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Balance sheet

YEAR- END TAX PLANNING

By Timothy J. Gephart, CPA

The Tax Cuts and Jobs Act (TCJA) made major changes in the tax rules for individuals and businesses and likely affected your tax returns last year. The changes to the many individual provisions are still scheduled to be temporary and are set to expire in 2025. With one year of changes behind us, it is a good time to review year-end tax planning strategies to minimize your taxes this year and next year, assuming that next year's general election does not result in retroactive tax changes that could affect your 2020 tax year.

The time-tested approach of deferring income and accelerating deductions to minimize taxes still works for many taxpayers, along with the tactic of "bunching" expenses into this year or the next to get around deduction restrictions. For individuals, deferring income also may help minimize or avoid phase-outs of various tax breaks based on a taxpayer's adjusted gross income (AGI). As always, however, year-end tax planning does not occur in a vacuum. It just takes account of each taxpayer's particular situation and planning goals, with the aim of minimizing taxes to the greatest extent possible. While most taxpayers will come out ahead by following the traditional approach, others with special circumstances may do better by accelerating income and deferring deductions.

Another reminder is to consider using a credit card to pay deductible expenses before the end of the year. When you charge the transaction, it is considered a deductible expense on the date of the charge. Doing so will increase your 2019 deductions even if you do not pay your credit card bill until the year 2020.

Unless noted, the effective date for the changes under the TCJA law was January 1, 2018 with a sunset date of December 31, 2025. The following summarizes the significant changes as result of the TCJA tax law:

- **Change in tax rates.** The corporate tax rate was permanently changed to a flat rate of 21%. Individual tax rates were also reduced while the maximum capital gains tax rates and qualified dividend tax rates remain the same. The net capital losses remain capped at $3,000 annually.
- **Change to personal exemptions and standard deduction.** The TCJA made significant changes to personal exemptions, the standard deduction and the child tax credit. The personal exemption has been eliminated with the standard deduction almost doubling. The standard deduction for 2019 for joint filers is $24,400; heads of household is $18,350; and single is $12,200. The child tax credit has been expanded into a family tax credit that may make up for the loss of the personal exemption. The family tax credit consists of a $2,000 credit per qualifying child who is not 17 by year-end and a $500 credit for each dependent who is not a qualifying child under age 17.
- **Changes in itemized deductions.** With the increase in the standard deduction amount, fewer taxpayers will itemize. If your total annual itemized deductions for 2019 will be close to your standard deduction amount, consider making additional expenditures before year-end to exceed the standard deduction amount. One suggestion is to bunch charitable contributions in alternating years. This will lower your tax bill in the year you itemize. The next year, you can claim the standard deduction, which will be increased a bit to account for inflation.
  - **Medical expenses.** The medical expense floor is 10% of adjusted gross income for 2019.
  - **State and local taxes.** The deduction for real estate taxes and state and local income taxes or sales tax is limited to $10,000.
  - **Mortgage interest.** The ceiling on acquisition indebtedness was reduced to $750,000 effective December 15, 2017. For mortgages existing before December 15, 2017, the prior limit of $1,000,000 still qualifies. Home equity indebtedness is no longer deductible unless the proceeds were used to improve the home and is included in the overall mortgage limitation of $750,000.

Items presented are not intended to be technically complete. Additional information may be required to make an informed decision. You cannot rely upon this information for avoiding tax penalties.

- **Charitable contributions.** For the most part, the charitable contribution deduction remains the same except that the threshold limitation was increased to 60% from 50% of adjusted gross income.
- **Casualty and theft losses.** The personal casualty and theft loss deduction was eliminated except for losses attributed to federally-declared disasters.
- **Miscellaneous itemized deductions.** All miscellaneous itemized deductions subject to the 2% floor are eliminated through 2025. This includes tax preparation fees, unreimbursed business expenses, investment expenses, and home office for an employee working from home.

- **Other important changes.**

  - **New Tax Form.** The 1040-SR is a new tax form for taxpayers who are 65 or older during the tax year. This is a result of the Bipartisan Budget Act to make it easier for these taxpayers to file their tax returns.
  - **Virtual Currency.** The sale or other exchange of virtual currencies, or the use of virtual currencies to pay for goods or services, or holding virtual currencies as an investment, generally has tax consequences that could result in tax liability.
  - **Health Care Coverage.** The individual responsibility for health care coverage was eliminated from further penalty effective after December 31, 2018.
  - **Moving expenses.** The moving expense deduction was eliminated except for active members of the Armed Forces. The exclusion from gross income for reimbursement of moving expenses has been suspended.
  - **Alimony.** For divorce or separation agreements executed after December 31, 2018, the deduction for alimony paid was eliminated, and, therefore makes all alimony received nontaxable.
  - **Alternative minimum tax.** The AMT exemption amount increase to $111,700 for married taxpayers filing a joint return and $71,700 for all other taxpayers. In addition, the exemption threshold phase-out was increased, so it is expected that fewer people will be subject to the AMT tax.
  - **Higher education expenses.** The definition of qualified higher education expenses was modified to allow distributions of up to $10,000 per student from a Section 529 account for tuition and other eligible expenses at elementary or secondary schools. This does not sunset after 2025.
  - **IRAs.** Just as a reminder, effective January 1, 2018, taxpayers who convert a traditional pre-tax IRA into a post-tax Roth IRA may no longer reverse the conversion; this was typically done if the value of the conversion had declined. The TCJA still allows annual Roth IRA contributions to be recharacterized as traditional IRA contributions as long as the recharacterization is completed by the due date of the tax return. Consistent with prior law, conversion of a traditional IRA to a Roth IRA triggers immediate taxation.
  - **Estate tax exemption.** Effective for deaths and gifts made after December 31, 2017 through December 31, 2025, the estate exemption for decedents dying in 2019 is $11,400,000. Do not overlook estate planning. Even though these big exemptions may mean you are not currently exposed to federal estate tax, your estate plan may need updating to reflect the current tax rules. More importantly, you may need to make some changes for reasons that have nothing to do with taxes. In addition, you may make annual gifts of up to $15,000 to each of an unlimited number of individuals during 2019 with no gift tax.

- **Changes affecting business owners of pass-through entities.** The TCJA established a new deduction based on an individual's qualified business income. The law provides that an individual taxpayer generally may deduct 20% of "qualified business income" from a partnership, S corporation, sole proprietorship, or farm, as well as 20% of the aggregate qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income. This deduction is subject to various rules and limitations such as restrictions that can apply at higher income levels and another restriction based on the owner's taxable income.

- **Changes affecting like-kind exchanges.** Under prior law, IRS Code Section 1031 allowed for tax-deferred exchanges of like-kind property. Effective January 1, 2018, tax-deferred exchanges are no longer allowed for personal property assets; however, tax deferral is still allowed for like-kind exchanges involving real estate transactions.

- **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. Expensing is generally available for most depreciable property, other than buildings. Expensing is also available for roofs, HVAC, fire protection, alarm, and security systems, and qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework). Contact us for additional details on how your business can take advantage of these changes.

The above 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 or would like us to help you with year-end planning.