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Reference Guide

For Financial Planners

2018

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INTRODUCTION

We designed this book as a reference guide for professionals serving clients on a wide variety of individual financial issues. Although the original construction of this book was designed to follow the comprehensive 78 topics tested on the CFP® Certification Examination from 2012-2015, we may at times take the liberty to add additional topics that we believe will be helpful to financial planners, as well as to insurance and securities professionals.

This book will help you stay up-to-date because it includes the 2018 key facts and figures you need to serve your clients. The topics covered in this guide include the following areas:

- Financial Planning
- Insurance Planning
- Investment Planning
- Income Tax Planning
- Retirement Planning
- Estate Planning
- Interpersonal Communication
- Professional Conduct and Fiduciary Responsibility

While there is some overlap and repetition of material among the topics, this repetition is a result of the interrelated issues of comprehensive financial planning. We hope the concise but complete treatment of each topic will help save you valuable time in serving your clients.

We did not design this book to help individuals study for the CFP® Certification Examination. If you are studying for the exam, you should purchase the Keir Comprehensive Review Package for the CFP® Certification Examination. Those comprehensive books cover the topics with more emphasis on issues commonly tested and also provide students with exam study tips, examples, practice questions, and prior exam questions.

Keir Educational Resources wishes to express our appreciation to the many people who helped to write, research, update, enhance, and produce this book. We also want to thank all of the individuals, universities, and companies who have offered suggestions over the years for improvements.

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2018 Reference Guide

What's New?

1) This special RED LINED edition of the *Reference Guide for Financial Planners* includes updates on the sweeping tax law changes made by H.R.1 – "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018". The act, which was signed into law by President Trump on December 22, 2017, is more commonly referred to as the Tax Cuts and Jobs Act (TCJA), and will be referred to as such within the text of this reference guide.

For your planning convenience we have updated all information as it would have been under prior law, redlined the items that are no longer in effect, and provided the new rules in red ink (for the e-book version of the Reference Guide). To make them easy to identify, the changes have also been highlighted in blue (for the e-book version of the Reference Guide; in the print version the changes will be highlighted in grey). For example:

Standard Deduction	To calculate taxable income, the IRC provides, first, for the deduction of the greater of the standard deduction or itemized deductions from AGI. The newly-created Section 199A deduction discussed below is available regardless of whether the taxpayer uses the standard deduction or itemizes deductions. The standard deduction depends on the filing status and is summarized below for 2018. | | 2018 Prior Law | 2018 TCJA | Married filing jointly | ~~$13,000~~ | 24,000 Married filing separately | $ ~~6,500~~ | 12,000 Head of household | $ ~~9,550~~ | 18,000 Single | $ ~~6,500~~ | 12,000

This format allows you to easily view the impact of the changes made by the TCJA, and plan for your clients accordingly.

NOTE: Please pay close attention to the dates stated within the text. Most of the changes for individuals are temporary and apply to tax years 2018 – 2025, while most of the changes for businesses are permanent. However, there are some changes that have different effective dates; for example, the 10% floor for deducting qualified medical expenses was reduced to 7.5% for 2017 and 2018 only.

The following is a list of the topics in which you will find changes from the TCJA:

General Principles	Insurance	Investments	Income Tax	Retirement	Estate
Topic 4	Topic 15	Topic 24	Topic 32	Topic 47	Topic 55
Topic 6	Topic 17	Topic 30	Topic 33	Topic 48	Topic 57
Topic 7	Topic 20		Topic 34	Topic 52	Topic 58
	Topic 21		Topic 35		Topic 60
	Topic 22		Topic 36		Topic 63
			Topic 37		Topic 65
			Topic 38		Topic 69
			Topic 39		Topic 70
			Topic 40		Topic 73
			Topic 42		
			Topic 43		

What Else is New?

2) Topic 6 – Impact of Funding Choices on Financial Aid chart

3) Topic 6 – Student loan repayment options

4) Topic 7 –FINRA Rule 216 (Financial Exploitation of Specified Adults, effective February 5, 2018)

5) Topic 15 – Medicare Part B premium income-related monthly adjustment amount (IRMAA) income thresholds reduced for higher tiers

6) Topic 15 & Appendix – Medicare enrollment illustration added to appendix as a full-page infographic

7) Topic 24 – Stock settlement change to T+2

8) Topic 47 – Qualified plan loan cure periods

9) Topic 48 – Tax treatment of IRA distribution when nondeductible contributions have been made

10) Topic 49 – Clean shares and T shares emerge as a result of the DOL fiduciary rule

11) Appendix – Convenient Infographic illustrating when RMD distributions from multiple plans and/or IRAs may be aggregated

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GENERAL PRINCIPLES OF FINANCIAL PLANNING

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Educational Planning (Topic 6)

Funding

Paying the costs of a child's college education is a high priority for many clients. It may be done on a pay-as-you-go basis while the child is in college, though this will take a large bite out of current income. Another possibility is to rely on grants, loans, and scholarships. The most beneficial option is to save and invest in advance, thereby taking advantage of time and compound interest or capital appreciation.

Needs Analysis

Planning for education funding typically requires calculating the amount that will be needed to pay for four years of expenses at a college or university and then determining the amount that must be saved annually to reach that goal. Annual expenses for a college or university can vary from approximately $5,000 to $40,000 and these expenses generally continue to increase at a rate faster than inflation. Average costs of tuition and room and board at public 2-year, public 4-year, private non-profit, and for-profit schools can be found at http://trends.collegeboard.org/college-pricing.

Tax Credits and Deductions for Education Expenses

Tax Credits/ Adjustments/ Deductions

To help taxpayers afford to send their children to college, Congress created the American Opportunity Tax Credit (formerly called the Hope Scholarship credit), the Lifetime Learning credit, deductions for certain higher education expenses, and deductions for student loan interest.

American Opportunity Tax Credit

The American Opportunity Tax Credit allows taxpayers to claim a yearly $2,500 credit (100% of the first $2,000 and 25% of the second $2,000 of qualified expenses) per student. Qualified expenses include tuition, fees, and course materials.

In order to qualify, the student must be in their first four years of college and be enrolled on at least a half-time basis. The student may be the taxpayer, the spouse, or a dependent of the taxpayer. The credit is not available if, at any time, the student was or is convicted of a state or federal felony drug offense.

For 2018 the American Opportunity Tax Credit starts to phaseout for taxpayers filing a joint return at $160,000 and is completely phased out at $180,000. The credit starts phasing out for other taxpayers at $80,000 and is completely phased out at $90,000 in 2018.

Taxpayers can receive up to 40% of the American Opportunity Tax Credit as a refundable credit. Refundable tax credits are treated as a

tax payment. This means that rather than being limited to reducing the tax owed to zero (as is the limit for most tax credits), up to 40% of the AOTC credit can be received as a refund that is larger than the amount of money the taxpayer actually paid in during the year. However, no portion of the credit is refundable if the taxpayer claiming the credit is a child subject to the kiddie tax.

Lifetime Learning Credit

The Lifetime Learning credit is a tax credit equal to 20% of academic higher education costs (tuition and fees), up to $10,000 per year per taxpayer (not per student). The credit is a maximum of $2,000 and is available for an unlimited number of years.

The student can be enrolled on less than a half-time basis and can be the taxpayer or his or her spouse or dependent. Expenses for most postsecondary education courses, including graduate courses, are eligible.

The Lifetime Learning credit starts to phaseout for taxpayers filing a joint return at $114,000 and is completely phased out at $134,000 in 2018. The credit starts phasing out for other taxpayers at $57,000 and is completely phased out at $67,000 in 2018.

Selecting the American Opportunity Tax Credit or the Lifetime Learning Credit

Taxpayers may not claim both the American Opportunity Tax Credit and the Lifetime Learning credit for the same student in the same year. However, if the taxpayer's son is in his fifth year of college and the taxpayer's daughter is in her third year of college, the taxpayer can claim the Lifetime Learning Credit for the son and claim the American Opportunity Tax Credit for the daughter.

Form 1098-T Required in Order to Claim Education Tax Credits

Effective for tax years that begin after June 29, 2015, the Trade Preference Extension Act of 2015 (TPE Act) requires that a taxpayer receive a Form 1098-T as a condition of receiving one of the education credits or the above-the-line deduction for qualified tuition payments. Higher education institutions must provide a Form 1098-T (Tuition Statement) to the IRS and to the student, indicating the amount paid by or billed to the student for qualified tuition and related expenses for the tax year.

Prior to the TPE Act, there was no requirement that the taxpayer receive a Form 1098-T in order to qualify for the credits or the deduction.

On July 29, 2016, the IRS issued Proposed Regulations (Prop Reg §1.25A-1(f)(1)) requiring the receipt of Form 1098-T in order for a student to qualify for the AOTC or Lifetime Learning Credit. The proposed regulations do note, however, that **the Form 1098-T may not reflect the total amount of qualified expenses. For example,**

course materials may have been purchased from a vendor other than the educational institution. If that is the case, then the total amount of qualifying expenses will be higher than what is reported on the Form 1098-T, and the taxpayer will still be able to count these expenses, so long as they are able to substantiate them as qualified expenses. (Editor's Note: As of the time of printing this Reference Guide, these are the rules that appear in the proposed regulations. As always, planners should consult the final regulations when issued.)

In order for parents to claim a student who is over age 19 but under age 24 as a dependent, and therefore claim the AOTC or Lifetime Learning Credit on their return, the student must have been enrolled as a full-time student during some portion of each of 5 months during the year (need not be consecutive months). Proposed Regulation §1.6050S-1(b)(2)(ii)(I) requires the educational institution to report on the Form 1098-T the number of months during which the student was a full-time student. This additional reporting will assist with determining whether the parents can appropriately claim the student as a dependent for the year, and claim the education tax credits. (Editor's Note: As of the time of printing this Reference Guide, these are the rules that appear in the proposed regulations. As always, planners should consult the final regulations when issued.)

Credits Not Used by Dependents

While parents usually claim the American Opportunity Tax Credit and the Lifetime Learning credit, students who are not claimed as dependents on their parents' income tax return may take these credits. Thus, when a student has substantial earnings and pays tuition, overall income taxes may be reduced if parents do not claim the student as a dependent. When parents do not claim the student as a dependent, the student will then be allowed one of the credits. The overall tax burden for the family may be lowered when college-age children living away from home claim the credit for paying tuition. **The use of the credits by the children will make sense when clients reach the AGI level where they are phased out of the credits and the student's use of the credit will create a greater tax savings than the parents would receive for claiming the student as a dependent**. ~~Losing the exemption can be more than offset by the child's ability to use the credit.~~ (Note: for 2018 – 2025, the dependency exemption is $0, however, the TCJA expanded the child tax credit to include up to a $500 credit for a dependent child over the age of 17.) However, the education credit can only be used to reduce the student's tax to zero, so the student must have taxable income sufficient to warrant using the education credit. If a parent provides more than half of the support for a student and is, therefore, eligible to claim the child as a dependent but chooses not to, the

child cannot receive the refundable portion of the AOTC. The student can, however, offset his tax liability using the AOTC credit for qualified education expenses paid by him or by the parent.

Parents who own a business may find an advantage from employing the student to work (during the summer and weekends during the school year, for example). The parent will reduce business income by shifting it to the student who is in a lower tax bracket for earned income, and if the student's earnings are high enough that they are providing over half of their own support, the student will have the advantage of being able to claim the refundable AOTC tax credit.

The education credits are only available to clients when they pay expenses for those they can claim as dependents. When parents claim a student as a dependent, any expenses paid by the student are deemed expenses of the parents. Whether a parent can claim a dependent becomes an issue when clients are divorced.

Assets expended for higher education from a UGMA or UTMA account will qualify for the American Opportunity Tax Credit and Lifetime Learning credit, but since these custodial accounts belong to the student, a parent cannot use expenditures from the custodial accounts as qualifying expenses toward the American Opportunity Tax Credit and Lifetime Learning credit.

Deduction for Interest on Education Loans

An above-the-line deduction of up to $2,500 may be taken annually for interest paid on qualified higher education loans. A person claimed as a dependent on another taxpayer's return cannot take this deduction. Furthermore, the deduction is available only to the taxpayer responsible for the debt. The deduction phases out between $65,000 and $80,000 for singles and between $130,000 and $160,000 for married taxpayers in 2018.

Funding Vehicles

Funding Vehicles

There are several different ways for a parent to fund a college education besides saving money in the parent's investment account or relying on tax credits and deductions. The paragraphs below summarize the most commonly used techniques, including transferring assets to a child or a trust, 529 plans, ESAs, UGMAs, UTMAs, and savings bonds.

Ownership of Assets

Most clients prefer to keep control over the assets earmarked for education. However, there are some advantages to transferring these assets to a child or a trust.

Transfers to Child

One way of saving on a tax-advantaged basis is to arrange for the income on the assets to be taxed to the child, rather than to the parents. Sometimes, this can be accomplished by a direct transfer of income-

producing assets to the child. This method assumes, however, that the child will not divert the assets or income to other uses. Another caution to be observed is the “kiddie tax” problem. Unearned income of a child under age 19 (or a student under the age of 24) ~~in excess of $2,100 (2018) will be taxed to the child at the parents’ marginal tax rate, not at the child’s income tax bracket.~~ will be taxed using the rate tables for trusts and estates (for tax years beginning after December 31, 2017), which are more compressed than the individual rate tables. It is unclear whether the standard deduction of $1,050 will continue to apply to the unearned income. New rules for calculating the Kiddie Tax in 2018 await IRS regulations issued pursuant to the Tax Cuts and Jobs Act.

Avoid Kiddie Tax

If the child is under age 19 (or if the child is a student under the age of 24), it is important to avoid the “kiddie tax” on unearned income. This tax can be avoided by investing in growth-oriented securities, rather than interest-paying securities, such as bonds. Also, Series EE government bonds should be considered because taxes on these bonds can be deferred (or even avoided if the proceeds are used to pay college tuition and fees and other rules are met). After the child reaches age 19 (or 24 if a student), income-producing securities can be properly emphasized because the “kiddie tax” problem is over.

Trusts

The following three types of trusts are commonly used to fund a child’s education:

- 2503(c) trust – Gifts to this trust qualify as gifts of a present interest for purposes of the annual exclusion; the trustee can accumulate the income; the income is taxed to the trust, so the “kiddie tax” problem is avoided; and the child must have the right to withdraw all of the accumulated property for a period of at least 30 days when the child turns 21 (assets not withdrawn during this period can remain in the trust).

- 2503(b) trust – Gifts to this trust qualify as gifts of a present interest; income must be paid out annually, so the “kiddie tax” problem remains; and the principal can be left in the trust indefinitely.

- Crummey trust – Gifts to the trust qualify as gifts of a present interest; the child is allowed (not required) to withdraw the amount contributed that year; unwithdrawn income is generally taxed to the trust; and the accumulated assets can be distributed at any age specified by the trust grantor.

Sec. 529 Plans

In recent years, Section 529 Qualified Tuition Programs (QTPs) have been growing in popularity as a way of funding the costs of a child’s education. Most of these plans are state-sponsored, and they are now available in almost every state. Some of these plans,

however, are sponsored by educational institutions that meet specified Sec. 529 requirements.

One type of Sec. 529 plan is the prepaid tuition plan. In this plan, the client can lock in the future tuition at certain universities at today's rates. The prepaid tuition plan might be a good option when the child is just a few years away from college. If this is the case, it may be difficult to find an investment opportunity that will earn a rate higher than the tuition inflation rate without taking on undue risk. By pre-paying the tuition at the current level, the client is, essentially, earning whatever the tuition inflation rate is. The other type of plan is the qualified tuition plan, which is by far the more popular type of plan for clients who begin saving for college when the child is younger. For these clients, there is ample time to take on the risks associated with an investment portfolio that could earn a rate of return higher than the tuition inflation rate.

Tax-Free Distributions from 529 Plans

In a Sec. 529 qualified tuition plan, money can be set aside in special accounts, usually in mutual funds, to grow on a tax-deferred basis. Moreover, the money can be taken out tax-free if used to pay for qualified education expenses, including tuition, room and board, books, computers and related equipment (such as a printer and software used for educational purposes), and other costs.

The money can be used for any college, university, or community college, and even for some technical schools, as long as the institution is eligible for federal student aid. The assets in a Sec. 529 plan are not counted as the student's property for financial need formulas.

The Tax Cuts and Jobs Act of 2017 extended the use of the 529 plan further, so up to $10,000 per year (per beneficiary) can be used to pay tuition at elementary and secondary public and private schools.

Withdrawals may be made tax-free from Sec. 529 plans in the same year that an American Opportunity Tax Credit or Lifetime Learning credit is taken if there are qualified education expenses to cover all these sources.

Distributions of contributions are always income tax and penalty free. Accumulated earnings withdrawn for purposes other than education are taxable and carry a 10% penalty tax. Nonqualified distributions are treated as a pro-rata distribution of contributions and earnings. Previously, the distributions were required to be aggregated if the same owner and beneficiary maintained multiple 529 plan accounts. The Protecting Americans from Tax Hikes (PATH) Act of 2015 eased the reporting requirements such that the

earnings portion of a distribution is now computed separately for each 529 plan account.

If tuition is paid from a 529 plan distribution and then is refunded, the refund is a qualified expense if the amount that is refunded is re-contributed to a 529 account within 60 days.

If the child named as the beneficiary of the plan elects not to go to college, the money can be rolled over to a 529 plan for another beneficiary who is a member or the previous beneficiary's family. IRS Publication 970 describes a "member of the beneficiary's family" to include the following 9 categories:

1. Son, daughter, stepchild, foster child, adopted child, or a descendant of any of them.
2. Brother, sister, stepbrother, or stepsister.
3. Father or mother or ancestor of either.
4. Stepfather or stepmother.
5. Son or daughter of a brother or sister.
6. Brother or sister of father or mother.
7. Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.
8. The spouse of any individual listed above.
9. First cousin.

Under federal tax law, many accounts that have tax advantages on withdrawals will have limits in dollar amounts for contributions and phaseouts for contributions based on the taxpayer's income. For Sec. 529 plans, there are no such phaseout limits, and the dollar contribution limits are fairly high, according to limits set by each state. Many of the states now offering qualified tuition plans make the plans available to out-of-state residents. Contribution limits vary from state-to-state, but range from $235,000 to over $500,000. Contributions to these plans can be made either periodically, on a level basis over time, or through lump-sum contributions. Up to $75,000 ($150,000 by a married couple) in 2018 can be contributed to an account in a single year with no gift tax consequences, due to an election to treat the contribution as if made over five years and the application of five years of annual gift tax exclusions.

Note that if the donor dies two years after making a gift of $75,000, $45,000 (three years of annual exclusions) will be brought back into the donor's gross estate for federal estate tax purposes.