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Client Advisor

Winter 2018

2018 YEAR END TAX PLANNING UNDER TCJA

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

Manage 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 filing joint 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 lower this year's tax bill. Next year, you can claim the standard deduction, which will be increased a bit to account for inflation.

The easiest 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 are probably unaffected. Check with us if you are uncertain.

Accelerating other expenditures could cause your itemized deductions to exceed your standard deduction in 2018. For example, 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), assuming you itemize.

Taxpayers who expect to have total itemized deductions below $24,000 but make substantial charitable contributions do have other options in order to receive a tax benefit for charitable giving.

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DONOR ADVISED FUNDS

Timing deductions so they are bunched in one tax year is a strategy often used. One effective way to do this is to utilize a **Donor Advised Fund (DAF)** for charitable giving. Typically these funds are set up through an investment firm such as Schwab or Fidelity. The taxpayer transfers funds or property to the DAF and receives a tax deduction for the fair market value of the assets transferred in the year of the transfer. The taxpayer then can direct the fund manager to distribute the funds to qualified charities of the taxpayer's choice over time in future years.

- Transfer cash, appreciated stock, and/or real estate and receive a deduction of the fair market value
- There are annual fund fees including management and investment fees
- The fund sets minimum initial contributions to set up the fund and minimum disbursements to charities. These vary, depending on the investment firm.
- DAF are best for donors who are committed to giving in future years and can afford to give up the use of the assets in the current year.

QUALIFIED CHARITABLE DISTRIBUTIONS

For taxpayers who are over age 70 ½ and receiving required minimum distributions (RMD's), **Qualified Charitable Distributions (QCD's)** may be a more advantageous way to give to charities. The taxpayer directs their IRA trustee to make a direct gift to a qualified charity from the IRA. This transfer is considered part of the RMD for the year however it is not taxable.

The QCD strategy works best for seniors if:

- Taxpayer will not be itemizing deductions – using a QCD for charitable giving reduces your taxable income even if you cannot itemize
- Taxpayer itemizes but charitable donations are delayed due to the 60% -of-AGI limitation (maximum cap)
- The annual limit is $100,000 of QCD's per taxpayer

Both of these strategies must be in place by 12/31/18 to benefit taxpayers in 2018.

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 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.

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

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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.

Harvest bit-coin losses before year end to offset any bit-coin gains.

Watch out for the AMT. The TCJA significantly reduced the odds that you will owe AMT for 2018 by greatly 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.

In Washington State the exemption per person for 2018 is $2,193,000. It may be a good idea to do gifting now to reduce your exposure to Washington estate taxes. Washington does not have any gift taxes, so you could use the federal exemptions to make nontaxable gifts now and reduce your potential Washington State estate.

Also, you may need to make some changes for reasons that have nothing to do with taxes. For example Washington State has new provisions related to Powers of Attorney. Contact us if you think you could use an estate planning tune-up.

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.

Contact us for more information on small business retirement plan alternatives, and be aware that if your business has employees, they will be included in your plan.

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. Contact us for details on eligible assets and how your business can take advantage of these new changes.*

Maximize the New Deduction for Pass-through Business Income. The new deduction based on Qualified Business Income (QBI)

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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).

The deduction does not apply to specified service businesses (health, law, consulting, accounting, financial or brokerage services) unless MFJ taxable income is less than $315,000 (fully phased out at $415,000)

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. We can help you put together strategies that give you the best overall tax results for the year.

"Small Business Taxpayer". The new law now defines a small business taxpayer as an entity with less than $25 million in revenue. These taxpayers now have the opportunity to change their method of accounting in several areas.

- Change from accrual basis of accounting to cash basis of accounting.
- Now exempt from capitalization of certain costs under Section 263A related to inventory.
- Exempt from accounting for inventory for certain taxpayers.
- Certain long-term contracts exempt from percentage of completion method of revenue recognition.

Each of these should be assessed related to your "Small Business". A change in accounting method – Form 3115 is required to be filed with the IRS and additional reporting is done with the return. In some cases these changes can result in an additional deduction in the year of change.

New Business Tax Credit. New law allows a credit for employers who offer paid family and medical leave. Please call us for details.

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. Contact us if you think you own stock that could qualify.

CONCLUSION

In general, most taxpayers will have significant changes to their taxes from 2017 to 2018 related to the Tax Cuts and Jobs Act. Please contact us to review your situation so you can make adjustments before year end. In addition, your estimated tax payments for 4th Quarter 2018 should be reviewed prior to January 15, 2019.

This article 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.

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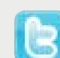
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