

## GMS SURGENT 2018 YEAR-END TAX SAVING TIPS

Previously we wrote to you regarding the “Tax Cuts and Jobs Act” (TCJA) that was signed into law at the end of 2017. The TCJA has broad implications for both individual and business taxpayers. As the year-end quickly approaches, it is time to revisit year-end tax planning ideas and suggestions.

### INDIVIDUAL TAX

The TCJA changed the individual income tax rates. Overall, the rates are lower for most taxpayers. While the lowest rate remains at 10%, the highest rate has been decreased to 37%.

**Planning Point:** If your income is projected to be higher in 2019 vs. 2018, consider accelerating income into 2018 to take advantage of lower marginal tax brackets. Similarly, if your income is projected to be lower in 2019, consider deferring income into 2019 to take advantage of lower marginal tax brackets.

The standard deduction is increased to \$24,000 for married taxpayers filing jointly, and \$12,000 for married filing separately or single filers. This means that more taxpayers will take the standard deduction each year.

**Planning Point:** Depending on your situation, it might make sense to “bunch” certain types of deductions (such as charitable contributions, and real estate/income tax payments up to the \$10,000 limit below) into one year to increase your itemized deductions above the standard deduction amount.

Personal exemptions are eliminated. The increased standard deduction, mentioned above, may offset this for many taxpayers. Note that though personal exemptions are eliminated, dependency is still important for purposes of determining filing status and claiming child tax credits.

Certain itemized deductions are limited or eliminated altogether.

- Real estate and state and local income tax deductions are capped at \$10,000 combined. This means that once a taxpayer is over the threshold for a given year, there is no rush to make further payments, and any remaining payments may be deferred into the subsequent year if possible. Note that for a business/rental property, real estate and certain other taxes are still deductible as business expenses against the income of the business/rental.

**Planning Point:** Consider bunching tax payments in a year when your total tax deduction would otherwise be less than \$10,000.

- Mortgage interest is deductible on up to two homes on total qualifying debt up to \$750,000. Existing mortgages incurred on or before December 14, 2017 are “grandfathered” under the old tax laws. Mortgage debt that is refinanced is also grandfathered under the old laws to the extent that the resulting debt does not exceed the amount refinanced. Interest expense incurred on home equity debt is now disallowed; however, if the home equity loan is used to buy, build, or substantially improve the taxpayer’s home that secures the debt, the interest on the debt is still deductible.

- Miscellaneous itemized deductions, such as unreimbursed business expenses, tax return preparation fees, investment advisor fees, etc. are eliminated.

**Planning Point:** To contend with the loss of the deduction for investment advisor fees, reassess whether it is better to pay IRA fees from the IRA vs. from amounts outside the IRA.

**Planning Point:** Employees that incur job-related expenses should consider requesting that their employer reimburse them.

- The medical expense deduction is allowed to the extent of 7.5% of AGI in 2017 and 2018, then to the extent of 10% of AGI for years thereafter.

**Planning Point:** Consider bunching medical deductions in a year to potentially result in a tax benefit.

- Charitable contributions remain deductible; the threshold based on adjusted gross income is increased to 60% from 50% (for cash contributions made to public charities.)

**Planning Point:** Consider bunching charitable contributions, perhaps via a contribution to a donor-advised fund, in one year if doing so will increase your total deductions above the standard deduction amount for that year.

**Planning Point:** Consider making a donation of highly appreciated securities to receive the tax deduction at the fair market value and avoid the tax on the capital gains.

**Planning Point:** Consider making a contribution through a state-sponsored tax credit program such as Pennsylvania's EITC/OSTC programs.

**Planning Point:** Consider making a qualified charitable distribution from an IRA. If over age 70 ½, individuals can instruct that up to \$100,000 from an IRA be sent directly to a charity. This counts toward the RMD requirement and it also excludes the RMD as income. This strategy reduces taxable income while still allowing the same standard deduction.

**Planning Point:** Remember to get contemporaneous acknowledgement letters from the charitable organization for all charitable contributions.

- The phase-out on itemized deductions is eliminated. Previously, when adjusted gross income exceeded a threshold, total itemized deductions began to phase out.
- The ability to deduct business losses against other income is limited to \$500,000 for a married taxpayer filing jointly. An overall business loss is the net amount of loss from partnerships, S corporations, and sole proprietorships. Any overall business loss that exceeds \$500,000 for a married taxpayer filing jointly cannot offset other income sources and must be carried forward to each subsequent year where it will be considered part of the overall business loss in that year.
- The deduction for alimony payments made is eliminated for divorces entered into after December 31, 2018. Alimony received is no longer taxable for divorces entered into after this date as well.
- The child tax credit is increased to \$2,000, of which \$1,400 is refundable. There is also a \$500 nonrefundable credit for qualifying dependents other than children. The adjusted gross income level at which these credits are subject to phase-out increases to \$400,000 for married taxpayers filing jointly.

- Balances in Section 529 plans have historically been available to be used for post-secondary education expenses. The benefits of Section 529 plans have been enhanced to allow up to \$10,000 (per student, per year) to be used for K-12 education. Many states also allow a tax deduction against the state taxable income for contributions to a Section 529 plan.
- The alternative minimum tax (AMT) is retained with higher exemption amounts. In addition, the exemption phase-out range increases significantly. This, together with the significant reduction in the amount of deductible real estate and state and local income taxes and miscellaneous itemized deductions will reduce the number of taxpayers subject to the AMT.

**Planning Point:** Under the TCJA, as under the old law, it is often advantageous to recognize additional ordinary income in a year when AMT applies because the AMT rate is often less than the taxpayer's marginal tax rate.

### BUSINESS TAX

- A deduction of 20% of the net income from certain pass-through businesses and sole proprietorships is created, subject to significant limitations. *Click here for a link to our prior alert on the mechanics of the deduction.* New regulations issued in August provide generally favorable definitions on the types of income qualifying for the deduction, and provide the opportunity to aggregate certain businesses to maximize the deduction. The regulations also clarify that certain rental real estate businesses qualify for the deduction as well. The ability to utilize this deduction is complex in nature, and is impacted by many intertwining variables, such as the type of income, level of wages and qualified business income, taxable income, cost basis in property, etc.

**Planning Point:** At the entity level, review compensation structure prior to year-end, and revisit partnership agreement allocations.

**Planning Point:** At the entity or individual level, consider increasing retirement plan funding levels and other tax strategies for certain business types to fall below income limits.

**Planning Point:** At the individual level, consider whether aggregation elections are available or beneficial; and if not available, whether factors can be changed to allow for aggregation.

- The deduction for entertainment expenses is eliminated. In addition, the deduction for certain meals provided to employees is reduced to 50% until 2025, and then eliminated after 2025. *Click here for a link to our prior alert on the changes to the deduction for meals and entertainment.*

**Planning Point:** Consider creating separate general ledger accounts to separate the 0%, 50%, and 100% deductible amounts to achieve the maximum tax deduction.

- The immediate expensing (via enhanced "bonus depreciation" rules) of certain types of assets, including used property, placed into service in a trade or business is enhanced. For qualifying business property acquired and placed into service between September 28, 2017 and December 31, 2022, 100% of the cost of property is deductible. For years beginning after December 31, 2022, the amount of the deduction is decreased.

- The Section 179 expensing election is now available for nonresidential building improvements such as roofs, HVAC equipment, fire protection and alarm systems, and security systems; and is now available for tangible personal property used to furnish lodging, such as residential rental property or a hotel. The Section 179 election is modified to increase the maximum value that may be deducted up to \$1,000,000, with a phase-out that begins at \$2,500,000 of property placed into service.

**Planning Point:** Consider a cost segregation study to split out the cost of the purchase of a building, for example, into assets with shorter depreciable lives.

**Planning Point:** Consider accelerating income into a year in which there are significant depreciation deductions available. *Click here for a link to our prior alert on changes to depreciation.*

- The maximum allowable deduction of interest expense for certain businesses cannot exceed 30% of the business' EBITDA (earnings before interest, taxes, depreciation, and amortization). Many businesses with average annual gross receipts of less than \$25 million are not subject to this limitation. However, an entity that is defined as a "tax shelter" (i.e. more than 35% of losses are allocated to limited partners) is subject to the limitation even if gross receipts do not meet the \$25 million threshold.

**Planning Point:** This 30% limitation can be avoided by an election available to "real property trades or businesses" that by definition are engaged in: leasing, construction, development, acquisition, operation, management, or brokerage of real property. Such an election would necessitate the use of a less favorable depreciation method (i.e. no bonus depreciation and longer depreciable lives).

- The threshold under the three-year average annual gross receipts test to determine whether the accrual method is required for small businesses is increased to \$25 million from \$5 million.
- The C corporation rate is reduced to 21% and the C corporation AMT is repealed. This may make a C corporation appear more attractive to certain businesses but the "double taxation" of C corporation earnings still applies. In addition, state corporate income taxes may make the C corporation option remain unattractive to businesses in many states, as the C corporation tax rate may be higher than the pass-through rate.
- Starting in 2018, taxpayers may be able to receive very favorable tax treatment on the sale of currently held investments if the proceeds are reinvested in business property and/or real estate located in a "Qualified Opportunity Zone" within 180 days.

**Planning Point:** The Federal QOZ program is intended for projects with long-term hold (greater than 10 years) considerations. The program has limited impact on short holding period projects (under 5 years). *Click here for a link to our prior alert on the mechanics of the program.*

## ESTATE AND GIFT TAX

- The basic exemption for federal estate and gift tax purposes is doubled to \$11.2 million per individual, up from \$5.6 million per individual in 2017. Note that many states have a much lower threshold for filing and/or paying state death tax.
- The annual exclusion amount is \$15,000 per donor, per donee, up from \$14,000 in 2017.

- Both the Federal estate and gift tax exemptions are indexed for inflation.

## GENERAL CONSIDERATIONS

Along with the above, do not forget about the following general tax-saving ideas:

- Max out on retirement plan contributions. This strategy applies to both employees and self-employed individuals.
- If you are looking to reduce the size of your taxable estate, consider utilizing the annual exclusion for making gifts.
- Tax loss harvesting – Consider selling stocks and other investments to generate capital losses that can be utilized to offset capital gains.
- Consider disposing of a passive investment before year end in order to utilize prior suspended passive losses.
- For certain businesses and individuals, consider these other ways to defer income or accelerate deductions:
  - Use a credit card to pay tax-deductible expenses in 2018. The date an item is charged to a credit card is the date that the item is deductible for tax purposes.
  - Manage bills and receipts.
- State tax business compliance has become more complex as states are increasingly looking for additional revenues.
  - The recent *Wayfair* case rendered by the U.S. Supreme Court in June of 2018 ruled in such a way as to potentially require out-of-state sellers to collect and remit sales tax in states in which they do business, even if the out-of-state seller does not have physical presence in the state. [Click here for a link to our prior alert on this issue.](#)
  - For state income tax purposes, many states are adopting “economic presence” standards, which may require the filing of tax returns in a given state for certain businesses that “direct business activities” into the state, even if the out-of-state seller does not have any physical presence in the state.

**Planning Point:** Many states offer voluntary disclosure programs where taxpayers can voluntarily reveal themselves. In addition, some states offer amnesty programs that may provide enhanced benefits such as reduced or eliminated penalty waivers assessed on tax amounts due.

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