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Year- End Tax Planning Moves for Individuals

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Dear Client:

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 backdrop of the Tax Cuts and Jobs Act (TCJA), that makes major changes in the tax rules for individuals and businesses. For individuals, there are new, lower income tax rates, a substantially increased standard deduction, severely limited itemized deductions and no personal exemptions, an increased child tax credit, and a watered-down alternative minimum tax (AMT), among many other changes.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make:

- 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 an unindexed 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, in 2019). 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.

- Postpone income until 2020 and accelerate 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 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 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).

- It may be advantageous to try to arrange with your employer to defer, until early 2020, a bonus that may be coming your way. This could cut as well as defer your tax.

- Beginning in 2018, many taxpayers who claimed federal itemized deductions year after year will no longer be able to do so. For 2019, the basic standard federal deduction has been increased (to $24,400 for joint filers, $12,200 for singles, $18,350 for heads of household, and $12,200 for marrieds filing separately), and many federal itemized deductions have been cut back 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 no longer 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 to the extent they exceed 7.5% 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 new, higher standard deduction.

- Some taxpayers may be able to work around the new reality 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 may be able to make two years' worth of charitable contributions this year, instead of spreading out donations over 2019 and 2020.

- Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2019 deductions even if you don't pay your credit card bill until after the end of the year.

- If you expect to owe state and local income taxes when you file your return next year and you will be itemizing in 2019, consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2019. But remember that state and local tax deductions are limited to $10,000 per year, so this strategy is not a good one if to the extent it causes your 2019 state and local tax payments to exceed $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 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. However, it could be beneficial to take both distributions in 2020 if you will be in a substantially lower bracket that year.

- If you are age 70-½ 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, resulting in tax savings.

- If you were younger than age 70-½ at the end of 2019, you anticipate that in the year that you turn 70-½ and/or in later years you will not itemize your deductions, and you don't have any traditional IRAs, establish and contribute as much as you can to one or more traditional IRAs in 2019. If the immediately previous sentence applies to you, except that you already have one or more traditional IRAs, make maximum contributions to one or more traditional IRAs in 2019. Then, when you reach age 70-½, do the steps in the immediately preceding bullet point. Doing all of this will allow you to, in effect, convert nondeductible charitable contributions that you make in the year you turn 70-½ and later years, into deductible-in-2018 IRA contributions and reductions of gross income from age 70-½ and later year distributions from the IRAs.

- Take an eligible rollover distribution from a qualified retirement plan before the end of 2019 if you are facing a penalty for underpayment of estimated tax and having your employer increase your withholding is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2019. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2019, but the withheld tax will be applied pro rata over the full 2019 tax year to reduce previous underpayments of estimated tax.
- 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 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.
- Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and 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 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.
- If you were in an area affected by a federally declared disaster area, and you suffered uninsured or unreimbursed disaster-related losses, keep in mind you can choose to claim them on either the return for the year the loss occurred (in this instance, the 2019 return normally filed next year), or the return for the prior year (2018).
- If you were in an area affected by a federally declared disaster area, you may want to settle an insurance or damage claim in 2019 in order to maximize your casualty loss deduction this year.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Sincerely,

Hunter, Hunter & Hunt, LLP