LINDA C. SLIDER

ATTORNEY AT LAW

P.O. BOX 5756
WALNUT CREEK, CALIFORNIA 94596

TEL: (925) 932-8450
FAX: (925) 938-4844
LINDA@SLIDERLAW.COM

November 15, 2018

Dear Clients and Colleagues:

As the end of the year approaches, it is a good time to think of planning moves that will help lower your tax bill for this year and possibly the next.

Year-end planning for 2018 takes place against the backdrop of the Tax Cuts and Jobs Act, which made major changes in the tax rules for individuals and businesses. For individuals, there are new, lower income tax rates, a substantially increased standard deduction, eliminated personal exemptions, severely limited itemized deductions, an increased child tax credit, and a watered-down alternative minimum tax (AMT), among many other changes. For businesses, the corporate tax rate is cut to 21%, the corporate AMT is gone, there are new limits on business interest deductions, significantly liberalized expensing and depreciation rules, and a new deduction for non-corporate taxpayers with qualified business income from pass-through entities (partnerships, limited liability companies and sole proprietorships).

I have compiled a checklist of actions based on current tax rules that may help you save tax dollars if you act before year-end. Year-end tax planning must always take account of each taxpayer's particular situation and goals. Not all actions will apply in your particular situation, but you (or a family member) may benefit from many of these actions. There's still a narrow window of time before year-end to best position yourself for the tax changes created by the Tax Cuts and Jobs Act. Here's a quick rundown of last-minute moves you should think about making.

<u>Year-End Tax Planning Moves for Individuals</u>

- The Tax Cuts and Jobs Act made significant pro-taxpayer changes to the tax rates and brackets applicable to individual taxpayers and standard deductions, but at the "cost" of reduced (or eliminated) itemized deductions and the elimination of personal exemptions. The IRS revised the tax withholding schedules to reflect the pro-taxpayer changes to tax rates and brackets, but these revised tax withholding schedules may result in under-withholding of taxes for those taxpayers who have lost significant deductions or personal exemptions or who are subject to tax surcharges. Taxpayers who make estimated taxes based on estimated 2018 income with erroneously assumptions about their ability to claim itemized deductions or personal exemptions may also be under-withholding on 2018 income taxes. Regardless of their sources of income and methods for tax withholding, taxpayers should double-check their tax withholdings to make sure that they have withheld enough 2018 taxes to be "penalty-safe".

- Beginning in 2018, many taxpayers who claimed itemized deductions year after year will no longer be able to do so. That's because the basic standard deduction has been increased ($24,000 for joint filers, $12,000 for singles, $18,000 for heads of household, and $12,000 for marrieds filing separately), and many itemized deductions have been cut back or abolished. These cut-back or abolished deductions include: (i) the deduction for state and local taxes (including property taxes) is capped at $10,000, regardless of filing status; (ii) miscellaneous itemized deductions (e.g., legal and tax preparation fees) and unreimbursed employee expenses are no longer deductible; and (iii) personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster and only to the extent the $100-per-casualty and 10%-of-AGI (adjusted gross income) limits are met. You can still itemize (i) medical expenses to the extent they exceed 7.5% of your adjusted gross income, (ii) state and local taxes (including property taxes) up to $10,000, (iii) charitable contributions (with an increased limit, in certain cases), and (iv) interest deductions on qualifying residence debt (subject to greater restrictions, especially for home equity debt). However, these still-permissible itemized deductions won't save taxes if they don't cumulatively exceed the new, higher standard deduction.

- Some taxpayers may be able to work around the limitations caused by the increased standard deduction coupled with restricted itemized deductions by applying a "bunching strategy" to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, if a taxpayer knows he or she will be able to itemize deductions this year but not next year, the taxpayer should consider making two years' worth of charitable contributions this year, instead of spreading out donations over 2018 and 2019. However, remember that, given the $10,000 cap on state and local tax deductions, there is no benefit to "bunching" state and local tax deductions once you hit the $10,000 cap.

- Higher-income earners must also be wary of the 3.8% surtax on certain unearned income. The surtax is 3.8% of the lesser of: (1) net investment income (NII), or (2) the excess of modified adjusted gross income (MAGI) over a threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case). As year-end nears, a taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on his estimated MAGI and NII for the year. Some taxpayers should consider ways to minimize additional NII for the balance of the year (most likely, by deferral of investment income until 2019), others should try to see if they can reduce MAGI other than NII (e.g., by deferring other income receipts or accelerating deductions), and other individuals will need to consider ways to minimize both NII and other types of MAGI.

- In addition, the 0.9% Medicare tax surcharge may also require careful planning for higher-income earners. The Medicare tax surcharge applies to taxpayers for whom the sum of their wages received with respect to employment and their self-employment income is in excess of a threshold amount ($250,000 for joint filers, $125,000 for married couples filing separately, and $200,000 in any other case). Employers must withhold the Medicare tax surcharge from wages in excess of $200,000 regardless of filing status or other income. Self-employed persons must take it into account in figuring estimated tax. There may be situations where an employee may need to have more withheld toward the end of the year to cover the Medicare tax surcharge. For example, if a taxpayer earns $200,000 from one employer during the first half of the year and a like amount from another employer during the balance of the year, the taxpayer would owe the Medicare tax surcharge, but there would be no withholding by either employer for the Medicare tax surcharge since wages from each employer don't exceed $200,000.

- Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on the taxpayer's taxable income. The 0% rate generally applies to the excess of long-term capital gain over any short-term capital loss to the extent that it, when added to regular taxable income, is not more than the "maximum zero rate amount" (e.g., \$77,200 for a married couple, \$38,600 for singles and \$51,700 for heads of households). If you hold long-term appreciated assets, consider selling enough of them to generate long-term capital gains sheltered by the 0% rate. If you qualify for the 0% rate for long-term capital gains you took earlier this year, you may want to delay selling assets which will yield a capital loss (depending on the amounts involved, such losses may not yield a tax benefit this year).

- Consider postponing income until 2019 and accelerating deductions into 2018 if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2018 that are phased out over varying levels of adjusted gross income (AGI). These phased-out tax breaks include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. <u>Note, however, that in some cases, it may pay to accelerate income into 2018</u>. For example, that may be the case where a person will have a more favorable filing status this year than next (e.g., head of household versus individual filing status) or expects to be in a higher tax bracket next year.

- If you believe a Roth IRA is better than a traditional IRA for your long-term retirement and investment goals, consider converting some or all of your traditional IRA into a Roth IRA, if eligible to do so. Keep in mind, however, that a Roth IRA conversion will increase your AGI for 2018 and possibly reduce tax breaks which are phased out based on AGI (or MAGI). Also keep in mind that "unwinding" Roth IRA conversions and moving the assets back to a traditional IRA is no longer allowed.

- It may be advantageous to try to arrange with your employer to defer payment of a bonus that may be coming your way until early 2019. This could both cut the taxes due (if you will be in a lower bracket or more favorable filing status next year), as well as defer the payment of the tax.

- Consider using a credit card to pay deductible expenses before the end of 2018. Doing so will increase your 2018 deductions even if you don't pay your credit card bill until after 2018.

- If you expect to owe state and local income taxes when you file your return next year and you will be itemizing in 2018, consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) <u>before</u> year-end to pull the deduction of those taxes into 2018. But remember that state and local tax deductions are limited to \$10,000 per year, so this strategy is effective only up to the point where your 2018 state and local tax payments reach \$10,000.

- Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retirement plan). RMDs from IRAs must begin by April 1 of the year following the year you reach age 70-½. (That start date also applies to company plans, but non-5% company owners who continue working may defer RMDs until April 1 following the year they retire.) Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. Thus, if you turn age 70-½ in 2018, you can delay the first required distribution to 2019, but if you do, you will have to take a double distribution in 2019 (the amount required for 2018, <u>plus</u> the amount required for 2019). Think twice before delaying 2018 distributions to 2019, as bunching income into 2019 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2019 if you will be in a substantially lower bracket that year.

- If you are age 70-½ or older by the end of 2018, have traditional IRAs, and particularly if you can't itemize your deductions, consider making 2018 charitable donations via qualified charitable distributions from your IRAs. Such distributions are made directly to charities from your IRAs, and the amount of the contribution is neither included in your gross income nor deductible on Schedule A, Form 1040. But the amount of the qualified charitable distribution reduces the amount of your required minimum distribution, resulting in tax savings, and this move may favorably impact other tax benefits or burdens which are pegged to your taxable income (such as the net investment income surcharge or Medicare tax surcharge).

- Consider increasing the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year.

- If you were in an area affected by a federally declared disaster (such as a California wildfire zone which is covered under a FEMA federally declared disaster), and you suffered uninsured or unreimbursed disaster-related losses, keep in mind you can choose to claim your losses on either the return for the year the loss occurred (in this instance, the 2018 return normally filed next year), or the return for the prior year (2017). If possible, you may want to settle an insurance or damage claim in 2018 in order to maximize your casualty loss deduction this year.

- Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and/or estate taxes. The exclusion applies to gifts of up to $15,000 made in 2018 to each of an unlimited number of individuals. You can't carry over unused exclusions from one year to the next. Such transfers may also save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the Kiddie Tax, or where appreciated assets are given to family members who can sell at a reduced capital gains tax rate (or who can wait to sell the assets until they are "free" of the Kiddie Tax).

- And speaking of the Kiddie Tax, the Tax Cuts and Jobs Act made substantial changes in this area. Prior to 2018, an affected child or young adult's investment income above $2100 was subject to tax at the parents' marginal rates. For 2018, affected child or young adult's investment income above $2100 is subject to tax at the rates imposed on trusts and estates. The trust and estates tax rates are onerous and (for some families) may even be higher than the parents' rates imposed under the pre-2018 rules. However, there are still some planning opportunities (e.g., an ability to harvest up to $4700 of long-term capital gains at a "zero" tax cost). If you have a child or young adult (student under age 24) who may be affected by the Kiddie Tax, you should consult with your tax advisor about how these substantial changes may impact your situation.

Year-End Planning Moves for Trusts and Estates. Fiduciaries for irrevocable trusts and estates should consider whether to make income distributions to beneficiaries to minimize income taxes:

- Under federal income tax laws, irrevocable trusts and estates pay income tax at a highly-compressed tax schedule and reach the top marginal income tax rates of 37% once taxable income exceeds $12,500 (for 2018). In addition, irrevocable trusts and estates pay capital gains tax at the top rate of 20%, and further pay the additional Medicare surcharge tax of 3.8% on "unearned income" (e.g., dividends, interest, royalties, and rents) once taxable income exceeds $12,600.

- Irrevocable trusts and estates are entitled to a "distribution deduction" for taxable income earned in the specified year, as long as the taxable income is distributed by the 65th day of the following year (generally March 5 for non-leap years, if the irrevocable trust or estate is using a calendar year). In this event, the taxable income is shifted from the irrevocable trust or estate's fiduciary income tax return to the beneficiaries' personal tax return for the specified year, where the taxable income may be taxed at lower rates. Fiduciaries need to act quickly once their 2018 tax information is available to decide whether it is advantageous to distribute taxable income by the 65th day deadline.

Year-End Tax-Planning Moves for Businesses & Business Owners. Finally, the Tax Cuts and Jobs Act included generous tax rate reductions for corporations, taxpayers who receive pass-through business income, and taxpayers who invest in additional business equipment:

- For tax years beginning after 2017, taxpayers other than corporations (e.g., partnerships, limited liability companies and sole proprietorships) may be entitled to a deduction of up to 20% of their qualified business income which is passed through to the business owner (the "Qualified Business Income Deduction"). For 2018, if taxable income exceeds $315,000 for a married couple filing jointly, or $157,500 for all other taxpayers, the Qualified Business Income Deduction may be limited, depending on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the trade or business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business. The limitations for the Qualified Business Income Deduction are phased in for joint filers with taxable income between $315,000 and $415,000 and for all other taxpayers with taxable income between $157,500 and $207,500. Taxpayers may be able to achieve significant savings by deferring income or accelerating deductions so as to come under the dollar thresholds (or be subject to a smaller phaseout of the Qualified Business Income Deduction) for 2018. Depending on their business model, taxpayers also may be able increase their Qualified Business Income Deduction by increasing W-2 wages before year-end or by acquiring qualified property (or re-structuring the ownership of qualified property). The rules are quite complex, so don't make a move in this area without careful planning with your tax adviser.

- More "small businesses" are able to use the cash (as opposed to accrual) method of accounting in 2018 and later years than were allowed to do so in earlier years. To qualify as a "small business" a taxpayer must, among other things, satisfy a gross receipts test. Effective for tax years beginning after Dec. 31, 2017, the gross-receipts test is satisfied if, during a three-year testing period, average annual gross receipts don't exceed $25 million (the dollar amount used to be $5 million). Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings till next year or by accelerating expenses, for example, paying bills early or by making certain prepayments.

- Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2018, the expensing limit is $1,000,000, and the investment ceiling limit is $2,500,000. Expensing is generally available for most depreciable property (other than buildings), and off-the-shelf computer software. For property placed in service in tax years beginning after Dec. 31, 2017, expensing also is available for qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems. The generous dollar ceilings that apply this year mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. The fact that the expensing deduction may be claimed in full (if you are otherwise eligible to take it), regardless of how long the property is held during the year, can be a potent tool for year-end tax planning. Thus, property acquired and placed in service in the last days of 2018, rather than at the beginning of 2019, can result in a full expensing deduction for 2018.

- Businesses also can claim a 100% bonus first year depreciation deduction for machinery and equipment [whether bought used (with some exceptions) or new] if the machinery and equipment is purchased and placed in service this year. The 100% write-off is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 100% bonus first-year write-off is available even if qualifying assets are in service for only a few days in 2018.

- Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2018.

- A corporation (other than a "large" corporation) that anticipates a small net operating loss (NOL) for 2018 (and substantial net income in 2019) may find it worthwhile to accelerate just enough of its 2019 income (or to defer just enough of its 2018 deductions) to create a small amount of net income for 2018. This will permit the corporation to base its 2019 estimated tax installments on the relatively small amount of income shown on its 2018 return, rather than having to pay estimated taxes based on 100% of its much larger 2019 taxable income.

- To reduce 2018 taxable income, consider disposing of a passive activity in 2018 if doing so will allow you to deduct suspended passive activity losses.

Please keep in mind that I've described only some of the year-end moves that should be considered in light of the Tax Cuts and Jobs Act. If you or your accountant would like more details about any aspect of year-end tax planning, please do not hesitate to call.

Very truly yours,

Linda Slider

Linda C. Slider