k) prior to departing his prior business. Also, because Jack doesn't have any employees, he doesn't need to factor in the requirement to contribute to a SEP on employees' behalf. Over the course of five years, he could direct more than a quarter-million dollars to the SEP account."

Because SEPs are handled at the business level, they can be established any time prior to the business' tax-filing date (including extensions). So, it may be possible in early 2019 for Jack to establish a SEP plan that can accommodate a contribution made from 2018 income. Like other IRAs, SEPs are also flexible: if the Rileys' situation changes anytime in the next few years, Jack can simply reduce or skip a year's contribution.

While the SEP contribution limits are high, there's another option that could enable Jack to contribute even more on a tax-advantaged basis—but likely not with 2018 income. "For 2019 and beyond, Jack might want to consider a 'personal' defined-benefit plan," says Sargeant.

With a defined-benefit plan, Jack would declare to the IRS the benefit amount he'd like to receive out of the plan upon reaching retirement (or another date, so long as it occurs after age 59 ½). Then, an actuary determines what level of contributions he needs to make now, and each subsequent year before retirement, in order to fund those distributions. Because of fees and complexities, defined-benefit plans probably won't make sense unless a person has substantial cash to set aside. And they usually are best suited for people in pre-retirement years—say, age 50 to 60 or so.

If Jack and Anne want to "to the max" with retirement-plan contributions, they may be best to focus on maxing out Anne's 403(b) contributions going forward, retroactively creating a SEP-IRA for Jack to handle 2018 income, and then either continuing with the SEP or switching over to a defined-benefit plan for 2019 and beyond.

Qualifying for the QBI deduction

Jack wonders if his new business qualifies for the new Section 199A qualified business income deduction he's been hearing so much about. His 2018 income was about $225,000, which together with Anne's $85,000 per year teacher's salary brings the couple's total income to around $310,000.

The Tax Cuts and Jobs Act of 2017 enacted a new section 199A (Qualified Business Deduction, or QBI) to level the playing field for Partnerships, S Corporations, Limited Liabilities Companies and Sole Proprietorships in light of significant federal tax rate deductions to C Corporations.

Eligibility for the deduction is based both upon the type of activity the business undertakes and the amount and type of taxable Income of the owners. Up to 20% of the qualified Income derived from the eligible business can be claimed by the business owner if the owner is an individual, estate or trust and meets the various tests.

In Jack and Anne's case it appears as though their taxable Income will be under $315,000. That being the case, they may be entitled to the QBI deduction.

Every situation is different, Weissman cautions. "'Not all owners of these pass thru entities qualify for the QBI deduction." The rules are complex, and taxpayers should consult their tax advisor to determine if they are eligible.

SALT/Real Estate Taxes

"In this scenario, Jack and Anne are among the millions of people affected by the recent tax reform's limitation on federal tax deductions for taxes paid at the state and local level," says Weissman.

Under the new tax law, a limited exemption is provided to allow individuals to claim as an itemized deduction up to $10,000 in the aggregate. For state and local taxes (SALT), property and other taxes, the

$10,000 limit does not apply if paid or accrued in carrying on a trade or business. Foreign real estate taxes cannot be part of the $10,000.

"Previously, many filers could deduct the full amount of state income and property taxes paid (if not subject to the Alternative Minimum Tax, or AMT) when filing their federal returns," says Weissman. "For high earners and property-tax payers, this limitation may be a significant hit."

However, Weissman recommends continuing to provide your CPA with the same information you have before. He explains, "In New York and several other states, state tax rules no longer follow the federal guidelines with respect to property-tax and other deductions. There may be benefit to capture these deductions at the state level."

Conclusion

"Because Jack and Anne can derive substantial benefits by channeling 2018 income into a SEP account even though the calendar has flipped to 2019, that topic should be among their top priorities," says Sargeant. "But Jack and Anne should also start giving close attention to 2019 planning, including Anne's 403(b) plan and potentially other gift- and estate-planning topics."

For example, Sargeant calls attention to 529 plans for educational savings. He says, "Supporting grandchildren's education is important to many people as they approach or enter retirement, given how the timing often works out. By channeling some income into 529 plans, grandparents can do so tax-free, both now and later, assuming the funds are eventually used for educational purposes."

Sargeant notes that 529 plans need to be funded during the calendar year, so they aren't a fit retroactively to 2018. IRAs, including the SEP-IRA that may be a fit for Jack, are the main exception to calendar-year funding rules.

"The tax and financial planning canvas has changed. In order to avoid pitfalls, the soundest approach is leveraging your team of experts," says Weissman.

Calamos Wealth Management | 2020 Calamos Court | Naperville, IL 60563 | 888.857.7604 | www.calamos.com/wm | cwm@calamos.com

8566 03190 CWM