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Financial Perspectives

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The Tax Reform Debate Heats Up as Winter Approaches

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As of this writing, both the House and the Senate are considering different versions of tax reform that could impact individuals and businesses in 2018. There are substantial differences between the two, and some common ground. That makes planning difficult when you don't know what the tax landscape is going to be next year. Will we see tax reform before year-end? Maybe. How will the changes impact you? Highlighted below are just a few of the provisions to watch for and how they may impact individuals and families. Although the tax proposals also include substantial business tax reforms, we have not included them here.

Individual Income Tax Proposals

One of the most widely publicized features of the tax reform proposals is how individual income tax brackets would be changing. The House is proposing to collapse the current seven brackets to four: 12%, 25%, 35%, and 39.6%. The Senate approach keeps seven brackets – 10%, 12%, 22%, 24%, 32%, 35% and 38.5% – but lowers some of the income thresholds where the new rates apply. In both proposals, the top bracket kicks in at $500,000 for single and head of household filers and at $1 million for married couples filing jointly. Current capital gains rates of 0%, 15% and 20% remain unchanged. However, the Senate's proposal would eliminate the ability to identify specific lots of securities when selling them by requiring investments to be taxed on a first-in, first-out basis. The House proposal repeals the Alternative Minimum Tax, whereas the Senate's proposal retains it with a higher exemption amount and phase-out thresholds.

There is commonality on a few key individual income tax provisions. Both the Senate and House have proposed eliminating the deduction for state and local income taxes (with the exception of allowing up to $10,000 in property taxes to be deducted), eliminating personal exemptions, and increasing the standard deduction by roughly doubling it – which may make itemizing less attractive. For those who itemize, both would also keep ability to deduct charitable gifts, but only the Senate proposal currently keeps the medical expense deduction. While Congress agrees that changes should be made to the mortgage interest deduction, they differ on their approach. The House limits the deduction to the first $500,000 in principal and eliminates the ability to use the deduction for second homes. The Senate proposes to eliminate it only for home equity loans. In addition, most of the Senate proposals would sunset at the end of 2025.

Education Savings Account Proposals

The House proposal would stop all contributions to Coverdell Education Savings Accounts (ESAs) beginning in 2018 (except for rollovers from other ESAs) and would expand the use of 529 plans to: permit up to $10,000 per year to be used for elementary and high school education expenses, include registered apprentice programs to the list of qualified education expenses, and allow 529 plan contributions to be made for unborn children. Tax free rollovers to 529 ABLE programs for disabled family members from 529 education savings programs would also be available. The Senate version includes similar provisions for allowing up to $10,000 per year to be used for elementary and high school expenses for public, private or religious schools, and for tax-free rollovers to ABLE accounts, but only through the end of 2025.

Estate and Gift Tax Proposals

Transitioning to the estate and gift tax side of these proposals, the two big areas to watch for are increases to the exemption amount and repeal of the estate tax altogether. If the exemption amount is increased, estate taxes will only be an issue for the very rich. If it is repealed altogether, it would result in huge tax savings for those with significant wealth.

The House bill would both double the exemption amount from $5.6 million to $11.2 million in 2018 ($22.4 million for married couples with proper planning) and repeal the estate and generation skipping tax beginning in 2025. The Senate's version also doubles the exemption amount, but does not provide for repeal and sunsets in 2025. Both continue to allow a step-up in cost basis at death.

Annual gift exclusions also remain intact ($15,000 in 2018) in both bills. Although neither version would repeal the gift tax for lifetime gifts, the gift tax rate would be reduced to a flat 35% rate for all taxable gifts that occur after 2024 in the House's version.

Retirement Savings Proposals

Sometimes, the biggest news is no news at all! After a lot of talk and media coverage about large reductions in the amount of pre-tax contributions to 401(k) plans (the "Rothification" of 401(k) contributions), neither the House nor the Senate chose to include it. The House and Senate also agree on a provision that would prevent you from "undoing" a Roth conversion once made or otherwise re-characterizing a Roth IRA contribution to a traditional IRA for the same year if, for example, you exceed the income limits or re-characterizing a traditional IRA contribution to Roth IRA, if you were to exceed the tax deduction income limits.

In addition, under the House bill, hardship distributions would be expanded to permit access to employer contributions and after a hardship withdrawal was taken, salary deferrals would not have to be suspended. The age for in-service withdrawals for defined benefit plans and governmental 457 plans would also be lowered from age 62 to age 59½ to bring consistency across all retirement plan types. The Senate's version only contains a similar hardship withdrawal provision.

Conclusion

As you can see, the differences between the House and Senate tax reform proposals are many. We expect continued debate and changes to these tax reforms in the coming weeks.

TSA Tips on How Not to be "That Guy" at Airport Checkpoint

1. Get there early.

Why start your vacation stressed out? Give yourself plenty of time to park, check in, and go through security. We recommend arriving two hours before your flight. If the lines are short, hey, more time for last minute gift shopping or to meet your fellow travelers.

2. Consider checking your bag.

More people flying = more carry-on bags = more time needed to get through the screening checkpoint.

3. If you must carry-on, make sure your bag is well-organized.

It takes time for TSA officers to make sure a jam-packed, cluttered, overstuffed bag is safe. And the more time it takes to screen your bag, the longer you—and everyone behind you—are stuck in line.

4. Get the 411 on 3-1-1.

TSA's 3-1-1 is shorthand for the liquids rule. Basically, limit your liquids, gels and pastes to no more than 3.4 ounces, or 100 milliliters, in 1 bag that's no bigger than 1 quart. That's bigger than a sandwich bag, but smaller than a huge freezer bag. Sure, they could call it 1 bag-1 quart-3.4 ounces, but that's much less catchy.

5. If you must travel with it, know how to safely pack your gun.

That sounds really obvious, right? Well, someone's not getting the message—TSA found 3,391 guns in carry-on bags last year. That averages out to more than 9 guns every day of 2016. Think of The Godfather—leave the gun, take the cannoli.

6. Be ready when you get in line.

Have appropriate ID and your boarding pass out and ready to go. Standard screening requires that you take your laptop out of your bag. Follow the 3-1-1 liquids rule. Wearing shoes you can get off and on easily also helps keep everyone behind you in line happy.

7. Get through the line faster with TSA Pre✓®.

TSA Pre✓® lets you leave your shoes, belt, and light jacket on while you go through security. You can also leave your laptop and your liquids in your bag. It costs $85 for five years—that's only $17 a year. And isn't your time worth $17 a year? Learn more at TSA.gov/precheck.

8. Now you're ready for takeoff. Safe travels!

https://www.tsa.gov/travel/travel-tips/how-not-be-%E2%80%9C-guy%E2%80%9D-airport-checkpoint

Cost of Living Adjustments

Cost of living adjustments (COLAs) impact a variety of tax and retirement limits each year. In addition to IRA deduction and Roth IRA adjusted gross income limit increases, here are some notable changes coming for 2018:

What's Changing?	2018 Limit	Increase
Contribution Limit for salary deferrals in 401(k), 403(b), 457, and government Thrift Savings Plans	$18,500	+ $500
Annual Gift Exclusion Limit	$15,000	+ $1,000
Unified Estate and Gift Tax Exemption	$5.6 Million	+ $110,000
Social Security Benefits		2%

New Market Report Available

We recently published a special report on market activity in the first year of the Trump era. The report explores how the market and individual industry sectors reacted to various executive actions and the promise of legislative change. We also examine which sectors were the winners and losers as the potential for legislative change faded. We hope you will enjoy reading about it all in the report, entitled *Twelve Months In;* please contact our office today to get your free copy or navigate your internet browser to this link:

https://benjaminfedwards.com/content/commentary/Twelve_Months_In.pdf

A Few Tax-Related Reminders to Consider Before the End of the Year

- Sell any securities for which you want to record a gain or loss for the year, make gifts to family members or charities, and make 529 plan contributions for 2017 (for federal gift tax purposes; state tax deadlines may vary).

- Take required minimum distributions (RMDs) from IRAs, and most qualified retirement plans, if you reached age 70 ½ before 2017.

- Start preparing now for your 2017 tax filing by making a folder where you can collect your forms such as W-2 for wages, 1099 for investments, 1099-INT for mortgage interest, etc. so you'll be ready to organize when you start receiving them.

- As discussed above, with the chance of new tax legislation on the horizon, consider whether tax strategies such as accelerating itemized deductions into 2017 and deferring income into 2018 to take advantage of what might be lower rates makes sense. Keep in touch with your tax advisor to discuss the impact of any changes on your situation.

Market Recap

Market Summary (As of November 30, 2017)

	Year-to-Date	Trailing 12-Months	3-Year Annualized	5-Year Annualized
DJIA	22.82%	26.92%	10.83%	13.26%
Nasdaq	27.69%	29.12%	12.78%	17.96%
Russell 2000	13.78%	16.77%	9.59%	13.44%
S&P 500	18.26%	20.41%	8.59%	13.33%

Sources: Benjamin F. Edwards & Co. and Bloomberg

	U.S. Treasury Yields
Two-year	1.77%
Five-Year	2.11%
10-year	2.36%
30-Year	2.76%

Source: Bloomberg (as of December 1, 2017)

U.S. Stocks

Performance of S&P 500: Index Price Returns

for Periods Ended November 30, 2017

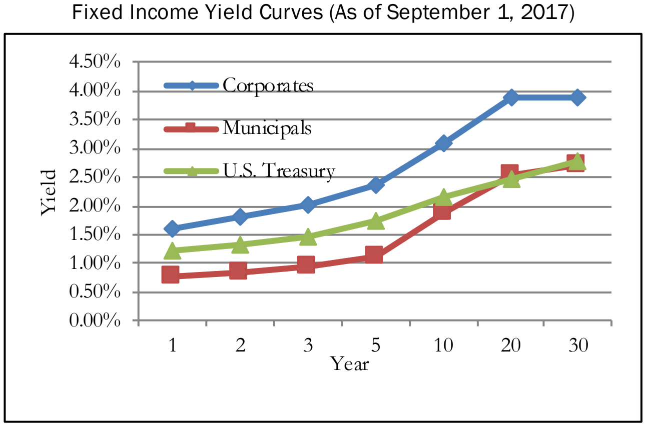
Sector	Weightings	Year-To-Date	Trailing 12-Months	Five-Year Annualized
Info. Technology	24.00%	36.96%	39.03%	18.96%
Financials	14.80%	17.87%	22.30%	16.58%
Health Care	14.10%	20.92%	21.65%	15.70%
Cons Discretionary	12.10%	18.52%	18.39%	15.40%
Industrials	10.10%	16.47%	16.84%	14.28%
Cons Staples	8.10%	8.33%	11.47%	9.25%
Energy	5.80%	-8.15%	-6.50%	-0.80%
Utilities	3.10%	15.67%	21.04%	9.90%
Materials	3.00%	19.31%	19.16%	10.03%
Real Estate	2.90%	8.25%	12.36%	7.70%
Tele. Services	2.00%	-11.10%	-3.91%	1.24%

Ranked by highest to lowest index weightings; Weightings may not equal 100 due to rounding.
Source: S&P®

- "Continuation" will likely be a word used repetitively during the new year. A key uncertainty for investors and markets over the next several months will be a continuation of the bull market in the face of anticipated interest rate increases. Setting aside the Federal Reserve's December 2017 interest rate decision, many economists still project perhaps three (which could be increased to four) 0.25% short-term interest rate hikes during 2018. The ability for the markets to absorb these changes will hinge in part on a continuation of favorable economic growth as measured by Gross Domestic Product, continued employment gains reflected in higher non-farm payrolls and an overall unemployment rate below the Fed's 4.6% long-term target, continued favorable consumer sentiment readings translated into continued consumer spending growth, housing prices which continue to grow, and overall home sales remaining strong despite higher mortgage rates. These variables do not even factor in tax reform and its impacts for taxpayers and corporations!
- The end of Janet Yellen's term as Fed Chair will bring change, but many hope in leadership only rather than sweeping changes in monetary and economic policy. The markets' reaction to even minor shifts in actual policy or just rhetoric could be significant if it is perceived that the Fed may stray too far from the status quo, given the strength of bull market of 2017. While President Trump has every right to make changes at the Central Bank, any discussion that economic growth could be stifled would be negative for investors. Of particular interest will be how the new Chair addresses the winding down of the Fed's stimulus programs, including the sale of mortgage-backed securities, as well as how the new Chair addresses President Trump's goals for additional deregulation.

Fixed Income

Fixed Income Yield Curves (As of September 1, 2017)



Sources: Bloomberg, Bloomberg US Corporate (A) Fair Value Index, Thomson Reuters MMD,

- The treasury market has been quite active in the first 10 years of the yield curve. The one-year Treasury bond is currently trading at 1.61% up from 1.22% in September, which reflects the market's anticipation of a rate increase at the December FOMC meeting. Additionally, there is an unknown as to how the nominee for the Federal Reserve Chairman appointment will differ from Chairwoman Yellen in terms of aggressiveness in raising interest rates.
- The municipal market has followed the treasury market in the front end (1-10 years) of the yield curve. With a lack of inflationary pressures, long-dated yields have stayed flat. We may see a reduction of new-issue paper coming to market next year if some of the tax reform amendments stay in the final bill. Namely, stopping advance refundings, will limit approximately 13% of the current new issuance as issuers will not be able to refinance their outstanding bonds until the stated call date.

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Diversification does not guarantee a profit or protect against loss.

Investing in securities entails certain risks, including the potential loss of all or a portion of the proceeds invested. Individuals should consider their specific financial needs, investment objectives and risk tolerance before making an investment.

Equity investments refer to buying stocks of U.S. companies as well as companies outside of the U.S. The market capitalization of U.S. companies is used to group large, medium (mid) and small companies. The investment return to the owner of stock (shareholder) is in the form of dividends and/or capital appreciation. Shareholders share in both the upside potential and the downside risk. Dividends are not guaranteed and are subject to change or elimination.

Mutual funds and ETFs are sold by prospectus. Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from your financial consultant and should be read carefully before investing.

There are special risks associated with an investment in real estate, including credit risk, interest rate fluctuations and the impact of varied ecomonic conditions. Distributions from REIT investments are taxed at the owner's tax bracket.

An investment in a 529 plan will fluctuate such that an investor's shares when redeemed may be worth more or less than the original investment. Investors should carefully consider a 529 plan's investment objectives, risks, charges and expenses before investing. This and other important information can be found in the 529 plan issuer's official statement, which should be read carefully before investing.

The return of principal for bond funds and funds with significant underlying bond holdings is not guaranteed. Fund shares are subject to the same interest rate, inflation and credit risks associated with the underlying bond holdings. Lower rated bonds are subject to greater fluctuations in value and risk of loss of income and principal than higher rated bonds.

Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline of the value in your investment.

An index is not managed and is unavailable for direct investment. The Dow Jones Industrial Average (DJIA) is an index that shows how 30 large, publicly owned companies based in the United States have traded during a standard trading session in the stock market. The Nasdaq Composite Index measures over 5,000 NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. The Russell 2000 is a stock-market index measuring the performance of 2000 small-capitalization stocks. The S&P 500 Index covers 500 industrial, utility, transportation and financial companies in the U.S. markets. S&P®, Standard & Poor's® and S&P 500® are registered trademarks of the Standard & Poor's Financial Services LLC.

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