Newsletter

TAX TIPS

Year-End Tax Planning

The Reardon Group of Companies:
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Dear Client:

With year-end approaching, now is the time to take steps to cut your 2018 tax bill. Here are some relatively foolproof year-end tax planning strategies to consider, taking into account changes included in the Tax Cuts and Jobs Act (TCJA).

Year-end Planning Moves for Individuals

Game the Increased Standard Deduction Allowances. The TCJA almost doubled the standard deduction amounts. For 2018, the amounts are $12,000 for singles and those who use married filing separate status (up from $6,350 for 2017), $24,000 for married joint filing couples (up from $12,700), and $18,000 for heads of household (up from $9,350). If your total annual itemizable deductions for 2018 will be close to your standard deduction amount, consider making additional expenditures before year-end to exceed your standard deduction. That will help to lower this year's tax bill. Next year, you can claim the standard deduction, which will be increased a bit to account for inflation.

If you plan to itemize deductions in 2018, consider state and local income and property taxes that are due early next year. Prepaying those bills before year-end can decrease your 2018 federal income tax bill because your itemized deductions will be that much higher. **However,** the TCJA decreased the maximum amount you can deduct for state and local taxes to $10,000 ($5,000 if you use married filing separate status). So, keep this new limitation in mind when making your decision.

The easiest itemizable deductible expense to accelerate is included in your house payment due on January 1. Accelerating that payment into this year will give you 13 months' worth of interest in 2018. Although the TCJA put new limits on itemized deductions for home mortgage interest, you may not be affected.

Accelerating other itemizable expenditures could also cause your itemized deductions to exceed your standard deduction in 2018. For example, when itemizing consider making bigger charitable donations this year and smaller contributions next year to compensate. Also, consider accelerating elective medical procedures, dental work, and vision care. For 2018, medical expenses are deductible to the extent they exceed 7.5% of Adjusted Gross Income (AGI), if you itemize.

Warning: In addition to the aforementioned state and local tax limitations, the state and local tax prepayment drill can be a bad idea if you owe Alternative Minimum Tax t(AMT) for this year. That's because write-offs for state and local income and property taxes are completely disallowed under the AMT rules. Therefore, prepaying those expenses may do little or no good even if the amounts are below the limits if you are an AMT victim.

Carefully Manage Investment Gains and Losses in Taxable Accounts. If you hold investments in taxable brokerage firm accounts, consider the tax advantage of selling appreciated securities that have been held for over 12 months. The maximum federal income tax rate on long-term capital gains recognized in 2018 is only 15% for

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most folks, although it can reach a maximum of 20% at higher income levels. The 3.8% Net Investment Income Tax (NIIT) also can apply at higher income levels.

To the extent you have capital losses that were recognized earlier this year or capital loss carryovers from pre-2018 years, selling winners this year will not result in any tax hit. In particular, sheltering net short-term capital gains with capital losses is a sweet deal because net short-term gains would otherwise be taxed at higher ordinary income rates.

What if you have some loser investments that you would like to unload? Biting the bullet and taking the resulting capital losses this year would shelter capital gains, including high-taxed short-term gains, from other sales this year.

If selling a bunch of losers would cause your capital losses to exceed your capital gains, the result would be a net capital loss for the year. No problem! That net capital loss can be used to shelter up to $3,000 of 2018 ordinary income from salaries, bonuses, self-employment income, interest income, royalties, and whatever else ($1,500 if you use married filing separate status). Any excess net capital loss from this year is carried forward to next year and beyond.

In fact, having a capital loss carryover into next year could turn out to be a pretty good deal. The carryover can be used to shelter both short-term and long-term gains recognized next year and beyond. This can give you extra investing flexibility in those years because you won't have to hold appreciated securities for over a year to get a preferential tax rate. Since the top two federal rates on net short-term capital gains recognized in 2019 and beyond are 35% and 37% (plus the 3.8% NIIT, if applicable), having a capital loss carryover into next year to shelter short-term gains recognized next year and beyond could be a very good thing.

Take Advantage of 0% Tax Rate on Investment Income. The TCJA retained the 0%, 15%, and 20% rates on Long-term Capital Gains (LTCGs) and qualified dividends recognized by individual taxpayers. However, for 2018–2025, these rates have their own brackets that are not tied to the ordinary income brackets. Here are the brackets for 2018:

	Single	Joint	Head of Household
0% bracket	$0–38,600	$0–77,200	$0–51,700
Beginning of 15% bracket	38,601	77,201	51,701
Beginning of 20% bracket	425,801	479,001	452,401

Note: The 3.8% NIIT can hit LTCGs and dividends recognized by higher-income individuals. This means that many folks will actually pay 18.8% (15% + 3.8% for the NIIT) and 23.8% (20% + 3.8%) on their 2018 LTCGs and dividends.

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who will be in the 0% bracket. If so, consider giving them appreciated stock or mutual fund shares that they can sell and pay 0% tax on the resulting long-term gains. Gains will be long-term as long as your ownership period plus the gift recipient's ownership period (before the sale) equals at least a year and a day.

Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 0% rate bracket, they will be federal-income-tax-free.

Warning: If you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting capital gains and dividends to be taxed at the higher rates that apply to trusts and estates which would defeat the purpose.

Convert Traditional IRAs into Roth Accounts. The best profile for the Roth conversion strategy is when you expect to be in the same or higher tax bracket during your retirement years. The current tax hit from a conversion done this year may turn out to be a relatively small price to pay for completely avoiding potentially higher future tax rates on the account's earnings.
A few years ago, the Roth conversion privilege was a restricted deal. It was only available if your modified AGI was $100,000 or less. That restriction is gone. Even billionaires can now do Roth conversions!

Watch out for the AMT. The TCJA significantly reduced the odds that you will owe AMT for 2018 by significantly increasing the AMT exemption amounts and the income levels at which those exemptions are phased out. Even if you still owe AMT, you will probably owe considerably less than under prior law. Nevertheless, it's still critical to evaluate year-end tax planning strategies in light of the AMT rules. Because the AMT rules are complicated, you may want some assistance. We stand ready to help.

Don't Overlook Estate Planning. The unified federal estate and gift tax exemption for 2018 is a historically huge $11.18 million, or effectively $22.36 million for married couples. Even though these big exemptions may mean you are not currently exposed to the federal estate tax, your estate plan may need updating to reflect the current tax rules. Also, you may need to make some changes for reasons that have nothing to do with taxes.

Year-end Planning Moves for Small Businesses

Establish a Tax-favored Retirement Plan. If your business doesn't already have a retirement plan, now might be the time to take the plunge. Current retirement plan rules allow for significant deductible contributions. For example, if you are self-employed and set up a SEP-IRA, you can contribute up to 20% of your self-employment earnings, with a maximum contribution of $55,000 for 2018. If you are employed by your own corporation, up to 25% of your salary can be contributed with a maximum contribution of $55,000.

Other small business retirement plan options include the 401(k) plan (which can be set up for just one person), the defined benefit pension plan, and the SIMPLE-IRA. Depending on your circumstances, these other types of plans may allow bigger deductible contributions.

The deadline for setting up a SEP-IRA for a sole proprietorship and making the initial deductible contribution for the 2018 tax year is 10/15/19 if you extend your 2018 return to that date. Other types of plans generally must be established by 12/31/18 if you want to make a deductible contribution for the 2018 tax year, but the deadline for the contribution itself is the extended due date of your 2018 return. However, to make a SIMPLE-IRA contribution for 2018, you must have set up the plan by October 1. So, you might have to wait until next year if the SIMPLE-IRA option is appealing.

Take Advantage of Liberalized Depreciation Tax Breaks. The TCJA included a number of very favorable changes to the depreciation tax rules, including 100% first-year bonus depreciation for qualifying assets and much more generous Section 179 deduction rules.

Time Business Income and Deductions for Tax Savings. If you conduct your business using a pass-through entity (sole proprietorship, S corporation, LLC, or partnership), your shares of the business's income and deductions are passed through to you and taxed at your personal rates. Assuming the current tax rules will still apply in 2019, next year's individual federal income tax rate brackets will be the same as this year's (with modest bumps for inflation). In that case, the traditional strategy of deferring income into next year while accelerating deductible expenditures into this year makes sense if you expect to be in the same or lower tax bracket next year. Deferring income and accelerating deductions will, at a minimum, postpone part of your tax bill from 2018 until 2019.

On the other hand, if you expect to be in a higher tax bracket in 2019, take the opposite approach. Accelerate income into this year (if possible) and postpone deductible expenditures until 2019. That way, more income will be taxed at this year's lower rate instead of next year's higher rate.

Maximize the New Deduction for Pass-through Business Income. The new deduction based on Qualified Business Income (QBI) from pass-through entities was a key element of the TCJA. For tax years beginning in 2018–2025, the deduction can be up to 20% of a pass-through entity owner's QBI, subject to restrictions that can apply at higher income levels and another restriction based on the owner's taxable income. The QBI deduction also can be claimed for up to 20% of income from qualified REIT dividends and 20% of qualified income from publicly-traded partnerships.

For QBI deduction purposes, pass-through entities are defined as sole proprietorships, single-member LLCs that are treated as sole proprietorships for tax purposes, partnerships, LLCs that are treated as partnerships for tax purposes, and S corporations. The QBI deduction is only available to noncorporate taxpayers (individuals, trusts, and estates).

Because of the various limitations on the QBI deduction, tax planning moves (or nonmoves) can have the side effect of increasing or decreasing your allowable QBI deduction. So, individuals who can benefit from the deduction must be really careful at year-end tax planning time.

Claim 100% Gain Exclusion for Qualified Small Business Stock. There is a 100% federal income tax gain exclusion privilege for eligible sales of Qualified Small Business Corporation (QSBC) stock that was acquired after 9/27/10. QSBC shares must be held for more than five years to be eligible for the gain exclusion break.

Conclusion

This letter only covers some of the year-end tax planning moves that could potentially benefit you and your business. Please contact us if you have questions, want more information, or would like us to help in designing a year-end planning package that delivers the best tax results for your particular circumstances.

Very truly yours,

Shawn, Jean and the Staff of Weiss + Reardon & Company, P.C.

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