2018 YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

INTRODUCTION

With year-end approaching, this is the time of year we *"normally"* suggest possible year-end tax strategies for our clients. However, from a tax-planning standpoint, 2018 is not a *"normal"* year. Late in 2017, Congress passed the **"Tax Cuts and Jobs Act" (TCJA)** which represents the most substantial tax reform legislation since 1986. Since the vast majority of its provisions **are first effective in 2018,** year-end planning is particularly challenging in light of the many new changes we must consider for the first time between now and the end of the year. For example, 2018 will be the first year we must consider changes under TCJA that: Reduce the overall tax rates for a majority of individuals; Enhance the Child Tax Credit (including and entirely new $500 Family Tax Credit); Substantially increase the Standard Deduction; Eliminate the Personal Exemption deduction; Place new limits on several Itemized Deductions (e.g., home mortgage interest and state and local tax deductions); Repeal certain deductions (e.g., unreimbursed employee business expenses, moving expenses); Substantially reduce the impact of the Alternative Minimum Tax (AMT) on many individuals; Provide a new 20% Deduction for individuals owning interest in businesses that generate qualified business income; and more!

Despite this backdrop of significant tax changes, many taxpayers should still benefit from traditional year-end tax planning strategies that include deferring *"income"* to a later year and accelerating *"deductions"* into the current year. Consequently, this letter is intended to remind you of the time-honored year-end tax planning techniques you should be considering. We also identify new wrinkles that the recent tax changes may bring to these strategies. **Caution!** Over the last few months, the IRS has been releasing guidance on various TCJA provisions. However, as we complete this letter, we are still waiting for further IRS clarifications on several important provisions. We closely monitor these IRS releases on an ongoing basis. Please call our firm for the latest IRS notifications and announcements regarding any TCJA provision that we do not address in this letter.

Be Careful! We suggest you call our firm before implementing any tax planning technique discussed in this letter. You cannot properly evaluate a particular planning strategy without calculating your overall tax liability with and without that strategy. This letter contains ideas for Federal income tax planning only. **State income tax issues are not addressed.**

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KEEP AN EYE ON CERTAIN PREVIOUSLY-EXPIRED TAX BREAKS

For well over a decade, we have been faced with the potential expiration of a long list of popular tax breaks. Historically, Congress has temporarily extended the majority of these tax breaks every few years. However, several popular tax breaks **expired at the end of 2017,** including: Deduction (up to $4,000) for Qualified Higher Education Expenses; Deduction for Mortgage Insurance Premiums as Qualified Residence Interest; Income Exclusion For Discharge Of Qualified Principal Residence Indebtedness; and the 10% Credit (with a lifetime cap of $500) for Qualified Energy-Efficient Home Improvements (e.g., qualified energy-efficient windows, storm doors, roofing). As we send this letter, legislation is being considered that would extend these expired tax breaks if enacted. Please call our Firm if you want a status report.

- **Planning Alert!** The 30% tax credit for **"Qualified" Solar Electric Property, Solar Water Heating Property, Energy-Efficient Fuel Cell Property, Small Wind Energy Property, Geothermal Heat Pump Property** doesn't begin phasing out until **after 2019.** This 30% credit generally applies if you install the qualifying energy-efficient property in or on property located in the U.S. that you use as a residence. Except for the Energy-Efficient Fuel Cell Property, the residence does **not** have to be your **"principal residence."** So, installations (other than for **Energy-Efficient Fuel Cell Property**) for a second residence or vacation home may qualify. The 30% credit also applies to the on-site installation costs. For example, if you are the initial purchaser of your newly-constructed residence that contains a qualifying solar water heater or solar electric generating property, you should ask the builder to provide you with a reasonable allocation of the cost of the home attributable to the qualified solar-energy property (including labor costs for on-site preparation, assembly, and installation of the property). **Caution!** To **take the 30% credit for 2018,** the qualifying energy-efficient property must **actually be installed** no later than **December 31, 2018.**

INCREASED CHILD TAX CREDIT AND NEW $500 FAMILY CREDIT

Increased Child Tax Credit. For 2017, subject to certain income phase-out thresholds, individuals were allowed a maximum Child Tax Credit of $1,000 for each **"Qualifying Child"** who **had not reached age 17** by the end of the tax year. **Starting in 2018 and through 2025,** the recently- enacted **Tax Cuts And Jobs Act ("TCJA")** doubles the previous $1,000 Child Tax Credit for each **"Qualifying Child"** to **$2,000,** while also significantly increasing the income level where the credit begins phasing out. Under TCJA, the $2,000 Child Tax Credit begins phasing out as an individual's modified adjusted gross income (MAGI) **exceeds $400,000** on a **Joint Return** (up from the previous $110,000), or **exceeds $200,000 for Singles** (up from the previous $75,000). For purposes of TCJA's enhanced Child Tax Credit, the term **"Qualifying Child"** has the same definition as under prior law (i.e., a child who meets certain residency, age, relationship, and support tests). **Tax Tip!** Due to the doubling of the maximum Child Tax Credit (from $1,000 to $2,000) and the substantial increase in the income phase-out thresholds, the Child Tax Credit will be more valuable and much more widely available than under prior law. **Caution!** In order to claim the Child Tax Credit of up to $2,000, TCJA requires that the Qualifying Child have a **qualified Social Security Number (SSN) before the return's filing due date.** The child's ITIN or ATIN will not satisfy this requirement.

- **Maximum "Refundable" Child Tax Credit Increased From $1,000 to $1,400.** In addition to increasing the maximum Child Tax Credit up to $2,000, TCJA allows **up to $1,400** (up from $1,000) of the Child Tax Credit to be "refundable" to the extent of 15% of the taxpayer's earned income in excess of $2,500 (down from $3,000). Thus, a taxpayer with only one Qualifying Child would need "earned income" of only $11,833 to get the full $1,400 refundable Child Tax Credit (i.e., [$11,833 less $2,500 = $9,333] x 15% = $1,400). **Please note** that a **"refundable"** credit generally means to the extent the credit exceeds the taxes you would otherwise owe with your individual income tax return without the credit, the IRS will send you a check for the excess.

New $500 Family Tax Credit. TCJA creates a **new non-refundable "Family Tax Credit" of up to $500** for each person the taxpayer could have claimed as a dependent under prior law but who does not qualify for the $2,000 Child Tax Credit. This credit will generally be available for: **1)** a "Qualifying Child" who does not qualify for the $2,000 Child Tax Credit because the child is 17 or older, and **2)** a "Qualifying Relative." Generally, **a "Qualifying Relative"** is a person who is not a Qualifying Child but who meets certain residency, gross

income, support, and relationship tests. This $500 Family Tax Credit is added to any other Child Tax Credits and the total credits begin phasing out once a taxpayer's MAGI **exceeds $400,000 on a joint return** or **$200,000 for singles.** **Planning Alert!** **Starting in 2018 and through 2025,** TCJA reduced the personal and dependancy exemptions **to zero** (and replaced them with a larger standard deduction discussed in more detail later in this letter). However, one of the requirements for being classified as a "Qualifying Relative" is that the individual cannot have "Gross Income" in excess of the "Personal Exemption" deduction amount (which is now zero). However, the IRS has announced that, solely for purposes of determining whether an individual meets the gross income requirement of a "Qualifying Relative", the personal exemption deduction amount will be deemed to be $4,150. In other words, an individual who otherwise satisfies the requirements of a "Qualifying Relative" cannot have gross income in excess of $4,150 for 2018.

THE ALTERNATIVE MINIMUM TAX (AMT) WILL HIT FAR FEWER TAXPAYERS AFTER TCJA

Changes To The Alternative Minimum Tax For Individuals. Although TCJA **retains** the **"Alternative Minimum Tax"** (AMT) for individual taxpayers, **starting in 2018 and through 2025,** it also offers new relief by: **1)** Increasing the AMT exemption amounts for joint filers to $109,400 (up from $86,200) and for single filers to $70,300 (up from $55,400), and **2)** Increasing the amount of alternative minimum taxable income where the AMT exemption amount begins to phase out for joint filers to $1 million (up from $164,100) and for single filers to $500,000 (up from $123,100). These amounts will be indexed for inflation for future years. **Planning Alert!** Due to these and other changes under TCJA, it has been estimated that the number of individuals subject to AMT will drop from approximately 5 million down to a level closer to 200,000. **Caution!** TCJA does retain certain adjustments that could potentially trigger AMT. For example, AMT adjustments and preference items that survived TCJA include: the Standard Deduction; the State and Local Tax (SALT) Deduction; Income from exercise of Incentive Stock Options; Interest on Private Activity Bonds; and Accelerated Depreciation Adjustments.

DON'T OVERLOOK THE NEW 20% DEDUCTION FOR CERTAIN QUALIFIED INCOME

Overview. One of the most significant and far-reaching provisions under TCJA is the new provision that may allow certain individuals to qualify for a **20% Deduction** with respect to **"Qualified Business Income," "Qualified REIT Dividends,"** and **"Publically-Traded Partnership Income."** This deduction is available **for tax years beginning after 2017 through 2025.** The 20% Deduction does not reduce your adjusted gross income (AGI) or impact your calculation for self-employment tax. Instead, the deduction simply reduces your Taxable Income (regardless of whether you itemized deductions or claim the standard deduction). In other words, the 20% Deduction is allowed **in addition to** your itemized deductions or your standard deduction.

- **What Type Of Income Qualifies For The 20% Deduction?** Generally, the following types of income are eligible for the 20% Deduction: Qualified REIT Dividends, Qualified Publically-Traded Partnership Income, and Qualified Business Income. The rules for determining the 20% Deduction for Qualified REIT Dividends and Publicly-Traded Partnership Income are relatively straightforward. However, the 20% Deduction for **"Qualified Business Income"** is expected to have the biggest impact on the greatest number of individual taxpayers, and in certain situations can be complicated and tricky.

- **Who Could Qualify For The 20% Deduction With Respect To "Qualified Business Income" (QBI)?** Taxpayers who may qualify for the 20% Deduction for "Qualified Business Income" (QBI) generally include taxpayers who report certain types of business income such as: Individual owners of S corporations and partnerships; Sole Proprietors; Trusts and Estates; and Certain beneficiaries of trusts and estates.

- **Planning Alert!** It is not feasible to provide a thorough discussion of the 20% Deduction with respect to **Qualified Business Income (QBI)** in this letter. However, you need to be aware that if you own an interest in a business operation as a sole proprietor, as an S corporation shareholder, or as a partner in a partnership, you could very likely be a good candidate for the 20% Deduction for QBI. Moreover, although taxpayers at all income levels may qualify for the 20% Deduction, it will be easier to qualify for the 20% Deduction for QBI for sole proprietors, S corporation shareholders, or partners in a partnership if their 2018 "Taxable Income" is $157,500 or below ($315,000 or below if filing a joint return). Consequently, if you own an interest in one of the businesses listed above and you expect your taxable income to be over $157,500 or $315,000 if filing a joint return, please call our Firm because you may have

an additional tax incentive to defer taxable income and/or increase deductions that cause your **Taxable Income for 2018** to **drop to $157,500** or less or **$315,000 or less if filing jointly.** If, after reviewing your specific situation, we decide that you would benefit by lowering your 2018 "Taxable Income" to **$157,500** or **$315,000**, we may recommend that you consider taking certain actions before the end of 2018. In the immediately-following segment we discuss traditional year-end planning techniques designed to reduce your anticipated 2018 Taxable Income by deferring income and/or accelerating deductions. **Planning Alert!** Regardless of your anticipated Taxable Income for 2018, if you want more information on this new 20% Deduction, please call our Firm and we will be glad to provide you with more details.

TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

POSTPONING TAXABLE INCOME MAY SAVE TAXES

Generally, deferring taxable income from 2018 to 2019 may reduce your income taxes if your effective income tax rate for 2019 will be lower than your effective income tax rate for 2018. For example, the deferral of income could cause your 2018 taxable income to fall below the thresholds for the highest 37% tax bracket (i.e., $600,000 for joint returns; $500,000 if single). In addition, if you have income subject to the 3.8% Net Investment Income Tax (3.8% NIIT) and the income deferral reduces your 2018 modified adjusted gross income (MAGI) below the thresholds for the 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single), you may avoid this additional 3.8% tax on your investment income. **Planning Alert! Starting in 2018,** TCJA temporarily reduced the tax rates on virtually all levels of income, including reducing the "highest" income tax rate from 39.6% to 37%. These lower rates are not scheduled to expire until after 2025.

If, after considering all factors, you believe deferring taxable income into 2019 will save you taxes, consider the following strategies:

Deferring Self-Employment Income. If you are a self-employed individual using the cash method of accounting, consider delaying year-end billings to defer income until 2019. **Planning Alert!** If you have already received the check in 2018, deferring the deposit of the check does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

Using Installment Sales To Defer Taxable Gain. If you plan to sell certain appreciated property in 2018, you might be able to defer the gain until later years by taking back a promissory note instead of cash. By taking a promissory note, you may qualify for the "installment method" which allows you to pay tax on the gain only as you collect payments on the note. Qualifying for the *installment method* not only defers the time you must pay the tax on the gain, but could also defer all or a portion of the gain into later years when your expected tax rate is less than your 2018 tax rate. For example, spreading the gain over several years could reduce the seller's income tax in the year of sale (and possibly subsequent years) by reducing the tax rates on long-term capital gains below the top 20% capital gains rate. This could also prevent the seller's income from exceeding the thresholds for the 3.8% NIIT (discussed in more detail below). **Planning Alert!** Although the sale of real estate and closely-held stock generally qualifies for installment sale treatment, some sales do not. For example, even if you are a cash-method taxpayer, you cannot use the installment method gain-deferral technique if: **1)** You sell publicly-traded stock or securities, **2)** You sell real estate that is *held primarily for sale to customers* (as opposed to holding it for investment), **or 3)** You sell a partnership or LLC interest to the extent the partnership or LLC owns certain appreciated disqualifying property (e.g., property producing depreciation recapture, property held primarily for sale to customers, unrealized receivables). **Caution!** You may not want to take back a promissory note in lieu of cash if you believe this reduces your chances of getting paid. Moreover, since TCJA's lower tax rates are currently scheduled to expire after 2025, you should pay careful attention to an installment sale arrangement that would defer gain beyond 2025 when your rates might be higher.

Postponing Cancellation Of Debt Income. If you negotiate or arrange a reduction or cancellation of a debt you owe to others, unless you meet certain exceptions, you will generally have to report *"cancellation of debt"* (COD) income. For example, you could have COD income where: Your creditor, such as a credit card company, agrees to accept as full payment an amount which is less than the amount you owe; You own real estate subject to a mortgage and the lender forecloses on the property (or, you enter into a short sale of the mortgaged property); You own an interest in a partnership (or LLC) or "S" corporation and the partnership or

S corporation has COD income. **Planning Alert!** If you are in the process of negotiating an agreement with your creditors that involves a debt reduction that would trigger COD income, consider postponing the action ***until after 2018*** to defer any debt cancellation income into 2019.

Planning For Required Distributions From IRAs. Generally, once you reach age 70½, you are required to begin taking "*Required Minimum Distributions*" (RMDs) from your IRA or qualified retirement plan account. A 50% penalty applies to the excess of the *"Required Minimum Distribution"* (RMD) over the amount actually distributed. You might consider the following ideas concerning RMDs which could save you overall taxes:

- **IRA Owners Who Attain Age 70½ During 2018.** If you reach age 70½ at any time during 2018, you must begin distributions from a traditional IRA account ***no later than April 1st of 2019.*** In addition, if you wait until 2019 to take your first payment, you will still be required to take your second RMD no later than December 31, 2019, which will cause you to *"bunch"* two payments into 2019. This *"bunching"* of the first two annual payments into one tax year (2019) could cause you to pay higher overall taxes if the bunching puts you in a higher tax bracket for 2019 than for 2018. However, if you expect your 2019 tax rate on the "bunched" payments to be lower than your tax rate on the first payment, if made in 2018, it could save you overall taxes to "bunch" the 2018 and 2019 RMDs into 2019.

- **Individuals Making Charitable Contributions Who Are Age 70½ Or Older.** If you have reached **age 70½** and you are planning to make charitable contributions before the end of 2018, there is a special tax break that could apply to you. For the past several years, we have had a popular rule that allows taxpayers, who **have reached age 70½,** to have their IRA trustee transfer **up to $100,000** from **their IRAs directly to a qualified charity,** and **exclude the IRA transfer from income.** The IRA transfer to the charity also counts toward the IRA owner's "Required Minimum Distributions" (RMDs) for the year. For those who wish to make charitable contributions, this tax break effectively allows a qualifying taxpayer to exclude all or a portion of their otherwise taxable RMDs from taxable income. This, in turn: **1)** Could cause your 2018 modified adjusted gross income (MAGI) to stay below the thresholds for the 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single), that might otherwise be imposed on your investment income (e.g., dividends, interest, capital gains), and **2)** Could also increase various credits and deductions for 2018 that would otherwise be phased out as your adjusted gross income increases. In addition, this could potentially reduce the portion of your social security payments that would otherwise be taxable. Moreover, this exclusion could reduce the amount of your Medicare Part B and Part D premiums for subsequent years which generally increase as your MAGI increases.

  Tax Tip. Starting in 2018, this planning technique could be even more valuable because TCJA increased the standard deduction for individuals filing a joint return to $24,000 (up from $12,700 in 2017) and to $12,000 for singles (up from $6,350 for 2017). Thus, far fewer individuals will gain a tax benefit by itemizing their deductions but instead will gain a greater tax benefit by taking the standard deduction. However, using this technique for a charitable contribution will provide an individual with this tax benefit **in addition to** the full benefit of the standard deduction (for those taking the standard deduction).

  Planning Alert! To qualify, the check from your IRA must be made out "directly" to your designated charity. In addition, if the **contribution is $250 or more,** you must get a **timely, qualifying receipt** from the charity for the charitable contribution. To take advantage of this exclusion for 2018, the **trustee** of your IRA **must write the check to the charity by December 31, 2018.** It may take the IRA custodian several days to complete all the necessary paper work to write the check. Consequently, you should alert the trustee that you want the check written to the charity **well before December 31, 2018.**

Individuals Who Inherit IRAs And Qualified Retirement Plan Accounts May Defer Income By Delaying Distributions. If you are the beneficiary of an IRA or qualified plan account of someone who has died, you should consider the following options for deferring your RMDs (and thus postponing taxable income):

- **Planning For IRA Distributions After The Owner's Death.** If you are the beneficiary of an IRA or qualified plan account of someone that has died in 2018, there are certain time-sensitive planning techniques you should consider without delay. For example, if the decedent named multiple individual beneficiaries or included an estate or charity as a beneficiary, we may be able to rearrange the IRA

beneficiaries for maximum tax deferral. The rules for rearranging IRA beneficiaries after the owner dies are tricky, and acting before certain deadlines pass is critical. **If the owner died in 2018,** the best tax results can generally be achieved by making any necessary changes **no later than December 31, 2018.** If you need our assistance, we should review your situation as soon as possible.

- **Rollovers By Surviving Spouses.** If your spouse passed away during 2018 and named you beneficiary of an IRA or qualified plan account, there are certain things you should consider if you want to maximize tax deferral. For example, if your spouse was **over age 70½** and died **during 2018,** and you are **over 59½,** you should consider rolling the deceased spouse's qualified plan or IRA amount into your name (as surviving spouse) **on or before December 31, 2018.** If you complete this rollover **before 2019,** then: **1)** If you are **under age 70½,** you will not be required to take any Required Minimum Distributions (RMDs) until the tax year you reach age 70½, or **2)** If you **are at least 70½,** your RMD for 2019 (and for future years) will be determined using the Uniform Lifetime Distribution Table that results in a smaller annual required payout. Therefore, **converting the account into your name** (as surviving spouse) on or **before December 31, 2018,** could substantially reduce the amount of your RMD for 2018 where the decedent was at least 70½.

  Planning Alert! If you (as surviving spouse) are not yet 59½, leaving the IRA or qualified plan account in the name of your deceased spouse may be the best option if you think that you will need to withdraw amounts from the retirement account before you reach age 59½. Otherwise, if your deceased spouse's account is transferred into your name and you take a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty.

- **Non-Spouse Beneficiaries Of Decedent's Retirement Plan.** Many employer-sponsored retirement plans (e.g., §401(k) plans) require a deceased individual's retirement plan balance to be paid out to a beneficiary no later than 5 years after the individual dies. If you are a non-spouse beneficiary of a deceased individual's plan balance (where the plan requires distributions to the beneficiary under the 5-year rule), you need to take certain time-sensitive steps if you want to take distributions and pay tax over your life expectancy instead of by the Plan's 5-year deadline. The IRS says the plan balance must be transferred (trustee-to-trustee) to an IRA titled in the name of both the deceased individual and you as beneficiary. For example, let's assume the decedent was your father (Bob Jones), and you are his daughter (Lucy Jones). You could direct the plan trustee to make a **"trustee-to-trustee"** transfer to an IRA titled **"Lucy Jones As Beneficiary Of Bob Jones, Deceased."**

  Planning Alert! For this to work, the IRS also says that this **"trustee-to-trustee"** transfer must be made **before the end of the year following the year of the plan participant's death.** So, if in this example your father **died in 2017,** you need to make sure that this trustee-to-trustee transfer from your deceased father's retirement plan to the properly-named IRA is made **no later than the end of 2018.** If the transfer occurs **after 2018,** the IRS says that you would be required to take distributions under the 5-year rule (instead of over your life expectancy). **Caution!** If you or a family member is in this situation, please call our Firm as soon as possible if you need our assistance.

TAKING ADVANTAGE OF DEDUCTIONS

Traditional year-end planning includes accelerating deductible expenses into the current tax year. This tactic could be particularly beneficial: **1)** If you expect your tax rate to be higher in 2018 than 2019, and/or **2)** The accelerated deductions cause your 2018 income to drop below certain income-sensitive thresholds allowing you to qualify for other tax breaks. **Planning Alert!** For example, as discussed previously, individuals who report Qualified Business Income will generally find it much easier to qualify for the new 20% Deduction with respect to that Qualified Business Income if their 2018 taxable income does not exceed $315,000 if filing a joint return ($157,500 if single).

Caution! Evaluating which, if any, deductions you should accelerate into 2018 has become more complicated because, starting in 2018, TCJA has: **1)** Placed new limits and restrictions on several popular deductions, and **2)** Repealed certain other deductions altogether. In the following segments, we discuss selected deductions you might consider accelerating into 2018, and the changes to those deductions caused by TCJA.

"Above-The-Line" Deductions Can Generate Multiple Tax Benefits. So-called **"above-the-line"** deductions reduce both your "adjusted gross income" (AGI) and your "modified adjusted gross income" (MAGI), while **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce either AGI or MAGI. Deductions that reduce your AGI (or MAGI) can generate multiple tax benefits by: **1)** Reducing your taxable income and allowing you to be taxed in a lower tax bracket; **2)** Potentially freeing up other deductions (and tax credits) that phase out as your AGI (or MAGI) increases (e.g., Certain IRA Contributions, Certain Education Credits, Adoption Credit, Child Tax Credit, New $500 Family Tax Credit, etc.); **3)** Potentially reducing your MAGI below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8% NIIT only applies if MAGI exceeds $250,000 if married filing jointly; $200,000 if single); or **4)** Potentially reducing your household income to a level that allows you to qualify for a "refundable" Premium Tax Credit for health insurance purchased on a government Exchange (the Premium Tax Credit is discussed in more detail below).

If you think that you could benefit from accelerating ***"above-the-line"*** deductions into 2018, consider the following:

- **Identifying "Above-The-Line" Deductions.** **"Above-the-line"** deductions include: Deductions for IRA or Health Savings Account (HSA) Contributions; Health Insurance Premiums for Self-Employed Individuals; Qualified Student Loan Interest; Qualifying Alimony Payments; Business Expenses for a Self-Employed Individual; and Un-Reimbursed Employee Business Expenses. **Caution!** TCJA made significant changes to the above-the-line deductions for **"Moving Expenses,"** and **"Alimony Payments,"** as follows:

  Moving Expenses. Before TCJA, the deduction for qualified **business-related "Moving Expenses"** was an above-the-line deduction and an employer's reimbursement of an employee's qualified moving expenses was a tax-free fringe benefit. **Starting in 2018 through 2025,** TCJA generally **suspends** the deduction for **"Moving Expenses"** and also suspends the income exclusion of employer-reimbursed moving expenses. **Planning Alert!** Generally, active members of the Armed Forces who move pursuant to a military order because of permanent change of station may still deduct un-reimbursed qualified moving expenses as above-the-line deductions and may exclude the reimbursement of those moving expenses. For 2018, an Armed Forces member may use the standard rate of **18 cents per mile** to determine the deductible moving expense.

  Alimony Payments. Currently, an individual making qualified alimony payments is allowed an "above-the-line" deduction for the payments and the recipient of the payments must include the payments in income. **Effective for "Divorce or Separation Instruments" executed after 2018,** TCJA **repeals altogether** the deduction for **alimony payments,** and the alimony payments **will no longer be taxable to the payee.** Alimony paid under a divorce instrument **executed before 2019** will generally be grandfathered under the existing rules. **Planning Alert!** Individuals contemplating divorce must **"execute"** a **"Divorce or Separation Instrument" before 2019** to ensure that any alimony payments will be deductible. Individuals who anticipate receiving alimony payments can avoid being taxed on those payments if they delay **"executing"** any **"Divorce or Separation Instrument"** until **after 2018.** The term **"Divorce or Separation Instrument"** means: **1)** A decree of divorce or separate maintenance, or a written instrument incident to such a decree, **2)** A written separation agreement, or **3)** A decree (not described in the previous Item 1) requiring a spouse to make payments for the support or maintenance of the other spouse.

- **Accelerating "Above-The-Line" Deductions.** As a cash method taxpayer, you can generally accelerate a 2019 deduction into 2018 by *"paying"* it in 2018. *"Payment"* typically occurs in 2018 if a check is delivered to the post office, if your electronic payment is debited to your account, or if an item is charged on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express) in 2018. **Caution!** If you post-date the check to 2019 or if your check is rejected, no payment has been made in 2018. **Planning Alert!** The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payments are not deductible in 2018.

- **Deductions For Business Expenses Paid By Partners.** Generally, the IRS allows a partner in a partnership (or owner of an LLC) to take an "above-the-line" deduction for business expenses the owner

pays on behalf of the partnership (or LLC) **only if** there is an agreement (preferably in writing) between the partner and the partnership providing that those expenses are to be paid by the partner, and that the expenses will not be reimbursed by the partnership. <u>**Tax Tip.**</u> If you are a partner or LLC owner paying unreimbursed business expenses on behalf of your partnership or LLC, to be safe, you should have a written agreement in place with the entity stipulating that those expenses are to be paid by you, and that the expenses will not be reimbursed by the partnership or LLC.

<u>BE CAREFUL WITH EMPLOYEE BUSINESS EXPENSES AFTER TCJA</u>

<u>**Un-Reimbursed Employee Business Expenses No Longer Deductible!**</u> **Starting in 2018 and through 2025,** "un-reimbursed" employee business expenses are not deductible at all. For example, you **will not be able to deduct** any of the following business expenses **you incur as an "employee"** if you are not properly reimbursed by your employer: **Automobile expenses** (including auto mileage, vehicle depreciation); **Costs of travel, transportation, lodging, and meals** related to the employee's work; **Union dues** and expenses; **Work clothes and uniforms;** Otherwise qualifying **employee's home office expenses; Dues** to a chamber of commerce for employment-related purposes; **Professional dues; Work-Related education expenses; Job search expenses** in the employee's present occupation; **Licenses and regulatory fees; Malpractice insurance premiums; Subscriptions** to professional journals and trade magazines related to the employee's work; and **Tools and supplies** used in the employee's work.

<u>**Good News - An Employer's Qualified Reimbursement Of An Employee's Business Expenses Remains Deductible!**</u> Generally, employee business expenses that are reimbursed under the employer's qualified **Accountable Reimbursement Arrangement are deductible by the employer** (subject to the 50% limit on business meals), and the reimbursements are **not taxable to the employee.** However, reimbursements under an arrangement that is not a qualified Accountable Reimbursement Arrangement generally must be treated as compensation and included in the employee's W-2, and the employee would get no offsetting deduction for the business expense. <u>**Planning Alert!**</u> Generally, in order for an employer to have a qualified **"Accountable Reimbursement Arrangement" - 1)** The employer must maintain a reimbursement arrangement that requires the employee to substantiate covered expenses, **2)** The reimbursement arrangement must require the return of amounts paid to the employee that are in excess of the amounts substantiated, and **3)** There must be a business connection between the reimbursement (or advance) and anticipated business expenses. **Please call our Firm if you need assistance.** We can help you establish a qualifying **Accountable Reimbursement Arrangement** with your employer.

<u>"ITEMIZED" DEDUCTIONS AFTER TCJA</u>

<u>**Background.**</u> As previously mentioned, although **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce your AGI or MAGI, they still may provide valuable tax savings. However, **starting in 2018 and through 2025,** TCJA substantially increases the "Standard Deduction" to the following levels: Joint Return - $24,000 (up from $12,700 in 2017); Single - $12,000 (up from $6,350 in 2017); and Head-of-Household - $18,000 (up from $9,350 in 2017). Moreover, TCJA not only increases the amount of the Standard Deduction, it also repeals or places new limits on several popular itemized deductions. Consequently, it is anticipated that far fewer individuals will "itemize" deductions under TCJA, but will instead take the Standard Deduction. <u>**Good News!**</u> Before TCJA, your aggregate itemized deductions began phasing out using a 3% phase-out rate once your adjusted gross income (AGI) exceeded a certain amount. For example, for 2017, the phase-out for joint filers began at $313,800 and at $261,500 for singles. **Starting in 2018 and through 2025, TCJA suspends this 3% phase-out rule.**

The following highlights the impact of TCJA on several of the most popular itemized deductions:

- <u>**Charitable Contributions.**</u> TCJA retains the charitable contribution deduction with the following changes: **1) From 2018 through 2025,** the 50% AGI limitation under prior law for cash contributions to public charities and certain other organizations **is increased to 60%,** and **2) Starting in 2018** (with no sunset date), a charitable contribution deduction is no longer allowed for contributions made to colleges and universities in exchange for the contributor's right to purchase tickets or seating at an athletic event (prior law allowed the taxpayer to deduct 80% as a charitable contribution).

Planning Alert! If you think your itemized deductions this year could likely exceed your Standard Deduction of $24,000 if filing a jointly ($12,000 if single) and you want to accelerate your charitable deduction into 2018, please note that a charitable contribution deduction is allowed for 2018 if the check is mailed **on or before December 31, 2018,** or the contribution is made by a credit card charge in 2018. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay the note or pledge. In addition, if you are considering a significant 2018 contribution to a qualified charity (e.g., church, synagogue, or college), it will generally save you taxes if you contribute *appreciated* long-term capital gain property, rather than selling the property and contributing the cash proceeds to the charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation. If instead you intend to use *"loss"* stocks to fund a charitable contribution, you should sell the stock first and then contribute the cash proceeds. This will allow you to deduct the capital loss from the sale, while preserving your charitable contribution deduction.

- **Casualty Losses.** **From 2018 through 2025,** TCJA generally suspends the itemized deduction for personal casualty losses and theft losses. However, personal casualty losses attributable to a Federally-declared disaster continue to be deductible as itemized deductions. **Planning Alert!** Even after TCJA, personal casualty losses generally continue to be deductible to the extent the taxpayer has personal casualty "gains" for the same year. In addition, TCJA did not change the existing rules for deducting casualty losses with respect to property held in a trade or business or for investment.

- **Medical Expense Deductions.** TCJA generally retains the existing rules for medical expense deductions. However, for **tax years beginning in 2017 and 2018,** for both regular tax purposes and AMT purposes, a taxpayer may deduct medical expenses to the extent they **exceed 7.5%** (down from 10%) of his or her AGI. **The 7.5%** threshold **reverts back to 10% after 2018.** **Planning Alert!** If you think your itemized deductions this year could likely exceed your standard deduction of $24,000 if filing jointly ($12,000 if single), it could save you taxes in the long run if accelerating elective medical expenses (e.g., braces, new eye glasses, etc.) allows you to exceed the 7.5% threshold for 2018. If you wait until 2019 to incur the medical expenses, you will be facing a 10% threshold.

- **$10,000 Cap On State And Local Taxes.** **From 2018 through 2025,** your aggregate itemized deduction for state and local real property taxes, state and local personal property taxes, and state and local income taxes (or sales taxes if elected) is **limited to $10,000** ($5,000 for married filing separately). Foreign real property taxes are not deductible at all unless the taxes are paid in connection with a business or in an activity for the production of income. **Planning Alert!** You are still allowed a full deduction (i.e., an above-the-line deduction) for state, local, and foreign **"property"** or **"sales"** taxes, and **foreign income, war profits,** or **excess profits taxes** paid or incurred in carrying on your **trade or business** (e.g., your Schedule C, Schedule E, or Schedule F operations).

- **New Limitation On Deduction For Interest Paid On Home Mortgage "Acquisition Indebtedness."** Before TCJA, individuals were generally allowed an itemized deduction for home mortgage interest paid on up to $1,000,000 ($500,000 for married individuals filing separately) of **"Acquisition Indebtedness"** (i.e., funds borrowed to purchase, construct, or substantially improve your principal or second residence and secured by that residence). Subject to certain transition rules, TCJA reduces the dollar cap for **Acquisition Indebtedness incurred after December 15, 2017 from $1,000,000 to $750,000** ($375,000 for married filing separately) for **2018 through 2025.** Generally, any Acquisition Indebtedness incurred on or before December 15, 2017 is "grandfathered" and will still carry the $1,000,000 cap. Moreover, subject to limited exceptions, if you incurred Acquisition Indebtedness on or before December 15, 2017 (i.e., grandfathered Acquisition Indebtedness), the refinancing of that indebtedness after December 15, 2017 will still be entitled to the $1,000,000 cap (to the extent of the outstanding balance of the original Acquisition Indebtedness on the date of the refinancing). **Caution!** The $750,000 cap that generally applies to "Acquisition Indebtedness" incurred after December 15, 2017, is reduced by the outstanding balance of any grandfathered "Acquisition Indebtedness." **Planning Alert!** If you think your itemized deductions this year could likely exceed your Standard Deduction, paying your January, 2019 qualifying home mortgage payment **before 2019** should shift the deduction on the interest portion of that payment **into 2018.**

- **<u>TCJA Suspends The Interest Deduction For "Home Equity Indebtedness."</u> For 2018 through 2025,** individuals **may not deduct interest** with respect to **"Home Equity Indebtedness"** (i.e., up to $100,000 of funds borrowed that do not qualify for "Acquisition Indebtedness" but are secured by your principal or second residence) **<u>Caution!</u>** Unlike the interest deduction for "Acquisition Indebtedness," TCJA **does not grandfather** any interest deduction for **"Home Equity Indebtedness"** that was **outstanding before 2018. <u>Planning Alert!</u>** A loan that has been labeled by your lender as a home equity loan, home equity line of credit (HELOC), or second mortgage on a Qualified Residence may, in certain situations, actually be classified as **"Acquisition Indebtedness."** This would be the case where the borrowed funds were used to **"substantially improve"** your Qualified Residence that secures the loan. For example, assuming you have not exceeded the dollar caps on Acquisition Indebtedness, you will still be able to deduct the interest on a second mortgage taken out as a home improvement loan so long as the improvement: **1) adds to the value** of your home that secures the second mortgage, **2) prolongs** your **home's useful life,** or **3) adapts** your home to **new uses.**

  <u>Caution!</u> These new rules can be tricky. We suggest that you talk with us before you sign off on a new mortgage: to buy your main house, to buy a second home, to place a second mortgage on your existing home, or to refinance your existing home mortgage. We will be glad to review your situation and determine if there are ways to structure the loan or refinance that maximizes your interest deduction.

<u>TAX PLANNING FOR INVESTMENT INCOME (INCLUDING CAPITAL GAINS AND THE 3.8% NIIT)</u>

<u>Planning With The 3.8% Net Investment Income Tax (3.8% NIIT).</u> The **3.8% Net Investment Income Tax (3.8% NIIT)** applies to the Net Investment Income of higher-income individuals. This tax applies to individuals with modified adjusted gross income (MAGI) exceeding the following **thresholds: $250,000** for **married filing jointly; $200,000** if **single;** and **$125,000** if **married filing separately.** The 3.8% NIIT is imposed upon **the <u>lesser of</u>** an individual's: **1)** Modified adjusted gross income (MAGI) in excess of the **threshold,** or **2)** Net investment income. **Trusts and estates** are also subject to the **3.8% NIIT** on the **lesser of: 1)** The adjusted gross income of the trust or estate in excess of $12,500 (for 2018), or **2)** The undistributed net investment income of the trust or estate.

The 3.8% NIIT not only applies to traditional types of investment income (i.e., interest, dividends, annuities, royalties, and capital gains), it also applies to "business" income that is taxed to a "passive" owner (as discussed in more detail below) unless the "passive" income is subject to S/E taxes. If you believe that the 3.8% NIIT may apply to you, consider the following planning techniques:

- **<u>Shifting To Investments That Generate Income Exempt From The 3.8% NIIT.</u>** Fortunately, the following types of income are **not subject** to the 3.8% NIIT: **tax-exempt bond interest;** gain on the sale of a principal residence otherwise excluded from income under the **home-sale exclusion** rules (i.e., up to $250,000 on a single return, up to $500,000 on a joint return); and **distributions from qualified retirement plans** (e.g., 401(k) plans, IRAs, §403(b) annuities, etc.). **<u>Tax Tip.</u>** Investments that generate tax-exempt income (e.g., tax exempt municipal bonds) potentially provide higher-income individuals with a double benefit: **1)** The interest will not be included in the individual's MAGI, thus reducing the chance that the individual will exceed the income thresholds for the 3.8% NIIT, and **2)** The tax-exempt interest itself is exempt from the 3.8% NIIT as well as from Federal income taxes. **<u>Planning Alert!</u>** Although taxable distributions from qualified retirement plans (e.g., IRAs, 401(k) plans, etc.) are exempt from the 3.8% NIIT, the taxable distributions will increase your "modified adjusted gross income" (MAGI). Therefore, to the extent the taxable distributions cause your MAGI to exceed the thresholds for the 3.8% NIIT (e.g., $250,000 for joint returns; $200,000 for singles), the distributions could cause your other "net investment income" (e.g., dividends, interest, capital gains, rents, passive income) to be hit with the 3.8% NIIT.

- **<u>Roth IRAs (Including Roth IRA Conversions).</u>** Tax-free distributions from a Roth IRA are exempt from the 3.8% NIIT, and do not increase your MAGI (and, thus will not increase your exposure to the 3.8% tax). Therefore, these tax-favored features should be factored into any analysis of whether you should contribute to a Roth IRA. However, if you are considering converting a traditional IRA into a Roth, the income triggered in the year of conversion would increase your MAGI and, therefore, may increase your

exposure to the 3.8% NIIT on your net investment income (e.g., dividends, interest, capital gains). **Planning Alert!** If you want a Roth conversion to be **effective for 2018,** you must transfer the amount from the regular IRA to the Roth IRA **no later than December 31, 2018** (you do not have until the due date of your 2018 tax return). **Caution!** Whether you should convert your traditional IRA to a Roth IRA can be an exceedingly complicated issue, and the 3.8% NIIT is just one of many factors that you should consider. **Please call our Firm** if you need help in deciding whether to convert to a Roth IRA.

- **TCJA's Impact On Roth Conversions.** If you convert your traditional IRA to a Roth IRA **on or after January 1, 2018,** TCJA will no longer allow you to later "re-characterize" that converted Roth IRA back to a traditional IRA. In other words, your conversion of an IRA to a Roth IRA can no longer be undone. Under prior law, you were generally allowed to recharacterize the previous conversion of a traditional IRA to a Roth IRA as late as October 15th of the following calendar year. This change eliminates the previous planning technique that allowed an individual to convert from a regular IRA to a Roth IRA and then later undo the conversion (by the following October 15th) if the value of the converted Roth IRA dropped significantly after the conversion. The IRS also says that the prohibition applies to the conversion from a traditional, SEP, or SIMPLE IRA to a Roth IRA, as well as amounts rolled over into a Roth IRA from other retirement plans such as 401(k) or 403(b) plans.

- **"Tax-Deferred" Investments.** The 3.8% NIIT does not apply to earnings generated by a **tax-deferred annuity** (TDA) contract **until the income is distributed.** Thus, after first considering the economics, investing in a TDA in your higher-income years may allow you to defer the annuity income until later years when your MAGI is below the 3.8% NIIT thresholds.

- **"Passive" Income.** "Net Investment Income" for purposes of the 3.8% NIIT generally includes net income from a business activity if you are a "passive" owner (unless the income constitutes self-employment income that is subject to the 2.9% Medicare tax). You will generally be deemed a "passive" owner if you do not "materially participate" in the business as determined under the traditional "passive activity loss" rules. For example, under the passive activity loss rules, you may be a "passive" owner unless you spend more than 500 hours working in the business during the year or meet one of the other "material participation" tests. Furthermore, rental income is generally deemed to be "passive" income under the passive activity loss rules, regardless of how many hours you work in the rental activity. **Tax Tip.** In certain situations, real estate rentals may not be treated as "passive" income and could also be exempt from the 3.8% NIIT. For example, if you are a "qualified real estate professional," or you lease property to a business in which you "materially participate," the rental income may be exempt from the 3.8% NIIT. If you believe you may qualify for one of these rental real estate exemptions, or you otherwise believe you may have "passive" income from non-rental business activities, please contact our Firm. We will gladly evaluate your situation to determine whether there are steps you could take before the end of 2018 to avoid "passive" income classification, and thus, reduce your exposure to the 3.8% NIIT.

Traditional Year-End Planning With Capital Gains And Losses. Generally, net capital gains (both short-term and long-term) are potentially subject to the 3.8% NIIT. This could result in an individual filing a joint return with taxable income of $479,000 or more ($425,800 or more if single) paying tax on his or her **net long-term capital gains** at a **23.8%** rate (i.e., the maximum capital gains tax rate of 20% plus the 3.8% NIIT). In addition, this individual's **net short-term capital gains** could be taxed as high as **40.8%** (i.e., 37% plus 3.8%). Consequently, traditional planning strategies involving the timing of your year-end sales of stocks, bonds, or other securities continue to be as important as before TCJA. The following are time-tested, year-end tax planning ideas for sales of capital assets. **Planning Alert!** Always consider the **economics of a sale or exchange first!**

- **Planning With Zero Percent Tax Rate For Capital Gains And Dividends.** For individuals filing a **joint return** with 2018 Taxable Income of **less than $77,200 (less than $38,600 if single),** their long-term capital gains and qualified dividends are taxed at a zero percent rate. **Tax Tip.** Taxpayers who have historically been in higher tax brackets but now find themselves between jobs, recently retired, or expecting to report higher-than-normal business deductions in 2018, may temporarily have income low enough to take advantage of the zero percent rate for 2018. If you are experiencing any of these

situations, please call our Firm and we will help you determine whether you can take advantage of this zero percent tax rate for long-term capital gains and qualified dividends.

- **Lower-Income Retirees.** The zero percent rate for long-term capital gains and qualified dividends is particularly important to lower-income retirees who rely largely on investment portfolios that generate dividends and long-term capital gains. Furthermore, gifts of appreciated securities to lower-income individuals who then sell the securities could reduce the tax on all or part of the gain from as high as 23.8% to as low as zero percent. **Caution!** If the lower-income individual is subject to the so-called kiddie tax, this planning technique will generally not work.

- **Timing Your Capital Gains And Losses.** If the value of some of your investments is less than your cost, it may be a good time to harvest some capital losses. For example, if you have already recognized capital gains in 2018, you should consider selling securities **prior to January 1, 2019** that would trigger a capital loss. These losses will be deductible on your 2018 return to the extent of your recognized capital gains, plus $3,000. **Tax Tip.** These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as the: $2,500 American Opportunity Tax Credit, $2,000 Child Tax Credit, Adoption Credit of $13,810, etc. **Planning Alert!** If, within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the "wash sale" rules (although the disallowed loss will increase the basis of the acquired stock). **Tax Tip.** If you are afraid of missing an upswing in the market during this 61-day period, consider buying shares of a different company in the same sector. Also, there is no wash sale rule for gains. Thus, if you decide to sell stock at a gain in order to take advantage of a zero capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

- **Planning With Capital Loss Carryforwards.** If you have substantial capital loss carryforwards coming into 2018, and your stock sales to date have created a net capital loss exceeding $3,000, consider selling enough appreciated securities **before the end of 2018** to decrease your net capital loss to $3,000. Stocks that you think have reached their peak would be good candidates. All else being equal, you should sell the short-term gain (held 12 months or less) securities first. This will allow your net capital loss (in excess of $3,000) to offset your short-term capital gain, while preserving favorable long-term capital gain treatment for later years. **Planning Alert!** Your net short-term capital gains can be used to free up a deduction for any "investment interest" you have incurred (e.g., interest you have paid on your margin account). If you eliminate your short-term capital gains by recognizing your short-term capital losses, you may be restricting your ability to deduct your investment interest. **Tax Tip.** If you are considering selling "loss" investments held 12 months or less, and you also have short-term capital gains and investment interest expense, please call our office. We will help you determine a strategy that will maximize your tax savings.

SELECTED MISCELLANEOUS YEAR-END PLANNING CONSIDERATIONS

Don't Miss Use-It-Or-Lose-It Deadline For Flex Plans. If you participate in a cafeteria or flexible savings account plan (flex plans), you can generally elect to make a pre-tax salary reduction contribution to the plan. You can then access that account to reimburse yourself tax-free for qualified expenditures (e.g., medical expenses, dependent care assistance, adoption assistance). For most *calendar-year* plans, you must clean out your 2018 account by March 15, 2019, or forfeit any funds that aren't used for qualifying expenses.

Consider Contributing The Maximum Amount To Your IRA. As your income rises and your marginal tax rate increases, deductible IRA contributions generally become more valuable. Also, making your deductible contribution to the plan as early as possible generally increases your retirement benefits. As you evaluate how much you should contribute to your IRA, consider the following limitations. If you are married, even if your spouse has no earnings, you can generally deduct in the aggregate up to $11,000 ($13,000 if you are both at least age 50 by the end of the year) for contributions to your and your spouse's traditional IRAs. You and your spouse must have *combined earned income* at least equal to the total contributions. However, no more than $5,500 ($6,500 if at least age 50) may be contributed to either your IRA account or your spouse's IRA account for 2018. If you are an active participant in your employer's retirement plan during 2018, your IRA deduction is reduced ratably as your adjusted gross income increases from **$101,000 to $121,000** on a joint return (**$63,000 to $73,000** on a single return). However, if you file a joint return with your spouse and your

spouse is an active participant in his or her employer's plan and you are not an active participant in a plan, your IRA deduction is reduced as the adjusted gross income on your joint return goes from **$189,000 to $199,000.** **Caution!** Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. For 2018, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **$189,000 to $199,000** on a joint return or from **$120,000 to $135,000** if you are single. **Planning Alert!** Unlike the rule for traditional IRA contributions, the amount you may contribute to a Roth IRA is reduced if your adjusted gross income falls within these phase-out ranges regardless of whether you or your spouse is a participant in another retirement plan. In addition, contributions to a Roth IRA are not deductible.

- **Workers At Least Age 70½.** If you are age 70½ or older, you **cannot** make a contribution to a traditional IRA for yourself. **Tax Tip.** If you are working, age 70½ or older, have a spouse under age 70½, and otherwise qualify, you can make a deductible IRA contribution to a separate traditional IRA for your spouse (not to exceed your compensation) even where the spouse has no earned income. Also, if you otherwise qualify, you can contribute to a nondeductible Roth IRA even after you reach age 70½ as long as you have sufficient earned income.

Consider Increasing Withholding If Facing An Estimated Tax Underpayment Penalty. If you have failed to pay sufficient estimated taxes during 2018 potentially causing an estimated tax underpayment penalty, **increasing your withholdings before the end of 2018** may solve the problem. Any income tax withholding (including withholdings at the end of 2018 from a year-end bonus or an IRA distribution) is generally deemed paid in quarterly installments by each quarter's estimated tax payment due date (i.e., April 17, 2018; June 15, 2018; September 17, 2018; and January 15, 2019). Therefore, amounts **withheld on or before December 31, 2018** may reduce or eliminate your penalty for underpaying estimated taxes. **Tax Tip.** If you are a higher-income individual with **investment income** that will trigger the **3.8% NIIT** for 2018, the additional 3.8% NIIT could subject you to the underpayment penalty if you haven't adjusted your estimated tax payments or withholdings to cover the 3.8% NIIT and you do not otherwise meet one of the exceptions to the penalty (i.e., paying in 110% of last year's tax). Increasing your withholdings on or before December 31, 2018 could eliminate the penalty.

- **Planning Alert!** If you take an IRA distribution and have taxes withheld from the distribution to avoid an underestimate penalty, you must roll the distribution (unreduced by the withheld taxes) into an IRA within 60 days of the distribution to avoid paying taxes (and possibly a 10% penalty) on the IRA distribution. You are allowed to take a distribution from an IRA and roll it over into a new IRA, **only one time every 12 months** (beginning with the date you received the distribution). **Caution!** If you used this withholding technique last year by having taxes withheld from an IRA distribution in 2017, **be very careful** that you do not violate the **one-rollover-per-year** rule if you plan to use this technique again this year. Please call our Firm before you initiate an IRA distribution in order to increase your tax withholdings.

TCJA Increased The Unified Exclusion Amount And GST Exemption Amount. **Effective for individuals dying and generation-skipping transfers after 2017 and before 2026,** TCJA increases the **Basic Unified Exclusion Amount** for gift & estate tax purposes and the generation-skipping exemption amount **to $11,180,000 for 2018** (after indexing for inflation). Previously, the exclusion and exemption amounts for 2018 were scheduled to be $5,600,000. TCJA did not change the current law provision allowing a deceased spouse's estate to elect to transfer the deceased spouse's unused Exclusion Amount (i.e., the portability election) to the surviving spouse. **Planning Alert!** Before this increase in the Unified Exclusion Amount, an individual dying in 2018 with a $11,180,000 estate would generally have had estate taxes payable of $2,232,000. After TCJA, the same estate would have estate taxes of zero. **Tax Tip!** Since the increased unified exclusion amount for gifts and the increased exemption for generation-skipping transfers are only available for gifts and generation-skipping transfers **through 2025,** individuals should examine their estate and gift tax plans in light of this temporary opportunity to make additional tax-free transfers. Feel free to call us if we can help with your estate plan.

TCJA Repeals The Affordable Care Acts Shared Responsibility Tax – But Not Until 2019! **Starting in 2019,** TCJA essentially eliminates the penalty for failure to purchase qualified health coverage by reducing the **"Shared Responsibility Tax"** (SR Tax) **to Zero.** **Planning Alert!** The SR Tax for failure to purchase

qualified health care coverage **continues to apply for <u>2017 and 2018,</u>** unless an exemption from the tax applies. For those without qualified health care coverage for 2018 (assuming no exemption applies), the **SR Tax** is generally the **greater of: 1)** 2½% of household income in excess of the income tax return filing threshold, or **2)** $695 per adult ($347.50 per child under age 18) limited to a household maximum of $2,085. **<u>Planning Pointer!</u>** If you or your dependent does not have qualifying health care coverage, you may qualify for an exemption, such as: You lived abroad and met certain conditions; You failed to have "qualified health plan coverage" for less than 3 months during the year; Your income is below the threshold for filing an income tax return; or, You qualify for a **"hardship exemption." <u>Tax Tip!</u>** Previously, to qualify for a "hardship exemption," you were required to apply for a "hardship exemption" certification with the Health Insurance Marketplace. However, the 2018 **"Draft" Form 8965** ("Health Coverage Exemptions") **does not require** you to obtain a hardship exemption certificate from the Marketplace in order to claim the exemption on your 2018 tax return. Instead, you may claim the exemption directly on Form 8965 if you experienced a hardship that prevented you from obtaining minimum essential coverage. The 2018 "Draft" Instructions to Form 8965 describe a variety of different types of qualifying hardships that you or a family member may have experienced during 2018 that could qualify for a hardship exemption. Please contact us if you need more information on the types of hardships you would need to satisfy.

<u>The "Premium Tax Credit" Under The Affordable Care Act (ACA) Is Not Repealed.</u> TCJA **<u>did not repeal</u>** the refundable **"Premium Tax Credit" or "PTC"** under ACA for eligible low-and-middle income individuals who purchase health insurance through a State or Federal Exchange. The PTC is generally paid **in advance directly to the insurer** ("Advance Payments").

- **<u>Who Qualifies For The "Premium Tax Credit" (PTC)?</u>** An individual who bought health insurance on a government Exchange generally qualifies for the PTC **for 2018** only if the individual's "Household Income" for **2018** is **at least 100%** and **not more than 400%** of the applicable Federal Poverty Line (FPL) for the individual's family size. **For example,** a **family of four** could qualify for at least some PTC with "2018" Household Income **of up to $98,400.**

- **<u>Certain Individuals May Be Required To Pay Back Some Or All Of Their "Advance Payments."</u>** Any individual who received Advance Payments for 2018 **is required to file** a **2018 income tax return** to reconcile: **1)** The amount of the **"actual"** PTC (based on the individual's **"actual"** 2018 Household Income) with **2)** The **Advance Payments** of the PTC (which were determined by the Exchange based on the individual's **"projected"** 2018 Household Income). If an individual's Advance Payments for 2018 exceed the "actual" PTC, the **excess must be paid back** on the **2018 tax return** as an **"additional tax liability." <u>Caution!</u>** Recent Tax Court cases have held that this excess must be paid back as an additional tax liability even where the taxpayers made a good faith effort to comply with requirements for Advance Payments of the PTC.

  <u>Possible Cap On The Amount That Must Be Paid Back!</u> The amount of the 2018 excess payment that must be repaid as an additional tax liability **is capped if** the individual's actual 2018 Household Income is **less than 400%** of the Federal Poverty Line (FPL) for the individual's family size. For example, for 2018, as long as an individual's actual household income is **less than 400% of the FPL,** the maximum amount that must be repaid will not exceed **$1,300 for a single individual** and **$2,600 for others. <u>Planning Alert!</u>** In some cases, an individual whose **"actual"** 2018 Household Income is projected to be 400% or more of the FPL may be able to trigger these dollar caps by reducing his or her **"actual"** 2018 Household Income **below** 400% of the FPL. **For example,** an individual might make a contribution to an IRA (if eligible to do so) in order to reduce his or her 2018 Household Income to less than 400% of the 2018 FPL for the individual's family size. Taking this step would cap the amount of the individual's excess payments required to be paid back as an additional tax liability to **$1,300 for single individuals** and **$2,600 for others. <u>Tax Tip!</u>** If you think that you may have to pay back some or all of your 2018 excess payments, please call our Firm as soon as possible so we can determine whether you can take steps **before the end of 2018** to minimize the amount of the pay back.

- **<u>Keep An Eye Out For IRS Form 1095-A.</u>** Any individual who purchased health insurance for 2018 through the Exchange should receive a **Form 1095-A** ("Health Insurance Marketplace Statement") by January 31, 2019. Information on this Form will be used to complete **Form 8962** ("Premium Tax Credit")

which reconciles an individual's Advanced Payments of the PTC with the "actual" PTC, as discussed above. If you, your spouse, or a dependent purchased health insurance through the Marketplace during 2018, **please bring us a copy of Form 1095-A along with your other tax information** when we prepare your 2018 tax return.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our Firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this material should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

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