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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 2019 takes place against the continuing backdrop of the major changes in the federal rules for individuals and businesses, contained in the Tax Cuts and Jobs Act of 2017, but no new significant federal tax legislation in 2019. The tax planning environment for individuals still includes lower income tax rates, a boosted standard deduction, severely limited itemized deductions, no personal exemptions, an increased child tax credit, and a watered-down alternative minimum tax (AMT). For businesses, the tax planning environment still includes a reduced corporate tax rate of 21%, no corporate AMT, limits on business interest deductions, and very generous expensing and depreciation rules. Non-corporate taxpayers with qualified business income from pass-through entities may be entitled to a special deduction.

California still has not conformed its state tax laws to include the bulk of the federal tax law changes adopted in the Tax Cuts and Jobs Act of 2017 and has, on the area of health insurance coverage, imposed a new California health insurance mandate for 2020.

In this environment, the time-tested approach of deferring income and accelerating deductions to minimize taxes still works for many taxpayers, along with the tactic of bunching expenses into this year or the next to get around deduction restrictions. 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, and here's a quick rundown of last-minute moves you should think about making.

Year-End Tax Planning Moves for Individuals.

- Many taxpayers won't be able to itemize because of the high basic standard deduction amounts that apply for 2019 ($24,400 for joint filers, $12,200 for singles and for marrieds filing separately, $18,350 for heads of household), and because many itemized deductions have been reduced or abolished. No more than $10,000 of state and local taxes may be deducted; miscellaneous itemized deductions (e.g., tax preparation fees and unreimbursed employee expenses) are not deductible; and 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 limits are met. You can still itemize medical expenses but only to the extent they exceed 10% of your adjusted gross income, state and local taxes up to $10,000, your charitable contributions, plus interest deductions on a restricted amount of qualifying residence debt, but payments of those items won't save taxes if they don't cumulatively exceed the standard deduction amount that applies to your filing status.

- Some taxpayers may be able to work around these deduction restrictions 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 will benefit by making two years' worth of charitable contributions this year, instead of spreading out donations over 2019 and 2020. But remember that this technique doesn't work for state and local income taxes, since the $10,000 maximum deduction for state and local income taxes limits the benefits of bunching.

- As always, higher-income earners must 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 (e.g., through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than NII, and other individuals will need to consider ways to minimize both NII and other types of MAGI.

- The 0.9% additional Medicare tax also may require higher-income earners to take year-end actions. It applies to individuals 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 additional Medicare tax 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 could be situations where an employee may need to have more withheld toward the end of the year to cover the tax. For example, if an individual 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, he or she would owe the additional Medicare tax, but there would be no withholding by either employer for the additional Medicare tax 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., $78,750 for a married couple). If the 0% rate applies to long-term capital gains you took earlier this year for example, you are a joint filer who made a profit of $5,000 on the sale of stock bought in 2009, and other taxable income for 2019 is $70,000 then before year-end, try not to sell assets yielding a capital loss because the first $5,000 of such losses won't yield a benefit this year. And if you hold long-term appreciated-in-value assets, consider selling enough of them to generate long-term capital gains sheltered by the 0% rate.

- Consider postponing income until 2020 and accelerating deductions into 2019 if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2019 that are phased out over varying levels of adjusted gross income (AGI). These 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. Note, however, that in some cases, it may pay to actually accelerate income into 2019. 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, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA in 2019 if eligible to do so. Keep in mind, however, that such a conversion will increase your AGI for 2019, and possibly reduce tax breaks geared to AGI (or modified AGI).

- 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 70½. (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 70½ in 2019, you can delay the first required distribution to 2020, but if you do, you will have to take a double distribution in 2020 the amount required for 2019 plus the amount required for 2020. Think twice before delaying 2019 distributions to 2020, as bunching income into 2020 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.

- If you are age 70½ or older by the end of 2019, have traditional IRAs, and particularly if you can't itemize your deductions, consider making 2019 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, which can result in tax savings.

- If you become eligible in December of 2019 to make health savings account (HSA) contributions, you can make a full year's worth of deductible HSA contributions for 2019.

- If you were in federally declared disaster area (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 them either on the return for the year the loss occurred (in this instance, the 2019 return normally filed next year), or on the return for the prior year (2018). If possible, you may want to settle an insurance or damage claim in 2019 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 2019 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, for 2019, affected child or young adult's investment income above $2200 is subject to tax at the rates imposed on trusts and estates. The trust and estates tax rates are onerous for investment income. However, there are still some planning opportunities (e.g., the potential to harvest long-term capital gains up to $4800 at a "zero" tax cost in some situations). 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.

<u>Year-End Planning Moves for Trusts and Estates</u>. 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 $12,750 (for 2019). 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 $12,750.

- Irrevocable trusts and estates are entitled to a "distribution deduction" for taxable income earned in the specified year, <u>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)</u>. 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 2019 tax information is available to decide whether it is advantageous to distribute taxable income by the 65th day deadline.

<u>Year-End Tax-Planning Moves for Businesses & Business Owners</u>. 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:

- Under Code Sec. 199A, taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. For 2019, if taxable income exceeds $321,400 for a married couple filing jointly, $160,700 for singles and heads of household, and $160,725 for marrieds filing separately, the deduction may be limited based 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 are phased in for example, the phase-in applies to joint filers with taxable income between $321,400 and $421,400 and to single taxpayers with taxable income between $160,700 and $210,700. The IRS has issued final regulations on how to apply the complex rules of Code Sec. 199A, and taxpayers may be able to achieve significant savings with respect to this deduction (which is available through 2025) by carefully structuring their businesses. The rules are quite complex, so don't make a move in this area without consulting your tax adviser.

- More small businesses are able to use the cash (as opposed to accrual) method of accounting in 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. For 2019, the gross-receipts test is satisfied if, during a three-year testing period, average annual gross receipts don't exceed $26 million (the dollar amount was $25 million for 2018, and for earlier years it was $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 2019, the expensing limit is $1,020,000, and the investment ceiling limit is $2,550,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also 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 2019, rather than at the beginning of 2020, can result in a full expensing deduction for 2019.

- Businesses also can claim a 100% bonus first year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if 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 2019.

- 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 2019.

- A corporation (other than a large corporation) that anticipates a small net operating loss (NOL) for 2019 (and substantial net income in 2020) may find it worthwhile to accelerate just enough of its 2020 income (or to defer just enough of its 2019 deductions) to create a small amount of net income for 2019. This will permit the corporation to base its 2020 estimated tax installments on the relatively small amount of income shown on its 2019 return, rather than having to pay estimated taxes based on 100% of its much larger 2020 taxable income.

California Tax-Planning Moves. Finally, California still has not conformed the majority of its tax laws to include the changes to federal tax laws enacted by the Tax Cuts and Jobs Act of 2017. Taxpayers need to pay attention to the following changes in California state taxes:

- Minor conforming changes have been made in the area of corporate and partnership tax laws, most notably in the area of changes of accounting methods, the disallowance of carrybacks of net operating taxable losses to prior years, and Section 1031 exchanges.

- Most notably, California still retains its alternative minimum tax for taxpayers, including corporations. Accordingly, as you consider your year-end tax moves, you should remember to take California's AMT into account.

- The federal Tax Cuts and Jobs Act eliminated the federal penalty for individuals who fail to maintain qualifying health insurance under the Affordable Care Act. However, California has adopted its own health insurance mandate. Starting 2020, Californians who choose not to buy qualified health insurance, will face a tax penalty of the greater of $695 per adult ($347.50 per child) or 2.5% of their annual income (adjusted for the number of members of your household). Exemptions are available for various reasons, including hardship, religious conscious, short-gaps in coverage, etc. California also adopted a new state subsidy program that will help lower the cost of health insurance for low and middle-income Californians. Previously, those who made above 400% of the federal poverty line (FPL) were not eligible for premium tax credits. In 2020, those who make between 400 to 600% of the FPL will newly be eligible for subsidies. If a taxpayer does not already have qualified coverage through the taxpayer's employer, Medicare, Medicaid, etc., individual coverage through Covered California can be obtained through January 1, 2020.

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,

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