RBC Wealth Management

# WealthMonitor


**RBC Wealth Management**
Hegge Wealth Management
Rick Hegge
400 N Robert Street Suite 1400
St Paul, MN 55101
651-228-6920
800-765-3246
rick.hegge@rbc.com
www.heggewealthmanagement.com


**May 2018**



Wealth Management

## Dividend Investing: Small Payments Can Boost Returns

Owning shares of stock or stock funds might increase the value of your portfolio in one of two fundamental ways: capital appreciation (i.e., price increases) and dividend payments. Of the two, capital appreciation carries the greatest potential for return, but it also carries the greatest potential for loss. And any gains or losses are only reaped when you sell your shares.

By contrast, dividends typically offer more consistent modest returns that are paid while you hold your shares. For this reason, dividends have long been popular with retirees and others who are looking for regular income. But focusing on dividends can be appropriate for almost any investor, especially if dividends are reinvested to purchase additional shares. Although reinvesting dividends from individual stocks may not be cost-effective, mutual funds and exchange-traded funds (ETFs) generally offer an option to reinvest dividends and/or capital gains.

### Growth and volatility

In general, more established companies tend to pay dividends, and these companies may not have as much growth potential as newer companies that plow all of their earnings back into the company. Even so, dividends can boost total return. A 2015 study found that dividends had accounted for about one-third of the total return of the S&P 500 index since 1956, with the other two-thirds from capital appreciation. In the fourth quarter of 2017, more than 80% of S&P 500 stocks paid a dividend with an average yield of 1.87% for the index as a whole and 2.24% for dividend-paying stocks. Many mid-size and smaller companies also paid dividends.[1]

Because dividends are by definition a positive return, even during a down market, dividend-paying stocks may be less volatile than non-dividend payers. However, dividend stocks tend to be more sensitive to rising interest rates; investors looking for income may move away from stocks if less risky fixed-income investments offer comparable yields.

### Quarterly payments

Dividends are typically paid quarterly in the form of cash or stock. The amount is set by the company's board of directors and can be changed at any time. Dividends can be expressed as the dollar amount paid on each share or as yield — the annual dividend income per share divided by the current market price. When the share price falls, the yield rises (assuming dividend payments remain the same), enabling investors who reinvest their dividends to buy more shares that have the potential to grow as market performance improves.

Investing in dividends is a long-term commitment. In exchange for less volatility and more stable returns, investors should be prepared for periods where dividend payers drag down rather than boost an equity portfolio. The amount of a company's dividend can fluctuate with earnings, which are influenced by economic, market, and political events. Dividends are typically not guaranteed and could be changed or eliminated.

The return and principal value of all investments fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Supply and demand for ETF shares may cause them to trade at a premium or a discount relative to the value of the underlying shares.

*Mutual funds and ETFs are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.*

1 S&P Dow Jones Indices, 2015, 2018

# Quiz: Can You Answer These Social Security Benefit Questions?

*Did you know that 94% of all workers are covered under Social Security?*

*Source: Social Security Fact Sheet on the Old-Age, Survivors and Disability Insurance Program, July 2017*

Most people will receive Social Security benefits at some point in their lifetimes, but how much do you know about this important source of income? Take this quiz to learn more.

## Questions

**1. Can you receive retirement and disability benefits from Social Security at the same time?**

a. Yes

b. No

**2. If your ex-spouse receives benefits based on your earnings record, your benefit will be reduced by how much?**

a. Reduced by 30%

b. Reduced by 40%

c. Reduced by 50%

d. Your benefit will not be reduced

**3. For each year you wait past your full retirement age to collect Social Security, how much will your retirement benefit increase?**

a. 6%

b. 7%

c. 8%

**4. Monthly Social Security benefits are required to be paid by which of the following methods?**

a. Paper check only

b. Paper check, direct deposit, or debit card

c. Direct deposit or debit card

**5. Are Social Security benefits subject to income tax withholding?**

a. Yes

b. No

**6. Once you've begun receiving Social Security retirement benefits, you can withdraw your claim if how much time has elapsed?**

a. Less than 12 months since you've been receiving benefits

b. Less than 18 months since you've been receiving benefits

c. Less than 24 months since you've been receiving benefits

## Answers

**1. b.** No. If you receive a disability benefit, it will automatically convert to a retirement benefit once you reach full retirement age.

**2. d.** Your benefit will not be reduced if your ex-spouse receives Social Security benefits based on your earnings record.

**3. c.** Starting at full retirement age, you will earn delayed retirement credits that will increase your benefit by 8% per year up to age 70. For example, if your full retirement age is 66, you can earn credits for a maximum of four years. At age 70, your benefit will then be 32% higher than it would have been at full retirement age.

**4. c.** Since 2013, the Treasury Department has required electronic payment of federal benefits, including Social Security. You can sign up for direct deposit of your benefits into your current bank account or open a low-cost Electronic Transfer Account (ETA) at a participating financial institution. Another option is to sign up for a Direct Express® prepaid debit card. Under this option, your Social Security benefits are deposited directly into your card account, and you can use the card to make purchases, pay expenses, or get cash.

**5. b.** No. Withholding isn't mandatory, but you may voluntarily ask the Social Security Administration to withhold federal income tax from your benefits when you apply, or later, if you determine you will owe taxes on your Social Security benefits (not everyone does). You may choose to have 7%, 10%, 15%, or 25% of your benefit payment withheld. Ask a tax professional for help with your situation.

**6. a.** If something unexpected happens and you've been receiving Social Security benefits for less than 12 months after signing up, you can change your mind and withdraw your claim (and reapply at a later date). You're limited to one withdrawal per lifetime, and there are also financial consequences. You must repay all benefits already paid to you or your family members based on your application (anyone affected must consent in writing to the withdrawal), and repay any money previously withheld, including Medicare premiums or income taxes.

RBC Wealth Management

# The College Landscape After Tax Reform

*Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans and ABLE plans before investing. Specific information can be found in each plan's official statement. Participating in a 529 plan or ABLE plan may involve investment risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful. Investments may not perform well enough to cover college costs as anticipated. As with other investments, there are generally fees and expenses associated with participation in a 529 savings plan, and each plan has its own rules and restrictions, which can change at any time. Before investing in a 529 plan or an ABLE plan, consider whether your state offers residents favorable state tax benefits, and whether those benefits are contingent on joining the in-state plan. Other state benefits for 529 plans may include financial aid, scholarship funds, and protection from creditors.*

College students and their parents dodged a major bullet with the Tax Cuts and Jobs Act of 2017. Initial drafts of the bill included the elimination of Coverdell Education Savings Accounts, the Lifetime Learning Credit, and the student loan interest deduction, along with the taxation of tuition waivers, which are used primarily by graduate students and college employees. In the end, none of these provisions made it into the final legislation. But a few other college-related items did. These changes take effect in 2018.

## 529 plans expanded

The new law expands the definition of 529 plan "qualified education expenses" to include K-12 tuition. Starting in 2018, annual withdrawals of up to $10,000 per student can be made from a 529 college savings plan for tuition expenses related to enrollment at a K-12 public, private, or religious school (excluding home schooling). Such withdrawals are now tax-free at the federal level.

At the state level, some states automatically update their state 529 legislation to align with federal 529 legislation, but other states will need to take legislative action to include K-12 tuition as a qualified education expense. In addition, 529 plan institutional managers will likely further refine their rules to accommodate the K-12 expansion and communicate these rules to existing account owners. Parents who are interested in making a K-12 contribution or withdrawal should understand their plan's rules and their state's tax rules.

The expansion of 529 plans may impact Coverdell Education Savings Accounts (ESAs). Coverdell ESAs let families save up to $2,000 per year for a child's K-12 or college expenses. Up until now, they were the only option for tax-advantaged K-12 savings. But now the use of Coverdell ESAs may decline as parents are likely to prefer the much higher lifetime contribution limits of 529 plans — generally $350,000 and up — over the $2,000 annual limit for Coverdell accounts. In addition, Coverdell ESA contributions can only be made for children under age 18.

Coverdell ESAs do have one important advantage over 529 plans, though: investment flexibility. Coverdell owners have a wide variety of options in terms of what investments they hold in their accounts, and may generally change investments as often as they wish. By contrast, 529 account owners can invest only in the investment portfolios offered by the plan, and they can change their existing plan investments only twice per year.

In addition, the new tax law allows 529 account owners to roll over (transfer) funds from a 529 account to an ABLE account without federal tax consequences if certain requirements are met. An ABLE account is a tax-advantaged account that can be used to save for disability-related expenses for individuals who become blind or disabled before age 26. Like 529 plans, ABLE plans allow funds to accumulate tax deferred, and withdrawals are tax-free when used for a qualified expense.

## New calculation for kiddie tax

The tax reform law changes the way the "kiddie tax" is calculated. Previously, a child's unearned income over a certain amount was taxed at the parents' rate. Under the new law, a child's unearned income over a certain amount ($2,100 in 2018) will be taxed using the compressed trust and estate income tax brackets. This change may make the use of UTMA/UGMA custodial accounts less attractive as a college savings vehicle due to the reduced opportunity for tax savings.

## New tax on large college endowments

The tax law creates a new 1.4% tax on the net investment income of large college endowments. Specifically, the tax applies to institutions with at least 500 tuition-paying students and endowment assets of $500,000 or more per student. Approximately 30 colleges are expected to be swept up in this net in 2018, including top-ranked larger universities and smaller elite liberal arts colleges. Some affected colleges have publicly stated that the tax will limit their ability to fund certain programs, including financial aid programs.

## Loss of personal exemptions

Starting in 2018, the tax law eliminates personal exemptions, which were $4,050 in 2017 for each individual claimed on a tax return. So on their 2018 tax returns (which will be completed in 2019), parents of college students will lose an exemption for each college student they claim. However, this loss may be at least partially offset by: (1) a larger standard deduction in 2018 of $24,000 for joint filers (up from $12,700 in 2017); $12,000 for single filers (up from $6,350 in 2017); and $18,000 for heads of household (up from $9,350 in 2017); and (2) a new family tax credit of $500 in 2018 for each dependent who is not a qualifying child (i.e., under age 17), which would include a dependent college student. The income thresholds to qualify for this credit (and the child tax credit) are significantly higher: up to $400,000 adjusted gross income for joint filers and up to $200,000 for all other filers.


**RBC Wealth Management**
Hegge Wealth Management
Rick Hegge
400 N Robert Street Suite 1400
St Paul, MN 55101
651-228-6920
800-765-3246
rick.hegge@rbc.com
www.heggewealthmanagement.com




## What are the gift and estate tax rules after tax reform?

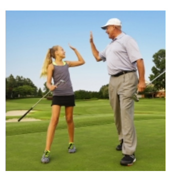
The Tax Cuts and Jobs Act, signed into law in December 2017, approximately doubled the federal gift and estate tax basic exclusion amount to $11.18 million in 2018 (adjusted for inflation in later years). After 2025, the exclusion is scheduled to revert to its pre-2018 level and be cut approximately in half. Otherwise, federal gift and estate taxes remain the same.

**Gift tax.** Gifts you make during your lifetime may be subject to federal gift tax. Not all gifts are subject to the tax, however. You can make annual tax-free gifts of up to $15,000 per recipient. Married couples can effectively make annual tax-free gifts of up to $30,000 per recipient. You can also make unlimited tax-free gifts for qualifying expenses paid directly to educational or medical service providers. And you can make deductible transfers to your spouse and to charity. There is a basic exclusion amount that protects a total of up to $11.18 million (in 2018) from gift tax and estate tax. Transfers in excess of the basic exclusion amount are generally taxed at 40%.

**Estate tax.** Property you own at death is subject to federal estate tax. As with the gift tax, you can make deductible transfers to your spouse and to charity; there is a basic exclusion amount that protects up to $11.18 million (in 2018) from tax, and a tax rate of 40% generally applies to transfers in excess of the basic exclusion amount.

**Portability.** The estate of a deceased spouse can elect to transfer any unused applicable exclusion amount to his or her surviving spouse (a concept referred to as portability). The surviving spouse can use the unused exclusion of the deceased spouse, along with the surviving spouse's own basic exclusion amount, for federal gift and estate tax purposes. For example, if a spouse died in 2011 and the estate elected to transfer $5 million of the unused exclusion to the surviving spouse, the surviving spouse effectively has an applicable exclusion amount of $16.18 million ($5 million plus $11.18 million) to shelter transfers from federal gift or estate tax in 2018.

## How has tax reform affected the generation-skipping transfer tax?



The Tax Cuts and Jobs Act, signed into law in December 2017, doubled the federal generation-skipping transfer (GST) tax exemption to $11.18 million in 2018 (adjusted for inflation in later years). After 2025, the exemption is scheduled to revert to its pre-2018 level and be cut approximately in half. Otherwise, the federal GST tax remains the same.

The federal GST tax generally applies if you transfer property to a skip person. A skip person is someone who is two or more generations younger than you (for example, a grandchild). The GST tax may apply in addition to any gift or estate tax. Similar to the gift tax provisions, annual exclusions (up to $15,000 per recipient in 2018) and exclusions for qualifying educational and medical expenses are available for GST tax. You can protect up to $11.18 million (in 2018) with the GST tax exemption. Transfers in excess of the GST tax exemption are generally taxed at 40%.

A GST generally occurs on a transfer that is subject to federal gift or estate tax and made to a skip person, or a transfer to a trust if all the beneficiaries with an interest in the trust are skip persons. A GST may also occur on certain distributions from trusts to skip persons. Additionally, a GST may occur when an interest in a trust terminates, and skip persons then hold all interests in the trust.

Unlike with the gift and estate tax applicable exclusion amount, the GST tax exemption is not portable between spouses. The estate of a deceased spouse cannot transfer any unused GST tax exemption to the surviving spouse.

**Note:** An early version of the legislation proposed approximately doubling the gift and estate tax basic exclusion amount and the GST tax exemption for 2018 to 2024. After 2024, the estate tax and the GST tax would have been repealed. The gift tax would not have been repealed, although the top gift tax rate would have been reduced from 40% to 35% after 2024. However, the only provision that made it into the final legislation was the doubling of the gift and estate tax basic exclusion amount and the GST tax exemption for 2018 to 2025.