BDO

Roth&Co
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

2018 YEAR-END TAX PLANNING FOR INDIVIDUALS

www.rothcocpa.com

Nearly one year later, tax reform is still making headlines and we continue to learn more about its broad implications. Whether your previous tax filing posture was straightforward or complex, you will be impacted by the myriad of changes to the tax code. Now more than ever, it is imperative to thoughtfully consider year-end tax planning opportunities and ensure you are positioned to be in compliance with the new rules.

2018 year-end tax planning begins with a projection of your estimated income, deductions and tax liabilities for 2018 and 2019. You should review actual amounts from 2017 to assist you with these projections. There may be opportunities to accelerate or defer income or deductions to optimize your total tax liability. This *Year-End Tax Planning for Individuals Letter (Tax Letter)* is written to help you do just that.

We have outlined the key topics impacting individual taxpayers in the below *Tax Letter*. Tax planning for individuals also requires consideration of the tax consequences from any businesses conducted directly or indirectly by individual owners. For information on those areas, we encourage you to read our *Year-End Tax Planning for Businesses Letter*.

As we continue to await guidance and regulations in certain areas, we encourage you to routinely visit our website rothcocpa.com for additional updates to guide you through the year-end tax planning process.

Finally, this *Tax Letter* focuses on planning for federal income taxes, however, state taxes should also be considered. Please consult your BDO advisor to discuss your personal state tax filing responsibilities.

On Tax Reform

On December 22, 2017, President Trump signed sweeping federal tax reform into law. Tax reform has significantly changed the U.S. tax system for both individuals and businesses. Some of the most impactful measures from tax reform affecting individuals include:

- The suspension of most itemized deductions
- The near-doubling of the standard deduction…
- The $10,000 cap on the state and local income and property tax deduction
- The suspension of personal exemptions
- The Section 199A deduction for pass-through business owners
- The increase of alternative minimum tax (AMT) exemptions for individuals
- The new individual income tax rates and brackets

2018 Versus 2019 Marginal Tax Rates

Whether you should defer or accelerate income and deductions between 2018 and 2019 depends to a great extent on your projected marginal (highest) tax rate for each year. With the compression of income tax rates starting in 2018, you should analyze your anticipated marginal tax rates for 2018 and 2019.

The highest marginal tax rate for 2018 is 37 percent, with an additional 3.8 percent tax on the net-investment income of high-income taxpayers. The tax rates for 2018 are included in this *Tax Letter* (see page 34). At the time of publication, 2019 inflation rates have not been made available. Projections of your 2018 and 2019 income and deductions are necessary to estimate your marginal tax rate for each year.

Shifting Income and Deductions into the Most Advantageous Year

You can shift taxable income between 2018 and 2019 by controlling the receipt of income and the payment of deductions. Generally, income should be received in the year with the lower marginal tax rate, while deductible expenses should be paid in the year with the higher marginal rate. If your top tax rate is the same in 2018 and 2019, deferring income into 2019 and accelerating deductions into 2018 will generally produce a tax deferral of up to one year. On the other hand, if you expect your tax rate to be higher in 2019, you may want to accelerate income into 2018 and defer deductions to 2019. Keep in mind, however, that the aforementioned tax reform repeals most itemized deductions.

Planning Suggestion: The time value of money should be considered when making a decision to defer income or accelerate deductions. Comparative computations should be made to determine and evaluate the net after-tax result of these financial actions.

Moreover, you should consider whether you expect to be subject to the AMT for either or both years (see page 27).

CONTROLLING INCOME

Income can be accelerated into 2018, or deferred to 2019, by controlling the receipt of various types of income depending on your situation, such as:

For Business Owners

- Year-end interest or dividend payments from closely-held corporations
- Rents and fees for services (delay December billings to defer income)
- Commissions (close sales in January to defer income)

Caution: Income cannot be deferred to 2019 if you constructively receive it in 2018. Constructive receipt occurs when you have the right to receive payment or have received a check for payment, even though it has not been deposited. Income also cannot be deferred if you effectively receive the benefit of the income; for example, if you are allowed to pledge a deferred compensation account balance to obtain a loan.

Bonuses that are determined based on work performed in 2018 can be paid during 2018 or in 2019. Payment in 2018 secures the 2018 deduction for the business using either the cash or accrual basis of accounting. Payment in 2019 will delay the deduction for a cash basis business, therefore allowing some flexibility in the year of deduction.

CONTROLLING DEDUCTIONS

The phase-out of itemized deductions for high income individual taxpayers, was suspended for tax years 2018 through 2025.

High-earning taxpayers will once again be able to take itemized deductions that were limited under Pease, however with the increased standard deduction, a taxpayer's amount of total deductions must generally be greater than $12,000 for single individuals and $24,000 for married couples filing jointly before they incur the benefit of itemizing deductions.

Deductions that may be accelerated into 2018 or deferred to 2019 include:

Charitable contributions (cash or property)

You must obtain written substantiation from the charitable organization, in addition to a canceled check, for all charitable donations in excess of $250.

Charities are required to inform you of the amount of your net contribution where you receive goods or services in excess of $75 in exchange for your contribution.

If the value of contributed property exceeds $5,000, you must obtain a qualified written appraisal (prior to the due date of your tax return, including extensions), except for publicly-traded securities and non-publicly-traded stock of $10,000 or less.

Planning Suggestion: If you are considering contributing marketable securities to a charity and the securities have declined in value, sell the securities first and then donate the sales proceeds. You will obtain both a capital loss and a charitable contribution deduction.

Caution: If you are contemplating the repurchase of the security in the future, you need to consider the wash sale rules discussed (see page 11).

On the other hand, if the marketable securities or other long-term capital gain property have appreciated in value, you should contribute the property in kind to the charity. By contributing the property in kind, you will avoid taxes on the appreciation and receive a charitable contribution deduction for the property's full fair market value.

If you wish to make a significant gift of property to a charitable organization yet retain current income for yourself, a charitable remainder trust may fulfill your needs. A charitable remainder trust is a trust that generates a current charitable deduction for a future contribution to a charity. The trust pays you (or another person) income annually on the principal in the trust for a specified term or for life. When the term of the trust ends, the trust's assets are distributed to the designated charity. You obtain a current income tax deduction when the trust is funded based on the present value of the assets that will pass to the charity when the trust terminates (at least 10 percent of the initial FMV). This accelerates your deduction into the year the trust is funded, while you retain the income from the assets. This method of making a charitable contribution can work very well with appreciated property.

Tax reform increased the adjusted gross income limitation for cash contributions to a public charity beginning in 2018 from 50 percent of adjusted gross income to 60 percent of adjusted gross income.

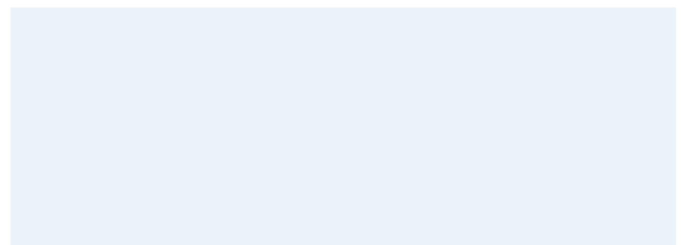
QUALIFIED SMALL BUSINESS STOCK

A non-corporate taxpayer can exclude specified percentages (50 percent, 75 percent or 100 percent depending on date of issuance) of any gain realized from the sale of "qualified small business stock" (QSBS). To be eligible, the stock must be issued after August 10, 1993, and must have been held for more than five years. The gain eligible for this exclusion cannot exceed the greater of (i) ten times the taxpayer's basis in the stock disposed of during the year or (ii) $10 million less the taxpayer's aggregate prior-year gains from the sale of the same corporation's stock. The includible portion of the gain is subject to a maximum tax rate of 28 percent, and a portion of the excluded gain is included as a tax preference in determining the taxpayer's liability (if any) for the AMT.

However, the 100-percent exclusion is available only for qualified stock issued after September 27, 2010. If a 100-percent exclusion is available, no portion of the gain is subject to the AMT.

A non-corporate taxpayer may also elect to rollover the entire gain from the sale of "qualified small business stock" held for more than six months if, within the 60-day period beginning on the date of sale, the taxpayer purchases QSBS having a cost at least equal to the amount realized from the sale.

Your BDO advisor can be consulted for more information.



Miscellaneous Deductions

The 2017 tax reform suspended most miscellaneous itemized deductions for tax years 2018 through 2025, including:

- Deductions for employee business expenses
- Tax preparation fees
- Investment expenses, including investment management fees
- Employment related educational expenses
- Job search expenses
- Hobby losses
- Safe deposit box fees
- Investment expenses from pass-through entities

Previously, unreimbursed employee business expenses, investment expenses, personal tax advice and preparation fees, and most other miscellaneous itemized deductions, were deductible only if they exceed 2 percent of AGI.

State and Local Deduction

Tax reform introduced a $10,000 cap on the itemized deduction for state and local, sales, income or property taxes for tax years beginning in 2018 and before 2026. While the limitation impacts all individual taxpayers, it will especially impact taxpayers who will file returns in states with high income and property taxes, including New York, New Jersey, Connecticut, California, Maryland, and Oregon, and on married couples (regardless of whether they file jointly or separately).

The cap limits taxpayers' SALT deductions to $10,000 per return, and married taxpayers who file separately can only deduct up to $5,000 each, for itemized deductions. The cap does not apply to deductions resulting from a trade or business.

Standard Deduction

A significant change for individuals resulting from tax reform was the near doubling of the standard deduction amounts. However, individual tax reform is temporary and is scheduled to sunset in 2026. Your BDO advisor can assist you in adapting to the temporary changes based on your individual circumstances. Where individuals can strategically increase their itemized deductions, including by using their retirement plan contribution if they are charitably inclined, they should consider contributing.

The 2018 standard deduction is:

Filing Status	Amount
Single	$12,000
Married filing joint return and qualifying surviving spouse with dependent child	$24,000
Married filing separate return	$12,000
Head of household	$18,000

An additional $1,300 standard deduction may be claimed by a married taxpayer who is at least 65 years old or blind for tax year 2018. In 2018, a total additional deduction of $2,600 ($1,600 by a single taxpayer) standard deduction can be claimed if the taxpayer is at least 65 years old and blind.

Planning Suggestion: A taxpayer benefits from itemizing deductions only if the deductions exceed the standard deduction. If your itemized deductions fluctuate from year to year, consider bunching your itemized deductions in one year and claiming the standard deduction in other years.

Personal Exemptions

The deduction for personal exemptions is suspended through 2025; however, the $100 and $300 exemptions for complex and simple trusts, respectively, were retained.

The $4,150 exemption for qualified disability trusts was also retained but is to be adjusted for inflation in future years.

Excess Business Loss Limitation

Introduced in the 2017 tax reform under Section 461(l), a taxpayer will only be able to deduct net business losses of up to $250,000 ($500,000 in the case of a joint return) for taxable years beginning after December 31, 2017, and before January 1, 2026. Excess business losses are disallowed and added to the taxpayer's NOL carryforward. Previously, suspended passive activity losses were allowed in full upon the taxable disposition of the passive activity.

Additionally, non-corporate NOL rules now limit deductible NOL carryforwards to the lesser of the carryforward amount or 80-percent of taxable income. Taxpayers are no longer permitted to carry back their NOLs to the previous two taxable years, but they may carryforward their NOLs indefinitely.

Section 199A

Tax reform lowered the corporate tax rate to a flat rate of 21 percent. In turn, under the new law (under Section 199A), for taxable years beginning after December 31, 2017, taxpayers other than C corporations with taxable income (before computing the Qualified Business Income (QBI)) at or below the threshold amount, are entitled to a deduction equal to the lesser of:

1. The combined QBI amount of the taxpayer, or
2. An amount equal to 20 percent of the excess, if any, of the taxable income of the taxpayer for the taxable year over the net capital gain of the taxpayer for such taxable year.

The combined QBI amount is generally equal to the sum of (A) 20 percent of the taxpayer's QBI with respect to each qualified trade or business plus (B) 20 percent of the aggregate amount of the qualified REIT dividends and qualified publicly traded partnership (PTP) income of the taxpayer for the taxable year. The Section 199A deduction may reduce a pass-through owner's maximum individual effective tax rate from 37 percent to 29.6 percent. It is critical to begin evaluating the extent the pass-through owner will be eligible for this deduction. For further information regarding the Section 199A deduction, please see our *2018 Year-End Tax Planning for Businesses*.

Children's Taxes (Kiddie Tax)

Beginning in 2018, unearned income of a child under age 18 is taxed at ordinary income and preferential rates applied to trusts and estates. Earned (compensation) income received by a child under age 18 is taxed at the rates applied to single filers.

The kiddie tax applies to full-time students who have not attained the age of 24 by the end of the taxable year and non-full-time students who have not attained the age of 19 by the end of the taxable year, but in either case, only if the child's earned income does not exceed one-half of the amount of the child's support.

A child with earned income may claim a standard deduction up to $12,000 for 2018 and may be eligible for the $5,500 deductible IRA contribution. Therefore, the child may earn $17,500 without paying federal income tax. The child should also consider a contribution to a nondeductible Roth IRA.

Planning Suggestion: If you own a business, consider hiring and paying a salary to your child. This income will be taxed at the child's rates, and the payment will be deductible by your business. This technique can be used to fund a college education. Of course, the child must perform services to earn the compensation, and the compensation must be reasonable for the services provided.

If the child is 18 or over, this compensation will be subject to social security tax. It will also be subject to federal unemployment insurance tax if the child is 21 or older. The child's compensation could also be subject to state and local income and payroll taxes.

For 2018, a child under age 18 is not required to file a tax return if the child only has interest and dividend income up to $1,050, has not made estimated payments, has total gross income less than $10,500, and is not subject to backup withholding. However, the parents must include the child's income exceeding $2,100 on his/her tax return.

Caution: A child under 18 who has capital gains or earned income must file his or her own tax return. Estimated taxes may have to be paid during the year if withholding taxes are not sufficient to cover the child's tax liability.

Planning Suggestion: Consider making gifts of growth stock or Series EE bonds (which can defer taxation of the interest until maturity) to a child under age 18 (or 24, if appropriate). These investments can be converted to investments producing current income after the child reaches 18 (or 24, if appropriate). The resulting income will be taxed at the child's rates rather than the parents' top rate. Further, parents in the higher tax brackets should consider making gifts of income-producing property to a child who is 18 (or 24, if appropriate) or older to take advantage of the child's lower tax bracket (see "Year-End Gifts" (see page 32).

Reminder: Your income tax return must report social security numbers for all children whom you claim as dependents. A social security number can be obtained by filing an application on Form SS-5 with your local Social Security Administration office.

If you claim a dependent care credit, you must report the service provider's social security or employer identification number on your tax return. You should use IRS Form W-10 to obtain this number from the provider.

Year-end and Other Gifts; Portability

The end of the year is the traditional time for making gifts. For 2018 you may give up to $15,000 to a person without incurring any federal gift tax liability. The $15,000 annual limit applies to each donee. Thus, you may make $15,000 gifts to as many people as you like. If you are married, you and your spouse can give a combined $30,000 to each donee, if your spouse consents to splitting the gift or if you give community property. To qualify for this annual exclusion, the property must be given outright to the donee or put into a trust that meets certain conditions.

In addition to the annual exclusion, the lifetime exemption (made available in the form of a credit against tax based on an exemption-equivalent amount) allows each person to transfer $11,180,000 for 2018 by gift without incurring any gift tax liability (reduced by the amount of any lifetime exemption that may have been used in a prior year). Using this credit now will keep future appreciation on the transferred property out of your estate. However, using the lifetime credit against 2018 gifts reduces the credit available for future years.

A widow or widower may have an increased lifetime exemption if the deceased spouse died after 2010 with an unused exemption amount and an estate tax return was filed. Please note that an estate tax return must be filed on a timely basis for the surviving spouse to obtain the increased exemption. This is true even if an estate tax return was otherwise not required to be filed because the value of the gross estate was less than the threshold required for filing an estate tax return. A full discussion of the portability of the lifetime exemption between spouses is beyond the scope of this letter. Please consult with your BDO advisor for a more complete explanation of the portability rules.

In addition to gifts subject to the annual exclusion and the lifetime credit, direct payments of tuition made on another person's behalf to a university or other qualified educational organization are also excluded from gift tax, as are direct payments of medical expenses to a medical care provider.

Planning Suggestion: You should consider using appreciated property in making gifts. If the recipients are in lower income tax brackets than you, income from the transferred property, including any gain on sale, will be taxed at lower rates.

Additional Suggestion: It is generally unwise to give property that has declined in value. Rather, you should consider selling the property and realize the tax benefits of the loss.

All outright gifts to a spouse (who is a United States citizen) are free of federal gift tax. However, for 2018, only the first $152,000 of gifts to a non-United States citizen spouse are excluded from the total amount of taxable gifts for the year. You should coordinate your year-end gift giving with your overall estate planning. Your BDO advisor can assist you with these matters.

Opportunity Zone Program

The opportunity zone program was created under tax reform to promote investment in economically distressed communities. There are now over 8,700 certified QOZs in all 50 states, the District of Columbia, Puerto Rico and the Virgin Islands. Investors must invest in a qualified opportunity fund (QOF) within 180 days after the sale or exchange of a capital asset. The QOF is an investment vehicle that must hold at least 90 percent of its assets in qualified opportunity zone property, which includes qualified opportunity zone stock, qualified opportunity zone partnership interest, or qualified opportunity zone business property. Investment of capital gains in a QOF can result in beneficial tax incentives, including the following:

- Deferral of tax due on the capital gains invested in the QOF until December 21, 2026.
- Basis step-up on the capital gains invested of 10 percent if the investment is held for five years and 15 percent if the investment is held for seven years.
- Permanent exclusion from taxable income post-acquisition capital gains on investments in QOFs that are held at least ten years.

Treasury released proposed regulations, a revenue ruling and a draft form on October 19, 2018. Although this guidance answered many questions, the preamble to the Proposed Regulations states that Treasury is working on additional regulations to address other issues. This was the first step of a larger regulatory project that should provide greater certainty in the near future.

Planning Suggestion: Taxpayers with recognized capital gain should consider making an investment in a QOF to obtain significant tax savings. Your BDO advisor can be consulted for further information and assistance.

Conclusion

Like an annual physical examination is important for maintaining good health, an annual financial examination that includes year-end tax planning can enhance your financial well-being. Your BDO advisor is available to help you achieve your tax and financial objectives.

TAX TIPS FOR THE SELF-EMPLOYED

- Establish a Simplified Employee Pension (SEP) Plan by the due date of your 2018 return, including extensions. The contribution to the plan must be made by that due date. For 2018, the maximum allowable contribution to a SEP an employee can make independently of an employer is $5,500 ($6,500 if a catch-up contribution). However, the maximum combined deduction for an active participant's elective deferrals and other SEP contributions is $55,000 for 2018.
- Alternatively, establish a Keogh Plan in 2018, before December 31. The full contribution to the plan need not be made until the due date of your 2018 return, including extensions.
- Consider placing business assets in service in 2018. If qualified, Section 179 expense allows you to deduct the full cost of depreciable assets in the tax year they are placed in service subject to an expense level of $1,000,000 and the phase out threshold amount commences at $2,500,00 for 2018
- For taxable year 2018, a taxpayer can deduct start-up expenditures up to $5,000 with the phase out threshold at $50,000.
- A self-employed individual generally may deduct the employer-equivalent portion of his or her self-employment tax in figuring adjusted gross income. This deduction only affects the taxpayer's income tax. It does not affect net earnings from self-employment or self-employment tax.
- 100 percent of medical and long-term care insurance premiums, subject to the limitations on long term insurance premiums paid by a self-employed person are deductible from gross income to arrive at AGI.
- Effective for payments made on or after March 30, 2010, the Affordable Care Act allows the self-employed health insurance deduction to include an adult child who has not attained the age of 27 before the end of the taxpayer's taxable year.

* See our *2018 Year-End Tax Planning Considerations for Businesses* Including Year-End Ideas for further information.