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Johnston Investment Counsel

LIFE THE WAY YOU PLANNED IT.

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The overall limit on itemized deductions that applied to higher-income taxpayers is repealed, the income threshold for deducting medical expenses is reduced for 2018, and the income limitations on charitable deductions are eased.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

Investing to Save Time Boosts Happiness Returns

"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

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

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.

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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.

As a business owner, what should I know about using temporary workers?

If you're planning to ramp up your temporary staff this summer, here are a few things to know.

Generally, temporary work is any work that is not intended to be permanent or long term. Temporary work can be full- or part-time. Use of temporary workers (sometimes referred to as temps) may provide you with some flexibility to handle employee absences due to illness, vacation, or maternity leave. They may also help you handle special projects, busy times, or seasonal work.

Temporary workers can be hired directly or through a temporary employment agency. Temporary workers you hire directly, even if part-time, are generally treated the same as full-time workers and may be entitled to employee benefits through you. For example, a worker who completes 1,000 hours of service in a year may be eligible to participate in your retirement plan.

On the other hand, a temporary employee hired through a temp agency works for the agency, not for you. The employment agency is generally responsible for the temporary employee's benefits, if any. The hourly wage rate you pay to the agency may be higher as a result.

The temp agency can save you time and effort by finding and screening potential employees so that you don't have to. The agency may have a pool of workers available at any time and at a moment's notice. The screening, in particular, may be worth the extra cost in the current tight job market.

However, you may need to break in or train a temporary employee each time you get one from the employment agency. To minimize this, you may request that the employment agency send a temporary employee who has already worked for you before.

Sometimes a temporary employee may become a permanent employee. If an employee was hired through a temporary employment agency, depending on your contract with the employment agency, you may need to pay a fee to the agency if you permanently hire the temporary employee.

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IRS Across the Pond

You probably don't invest a great deal of time feeling sorry for a certain U.S. citizen named Meghan Markle, who has just tied the proverbial knot with Prince Harry of England. However, an article in the Wall Street Journal, states that the bride-to-be, as well as other American citizens who marry foreigners, are subject to a lifetime of harassment by America's Internal Revenue Service.

As an example, what happens if the Queen of England lends her a tiara or diamond bracelet? She'd need to tell the IRS about it. If (as is probable) Harry and Meghan share a charge card and it is also tied to a bank account that has more than $10,000 (which is also likely), this card and account need to be reported to U.S. authorities.

It is possible that none of these things will raise the newlywed's tax bill. But, there are serious penalties for not giving the correct reports to the U.S. government -- possibly as much as half of the total assets within an account. Assets that are held in trust can be taxed at rates up to 37 percent -- and many English royal assets happen to be held in trust.

The report goes into some other strange provisions from the tangle of global financial requirements. In situations where a U.S. citizen works in Australia, Australian law requires that person to have a retirement account. But, U.S. tax law treats the accounts the same as overseas trusts, using complex reporting rules.

Obviously, Meghan could opt out of U.S. citizenship, which thousands of others have done. But, she wouldn't receive U.K. citizenship until after a potentially significant waiting period. She would still have to cope with U.S. tax law in the meantime.

New and Improved

18,000 adults in nine countries were asked a very simple question: "All things considered, do you think the world is getting worse or better, or neither getting better nor worse?"

As you can see in the picture, the most optimistic country regarding the long run is Sweden, but with the sad news being that only 10% of Swedes think the planet is growing positively. It only goes down from there, other Norwegian nations are at 8% optimistic, while 6% of Americans and just 4% of German and British residents believe the world is getting to be a better place.

As it happens, this small minority is right. A post in Our World In Data says that if we look back 30 or perhaps 50 years, we could see progress that may not be visible if our narrowed time period is "since last week" The post, in actuality, suggests that the planet is growing tremendously better in a variety of ways that are happening too slowly for us to appreciate in day to day life.

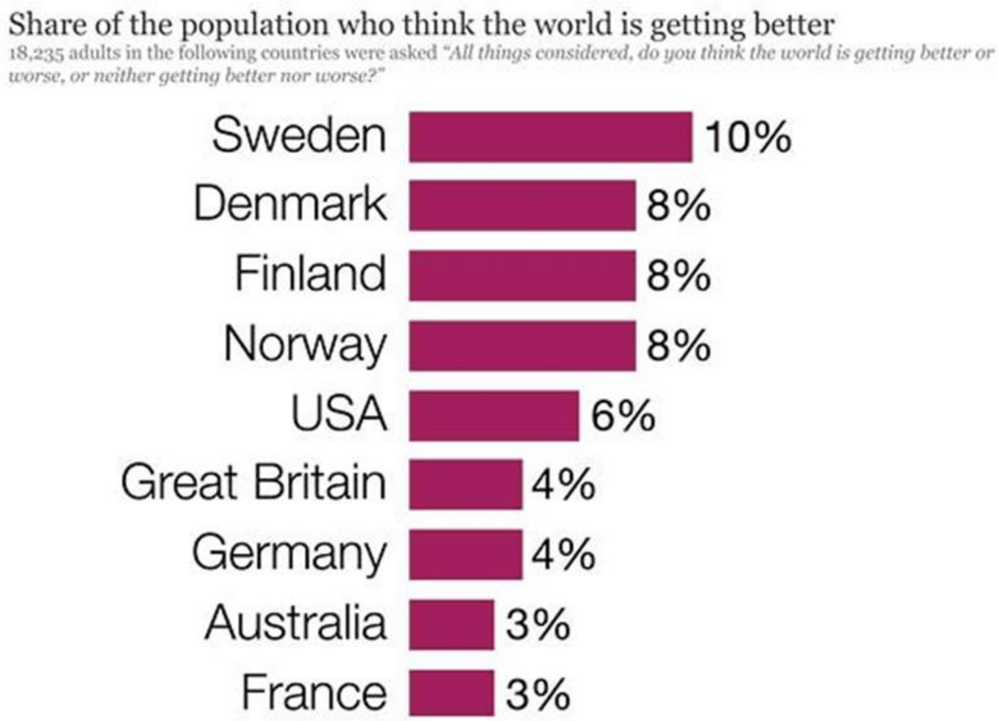
For example? The amount of people living in extreme poverty—which is defined as living on less than $1.90 a day, adjusted for different currencies in different countries and for inflation (and for subsistence farming, where each crop is given equal value) --has dropped from nearly everybody in 1820 to 44 percent in 1981 and down to less than 10 percent of international taxpayers in 2015 (the last year which we have the data). Is that not an incredible improvement?

Another step is literacy. Back in 1915 only about 1 in 10 people 15 years of age could write and read. Then in 1930, the amount was around 33%. Now, internationally, almost 85% of our planet's people can read and write in their native language, and of course many people nowadays are bilingual.

When reviewing health, the researchers state that we can't appreciate how much safer the world has become before we peek back at how dreadful the past had been. In 1800, about 43 percent of the planet's newborn childeren died prior to their 5th birthday. Ever since then, we have enjoyed improved housing, sanitation, nutrition, and much more accessible food (which also made us smarter and taller), as well as the germ theory of medicine, antibiotics and vaccines. Today, only about 4.3% of childeren die before age 5.

The article also considers political freedom, which has shifted from only those living in colonial regimes to virtually everybody living under a republican government today. Educational opportunities as well are far more prevalent now than they were even 50 years ago, around the globe generally the world has had better health, more money, and a higher intellect than we have in the past.

Not understanding that we've come so far shows that we may not know our own history quite well as we thought--also, the article indicates, that this deprives us of a positive outlook on ourselves and also on the future. We should have more confidence in ourselves; despite the obvious hiccups and speed bumps of everyday life, the human race appears to be doing a fantastic job of enhancing its living conditions and improving the world.



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Robots among us?

Have you heard that the European Parliament has introduced an idea to grant "personhood" status to some of the more intelligent machines (aka robots)? In case you don't believe it, here is the specific proposal:

"At the least, the most sophisticated autonomous robots could be established as having the status of electronic persons responsible for making good any damage they may cause, and possibly applying electronic personality to cases where robots make autonomous decisions or otherwise interact with third parties independently."

Electronic personhood applies to robots having the capability to learn through interaction and experience, as well as the capacity to adapt their behavior and activities into their environment. The point is to help straighten out who's legally responsible in case a robot injures an individual or destroys land. The maker? The programmer? Or perhaps the robot? The "personhood" provision wouldn't allow the robots to vote or allow them to have property. The legal status is more just like a corporation, that may be held liable for neglect or actual harm to others or the environment. It would enable the robot to have an insurance policy that would cover any potential damage it may cause. Exactly like our own insurance.

Are you skeptical that this is a good idea? If so, you're one of many. Recently, 156 experts in robotics signed an open letter to the European Commission. They stress that granting personhood to robots puts the wrong incentives for manufacturers, who would be absolved of responsibility for the actions of their newly-created legal workers. There is talk about a unique kind of personhood or classification for robots and intelligent machines but that status hasn't been determined yet. Regardless, today's intelligent machines probably aren't smart enough to have their own special status (but it may only be a matter of time.)

Interestingly, these experts think that autonomous legal status for robots is coming up in the near future. After all, there's no reason to think that an aware mind has to be strictly restricted by organic beings. If an artificial being can pass the language and behavioral evaluations, given to individuals, then it is going to be time for us to think of a presumption of legal status. The European initiative may be ahead of its time, but it signifies that the days of us working and living alongside thinking, intelligent machines are not way off.