

2018



year-end year-round Tax Planning Guide



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2018 Year-End Tax Planning Guide

Year-end tax planning always has its share of complexity.

In 2017, taxpayers faced a distinct set of challenges due to the uncertainty surrounding proposed tax reform. The Tax Cuts and Jobs Act of 2017, which we will refer to as the Tax Cut and Job Act, was not signed by President Trump until December 22, giving taxpayers and their advisors just a few days to consider the major changes in the tax rules. Most, but not all, of the Tax Cut and Job Act changes were intended to go into effect after 2017, and many of those changes are long-term but not permanent.



We note two major brushstroke differences in 2018 year-end planning compared to 2017 year-end planning. In 2017, we were looking at significant tax rate reductions in the following year, which is not likely to be the case in 2018—barring new legislation, which is always a possibility. Saving taxes sooner is generally better. Accelerating deductions is typically a good strategy due to the time value of money, and while that is true of 2018, it was particularly advantageous in 2017 because of the higher tax rates.

The second major brushstroke is the reduction in or elimination of traditional tax deductions, such as capping the amount of state income tax that can be claimed as an itemized deduction and the elimination of the moving expense deduction. However, there is also the new 20% of business income tax deduction, which will benefit many taxpayers, and for corporate taxpayers, a significant reduction in the tax rate. The new 20% deduction provision, Section 199A, comes with the repeal of Section 199, which allowed a domestic manufacturing deduction of 9%. Additionally, in 2018 there are rather liberal provisions for writing off equipment costs in the year of acquisition.

All of these considerations put a new emphasis on understanding one's current and projected tax position. For this reason, "doing the math" with the help of your tax professional in your year-end planning is more important than ever. We urge you to obtain professional advice before acting on any of the suggestions provided in this guide.

We look forward to helping you assess your situation, weigh your options, and prepare for a variety of possible scenarios. As your trusted advisor, you can rely on us to keep you abreast of the latest tax changes and help you prepare for their impact.

The Tax Rate Perspective

The following federal rates apply to taxable income. The rates will remain the same in 2019, barring new legislation. A common feature of the Tax Cut and Job Act was that many of its provisions apply through 2025, when the old rules will be reinstated. We may not always mention the "change back" rules that apply to many of the recent changes in the law, but we do note here that the rate reductions reflected below will change after 2025.

| TAX RATE | SINGLE FILERS | MARRIED FILING JOINTLY OR QUALIFYING WIDOW(ER) | MARRIED FILING SEPARATELY | HEAD OF HOUSEHOLD |
|----------|-----------------------|--|---------------------------|-----------------------|
| 10% | Up to \$9,525 | Up to \$19,050 | Up to \$9,525 | Up to \$13,600 |
| 12% | \$9,526 – \$38,700 | \$19,051 – \$77,400 | \$9,526 – \$38,700 | \$13,601 – \$51,800 |
| 22% | \$38,701 – \$82,500 | \$77,401 – \$165,000 | \$38,701 – \$82,500 | \$51,801 – \$82,500 |
| 24% | \$82,501 – \$157,500 | \$165,001 – \$315,000 | \$82,501 – \$157,500 | \$82,501 – \$157,500 |
| 32% | \$157,501 – \$200,000 | \$315,001 – \$400,000 | \$157,501 – \$200,000 | \$157,501 – \$200,000 |
| 35% | \$200,001 – \$500,000 | \$400,001 – \$600,000 | \$200,001 – \$300,000 | \$200,001 – \$500,000 |
| 37% | \$500,001 or more | \$600,001 or more | \$300,001 or more | \$500,001 or more |

STRATEGIES FOR INDIVIDUAL TAXPAYERS

A good way to start your year-end tax planning is by identifying any changes in your personal situation that may affect your taxes. A change in your marital status, a move, a job change, starting a business, retirement, a new dependent or loss of one—any of these life events would likely have a tax impact. Similarly, you'll want to be alert to any tax law changes that may present planning opportunities.

Your marginal rate. For planning purposes, focus on your marginal tax rate, the rate that applies to your next dollar of taxable income. Knowing your marginal rate can help you gauge the impact of various planning strategies. For example, an additional \$1,000 deduction would save \$350 in taxes for a taxpayer in the 35% tax bracket.

Personal exemptions are gone. The Tax Cut and Job Act increased the standard deduction, but it repealed the personal exemption deduction, effective 2018 through 2025.

Standard deduction vs. itemized deductions. The standard deduction is made in lieu of itemized deductions. There is some good news in 2018.

The standard deduction increases in 2018 as follows:



Single

\$12,000 (previously \$6,350)



Heads of household

\$18,000 (previously \$9,350)



Married filing jointly

\$24,000 (previously \$12,700)



Married filing separately

\$12,000 (previously \$6,350)

There is some increase in the standard deduction for the elderly and blind.

The increased standard deduction means fewer taxpayers will itemize. As a possible tax savings strategy, consider itemizing every other year, accelerating or postponing itemized deductions as necessary to “bunch” more itemized deductions in a particular year.

Previously, there was a rule that phased out itemized deductions at higher income levels, but that rule was repealed effective in 2018. Certain deductions are still affected by the measure of the taxpayer's adjusted gross income, notably charitable donations and medical expenses.

The big news for taxpayers in states with higher income tax rates is the new limit of \$10,000 for the sum of property tax on a US personal residence plus state income tax (or sales tax can be substituted for state income tax). These limits don't apply to such taxes when incurred in a trade or business or for the production of income.

An itemized deduction for a home loan is usually limited to mortgages not exceeding \$750,000 under the new law, or \$1,000,000 if the home loan was in place by December 15, 2017.

“Home equity indebtedness” may not be deductible as home mortgage interest, but there is an exception when such debt is used to buy, build, or substantially improve the home, and the home secures the debt. The rules were much more liberal last year. The old rule was that the loan interest was deductible up to \$100,000 if the debt was secured by a primary or sec-

ondary residence, even if the loan went to buy a personal-use auto. The rules are now much more strict.

Refinancing is contemplated in the legislative history, but to preserve your interest deduction, this needs to be done with careful attention to the tax rules.

Interest expense is still generally deductible if it relates to business or investments, but there is a new limitation that can affect higher levels of business interest expense. This new limitation, Section 163(j) typically doesn't apply to businesses with income under \$25 million. It does not grandfather old debt, and realty businesses can typically elect out of it.

Donation deductions are still with us. After much debate, charitable donation deductions are still very much with us. The percentage of adjusted gross income limit on the deduction for cash gifts to public charities even increased from 50 to 60% in 2018. It is still generally a good plan to donate appreciated long-term, publicly traded stocks to charity because, while there are some percentage of income limitations to review with your advisor, the donation is relatively easy to accomplish, and it typically yields a deduction measured by current value. The donation deduction is full measure even though the inherent gain is never recognized, because the listed securities will eventually be sold by the exempt organization.

Caveat: Practically any type of deduction can have the effect of reducing the benefit of the 20% of business income deduction. Consider having your tax advisor "do the math" if you're considering a large charitable donation. Your advisor will evaluate how the gift may impact the projected 20% of business income deduction calculations. Those calculations may be affected by a taxable income limitation, not just the amount of business income.

Miscellaneous itemized deductions. Miscellaneous itemized deductions used to be counted as itemized deductions to the extent they exceeded 2% of adjusted gross income of the year, but the Tax Cut and Job Act repealed these as deductions on your federal return.

This is only a partial list of items you may have claimed as a miscellaneous itemized deduction in the past but which are not deductible in 2018.

▶ **Tax preparation fees:**

Your circumstances may justify allocating some of your tax professional's fee to other schedules, such as business or rental income schedules.

▶ **Unreimbursed employee expenses:**

Examples include depreciation on a computer even when required by the employer; license, regulatory, and legal fees related to your job; subscriptions to professional journals and newspapers; tools and supplies used in your work; travel, transportation, meals, and entertainment related to your work and not reimbursed by your employer; union dues; and work-related education.

▶ **Expenses for the production or collection of income:**

Examples include depreciation on a computer used for investments; investment fees and expenses; service charges on dividend reinvestment plans; trustee's fees for an IRA if separately billed and paid; appraisal fees to support a charitable donation or casualty loss; and miscellaneous itemized deductions from pass-through entities.

Other important individual changes. Beginning in 2018, moving expenses, whether paid by the individual in connection with

employment or a trade or business, are no longer deductible unless you are in the military. An employer paying an employee's moving expenses can normally continue to deduct such payments, but the reimbursements by an employer are now taxable to the employee.

As a reminder, many of the provisions we discuss as changing in 2018 may only last a period of some years. For example, the more liberal moving expense deduction rules will return after 2025. Consult the effective dates with the help of your advisor to determine when the long-term perspective of changes may be important.

In general, the tax rules are changing when it comes to alimony and separate maintenance payments. The old rules continue to apply in 2018, which is to say such payments are generally deductible by the payer and included in the income of the recipient spouse. The general rule for such agreements entered into after 2018 is that payments are no longer deductible and receipts are no longer taxable.

Personal casualty and theft losses were previously deductible, but beginning in 2018 they are deductible only in federally declared disaster areas.

Additional 0.9% Medicare tax. This additional Medicare tax on employment and self-employment earnings sometimes catches taxpayers by surprise. While the regular Medicare tax applies to all earnings, the 0.9% tax applies only to earnings over \$200,000 (single/head of household), \$250,000 (married filing jointly), or \$125,000 (married filing separately). The additional Medicare tax was introduced by the Affordable Care Act and is still with us.





Net investment income tax. Another Affordable Care Act provision, the 3.8% net investment income tax affects higher income investors with modified AGI over \$200,000 (single/head of household), \$250,000 (married filing jointly), or \$125,000 (married filing separately). You can find more details regarding the net investment income tax and some tips for lessening your exposure to it on page 9.

Alternative minimum tax (AMT). The basic purpose of the AMT system is to ensure that taxpayers who use various deductions, credits, and exclusions to reduce their regular tax liability still pay a minimum amount of tax. The table on the next page shows the AMT rates and exemption amounts. A tax projection can tell you whether you are likely to owe the AMT for 2018. If you are, there may be strategies you can consider to mitigate the impact of the tax.

Medical and related. Unreimbursed medical expenses are still deductible, and in 2018 they qualify as itemized deductions to the extent they exceed 7.5% of adjusted gross income. This rule applies regardless of the taxpayer's age. After 2018 the old rule will return. That rule says medical expenses are deductible to the extent they exceed 10% of that year's adjusted gross income. So, to the extent medical expenses can be controlled, such expenses may yield more deductions in 2018 if adjusted gross income is stable between years. But keep in mind that medical is just one of the components of itemized deductions, the sum of which must exceed the standard deduction to yield any real tax savings. The Tax Cut and Job Act also made the more liberal 7.5% rule apply for 2017.

For 2018 participants who have self-only coverage in a Medical Savings Account, the plan must have an annual deductible that is not less than \$2,300 but not more than \$3,450. For self-only coverage, the maximum out-of-pocket expense amount is \$4,550. For 2018 participants with family coverage, the floor for the annual deductible is \$4,550; however, the deductible amount cannot be more than \$6,850. For family coverage, the out-of-pocket expense limit is \$8,400 for 2018.

Starting in 2019, the Tax Cut and Job Act will repeal the provision in the Affordable Care Act imposing an excise tax on individuals who do not secure minimum healthcare coverage. The excise tax still applies in 2018. The 2018 shared responsibility payment (the penalty for not having health insurance) is the higher of the following amounts: 2.5% of the household income up to a maximum of the total yearly premium for the national average price of a Bronze plan sold through the Marketplace, or a per-person fee of \$695 per adult and \$347.50 per child under 18 up to a maximum of \$2,085.

Energy. Solar energy systems, both for existing homes and new construction, still qualify for a credit. The credit available is 30% of the cost of the system for 2018-2019, 26% for 2020, and 22% for 2021.

Education. The American Opportunity Tax Credit and the Lifetime Learning Credit are still available with little change from 2017. The credits are reduced with higher levels of income. The student loan interest deduction was not repealed in the Tax Cut and Job Act.

TIMING MATTERS

Timing plays a significant role in year-end tax planning. Typically, you'll want to look for ways to delay the taxation of income until a later tax year and accelerate deductible expenses into the current tax year. Such strategies can lower this year's taxable income—and the amount of income taxes currently payable.

However, if you expect to be in a higher tax bracket next year, consider doing the reverse: move taxable income into this year and push deductible expenses into next year, when the deductions can potentially save you more tax dollars. Before implementing this plan, though, consider the time value of money. By paying taxes earlier, you give up the opportunity to invest those funds in the interim.

Here are some potential ways to defer taxable income:

- ▶ Increase pretax salary deferrals to an employer's 401(k), 403(b), governmental 457, or SIMPLE retirement plan. You'll find the 2018 deferral limits in the table on page 6.
- ▶ Ask if you can receive a year-end bonus or commission payment shortly after year-end.

Deductible expenses you might be able to accelerate include:

- ▶ Charitable contributions. If you mail your check or charge your donation to your credit card by year-end, it will count as a 2018 contribution. Caveat: The tax savings from charitable contributions may be affected by an interplay with the 20% of business income deduction that began in 2018. It is particularly important to "do the math" in planning charitable contributions.
- ▶ State income tax payments. Ask your employer to withhold more tax from your remaining 2018 paychecks. Alternatively, make your January estimated state and local income tax payment before year-end and pay enough to cover any projected balance due. Caveat: To obtain a benefit from a state income tax payment, you must itemize rather than use the standard deduction in 2018. Also, as noted above, there is a \$10,000 limit to the sum of property taxes on a residence plus state income tax (assuming one doesn't deduct sales tax).

Consider the AMT. Before accelerating state and local tax payments, though, check to make sure that doing so will not create an AMT problem. Also consider that additional year-end payments of state and local taxes may not translate into additional deductions, because in 2018 the deduction for the sum of the state income tax and residential property tax on the residence (or state income tax plus sales tax) is limited to a maximum of \$10,000. Other potential AMT triggers include:

- The exercise of incentive stock options
- Significant amounts of tax-exempt interest from "private activity" municipal bonds
- Investment interest deduction

Maximize above-the-line deductions. Certain expenses are deductible from your gross income in arriving at your AGI. These "above-the-line" deductions (adjustments) are available whether you claim the standard deduction or itemize your deductions. And they're especially valuable because they work double-time, both reducing your AGI and helping you reserve tax breaks you might otherwise lose because your AGI is too high.

Making the most of your above-the-line deductions will help lower your tax bill. Here are some potential deductions to keep in mind. The list is shorter than last year's due to the repeal of de-

ductions that political leaders considered necessary to achieve rate reductions.

- Contributions to a traditional IRA
- Student loan interest (up to \$2,500)
- Health savings account (HSA) contributions (see page 9)
- Alimony payments
- Educator expenses (up to \$250)
- Penalties on the early withdrawal of savings

Self-employed individuals may also claim an above-the-line deduction for half of their self-employment tax (other than the 0.9% additional tax), certain retirement account contributions, and qualifying medical insurance premiums. Since minimizing AGI gives you a variety of tax advantages, you won't want to overlook any above-the-line deductions you are entitled to claim.

2018 AMT TAX RATES

Recent changes kept the AMT for individuals while repealing it for corporate taxpayers. However, there are higher exemption thresholds and the phaseout of the exemption begins at a higher level, so there is some relief for individuals. The exemption is much less likely to be reduced or eliminated by higher levels of income. Additionally, some of the preference items are no longer available or available but with limits.

| STATUS | 2017 | | 2018–2025 | |
|---------------------------------|-----------|-----------|-----------|-----------|
| | Exemption | Phaseout | Exemption | Phaseout |
| Single/ Head of Household | \$54,300 | \$120,700 | \$70,300 | \$500,000 |
| Married Filing Jointly | \$84,500 | \$160,900 | \$109,400 | \$1 M |
| Married Filing Separately | \$42,250 | \$80,450 | N.A. | N.A. |



RETIREMENT PLANNING

No matter where you are in your career, accumulating assets for your future retirement is probably one of your biggest financial goals. Maximizing your contributions to tax-favored retirement plans can help you pursue that goal while also saving you money on your taxes.

Take advantage of employer plans. With an employer-sponsored retirement savings plan such as a 401(k), 403(b), or SIMPLE plan, your contributions and any earnings on those contributions generally won't be taxed until you begin receiving funds from the plan.

Some employers also allow employees to make after-tax Roth contributions to their 401(k) or 403(b) retirement savings plans. Roth contributions are subject to current income taxes, but once in the plan, the contributions potentially grow tax-deferred. Withdrawals of both Roth contributions and related earnings are not taxed if certain requirements are met.

Fund an IRA. You may make an IRA contribution for the 2018 tax year as late as the April 2019 filing deadline for your federal income tax return. There are no income restrictions on making tax-deductible contributions to a traditional IRA unless you or your spouse actively participates in an employer-sponsored retirement plan. With active plan participation, the 2018 deduction gradually phases out once AGI exceeds:

- \$63,000 (single/head of household), \$101,000 (married filing jointly), or \$10,000 (married filing separately), or
- \$189,000 (married filing jointly) for a contribution to an IRA of a married person who does not actively participate in an employer plan but whose spouse does.

HOW MUCH CAN YOU CONTRIBUTE FOR 2018?

To maximize your retirement savings, contribute as much as possible each year. The 2018 limits are shown below. Note, however, that employer plans may not permit employees who have reached age 50 to contribute the higher amount indicated. Additional contribution limits could apply.

| TYPE OF PLAN | UNDER AGE 50 | AGE 50 OR OLDER |
|---------------------------|--------------|-----------------|
| 401(k), 403(b), 457, SEP* | \$18,500 | \$24,500 |
| SIMPLE IRA | \$12,500 | \$15,500 |
| Traditional/Roth IRA** | \$5,500 | \$6,500 |

**Only SEP plans established before 1997 may allow employees to make pretax contributions.*

***IRA contributions may not exceed earned income.*

With a Roth IRA, contributions aren't tax-deductible and won't be taxed on withdrawal. You also may withdraw account earnings tax-free after you've had a Roth IRA for at least five tax years and reached age 59½ (or in certain other circumstances).

Your eligibility to make Roth IRA contributions hinges on your income. In 2018, the allowable Roth IRA contribution phases out as AGI rises from \$120,000 to \$135,000 for unmarried filers, \$189,000 to \$199,000 for joint filers, and \$0 to \$10,000 for married persons filing separately.

If a Roth IRA is attractive to you but your income is too high to make a contribution, you may be in a position to convert a traditional IRA to a Roth IRA. There are no income restrictions on conversions. Consider any such conversion carefully, however. A Roth conversion is a taxable event that may trigger a large tax bill.

- ▶ Assuming you want to move forward with a Roth IRA conversion, you may save taxes by completing the transaction during a year in which you expect to be in a relatively low tax bracket (because, for example, you have a large loss or your income from other sources is lower than usual).
- ▶ Converting when the market value of your IRA investments has fallen can save you tax dollars.
- ▶ Consider spreading the conversion over several tax years to prevent the extra conversion income from pushing you into a higher bracket.

Take required minimum distributions (RMDs). Don't overlook any minimum distributions you are required to take from your traditional IRAs and employer-sponsored retirement plans for 2018. Generally, you must start taking annual minimum distributions after you reach age 70½. The additional excise tax for failure to take an RMD is a steep 50% of the amount you should have withdrawn.





Your first RMD will typically be due by April 1 of the year after you reach age 70½, and another RMD will be due by December 31 of that same year. RMDs for subsequent years must be taken by year-end. (You typically can delay distributions from your employer's retirement plan until retirement if you are not a 5% owner of the company. Check with your plan administrator for information on your plan's rules.)

- ▶ Weigh the tax deferral benefit of waiting until right before the April 1 deadline to take your first RMD against the potential for being pushed into a higher tax bracket by taking two RMDs in one year.
- ▶ Consider state tax issues, particularly if you anticipate moving to a state with a significantly different tax rate structure.

Minimize tax on Social Security. If you are a Social Security recipient, monitor your year-end transactions carefully. When "provisional income" exceeds specified levels (see table to the right), a portion of Social Security retirement benefits become taxable (state rules may vary). For this purpose, provisional income is defined as modified AGI, which includes otherwise tax-exempt municipal bond interest, plus half of your Social Security benefits.

- ▶ If realizing additional income in 2018 would trigger additional tax on your Social Security benefits, consider whether you're able to defer the income until early 2019.

WILL YOUR SOCIAL SECURITY BENEFITS BE TAXABLE?

UP TO THIS PERCENTAGE OF YOUR BENEFITS WILL BE TAXED

| JOINT RETURN* If your provisional income is: | | SINGLE OR HEAD-OF-HOUSEHOLD RETURN If your provisional income is: |
|---|-----|--|
| \$32,000 or less | 0% | \$25,000 or less |
| Between \$32,000 and \$44,000 | 50% | Between \$25,000 and \$34,000 |
| Over \$44,000 | 85% | Over \$34,000 |

**The provisional income threshold is zero for married persons filing separately who do not live apart from their spouses for the entire year.*

YOUR INVESTMENTS

For tax purposes, not all income is created equal. Capital gains and dividends, for instance, are taxed differently—and often more favorably—than ordinary income. Following are some planning strategies you can use to secure more favorable tax treatment for your investment income.

Plan investment gains and losses. As part of your year-end tax planning, review investments that you hold outside of your tax-deferred accounts to see if there may be opportunities to save taxes.

If you have already realized (or expect to realize) a large capital gain this year, consider whether you are holding securities in your portfolio that you want to sell because they haven't performed up to your expectations. Realizing capital losses before the end of the year would allow you to use those losses to offset your capital gains.

CAPITAL GAIN/
DIVIDEND RATES

Previously, you faced three federal income tax rates on Long Term Capital Gains (LTCGs) and qualified dividends: 0%, 15%, and 20%, and they were tied to the ordinary income rate brackets. For 2018-2025, these rates have their own brackets that are no longer tied to the ordinary income brackets.

INCOME RANGES FOR LONG-TERM CAPITAL GAIN RATES

| | 0% | 15% | 20% |
|---------------------------|----------------|----------------------|----------------|
| Single | Up to \$38,600 | \$38,601 – \$425,800 | Over \$425,800 |
| Married Filing Jointly | Up to \$77,200 | \$77,201 – \$479,000 | Over \$479,000 |
| Head of Household | Up to \$51,700 | \$51,701 – \$452,400 | Over \$452,400 |
| Married Filing Separately | Up to \$38,600 | \$38,601 – \$239,500 | Over \$239,500 |

| SHORT-TERM CAPITAL GAINS | |
|--------------------------------------|--------------------------|
| (taxed at ordinary income tax rates) | as high as 37% |

Certain higher income taxpayers are also subject to the additional 3.8% net investment income tax.

Capital losses are generally deductible in full against capital gains, and any capital losses in excess of capital gains may offset up to \$3,000 of ordinary income (\$1,500 if you are married filing separately). You may carry forward any excess capital losses you aren't able to deduct for use in later years, subject to the same limitation.

- ▶ If you have incurred capital losses in 2018, it may be a good time to take profits on appreciated investments you no longer want to hold. But be sure to weigh all relevant factors before

you make any investment decisions. In certain circumstances some taxpayers may want to consider the rule that when the taxpayer passes away, assets usually take on a basis equal to fair market value, so the heir may have little or no gain for tax purposes.

Avoid wash sales. Exercise caution before selling securities to realize a tax loss with the thought of buying back in shortly afterward. Under the tax law's "wash-sale" rules, no capital loss deduction is allowed in the year of the sale if you buy substantially identical securities within 30 days after (or before) the sale. Instead, the disallowed loss becomes part of your cost basis in the newly acquired securities. This delays the tax benefit from the capital loss until you sell the replacement securities.

- ▶ To avoid a wash sale and take advantage of a tax loss on a stock you still want to own, consider "doubling up" on your position by buying additional shares at least 31 days in advance of your planned sale. Then sell your original securities at a loss. But pay attention to any dividend payments during the wash-sale period. If they are reinvested in additional shares, you may lose your ability to deduct part of your original loss.
- ▶ Alternatively, you could sell the securities on which you have a paper loss and replace them with shares of another company in the same industry having similar prospects.

Watch holding periods. The length of time you hold an investment before selling it (your "holding period") determines if a capital gain or loss is short term or long term. The short-term holding period is one year or less. The long-term holding period is more than one year.



Ideally, any taxable net capital gain you have will be long term so that you'll benefit from the preferential tax rates (see table on page 8).

You can see from the same table that "qualified" dividends are taxed at the favorable capital gain rate.

Most regular dividends paid by US corporations (and certain foreign corporations) will be considered qualified if you hold the stock for a minimum number of days:

- More than 60 days during the 121-day period that begins 60 days before the stock's ex-dividend date (common stock)
- More than 90 days during the 181-day period that begins 90 days before the stock's ex-dividend date (preferred stock)

A stock's ex-dividend date is the date on which the stock begins trading without rights to the most recently declared dividend.

Donate appreciated securities. As noted above, when you contribute appreciated securities that you've held for more than one year to a qualified charitable organization, you may deduct the full fair market value of the donated securities as an itemized deduction (subject to certain restrictions and limitations).

- ▶ Making a charitable gift of appreciated securities can help you avoid the capital gains tax that might otherwise be due if you sold the securities first and then donated the sales proceeds.

Monitor fund distributions. Many mutual funds make taxable distributions of capital gains to fund investors during the last couple of months of the year. All fund investors as of the date of record set by the fund for the distribution receive their proportionate share of the capital gains.

- ▶ If you are considering buying into a fund near year-end, check to see if the fund anticipates making a capital gain distribution. To avoid receiving additional taxable income this year, consider waiting to invest until after the record date for the distribution.

Minimize net investment income tax. If your modified AGI is high enough for the 3.8% net investment income tax to be a factor, you will want to consider strategies to lessen your exposure to the tax. The tax is calculated by multiplying 3.8% by the lesser of: (1) your net investment income or (2) the excess of your modified AGI over the relevant threshold for your filing status. As mentioned earlier, the modified AGI thresholds are \$250,000 (married filing jointly), \$125,000 (married filing separately), and \$200,000 (single/head of household).

Net investment income can include income from interest, dividends, annuities, royalties, rents, net capital gain, and passive trade or business activities. It does not include any amount that is subject to self-employment tax, amounts distributed from retirement plans, exempt interest on state and local bonds, or gain on the sale of a principal residence to the extent the gain is excludable from income.

- ▶ Increasing the number of hours you participate in an entity's affairs to meet the tax law's "material participation" standards can convert passive income into active income that is not subject to the 3.8% tax.
- ▶ Consider structuring a sale of appreciated real estate held as an investment as an installment sale. With an installment sale, you spread your gain—and the taxes on that gain—over more than one year. (The installment sale method cannot be used for sales of publicly traded securities or for certain sales to related parties, and it is not available to dealers.)



MORE PLANNING TIPS

Don't overlook mortgage points. You may deduct mortgage "points" (prepaid interest) in full in the year you purchase or build your main home. Alternatively, you may spread out the deduction of purchase points over the life of the loan. Points paid when financing a mortgage are generally deductible over the life of the loan.

Avoid an underpayment penalty. Paying enough income tax during the year is essential if you want to avoid an underpayment penalty. Generally, the amount of federal income tax withheld from your pay and/or your quarterly estimated tax payments for 2018 should at least equal the lower of (1) 90% of your 2018 tax liability or (2) 100% of your 2017 tax liability. Substitute 110% for 100% if your 2017 AGI exceeded \$150,000 (\$75,000 on a married-separate return). However, if the tax shown on your 2018 return (after withholding tax paid) is less than \$1,000, an underpayment penalty won't apply.

- ▶ When you are checking your tax payments, be sure to take into account any potential liability you may have for the 0.9% additional Medicare tax discussed on page 3.
- ▶ If you missed an estimated payment earlier this year or didn't pay enough, consider having more income tax withheld from your or your spouse's paychecks before year-end. Because the IRS applies withheld tax pro rata over the full tax year, this strategy can be helpful in reducing previous underpayments of estimated tax.

Contribute to an HSA. You may make up to a full year's worth of deductible health savings account (HSA) contributions for 2018 at any time prior to your tax return's due date (not considering extensions), provided you meet the contribution eligibility rules. Among other requirements, you must have coverage under a qualifying high-deductible health plan. The maximum deductible HSA contribution for 2018 is \$3,450 for self-only coverage or \$6,900 with family coverage. If you are 55 or older and not enrolled in Medicare, you may make an additional \$1,000 contribution.

Spend FSA funds. Do you have a flexible spending account (FSA) through your employer? Generally, you'll forfeit any amount remaining in your FSA at year-end or the end of the plan's grace period, if applicable. However, a health FSA may allow employees to carry over up to \$500 for the next year in lieu of the optional grace period. If you have money in an FSA, you'll want to know the timing rules for your plan so you can use up your money within the allotted time.

OPPORTUNITIES FOR BUSINESS OWNERS

For a business owner, tax planning is a year-round activity. But the last several months of the year may present specific opportunities to minimize taxes on business income.

REVIEW EARNINGS AND TAXES

The structure of your business—C corporation, S corporation, partnership, limited liability company (LLC), or sole proprietorship—determines how your business income is taxed. Generally, the income, losses, deductions, and credits of an S corporation, partnership, or LLC are passed through to the owners to be reported on their tax returns. Sole proprietors also report business income and deductions on their personal tax returns.

New 20% of business income tax deduction for taxpayers other than corporations. With the Tax Cut and Job Act, corporations received a major rate reduction, and noncorporate taxpayers received a new deduction that begins in 2018 and expires after 2025. It is measured by 20% of their business income.

This is a new concept, so it is worth discussing with your tax advisor. The rules themselves become rather complex, at times even calling for the taxpayer to distinguish the income or loss of each separate trade or business. There is also an emphasis on projecting one's taxable income for the year.

The business generally needs to be an active one, but passive investors with flow-through income from an active business may benefit. Wage income doesn't qualify for this deduction, but within the new rules, it helps to weigh wage payments and/or capital expenditures in the context of their impact on this deduction. Wage payments and/or capital expenditures are sometimes necessary to qualify for this new deduction.

Subchapter S income from an active business may qualify, but payments out of the S corporation to owners can affect the computations, depending on whether they are wages to the owner-employees or just dividends. Wage levels of owners or guaranteed payment levels to partners can be important planning aspects of this new deduction.

Decisions about electing to expense capital expenditures within the limits of those rules need to be weighed in the context of the impact on this new deduction.

The 20% deduction may focus on taxable income rather than business income, when taxable income is less.

This deduction is available whether or not one itemizes or uses the standard deduction.

There is a lot of math involved in considering this new rate reduction. Even itemized deductions, such as charitable contributions, can at times impact the measurement of this new deduction.

See your tax advisor in planning for these important changes.

Other important business provisions. There is also an important new limitation on individual business losses. In general, if an individual has a business loss of \$250,000 (or \$500,000 for married individuals filing jointly), the loss is not currently deductible but rather has to be considered part of the taxpayer's net operating loss carryover. Net operating losses carried forward are limited to 80% of taxable income.

There's another important new limitation which says that after 2017, net operating losses have to be carried forward. They can no longer be carried back to recover prior taxes. A new business that loses money then makes money in later years may qualify to carry forward business losses and essentially pay tax on net taxable income over a period of years. But if the same business has income then losses in later years, it may end up paying tax and having only loss carryforwards.

Business-related membership dues may be limited or no longer deductible.

The Tax Cut and Job Act also made it easier for small businesses, generally defined as having gross receipts of less than \$25 million, to stay on the cash method of accounting, as well as to avoid or minimize what may otherwise be capitalized as inventory costs, and to avoid the uniform capitalization rules for personal property acquired for resale. See your advisor for details.

Lower corporate taxes. There was a significant reduction in corporate taxes enacted in late 2017. Beginning in 2018, the corporate rate is a flat 21%. The old rate structure began at 15% on the first \$50,000 but then exceeded the new current corporate tax rate. The old rate structure generally reflected a top rate of 35%, although the incremental rate was higher in certain ranges of income.

Many business taxpayers will want to discuss these changes with their tax advisor and consider whether the new rate structure for corporations, along with the new 20% of business income deduction available in some cases for noncorporate taxpayers, should cause them to review the advantages of a C corporate structure—incorporating or terminating an S election.

Corporate income is potentially subject to two layers of income tax—once at the corporate level and again if distributed to shareholders as dividends. Corporate earnings paid out to you as reasonable compensation are included in your taxable income but are deductible by the corporation. Thus, they are taxable only once—to you.

Before deciding to pay out earnings as compensation, though, remember that qualified dividends are taxed at a maximum rate of 20%. Your compensation will be taxed at rates as high as 37%, plus you'll owe FICA tax, which may include the additional 0.9% Medicare tax discussed on page 3.

- If you expect your closely-held C corporation to have a profitable year, consider whether it makes business (as well as tax) sense to pay bonuses or make a tax-deductible profit-sharing contribution this year to minimize corporate taxable income.
- Bear in mind that the IRS can assess a 20% accumulated earnings tax penalty on corporations that accumulate excessive earnings and profits. Generally, a corporation can accumulate up to \$250,000 of earnings (\$150,000 in the case of certain service corporations) without penalty.
- If your corporation has a reasonable business purpose for accumulating additional earnings, document why the additional money is needed in the corporate minutes. Possible reasons include the purchase of new equipment or the construction of new facilities.
- The alternative minimum tax for corporations, but not individuals, was repealed for taxable years beginning after December 31, 2017.





TIMING STRATEGIES

The tax accounting method your business uses determines when income must be recognized for tax purpose and when expenses are deductible. Cash method taxpayers report income when it is actually or constructively received and generally deduct expenses when payments are disbursed. Accrual method taxpayers report income in the year their right to the income becomes fixed and the income amount can be determined with reasonable accuracy. Deductions are taken when all events have occurred creating the liability and when the amounts can be determined with reasonable accuracy.

- ▶ If your business uses the cash method, you might defer income by delaying billing notices so the payment won't be received until early next year.
- ▶ As an accrual method taxpayer, you might defer income by delaying the shipment of products or provision of services until the beginning of your 2019 tax year.
- ▶ Also look for opportunities to defer certain advance payments received for services and the sale of goods. (Requirements apply.)

Time bonus payments. If your company intends to pay employees bonuses for 2018, consider the timing of those payments.

- ▶ As a cash method business, your company may want to pay bonuses before the end of the year to gain a 2018 deduction for the expense.
- ▶ You have a little more flexibility if your business uses the accrual method. A 2018 deduction will be available for bonus payments made to unrelated employees within 2½ months after year-end, provided the liability to pay the bonuses is both fixed and determinable by the end of the year.

Business bad debts. Business bad debts represent another potential deduction your business should consider if it extends credit to customers. A deduction is available for any debt that is wholly or partially "worthless," assuming your company has already included the amount in income. However, businesses that use the cash method of accounting can't write off uncollectible amounts as bad debts because they don't recognize sales revenue until it is received.

- ▶ Review accounts receivable reports before year-end to identify uncollectible accounts that may be written off as bad debts.

ASSET PURCHASES

The PATH Act's provisions regarding tax depreciation and expensing have made it possible for businesses to approach planning for purchases of machinery, equipment, and other fixed assets with more certainty regarding the tax results. Several significant tax breaks are potentially available.

Use Section 179 expensing. A popular provision among small businesses, the Section 179 election allows a business to expense a portion of eligible asset purchases in the year the assets are placed in service, in lieu of depreciating the assets over several years. Beginning in 2018, Section 179 allows businesses to expense up to \$1 million of eligible asset purchases, up from \$510,000 in 2017. Eligible Section 179 property includes:

- New and used machinery, equipment, vehicles, and other tangible non-real estate property
- Computer software purchased off the shelf
- Qualified real property (includes qualified improvement property such as roofs, HVAC systems, fire and alarm systems, and security systems)

For 2018, the \$1 million expensing election is reduced (dollar for dollar) once qualifying asset purchases exceed a \$2.5 million investment ceiling. The \$1 million/\$2.5 million amounts will be indexed for inflation going forward. Additionally, the election is limited to taxable income from any of your active trades or businesses.

Deduct bonus depreciation. Your business will also want to consider taking advantage of bonus depreciation, which allows a business to take an immediate write-off of 100% of an asset's cost, beginning with assets purchased and placed in service after September 27, 2017. The Tax Cut and Job Act increased the percentage of the write-off from 50% to 100%. Beginning in 2018, this applies to new and used property. Previously, the rule applied only to new property.

Only certain types of depreciable property can qualify, including tangible property with a recovery period of 20 years or fewer under the Modified Accelerated Cost Recovery System (MACRS).

- ▶ Because bonus depreciation isn't limited to taxable income, the deduction can contribute to or create a net operating loss (NOL). However, post-2017 NOLs for corporate and other taxpayers are no longer subject to carryback but rather carry-forward. Additionally, there is an 80% limitation applicable to losses arising in tax years beginning after December 31, 2017.
- ▶ If your business intends to elect Section 179 expensing and bonus depreciation for only some of its asset acquisitions and regular depreciation for others, consider using the Section 179 election for the assets with the longest lives.

Expense lower cost purchases. In addition to the Section 179 and bonus depreciation elections, also consider the election that is available for "de minimis" asset purchases if certain requirements are met.



S CORPORATION STRATEGIES

Is your business organized as an S corporation? If so, you and your individual shareholders will pay taxes on your proportionate share of corporate income at rates as high as 37%. As a result, steps taken to lower your S corporation's business income before year-end can help reduce your income tax burden. As we noted, Subchapter S income may be subject to the new 20% of business income deduction.

Review shareholder compensation. Although employee salaries and bonuses (and the related employment taxes) are generally deductible corporate expenses, it is usually best for S corporation shareholder/employees to draw only "reasonable" compensation from their companies. The reason: any additional nonwage distributions or corporate earnings escape Social Security, Medicare, and self-employment taxes.

- ▶ Review the amount you are taking as a salary from your S corporation to make sure it is reasonable for the services you perform for the company, but don't overpay yourself. If desired, the company can distribute additional earnings to

you and any other shareholders free of employment taxes. Wages to yourself may also reduce the 20% of business income deduction.

Know your basis. Special tax planning may be called for if an S corporation expects to generate an NOL for the year. Generally, a shareholder's loss deduction is limited to the shareholder's investment in the company, as reflected in a figure known as adjusted basis. The adjusted basis figure changes each year to account for any money flowing between the company and the shareholder—distributions, capital contributions, loans, and loan repayments—as well as for the shareholder's allocated share of corporate income or loss.

- ▶ If you anticipate that your S corporation will show a loss this year, check to see if you have enough basis to deduct it. If not, you can increase your basis either by loaning the company money or making an additional capital contribution before year-end to potentially save on taxes by deducting the loss individually.





ADDITIONAL PLANNING TIPS

Below are more strategies that can prove useful in lowering business taxes.

Deduct retirement plan contributions. Maximizing tax-deductible contributions to a retirement plan for yourself and any eligible employees can lower your business taxes and help you accumulate funds for your retirement. The table to the right shows the 2018 contribution limits for different types of plans.

Know the health care reform rules. Although the Affordable Care Act has been in place for several years, 2015 was the first full year that employer shared responsibility provisions and the related information reporting requirements applied. If your business is large enough to be affected by these rules (i.e., it is an “applicable large employer”), you must offer minimum essential health care coverage that is “affordable” and that provides “minimum value” to your full-time employees (and their dependents) or potentially be required to make a shared responsibility payment to the IRS. You’ll also have reporting responsibilities. Generally, a business that had an average of at least 50 full-time employees (including full-time equivalent employees) during 2017 is considered an applicable large employer for 2018.

Deduct start-up expenditures. If you are involved in a new business venture in 2018, you may elect to deduct up to \$5,000 of your business start-up expenditures, such as travel expenses incurred in lining up prospective distributors or supplies and advertising costs paid or incurred before the new business began operating. (Remaining costs are deductible over a 180-month period.) To claim the deduction for 2018, your new business must be up and running by year-end.

Hire your child. Paying your child for doing legitimate work for your business can be a tax saver if you are self-employed. You may deduct reasonable wages paid to your child as a business

expense. The income will be taxed to your child, but the standard deduction can shield as much as \$12,000 from tax (in 2018). Any earnings over that amount will be taxed at your child’s rate—which is probably much lower than yours. Wages you pay your child will be exempt from FICA taxes until your child turns 18, assuming your business is unincorporated.

Take credit. Eligible businesses can use tax credits to lower their tax liabilities. The table on page 16 shows some of the tax credits available for 2018.

2018 RETIREMENT PLAN CONTRIBUTIONS

| PLAN TYPE | MAXIMUM ADDITION TO A PLAN PARTICIPANT’S ACCOUNT |
|----------------|--|
| 401(k)* | Lesser of \$55,000 or 100% of compensation |
| Profit sharing | Lesser of \$55,000 or 100% of compensation |
| SEP-IRA | Lesser of \$55,000 or 25% of compensation |
| SIMPLE IRA | Up to \$12,500 of employee salary deferrals plus employer contributions (3% match or 2% nonelective contributions) |

*See page 6 for the applicable limits on employee salary deferrals.

Some plans allow participants age 50 and older to make additional catch-up contributions, which would not be subject to the limits set forth above.

SEE IF YOUR BUSINESS QUALIFIES FOR TAX CREDITS



EMPLOYER-PROVIDED CHILD CARE

25% of expenses to buy, build, rehabilitate, or expand property that will be used as part of an employer's child care facility plus 10% of the amount paid under a contract to provide child care resource and referral services to employees, up to a maximum credit of \$150,000 a year



FICA TIP

Amount of employer's FICA taxes paid on employee tips in excess of the amount treated as wages in satisfaction of minimum wage requirements (food and beverage establishments only)



SMALL EMPLOYER PENSION PLAN START-UP COSTS

50% of administration and retirement-related education expenses for the first three plan years, up to a maximum credit of \$500 a year



RESEARCH

Generally, 20% of the amount by which qualified research expenses exceed a base amount



EMPLOYER WAGE DIFFERENTIAL

20% up to \$20,000 of wage differential payments paid for each employee called to active military service



WORK OPPORTUNITY

For hiring members of targeted groups—generally 40% of up to \$6,000 of first-year wages paid (per employee)



SMALL EMPLOYER HEALTH INSURANCE

Up to 50% of employer contributions for employee health insurance (available for two consecutive years only)



DISABLED ACCESS

50% of eligible access expenditures over \$250 and not more than \$10,250 (eligible small businesses only)

TALK WITH US

Now may not be the most convenient time for tax planning, but it can be one of the most rewarding. By beginning your year-end planning as soon as possible, you'll have more time to accomplish your tax-saving goals.

As skilled professionals, we have the knowledge and experience to help you with planning needs. Please contact us for more information about any of our services.

The general information provided in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your situation.

