



## Johnston Investment Counsel

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Protect Your Heirs by Naming a Trust as IRA Beneficiary

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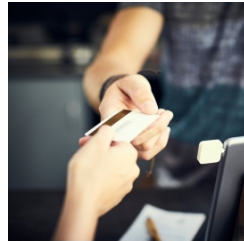


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### Pick Your Plastic: Debit or Credit?



According to a Federal Reserve study, Americans use debit cards more often than credit cards, but the total value and the average value of credit card transactions are higher than those of debit card transactions.

While consumers made 69.5 billion transactions using debit cards, the total value of these transactions was \$2.56 trillion, with an average transaction value of \$37. Credit card usage resulted in 33.8 billion transactions, with a total value of \$3.16 trillion, and a \$93 average transaction value.<sup>1</sup>

This reflects fundamental differences. A debit card acts like a plastic check and draws directly from your checking account, whereas a credit card transaction is a loan that remains interest-free only if you pay your monthly bill on time. For this reason, people may use a debit card for regular expenses and a credit card for "extras." However, when deciding which card to use, you should be aware of other differences.

#### Fraud protection

In general, you are liable for no more than \$50 in fraudulent credit card charges. For debit cards, a \$50 limit applies only if a lost card or PIN is reported within 48 hours. The limit is \$500 if reported within 60 days, with unlimited liability after that. A credit card may be safer in higher-risk situations, such as when shopping online, when the card will leave your sight in a restaurant, or when you are concerned about a card reader. If you regularly use a debit card in these situations, you may want to maintain a lower checking balance and keep most of your funds in savings.

#### Merchant disputes

You can dispute a credit card charge before paying your bill and shouldn't have to pay it while the charge is under dispute. Disputing a debit card charge can be more difficult when

the charge has been deducted from your account, and it may take some time before the funds are returned.

#### Rewards and extra benefits

Debit cards offer little or no additional benefits, while some credit cards offer cash-back rewards, and major cards typically include extra benefits such as travel insurance, extended warranties, and secondary collision and theft coverage for rental cars (up to policy limits). Of course, if you do not pay your credit card bill in full each month, the interest you pay can outweigh any financial rewards.

#### Credit history

Using a credit card responsibly can help you build a positive credit history because your usage is reported to credit reporting agencies. A debit card has no effect on your credit.

#### Money management

Using a debit card helps ensure that you don't overspend. Because purchases are deducted right away from your checking account, you aren't in the dark about how much you're spending. You can quickly check your balance online or at an ATM, and see which purchases are pending.

A credit card offers you the flexibility of tracking your monthly expenses on one bill, which can help you establish and stick to a realistic budget. A credit card can also be used in emergencies.

Considering the additional protections and benefits, a credit card may be a better choice in some situations — but only if you pay your monthly bill on time. The good news is, you don't have to choose just one option.

<sup>1</sup> U.S. Federal Reserve, 2016 (2015 transactions, most recent data available)

## Marriage and Money: Taking a Team Approach to Retirement



Open communication and teamwork are especially important when it comes to saving and investing for retirement.

Now that it's fairly common for families to have two wage earners, many husbands and wives are accumulating assets in separate employer-sponsored retirement accounts. In 2018, the maximum employee contribution to a 401(k) or 403(b) plan is \$18,500 (\$24,500 for those age 50 and older), and employers often match contributions up to a set percentage of salary.

But even when most of a married couple's retirement assets reside in different accounts, it's still possible to craft a unified retirement strategy. To make it work, open communication and teamwork are especially important when it comes to saving and investing for retirement.

### Retirement for two

Tax-deferred retirement accounts such as 401(k)s, 403(b)s, and IRAs can only be held in one person's name, although a spouse is typically listed as the beneficiary who would automatically inherit the account upon the original owner's death. Taxable investment accounts, on the other hand, may be held jointly.

Owning and managing separate portfolios allows each spouse to choose investments based on his or her individual risk tolerance. Some couples may prefer to maintain a high level of independence for this reason, especially if one spouse is more comfortable with market volatility than the other.

However, sharing plan information and coordinating investments might help some families build more wealth over time. For example, one spouse's workplace plan may offer a broader selection of investment options, or the offerings in one plan might be somewhat limited. With a joint strategy, both spouses agree on an appropriate asset allocation for their combined savings, and their contributions are invested in a way that takes advantage of each plan's strengths while avoiding any weaknesses.

Asset allocation is a method to help manage investment risk; it does not guarantee a profit or protect against loss.

### Spousal IRA opportunity

It can be difficult for a stay-at-home parent who is taking time out of the workforce, or anyone

who isn't an active participant in an employer-sponsored plan, to keep his or her retirement savings on track. Fortunately, a working spouse can contribute up to \$5,500 to his or her own IRA and up to \$5,500 more to a spouse's IRA (in 2018), as long as the couple's combined income exceeds both contributions and they file a joint tax return. An additional \$1,000 catch-up contribution can be made for each spouse who is age 50 or older. All other IRA eligibility rules must be met.

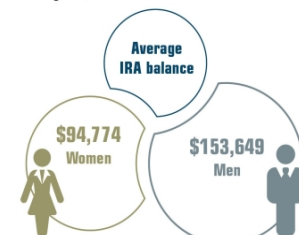
Contributing to the IRA of a nonworking spouse offers married couples a chance to double up on retirement savings and might also provide a larger tax deduction than contributing to a single IRA. For married couples filing jointly, the ability to deduct contributions to the IRA of an active participant in an employer-sponsored plan is phased out if their modified adjusted gross income (MAGI) is between \$101,000 and \$121,000 (in 2018). There are higher phaseout limits when the contribution is being made to the IRA of a nonparticipating spouse: MAGI between \$189,000 and \$199,000 (in 2018).

Thus, some participants in workplace plans who earn too much to deduct an IRA contribution for themselves may be able to make a deductible IRA contribution to the account of a nonparticipating spouse. You can make IRA contributions for the 2018 tax year up until April 15, 2019.

*Withdrawals from tax-deferred retirement plans are taxed as ordinary income and may be subject to a 10% federal income tax penalty if withdrawn prior to age 59½, with certain exceptions as outlined by the IRS.*

### Savings Gap

Despite career gains, women tend to retire with fewer assets than men.



Source: Employee Benefit Research Institute, 2017 (2014 data)



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## Protect Your Heirs by Naming a Trust as IRA Beneficiary



While trusts offer numerous advantages, they incur up-front costs and often have ongoing administrative fees. The use of trusts involves a complex web of tax rules and regulations. You should consider the counsel of an experienced estate planning professional and your legal and tax advisers before implementing such strategies.

Often, tax-qualified retirement accounts such as IRAs make up a significant part of one's estate. Naming beneficiaries of an IRA can be an important part of an estate plan. One option is designating a trust as the IRA beneficiary.

**Caution:** *This discussion applies to traditional IRAs, not to Roth IRAs. Special considerations apply to beneficiary designations for Roth IRAs.*

### Why use a trust?

Here are the most common reasons for designating a trust as an IRA beneficiary:

- Generally, inherited IRAs are not protected from the IRA beneficiary's creditors. However, IRA funds left to a properly drafted trust may offer considerable protection against the creditors of trust beneficiaries.
- When you designate one or more individuals as beneficiary of your IRA, those beneficiaries are generally free to do whatever they want with the inherited IRA funds, after your death. But if you set up a trust for the benefit of your intended beneficiaries and name that trust as beneficiary of your IRA, you can retain some control over the funds after your death. Your intended beneficiaries will receive distributions according to your wishes as spelled out in the trust document.
- Through use of a trust as IRA beneficiary, you may "stretch" IRA payments over the lifetimes of more than one generation of beneficiaries. Payments to IRA trust beneficiaries must comply with distribution rules depending on the type of IRA plan.

### What is a trust?

A trust is a legal entity that you can set up and use to hold property for the benefit of one or more individuals (the trust beneficiaries). Every trust has one or more trustees charged with the responsibility of managing the trust property and distributing trust income and/or principal to the trust beneficiaries according to the terms of the trust agreement. If the trust meets certain requirements, the beneficiaries of the trust can be treated as the designated beneficiaries of your IRA for purposes of calculating the distributions that must be taken following your death.

### Special rules apply to trusts as IRA beneficiaries

Certain special requirements must be met in order for an underlying beneficiary of a trust to qualify as a designated beneficiary of an IRA. The beneficiaries of a trust can be designated beneficiaries under the IRS distribution rules only if the following four trust requirements are

met in a timely manner:

- The trust beneficiaries must be individuals clearly identifiable from the trust document as designated beneficiaries as of September 30 following the year of the IRA owner's death.
- The trust must be valid under state law. A trust that would be valid under state law, except for the fact that the trust lacks a trust "corpus" or principal, will qualify.
- The trust must be irrevocable, or by its terms become irrevocable upon the death of the IRA owner.
- The trust document, all amendments, and the list of trust beneficiaries must be provided to the IRA custodian or plan administrator by October 31 following the year of the IRA owner's death. An exception to this rule arises when the sole trust beneficiary is the IRA owner's surviving spouse who is 10 years younger than the IRA owner, and the IRA owner wants to base lifetime required minimum distributions (RMDs) on joint and survivor life expectancy. In this case, trust documentation should be provided before lifetime RMDs begin.

**Note:** *Withdrawals from tax-deferred retirement plans are taxed as ordinary income and may be subject to a 10% federal income tax penalty if withdrawn by the IRA owner prior to age 59½, with certain exceptions as outlined by the IRS.*

### Disadvantages of naming a trust as IRA beneficiary

If you name your surviving spouse as the trust beneficiary of your IRA rather than naming your spouse as a direct beneficiary, certain post-death options that would otherwise be available to your spouse may be limited or unavailable. Naming your spouse as primary beneficiary of your IRA provides greater options and maximum flexibility in terms of post-death distribution planning.

Setting up a trust can be expensive, and maintaining it from year to year can be burdensome and complicated. So the cost of establishing the trust and the effort involved in properly administering the trust should be weighed against the perceived advantages of using a trust as an IRA beneficiary. In addition, if the trust is not properly drafted, you may be treated as if you died without a designated beneficiary for your IRA. That would likely shorten the payout period for required post-death distributions.



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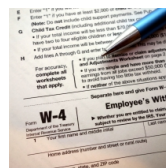
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## I received a large refund on my tax return this year. Should I adjust my withholding?

You must have been pleasantly surprised to find out you'd be getting a refund from the IRS — especially if it was a large sum. And while you may have considered this type of windfall a stroke of good fortune, is it really?

The IRS issued over 112 million federal income tax refunds, averaging \$2,895, for tax year 2016.<sup>1</sup> You probably wouldn't pay someone \$240 each month in order to receive \$2,900 back, without interest, at the end of a year. But that's essentially what a tax refund is — a short-term loan to the government.

Because you received a large refund on your tax return this year, you may want to reevaluate your federal income tax withholding. That way you could end up taking home more of your pay and putting it to good use.

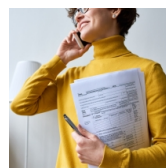
When determining the correct withholding amount, your objective is to have just enough withheld to prevent you from having to owe a large amount of money or scramble for cash at tax time next year, or from owing a penalty for having too little withheld.

It's generally a good idea to check your withholding periodically. This is particularly important when something changes in your life; for example, if you get married, divorced, or have a child; you or your spouse change jobs; or your financial situation changes significantly.

Furthermore, the implementation of the new tax law at the beginning of 2018 means your withholding could be off more than it might be in a typical year. Employers withhold taxes from paychecks based on W-4 information and IRS withholding tables. The IRS released 2018 calculation tables reflecting the new rates and rules earlier this year. Even so, the old W-4 and worksheet you previously gave to your employer reflect deductions and credits that have changed or been eliminated under the new tax law.

The IRS has revised a useful online withholding calculator that can help you determine the appropriate amount of withholding. You still need to complete and submit a new W-4 to your employer to make any adjustments. Visit [irs.gov](https://www.irs.gov) for more information.

<sup>1</sup> Internal Revenue Service, 2018



## What is the difference between a tax deduction and a tax credit?

Tax deductions and credits are terms often used together when talking about taxes.

While you probably know that they can lower your tax liability, you might wonder about the difference between the two.

A tax deduction reduces your taxable income, so when you calculate your tax liability, you're doing so against a lower amount. Essentially, your tax obligation is reduced by an amount equal to your deductions multiplied by your marginal tax rate. For example, if you're in the 22% tax bracket and have \$1,000 in tax deductions, your tax liability will be reduced by \$220 ( $\$1,000 \times 0.22 = \$220$ ). The reduction would be even greater if you are in a higher tax bracket.

A tax credit, on the other hand, is a dollar-for-dollar reduction of your tax liability. Generally, after you've calculated your federal taxable income and determined how much tax you owe, you subtract the amount of any tax credit for which you are eligible from your tax obligation. For example, a \$500 tax credit will reduce your tax liability by \$500, regardless of your tax bracket.

The Tax Cuts and Jobs Act, signed into law late last year, made significant changes to the individual tax landscape, including changes to several tax deductions and credits.

The legislation roughly doubled existing standard deduction amounts and repealed the deduction for personal exemptions. The higher standard deduction amounts will generally mean that fewer taxpayers will itemize deductions going forward.

The law also made changes to a number of other deductions, such as those for state and local property taxes, home mortgage interest, medical expenses, and charitable contributions.

As for tax credits, the law doubled the child tax credit from \$1,000 to \$2,000 for each qualifying child under the age of 17. In addition, it created a new \$500 nonrefundable credit available for qualifying dependents who are not qualifying children under age 17. The tax law provisions expire after 2025.

For more information on the various tax deductions and credits that are available to you, visit [irs.gov](https://www.irs.gov).



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## Reducing SALT Pain

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Annually, thousands of professionals use their own artistry and originality to find the best ways to decrease your federal taxes. You know you're living in new times when state lawmakers are added to the mix.

The reason they're putting in so much effort is something popularly called the SALT provisions of the new Tax Cuts + Jobs Act -- which sets a \$10,000 cap on the deductibility of state and local income tax. That limit isn't a major deal for residents of Texas or Florida, as well as other states that do not collect income taxes. But people living in New York, New Jersey, Connecticut and California generally pay far more than \$10,000 into their state, in addition to the property and municipal taxes.

Those higher-tax areas are now using the above originality and artistry to aid their taxpayers to reclaim those deductions -- and also some of these proposed solutions are indeed quite creative. For example, New York has recently started to allow taxpayers to, instead of paying their local property taxation, simply make a corresponding charitable donation to a charity set up from their regional school district. Presto! What used to be a tax would now be a charitable contribution that becomes deductible for taxpayers who itemize. The state would also allow New York City as well as other municipalities to establish their own charitable trusts, converting local taxation to deductible charitable contributions.

To not fall behind, New Jersey and Connecticut are trying to reclassify state taxes as charitable donations, while the Empire State plans to allow taxpayers to convert their own state income tax to a payroll tax, which their employers would pay for them -- and then deduct that from their federal tax bill.

Thinking even further out of the box, California's Senate Bill 277 would introduce something called the "California Excellence Fund," which would offer a credit against state income tax liability for any donations to the fund -- effortlessly recharacterizing just as much of this state tax liability as the resident needs into allowable charitable contributions. Similar legislation has been put forward in Illinois, Nebraska and Virginia. In Washington state, which will not impose a income tax, a copycat bill would let taxpayers create charitable donations to the state and receive a sales tax exemption certificate in return.

The most detailed fix is being proposed in Connecticut, whose legislature is finishing up a bill which will charge an "entity-level" tax on pass-through businesses like Subchapter S corporations and LLCs. These entities are only taxed at the shareholder level (hence the name "pass-through"). Those entity-

level taxes could be deductible by the S corp. or LLC, and the state would issue an offsetting individual tax credit to entity shareholders. The state tax becomes deductible at the entity, and the individual's state income tax obligation goes away. Connecticut's Department of Revenue estimates that the provision will regain \$600 million in otherwise-lost SALT deductions for state residents from the very first year alone.

Is any of this legal? In all honesty, we're not quite sure yet. The IRS has recently issued caution against states' creative use of charitable contributions, plus it never helps when lawmakers openly admit their aim to evade the federal SALT terms when they introduce state legislation. But taxation experts note that the IRS has provided positive rulings in more narrow cases about the federal deductibility of state tax credits in 33 states.

For instance, Alabama provides a 100% state tax credit for taxpayers who contribute money that provides children vouchers to attend private school. New York's new SALT-related provision would give an 85% state tax credit to residents who contribute to a neighborhood charitable fund that supports education. Can one approach be upheld but one other not?



## Enhancing Value of Charitable Contributions?

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You might recall that when the tax legislation was being debated, there was plenty of chatter around the risk that Congress would completely remove the deduction for charitable gifts. This Republican-backed proposition never made it into the final Tax Cuts + Jobs Act, but the tax changes could end up having a similar impact on plenty of taxpayers in different ways.

How? By doubling the standard deduction, the Tax Code will significantly lessen the amount of tax filers that itemize. Another portion of this new law reduces itemizing further by limiting the value of the deduction for state and local taxation to \$10,000 -- way under what many taxpayers in high-tax regions of the nation will pay.

The outcome? Historically, roughly 30% of people were itemizers. That amount is forecasted to fall to 10% before we begin filing this year's taxes. Obviously, when you don't itemize your deductions, you do not have the opportunity to deduct your charitable gifts.

Some quick math reveals how it works. Let us assume a married couple makes \$14,000 in charitable contributions this year. The couple's state and local tax deduction is capped at \$10,000. Together, both add up to \$24,000—which equals the new standard deduction. They receive no incremental deduction because of their \$14,000 of charitable contributions.

How to proceed? One approach to overcoming the effect of the new tax provisions would be to package many year's charitable contributions into an individual tax year -- donating the greater sum to a donor-advised fund instead of the charity directly. If the exact same couple were to provide two years' worth of contributions to a donor-advised fund that would be \$28,000. Add the \$10,000 maximum taken out for state and local taxes, and it most likely makes sense to itemize. The extra \$14,000 (above the standard deduction) leads to a tax savings of approximately \$5,180 for filers in the 37% tax bracket.

If the couple were to package five or ten years' worth of charitable contributions into a single tax year, they would receive a large charitable deduction in one year and will use the standard deduction in subsequent years.

The donor-advised fund could then make annual gifts for many years. Ideally, donor-advised fund assets will appreciate (tax free) allowing for additional charitable contributions.



## Index Fluctuations

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Index investing isn't very interesting, right? This seems particularly true with all the large cap indicators like the S&P 500, which include large, permanent, steady titans of the worldwide market.

Or is it? The S&P 500 actually added and got rid of three stocks in the past year- Advanced Micro Devices, Raymond James, Inc. and Alexandria Real Estate Equities were added while Urban Outfitters, Frontier Communications and First Solar were deleted. This year has been consistent with the past in terms of additions / deletions.

All these tiny incremental changes can accumulate over time. Imagine if you fell asleep in 1955 holding equal shares of every company in the Fortune 500 (the S&P index did not exist then) and awakened this past calendar year, in which you instantly reviewed your holdings. You would be amazed to see that only 60 companies on the list were also present in the 500 firms in the 1955 one. Some companies merged and others lost their name value such as Armstrong Rubber, Cone Mills, Hines Lumber, Pacific Vegetable Oil and Riegel Textile.

The point is that, in the long run, there's nothing extremely consistent with the hierarchy of big businesses in the U.S. or worldwide market. We do not know who the important corporate titans of tomorrow's market will be, exactly how no one from the 1950s would've been able to predict the rise of social media or even the internet. This is precisely why we purchase index funds or diversified portfolios. Nobody can predict which individual business rise from darkness or turn into another Pacific Vegetable Oil.





## Inverted Yield Curve

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Economists have discovered that an inverted yield curve could be a warning signal of a recession to come.

A what? A yield curve is a map of bond yields for different maturities — one month, three months, six months, 1, 2, 4, 7, 10 and all the way in between for 30 years. Generally, the borrower pays you extra for bonds with a longer maturity to compensate you for the dangers of inflation and interest rate changes. For example, a 5-year bond should yield at least incrementally more compared to the yield of a 1-year bond.

Deviations from this hierarchy are infrequent -- as it happens, nearly as uncommon as a recession itself. Interestingly, since 1955, long-term bonds yields were lower than short-term yields prior to each single U.S. economic downturn. Nobody knows precisely why a spate of marketplace illogic precedes economic troubles. There are theories, however, the cause/effect is unclear.

Historically, the inversions previously happened anywhere from 6 month to 24 months prior to the true recession, so there is not an exact time frame. But maybe we ought to think about another yield curve inversion as an opportunity to buckle our seat belts in the investment roller coaster.

Where exactly are we today? The chart found below shows the current yield in red, compared with a week ago in blue, a month ago in green, and a year ago in orange. As you may see, the curve has flattened in the previous 12 months, not necessarily to the point of inversion, but surely a thinner spread.

