JANUARY, 2019

What’s trending on NP Trusts & Estates

The tax treatment of alimony is changing in 2019, five factors to consider before donating to a political candidate or organization, January economic highlights and more. Here’s what’s trending in estate planning and wealth management.

Wealth Management

Market Pulse: January 2019 Economic Highlights

What’s happening: highlights from the NP Investment Team

What is behind the global slowdown and is the worst behind us? At this point last year only one major economy had a PMI below 50 (representing a contraction) but that number has now grown to ten. In most cases, the reasons are mainly domestic, with China experiencing weaker credit growth in response to past policy tightening, Germany being affected by new car emission standards and Brexit weighing on the UK. Importantly, the main headwinds in the two largest economies, the U.S. and China, are starting to fade.

China and the U.S. were last year’s big global headwinds but with Beijing easing and the Federal Reserve dialing back its tightening, signs of a global pick-up are appearing in the markets. China has made 60 easing moves since last June and fiscal stimulus is now on track to exceed 2016’s levels. The president’s hawkish commentary in October raised fears of a U.S. recession but his most recent statements have put those fears to rest for now. The U.S. economy remains healthy, with domestic corporate profits before tax expected to increase by 10% in the first half of this year and unemployment claims hitting their lowest level in 50 years. This is important because it is domestic profits that drive U.S. employment and capital spending.

Leaders and laggards: What's up and down in the U.S. stock market?

ECONOMIC SECTORS	JANUARY THROUGH 1/29/19	CALENDAR YEAR 2018
Energy	9.55%	-18.10%
Health Care	2.49%	6.47%
Consumer Discretionary	8.19%	0.83%
Information Technology	5.60%	-0.29%
S&P 500	6.06%	-4.38%
Industrials	9.95%	-13.29%
Consumer Staples	2.70%	-8.38%

The stock market is experiencing a significant rebound to start the year as concerns about the Federal Reserve overtightening and a slowdown in corporate earnings easing. Following the pullback in the 4th quarter of 2018, stock valuations are more attractive and the Nixon Peabody investment team is initiating new positions in companies that we believe will generate positive returns over the coming years.

Click here for more information about NP's investment capabilities.

— *NP Investment Team*

Tax Cuts and Jobs Act affects tax planning for education costs

The Tax Cuts and Jobs Act (TCJA) affected several tax provisions related to saving for education costs.

529 plans

Section 529 plans provide a valuable tax-advantaged savings opportunity. You can choose a prepaid tuition plan to secure current tuition rates or a tax-advantaged savings plan to fund college expenses beyond just tuition. Some states offer both types of plans, while other states only administer one type of plan or the other. Here are some of the possible benefits of such plans:

· Although contributions are not deductible for federal purposes, any growth is tax-deferred. Some states do offer tax breaks for contributing.

· Plans usually offer high contribution limits but there are no income limits for contributing.

· Generally there is no beneficiary age limit for contributions or distributions.

· You, the donor, can control the account, even after the child is of legal age.

· You can make tax-free rollovers to another qualifying family member's 529 plan.

· A special break for 529 plans allows you to front-load five years' worth of annual gift tax exclusions and make up to a $75,000 contribution (or $150,000 if you split the gift with your spouse) in 2018.

Prepaid tuition vs. savings plan

Understanding the difference between the two plans is critical for making your decision.

With a 529 prepaid tuition plan, if your contract is for four years of tuition, tuition is guaranteed regardless of its cost at the time the beneficiary actually attends the school. One downside is that there's uncertainty in how benefits will be applied if the beneficiary attends a different school. Another negative is that the plan typically doesn't cover costs other than tuition, such as room and board.

A 529 college savings plan, on the other hand, can be used to pay a student's expenses at most postsecondary educational institutions. Distributions used to pay qualified postsecondary school expenses (such as tuition, mandatory fees, books, supplies, computer equipment, software, Internet service and, generally, room and board) are income-tax-free for federal purposes and typically for state purposes as well, thus making the tax deferral a permanent savings.

TCJA has permanently expanded qualified expenses to include elementary and secondary school tuition. But tax-free distributions for such expenses are limited to $10,000 annually per student. The biggest downside may be that you don't have direct control over investment decisions; you're limited to the options the plan offers. Additionally, for funds already in the plan, you can make changes to your investment options only twice during the year or when you change beneficiaries. For these reasons, some taxpayers prefer Coverdell ESAs.

Education Savings Accounts

Coverdell Education Savings Accounts (ESAs) are like 529 savings plans in that contributions are not deductible for federal purposes, but plan assets can grow tax-deferred and distributions used to pay qualified education expenses are income-tax-free.

One of the biggest ESA advantages used to be that they allowed tax-free distributions for elementary and secondary school costs and 529 plans did not. With the TCJA enhancements to 529 plans this is less of an advantage. However, tax free withdrawals from 529 plans are limited to K–12 tuition, while Coverdell ESAs can be used to pay for elementary and secondary qualified education expenses other than tuition and there is no dollar limit on such annual distributions.

Another advantage is that you have more investment options. ESAs are worth considering if you want to fund elementary or secondary education expenses in excess of $10,000 per year or beyond just tuition or would like to have direct control over how and where your contributions are invested. However, the $2,000 contribution limit per year for each beneficiary, and only until they turn 18, is low and is phased out based on income. The limit begins its phase out at a modified adjusted gross income (MAGI) of $190,000 for married couples filing jointly and $95,000 for other filers. No contribution can be made when MAGI hits $220,000 and $110,000, respectively.

Amounts left in an ESA when the beneficiary turns age 30 generally must be distributed within 30 days and any earnings may be subject to tax and a 10% penalty.

— Smita Patel

Income Tax

IRS announces limited relief for 2018 underpayment penalties

The IRS has announced limited penalty relief for underpayment of estimated income tax due for the year 2018. IRS Notice 2019-11 provides a waiver of penalties to individuals whose total tax payments for 2018 via wage withholding and/or timely-made estimated tax payments exceed 85% of the tax ultimately determined to be due.

Background. Generally, the Internal Revenue Code requires taxpayers to pay federal income tax as they earn income. Payments are made via wage withholding or by quarterly estimated income tax payments. The required estimated payment is generally the lesser of (1) 90% of the tax ultimately determined to be due or (2) 100% of the tax owed by the taxpayer for the prior year (110% if the taxpayer's adjusted gross income for the prior year was greater than $150,000). If the taxpayer fails to make these estimated payments, a penalty is imposed. There are some exceptions to the imposition of penalties for underpayment, the most common one being that there is no penalty if the remaining tax owed on April 15th is less than $1,000.

The Tax Cuts and Jobs Act ("TCJA") of December 2017 made substantial changes to the Internal Revenue Code. These changes made it challenging for taxpayers to determine the appropriate amount of their wage withholding or estimated payments for 2018. In February 2018, the IRS issued a revised Withholding Calculator to help taxpayers determined their proper withholding (or estimated tax payment) amounts for 2018. The updated federal tax withholding tables reflected the TCJA's lower tax rates and doubled standard deduction. It resulted in less tax withheld. However, the new tables did not completely reflect changes such as the suspension of dependence exemptions and significantly decreased itemized deductions. As a result, some taxpayers did not pay enough in federal taxes via wage withholding or estimated payments for 2018.The General Accounting Office (GAO) reports that the Department of the Treasury expects that 21% of filers will be under withheld for 2018. While this number is significant, the GAO reports that 18% of filers were likely to have been under withheld if the tax laws had not changed.

Notice 2019-11. The Notice reports that due to the substantial changes generated by the TCJA (and despite the publication of the revised Withholding Calculator) the IRS is providing relief to individual taxpayers. To qualify for the waiver of penalties due to underpaid tax estimates, the taxpayer must (1) be an individual (2) whose total withholding and estimated tax payments for the year 2018 were made by January 15, 2019, and (3) whose payments equaled at least 85% of the tax ultimately determined to be owed for 2018.

To claim the relief, the taxpayer must file Form 2210, Underpayment of Estimated Tax by Individuals, Estate and Trusts, with his/her 2018 income tax return.

Handling 2018. Given the magnitude of the changes to the Internal Revenue Code, it may be smart to gather your tax information as soon as possible to do a rough draft of your 2018 federal income tax return. You can pull information from your final paystub and from your financial records to estimate your wage and other income. Your tax records will help you determine if you are limited to the new standard deduction or if itemizing is available to you.

Planning for 2019. After you have attended to your 2018 income taxes, make sure your tax estimates for 2019 are on-target using the 2019 Withholding Calculator on the IRS website.

— *Sarah M. Richards, Elena N. O'Leary*

Income tax treatment of scholarships

Everyone knows what a scholarship is. Free, no-strings-attached money to help a student pay for his or her higher education. Right? Usually. But not always.

A (very) brief history of the tax treatment of scholarships

The tax status of scholarships was first codified in 1954, and until 1980 it was exceedingly simple: for students pursuing a degree, all scholarships, fellowships and grants were tax-free, no matter what the funding was used for.

The first major change to this system came in 1980, with the Tax Treatment Extension Act. This amendment stated that scholarships, grants or fellowships could be taxed if they could be considered "fees for services." This can include… "[money] received as payments for teaching, research[] or other services required as a condition for receiving the scholarship or fellowship grant." Exceptions were later added for teaching and research assistantships and for certain federal student aid programs, but this represented the first time any income related to scholarships was regarded as taxable.

The 1986 Tax Reform Act added significantly more potential taxation to scholarship and grant funds. For the first time, the new law specified that portions of scholarship aid used for living, travel or research expenses would be treated as taxable income. While later amendments eased some of the tax burden (especially for graduate student teachers), this potentially costly law remains on the books today.

Finally, current law also states that scholarships for non-degree-candidates are taxable.

What is tax-free?

A scholarship, a fellowship grant or other grant may be partly or entirely tax free if you meet the following conditions:

- You're a candidate for a degree at an educational institution that maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where it carries on its educational activities; and
- The amounts you receive are used to pay for tuition and fees required for enrollment or attendance at the educational institution, or for fees, books, supplies and equipment required for courses at the educational institution.

What is taxable?

You must include in taxable income:

- Amounts used for incidental expenses, such as room and board, travel and optional equipment.
- Amounts received as payments for teaching, research or other services required as a condition for receiving the scholarship or fellowship grant. However, you don't need to include in gross income any amounts you receive for services that are required by the

National Health Service Corps Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program.

For a complete plain English explanation of the rules refer to IRS publication 970 – Tax Benefits for Education.
— Christopher F. Caldwell

Deduction for medical and dental expenses modified in 2018

With an aging population in the United States, the medical and dental expense income tax deduction may be available to many taxpayers. Understanding when and what can be deducted is important.

Will you itemize your deductions in 2018?

The Tax Cuts and Jobs Act of 2017, significantly increased the standard deduction. For tax year 2018, the standard deduction amounts are $24,000 for married couples filing jointly and surviving spouses, $12,000 for single and $18,000 for head of household filers. Therefore, it is important for a taxpayer to run the numbers to determine if a standard deduction or an itemize deduction is more advantageous.

In order to benefit from itemizing, the taxpayer's total itemize deductions need to be greater than the standard deduction amount. If the taxpayer's total allowable medical and dental expenses (as detailed below) along with the taxpayer's mortgage interest, charity and state, local and property taxes are greater than the standard deduction for the taxpayer's filing status, then the taxpayer will want to opt for itemizing deductions.

What medical and dental expenses are eligible?

Taxpayers should carefully review their checkbook ledger, credit card statements and other payment methods thoroughly for deductible medical and dental expense. These are costs of diagnosis, cure, mitigation, treatment or prevention of disease and the costs for treatments affecting any part or function of the body, including:

• Out-of-pocket costs (including co-pays) not covered by insurance to medical professionals or medical facilities. Examples of these types of expenses are laser eye surgery, a weight loss program as treatment for a disease diagnosed by a physician (obesity, hypertension or heart disease), nursing services and treatment, meals and lodging at a therapeutic center for alcohol or drug addiction.
• Copays for prescription drugs.
• Insurance premiums paid with after tax dollars for Medicare Parts B and D, Medigap, Medicare advantage or long-term care.

• Transportation costs to and from medical appointments.
• Modifications to your home for medical reasons.
• Payments for dentures, glasses, hearing aids, walkers, wheelchairs or other medical equipment.

What medical expenses are NOT eligible?

The following medical expenses are not eligible for itemization:

• Cosmetic surgery not considered necessary such as facelifts, hair transplants or liposuction.
• Health club dues for general health and well-being.
• Vitamins and nutritional supplements unless recommended by a medical professional as treatment for a physician-diagnosed medical condition.

Whose medical expenses can you deduct on your return?

In general, you can deduct medical expenses paid for yourself, your spouse and any person who qualifies as your dependent (for claiming the dependent exemption). However, there are a few exceptions. Taxpayers can still deduct medical expenses for individuals who don't qualify as their dependent. Examples are a parent for whom the taxpayer provides over half the support but the parent's gross income exceeds $4,050 or medical expenses for a married child who doesn't qualify as a dependent of the taxpayer because she/he files a joint return.

When can medical and dental expenses be deducted in 2018?

If the total of a taxpayer's medical and dental expenses is greater than 7.5 percent of the taxpayer's adjusted gross income, then the expenses can be taken as a deduction.

What changes are on the horizon for 2019 for the medical and dental expense deduction?

In 2019, the threshold for medical and dental expenses increases from 7.5 percent to 10 percent of the taxpayer's adjusted gross income.

— *Alyson Stevenson*

Tips to ensure political contributions are proper

Political contributions are heavily regulated by the government and can impact public perception. If you are considering donating to a political candidate or organization, ensure that you carefully consider the following five factors before doing so.

1. Campaign finance laws that regulate and restrict political contributions vary greatly by jurisdiction, and restrictions on political giving can come in many different shapes and sizes.

In particular, you should always be mindful of whether there are applicable contribution limits, prohibitions or disclosure requirements when making a contribution. Penalties for violating these rules can be very significant, including potentially hefty fines and, in rare instances, incarceration.

Depending on the circumstances, making a political contribution can even result in canceling a government contract or making a contractor ineligible to bid on government contracts in some jurisdictions. Accordingly, it's critical that donors do their own due diligence or seek counsel to confirm that their political contributions are compliant with the applicable rules before making a contribution.

2. When you contribute to a candidate or a political organization, you are expressly endorsing them. You may be supporting them for a very specific reason, but you are generally associating yourself and potentially your business with that candidate or organization when you make a contribution.

Further, the world of campaign finance is generally very transparent. Despite what you may have heard about "dark money" in politics, there are very few options, if any, to effectively participate in elections confidentially. You should assume that any political contribution that you make will either be reported in a public filing or discoverable by the general public and the media.

3. Although political laws vary from jurisdiction to jurisdiction, one rule is consistent everywhere—it's illegal for an individual or entity to reimburse another individual or entity for making a contribution to a political candidate. Not only is it a violation of campaign finance laws but also it's a felony in most jurisdictions. While most campaign finance violations won't result in jail time, this is one violation that could. Simply put, you should never pay or reimburse anyone for making a political contribution.

4. You should never make a request of a candidate or officeholder when making a political contribution. Similarly, never mention a political contribution when making a request to a candidate or officeholder. Political giving and lobbying requests shouldn't be made contemporaneously. It's frowned upon and makes most candidates and officeholders

uncomfortable. In addition, it could be a crime depending on the circumstances. There's a time for lobbying and making requests, and there's a time for fundraising. Those times are never the same.

5. Elected officials contribute to the climate in which we do business and pursue happiness. Thus, elections can have consequences that negatively or positively affect us, so participating in the political process can make a difference. Not only is it a fundamental right, but also supporting certain candidates and political organizations can often be in the best interest of both you as an individual and your business. While there are risks with everything you do in life, the risks involved with making political contributions can be mitigated. Depending on the circumstances, being apolitical or apathetic could be riskier.

— *Masha Rabkin*

IRS standard mileage rate for 2019

As of January 1, 2019, the Internal Revenue Service (IRS) standard mileage rates for cars, vans, pickups and panel trucks will be:

- 58¢ per mile for business travel purposes
- 20¢ per mile for medical or moving purposes
- 14¢ per mile for charitable purposes

The business, medical and moving rates increased over the 2018 standard mileage rates while the charitable rate remained the same.

Careful mileage records should be kept, which include the date, miles driven, start and end location and how the travel related to one of the categories above.

— *Mary-Benham B. Nygren*

The tax treatment of alimony is changing in 2019

The Tax Cuts and Jobs Act has reversed the longstanding tax treatment of alimony payments for divorces filed after December 31, 2018.

For decades, alimony payments have been deductible by the payer spouse and included in the taxable income of the recipient spouse. That changed. Starting in 2019, spousal support payments will no longer be deductible to the payer or considered income to the recipient.

Modifying divorce decrees filed before December 31, 2018 will be subject to the old tax rules unless the modified agreement specifically states that the 2019 tax treatment will apply.

The elimination of the alimony deduction will result in greater tax revenue for the government, higher tax liability for payers and possibly lower payments to recipients as the loss of the deduction may lead payers to negotiate lower payments.

— *Aaron Poirier*

For more information, please contact:

- Smita Patel at spatel@nixonpeabody.com or 617-345-6099
- Sarah M. Richards at srichards@nixonpeabody.com or 617-345-6082
- Elena O'Leary at eoleary@nixonpeabody.com or 585-263-1351
- Christopher F. Caldwell at ccaldwell@nixonpeabody.com or 617-345-6058
- Alyson Stevenson at astevenson@nixonpeabody.com or 585-263-1262
- Masha Rabkin at mrabkin@nixonpeabody.com or 585-263-1117
- Mary-Benham B. Nygren at mnygren@nixonpeabody.com or 617-345-6165
- Aaron Poirier at apoirier@nixonpeabody.com or 617-345-6022