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July 25: Understanding Your Dental Practice's Overhead
Presented by Andrew Schwartz, CPA

Aug 16: Economic and Investment Overview: Looking Past the Headlines
Presented by Alex Oliver, First National Corporation

Sept. 20: Changes to MA Payroll and Employment Laws
Presented by Laurie LaBrie and Greta Malstrom

Oct. 23: The Home Stretch: Steps to Consider When Planning for Retirement
Presented by Alex Oliver, First National Corporation

IRS Explains Deducting Mortgage & Equity Loan Interest

From IRS NEWS – Issue IR-2018-32

The Internal Revenue Service advised taxpayers that in many cases they can continue to deduct interest paid on home equity loans.

Responding to many questions received from taxpayers and tax professionals, the IRS said that despite newly-enacted restrictions on home mortgages, taxpayers can often still deduct interest on a home equity loan, home equity line of credit (HELOC) or second mortgage, regardless of how the loan is labeled. The Tax Cuts and Jobs Act of 2017, enacted Dec. 22, suspends from 2018 until 2026 the deduction for interest paid on home equity loans and lines of credit, unless they are used to buy, build or substantially improve the taxpayer's home that secures the loan.

Under the new law, for example, interest on a home equity loan used to build an addition to an existing home is typically deductible, while interest on the same loan used to pay personal living expenses, such as credit card debts, is not. As under prior law, the loan must be secured by the taxpayer's main home or second home (known as a qualified residence), not exceed the cost of the home and meet other requirements.

New dollar limit on total qualified residence loan balance

For anyone considering taking out a mortgage, the new law imposes a lower dollar limit on mortgages qualifying for the home mortgage interest deduction. Beginning in 2018, taxpayers may only deduct interest on $750,000 of qualified residence loans. The limit is $375,000 for a married taxpayer filing a separate return. These are down from the prior limits of $1 million, or $500,000 for a married taxpayer filing a separate return. The limits apply to the combined amount of loans used to buy, build or substantially improve the taxpayer's main home and second home.

This Year's Most Interesting Tax Season Observations

by Andrew D. Schwartz, CPA, Founder of The MDTAXES Network

This year's most interesting observation actually has more to do with next year's taxes. The tax software we use comes with a Tax Projection option, and I prepared a **2018 tax projection** for many of the clients I met with during the winter to see how their **taxes would change under the new rules that took effect on January 1st.**

As far as I could tell, the healthcare professionals who are the biggest winners under the new tax rules are high-income married couples with children and with income ranging from $300k to about $500k. Here is why:

1. **Child Tax Credit**: Under the prior rules, families were eligible for a tax credit of $1k per child under the age of 17. The problem was that this credit began to phase out once their income exceeded $110k. The new child tax credit is $2k per child under the age of 17 and doesn't begin to phase out for married couples until $400k of income. Plus, there is a new $500 tax credit for older children and other dependents that also begin to phase out at $400k of income.

2. **State Income Taxes and Real Estate Taxes**: As everyone is well aware, the deduction for state income taxes and real estate taxes is now capped at a combined total of $10k. Most married couples who own a home or earn a good salary in a state that has an income tax will see their deduction capped. That being said, this deduction was already being limited. For 2017, married couples whose income exceeded $313,800 were seeing this deduction phase out by 3% of the amount their income exceeded that threshold. And then, the dreaded Alternative Minimum Tax (AMT) eliminated any remaining tax benefit. What this means is that the $10k now allowed might actually allow for a higher tax break for high income taxpayers than they were receiving pre-2018.

3. **Personal Exemptions:** The new tax rules eliminated the $4,050 tax break for yourself, your kids, and your other dependents. This is no problem for high income taxpayers who were already not benefiting from their personal exemptions due to a combination of a similar phase-out threshold to itemized deductions, and then the AMT eliminating any remaining tax break for your personal exemptions.

4. **Alternative Minimum Tax (AMT):** Looks like the dreaded AMT will affect very few taxpayers going forward. Since married couples earning between $300k and $500k annually seemed to be the ones paying the highest amount of Alternative Minimum Tax each year, it stands to reason that they will benefit the most from changes made to this tax.

5. **Lower Tax Rates:** A reduction in tax rates will reduce everyone's taxes. The higher your income, the greater your tax savings.

6. **The New Qualified Business Income Deduction**: There is a new tax break equal to 20% of your self-employment income plus your share of "pass-through" income from S-Corps and LLCs. This new tax break is fully phased out for healthcare professionals whose taxable income exceeds $415k if married (or $207,500 if single). Married couples with taxable income of less than $315k (or $157.5k for single individuals) will get the full benefit of this new 20% QBI tax break.

Prior Year Trends:

2017:

More clients installed solar panels on their homes than all of the prior years combined

2016:

Increase in the number of clients choosing to allocate $3 of their tax liability to the Presidential Election Campaign Fund

2015:

More clients had energy efficient tax credits for purchasing solar panels, electric cars and even re-charging stations for those electric cars

2014:

A variety of tax hikes took hold causing higher taxes on lower income for high-income taxpayers

2013:

Uptick in the number of individuals taking advantage of Health Savings Accounts (HSA)

2012:

Record low interest rates meant many homeowners refinanced their home mortgages

Get a Tax Projection:

The only way to determine how the new tax rules will impact you is to work through a tax projection. Now that April 15th has come and gone, your CPA would love to hear from you to help you figure this out. From what I've seen, if you are married and earn between $300k and $500k, your federal income taxes will be $10k-$20k lower this year than what you paid for federal income taxes in 2017.

HSAs Make a Great Buy and Hold Proposition

Are you aware that there is an investment option available that allows for tax-deductible contributions and also for tax-free distributions?

First introduced back in 2004, Health Savings Accounts offer individuals that unique winning combination. The favorable tax advantages of HSAs have caused them to become increasingly more popular in recent years.

To be eligible to contribute to an HSA, you need to have a qualifying high-deductible health insurance plan in place, your health insurance company can let you know whether the medical insurance product you currently have with them qualifies.

Here are the four tax advantages that come with HSAs:

- Money contributed into an HSA is tax-deductible. Either you contribute money into an HSA on your own and/or your employer contributes on your behalf.
- Money invested within the HSA is your money and grows tax-deferred. And unlike Flexible Spending Accounts (FSAs) offered to you as part of your employer benefit package where you set aside a certain amount of money each year to pay for your family's healthcare costs with pre-tax dollars, there is no "use it or lose it" pitfall with HSAs, allowing the account can grow in value over time.
- Money can be withdrawn tax-free from your HSA at any time to pay for your family's healthcare expenses.
- Any money remaining in your HSA upon reaching the age of 65 is available to subsidize your retirement. You will owe taxes but no penalties on money taken out at that time that is not used for your family's healthcare costs once you turn 65.

With tax-deductible contributions and tax-free distributions, we are seeing a lot of our clients who have decided to let their HSAs grow instead of taking out money to pay their current year's medical expenses.

Adding money to an HSA when eligible makes perfect sense thanks to the tax deductibility of those contributions. For 2018, the maximum contribution is $6,850 for families and $3,450 for single individuals. Anyone 55 or older can contribute an additional $1,000 per year.

The question is what you should do about paying your family's healthcare costs when you have money in an HSA and have most likely been given a debit card connected to your HSA to easily pay your co-pays, deductibles, and other costs. I've spoken to many clients about this recently, and we came to the conclusion that NOT using money in your HSA account actually seems to make the most financial sense.

Instead, pay for the medical expenses out of money sitting in your checking account since that money is either not invested, is earning .1% in a bank savings account, or will ultimately be invested in a taxable account. Doing so will allow the HSA to remain fully invested and growing within its tax-deferred envelope. Why reduce the money growing within the HSA when there is no requirement mandating you to do so?

Lastly, for people looking to build up assets within their HSA, there are a lot of options out there now to purchase mutual funds and take full advantage of years of compounded tax-deferred growth.

Trade Rhetoric Buries Strong Economic Fundamentals

By Alex Oliver, Investment Advisor, First National Corporation

Volatility returned to the markets this past quarter as fears of inflation, trade wars, and privacy issues with technology companies flooded the headlines. The S&P 500 fell as much as 10%, the first time in fifteen months this has happened. After the steep rise in stocks with just a 3% "pull-back" during the 2017 calendar year, some investors may have forgotten that 10% drawdowns are very normal and typical, usually happening at least once per year. For the quarter, the S&P 500 Index declined less than 1%, while the Russell 2000 Index of small U.S. stocks was essentially unchanged, though it sure felt worse than that due to the volatility.

The market is trying to decide if we are currently entering a trade "war," or simply witnessing a trade "skirmish." To summarize, **President Trump is hoping to reduce the current trade imbalance with China by installing tariffs on steel and aluminum imports**, which is noteworthy because the United States is the world's largest importer of steel. A tariff is a tax on an imported good, making the product more expensive in hopes that domestic steel would see increased demand. One concern would be whether domestic manufacturers have the capacity to keep up with increased demand which could result in a price spike. A second and greater concern would be the "tit-for-tat" war it could start, as seen by China's announced tariffs on American imported goods such as soybeans, cars and whiskey. However, some analysts speculate that Trump is trying to weaken the U.S. dollar with his rhetoric, which would be good for the trade deficit and make American exports more competitive on the foreign market as they become cheaper for offshore buyers. The MSCI EAFE Index of foreign stocks declined 1.5% for the quarter as a result of the uncertainty surrounding trade.

Rather than over-react to normal market volatility, we try to stay focused on the economic and market fundamentals. In January, the S&P 500's price to earnings ratio was about 14% more expensive than the 25-year average, implying that we were paying a small premium for U.S. stocks. **As of the close of the first quarter, the S&P 500 lost 6% while the price to earnings ratio actually fell by 12%, bringing it almost in line with the 25-year average.** With corporate profits expected to increase a whopping 25% from 2017 to 2018, U.S. stock valuations seem very reasonable.

It's not just the U.S. economy that is rebounding though. **Economic data around the world is looking much better.** Thus, all eyes are on the Federal Reserve, the European Central Bank, and the Bank of Japan to continue tightening their monetary policies by raising interest rates to avoid an overheating global economy. On March 21st, the Federal Reserve raised the benchmark to a range of 1.5% to 1.75% in the first of three expected rate hikes for 2018. This hurts real estate investments and bonds values which are sensitive to interest rate increases. For the quarter, real estate declined 7%, while the Barclay's Aggregate Bond Index lost 1.5%.

As we will continue to emphasize, we encourage all investors to keep a long-term view and ignore the headlines. Bouts of volatility are healthy to ensure that irrational exuberance is tempered, providing positive returns for the patient investor. For those who sat in cash for too long and felt like they missed the boat on stocks, keep in mind that international equities have still yet to have an American-style run up and could be ripe with opportunities.

Need Help with Your Investment Planning?

Contact Alex at 781.878.7757
or
Alex@fncadvisor.com

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