TAG
TAX ACCOUNTING GROUP
OF DUANE MORRIS LLP
www.TaxAccountingGroup.com

November 26, 2019

YEAR-END TAX PLANNING GUIDE FOR 2019

Top Quick-Strike Strategies to Consider for Individuals and Businesses

2019 was both an interesting and challenging year in the tax world. Earlier this year, taxpayers filed hundreds of millions of 2018 returns, reflecting the first tax reporting year under the Tax Cuts and Jobs Act (TCJA) of 2017, the most sweeping tax legislation in more than 30 years. While tax compliance may have been simplified for many wage earners, it turned out executives, investors and entrepreneurs experienced greater complexities, thicker tax returns, new computations and new decisions, and more interactions with their tax lawyer or CPA.

Unprepared taxpayers were caught off guard for tax year 2018 due to increased complexity, additional tax reporting, increased limitations on deductions, new rules and last minute IRS interpretations of new provisions, whether or not favorable, inadequate income tax withholding, as well as missed opportunities. Prepared taxpayers, many of whom are our clients, were able to take advantage of new deductions, new provisions and new planning developments and strategies in both their personal and business tax and financial matters to “win” under tax reform. More on this in our “Introduction” section.

While the tax code is certainly complex in many respects and IRS and Treasury guidance and interpretation continues to evolve, there is still time to position yourself to take advantage of the opportunities presented by tax reform, including identification and execution of valuable strategies, before year-end to reduce your 2019 tax liability. Our annual Tax Planning Guide highlights select tax provisions and potential planning opportunities to consider and quickly execute for 2019, and in some cases, 2020 and beyond, based on current law and guidance.

With the split of the two houses of Congress and legislative priorities focused elsewhere, bipartisan agreement on future tax cuts at this time seems unlikely. While we entered the year expecting Congress to address the expired tax “extenders” and technical corrections to the TCJA, the political climate in Washington has prevented progress. The annual tax extenders, now largely expired since December 31, 2017, include such previous tax breaks as the exclusion of mortgage loan forgiveness from income, the mortgage insurance premium deduction and the residential energy property credit, among about 30 others. With each passing quarter, extension of these tax breaks becomes more unlikely, as the uncertainty of the extenders’ future hampers the ability of the extenders to influence behavior, and retroactive application seems more arbitrary.

Ironically, in May 2019, the House passed the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which featured bipartisan support and includes measures to enhance retirement savings by increasing access to tax advantaged accounts and preventing older U.S. citizens from outliving their assets during prolonged retirements and longer lifespans. For example, the SECURE Act would push the age that triggers required minimum distributions (RMDs) from 401(k) plans and traditional IRAs from 70½ to 72, which means you could let your retirement funds grow for an extra 1½ years before drawing from them. This could result in a significant boost to overall retirement savings for many seniors. However, buried in the SECURE Act is the elimination of the current rules that allow nonspouse IRA beneficiaries to "stretch" RMDs from an inherited account over his or her own lifetime and, therefore, allow the funds to continue to grow tax-free. Under the act, all monies from inherited IRAs (as well as inherited 401(k) accounts and defined contribution plans) generally would have to be distributed to nonspouse beneficiaries within 10 years of the IRA owner's death.

Interestingly, the Senate has showed little interest in taking up the bill before the end of the year as the GOP-led chamber looks to remain focused on judicial appointments for the balance of the year. One

potential avenue to passage, which would not require any floor time, would be through a unanimous consent procedure, where if a bill enjoys the support of all senators, it can be passed without a floor debate. However, at this point, it appears that three senators – Cruz, Lee and Toomey – have concerns with the bill as written and are holding up passage.

Additionally, in June, the president signed into law the Taxpayer First Act, representing the only significant tax legislation of 2019 thus far, albeit of no benefit to taxpayers' pocketbooks. This law focused on IRS and tax administration reforms and enjoyed bipartisan support in aiming to update IRS technology, address cybersecurity and make various improvements to customer service (which has been long overdue).

Although the Treasury and the IRS continue to issue regulatory guidance addressing questions remaining about the TCJA, we anticipate limited legislative changes on the horizon, especially as the congressional calendar provides limited opportunities for new tax legislation. Furthermore, with the focus shifting to political disputes and the 2020 election, we expect more gridlock than tax code progress.

As a result and with no scheduled changes in income tax rates for 2020, many of the tried-and-true tax planning strategies, in particular deferring income and accelerating deductions, with some exceptions, will continue to be an effective method of minimizing your tax obligations. As has been one of our longstanding philosophies, especially in light of the record-setting and volatile nature of the stock market, we recommend the prudent approach of year-round planning based on current law and revising those plans as the need arises. So, please check in with us and keep a watchful eye on our *Alerts*, which are published throughout the year and offer insights on tax developments and changes that may directly affect you, your family and your business.

In this **2019 Year-End Tax Planning Guide** prepared by the Tax Accounting Group (TAG) of Duane Morris, we walk you through some of the quick-strike planning opportunities available to improve your personal and business federal income tax situation and identify actions needed before year-end and beyond to reduce your 2019 and future income tax liabilities.

This focus on personal and business federal income tax has been intentional. For anyone interested in state, local or sales tax planning, please feel free to connect with us. Our national state and local tax practitioners continue to monitor states' reactions to the TCJA and the Supreme Court's decision in *Wayfair v. South Dakota* along with the far-reaching expansion of sales tax and economic nexus rules. All of these developments could affect your tax reporting and obligations to other states and for other taxes.

From nonprofits, whether public charities or private foundations, to estates and trusts as well as international taxpayers, IRS and Treasury guidance and interpretation continue to evolve and bring clarity to changes enacted by the TCJA and tax planning strategies resulting therefrom. Our colleagues practicing in each of these disciplines would enjoy working with you, so please feel free to connect with us as your needs arise.

We hope you find this complimentary guide valuable and invite you to consult with us regarding any of the topics covered or your own unique situation. We will be pleased to help you sort through the options and determine the strategies that are most effective for you, your family and your business. For additional information, please contact me at 215.979.1635 or magillen@duanemorris.com, or my colleagues John I. Frederick at 215.979.1649 or jifrederick@duanemorris.com, Steven M. Packer at 215.979.1697 or smpacker@duanemorris.com, or the practitioner with whom you are in regular contact.

We wish you and your families a joyous holiday season and a healthy and prosperous new year.

Michael A. Gillen
Tax Accounting Group

About Duane Morris LLP

Duane Morris LLP, a law firm with more than 800 attorneys in offices across the United States and internationally, is asked by a broad array of clients to provide innovative solutions to today's legal and business challenges. Evolving from a partnership of prominent lawyers in Philadelphia more than a century ago, Duane Morris' modern organization stretches from the U.S. to Europe and the Middle East, and now across Asia. Throughout this global expansion, Duane Morris has remained committed to preserving its collegial, collaborative culture that has attracted many talented attorneys. The firm's leadership, and outside observers like the Harvard Business School, believe this culture is truly unique among large law firms and helps account for the firm continuing to prosper throughout changing economic and industry conditions.

In addition to legal services, Duane Morris is a pioneer in establishing in-depth, nonlegal services to complement and enhance the representation of our clients. The firm has independent affiliates employing approximately 100 professionals engaged in other disciplines, such as the tax, accounting and litigation consulting services offered by the Tax Accounting Group.

About the Tax Accounting Group (TAG)

TAG maintains one of the largest tax, accounting and litigation consulting groups within any law firm in the United States and has an active and diverse practice with over 60 services lines in more than 45 industries from A to Z.

TAG's certified public accountants, lawyers, certified fraud examiners, financial consultants and advisers provide a broad range of proactive and cost-effective tax compliance, planning, consulting and representation services as well as accounting, financial and management advisory services to individuals, businesses, estates, trusts and nonprofit organizations. TAG also provides an array of litigation consulting services to lawyers and law firms representing clients in regulatory and transactional matters and throughout various stages of litigation.

To learn more about our service lines and industries served, please refer to our **Quick Reference Service Guide**.

Why TAG of Duane Morris?

At TAG, our goal is to provide highly personalized and uninterrupted service to maximize our ability to assist our clients in meeting their total tax, financial, accounting and, if necessary, litigation needs.

Our service mission is to enthusiastically provide effective solutions that exceed client expectations. What allows us to fulfill our mission and maintain long-term client relationships is the passion, objectivity and deep experience of our talented professionals. Our senior staff has an average of nearly 25 years working together as a team within our group (with a few having almost 35 years on our platform). Our team believes that extra effort, extra care and extra attention achieve the best results.

As the entrusted adviser to our clients in nearly every state in our nation and 25 countries, TAG continues to enjoy impressive growth year after year, in large part because of our clients' continued expressions of confidence and referrals. We sincerely appreciate the trust and confidence that our clients have bestowed upon us. We are both humbled and invigorated when our clients, both existing and new, tell us that our standards of personalized attention and sense of urgency are refreshing. We are not surprised to often hear from our clients that, while our firm is big enough to serve their various needs, we take a remarkable personal interest in them and are intimately familiar with their activities. The number of referrals we

receive from our clients, their families, friends and colleagues is simply incredible. To our clients, we sincerely appreciate your trust and confidence in us, as well as the continued referrals. As always, we strive to work very hard to sustain your trust in us and our firm.

When it comes to serving our clients, we combine the advantages of a boutique national CPA practice with the bench strength, convenience, resources and efficiency of accessing the resources of an international law firm of more than 800 lawyers.

So, while you can depend on us for proactive services as well as for critical advocacy and prompt action in connection with your short- and long-term personal and business objectives, we are also available for any immediate or last-minute needs you may have or Congress may create. Additionally, our one-of-a-kind platform allows us to deliver the flexibility, customization and specialization that assures our clients have the resources required to meet each of their unique needs, all with the convenience of working with a single-source provider.

Selecting an advisor is one of the most important decisions you will make. To meet your unique and specific needs, we invite you to evaluate our truly distinctive approach to personal attention and service, unmatched sense of urgency, deep and broad proficiency and innovative ideas.

TAG
Tax Accounting Group of Duane Morris LLP

Introduction

Every year poses tax planning opportunities and challenges to achieve tax savings. With tax year 2019 rapidly coming to an end, it is time once again to consider and, where appropriate, implement year-end tax planning strategies available to you, your family and your business.

For both individuals and businesses, many of the tried-and-true tax planning strategies, such as deferring taxable income and accelerating deductions, remain in play for 2019 and 2020.

For individuals, with the increase in the standard deduction, many more taxpayers are considering "bunching" their deductions to maximize itemized deductions in one year, while claiming the higher standard deduction in the following year. To accomplish this, while maintaining consistent funding to charitable programs, many clients are turning to donor-advised funds (DAFs), as we discuss in greater depth below. Additionally, a focus this past year and presently has been on the explosion of qualified opportunity funds (QOFs). While an investment obviously must, above all, be financially sound, QOFs, created with the passage of the TCJA, have many gain deferral and exclusion features that make them very attractive from a tax perspective.

For many, an expanded safe harbor for the new 20 percent qualified business income (QBI) deduction for pass-through entities and single owner businesses creates, if certain qualifications are met, ongoing tax saving opportunities. Finally, an expanded alternative minimum tax credit exemption and increases in child tax credits continue.

For businesses, the headlines of the past two years include the lowering of the corporate tax rate from 35 percent to 21 percent and the corresponding QBI deduction for pass-through income. In 2018 and 2019, businesses large and small evaluated their entity selection, with several large partnerships deciding that the benefits of a C corporation, including the ease of raising capital was ultimately worth a second tier of tax at the new lower rate. Also in the business arena, the thresholds for accelerated and bonus depreciation remain high for 2019 and 2020, allowing more businesses to immediately deduct a greater percentage of their capital expenditures. Finally, the move to a territorial tax system (as opposed to the previous tax system based on worldwide income) will continue to reverberate through businesses with international operations.

The impact of certain tax provisions that became effective in 2019 should be considered now in order to ensure that you take advantage of any tax savings opportunities available.

This guide focuses on tax planning strategies for corporate executives, businesses and individuals. We hope that this guide will help you leverage the tax benefits available to you or reinforce the tax savings strategies you may already have in place.

For your convenience, we begin this year's edition with a quick reference guide of action steps that can help you reach your tax-minimization goals, as long as you act before the clock strikes midnight on December 31, 2019. Not all of the action steps will apply in your particular situation, but you may benefit from many of them. Taxpayers should consult with us to develop and tailor a customized plan, and to focus on the specific actions that should be taken. We will be pleased to help you analyze the options and decide on the strategies that are most effective for you, your family, and your business.

TABLE OF CONTENTS

Year-End Tax Planning Quick Reference Action Steps	**Page 7**
Words of Caution	**Page 8**
Tax Planning Strategies for Individuals	**Page 10**
Find Ways to Defer Income	**Page 10**
Tax-Efficient Investment Planning	**Page 12**
Reevaluate Your Deduction Strategy	**Page 19**
Planning for Retirement	**Page 25**
Tax Payments, Tax Liabilities and Credits	**Page 28**
A Note on Estate Planning	**Page 29**
Tax Planning Strategies for Businesses	**Page 30**
Maximize your Qualified Business Income Deduction	**Page 30**
Acquiring Assets to Reduce Tax Liability	**Page 32**
Maximize Your Deductions	**Page 34**
Involve Your Children in the Family Business	**Page 34**
Establish a Tax-Efficient Business Structure	**Page 35**
TAG's Perspective	**Page 36**

Year-End Tax Planning Quick Reference Action Steps

For your convenience, below is a quick and easy reference guide of action steps that can help you reach your tax-minimization goals, as long as you act before midnight on December 31, 2019. All of the action steps listed below are featured in greater depth later in this guide. Of course, not all of the action steps will apply in your particular situation, but you may benefit from many of them. Consultation with us to develop and tailor a customized plan and focus on the specific actions that should be taken is paramount.

10 Income and Loss Quick-Strike Strategies

1. Defer income to 2020 and accelerate deductions into 2019.
2. Coordinate timing of your capital gains and losses to minimize tax on your gains and maximize the tax benefit from your losses.
3. Increase your tax basis in pass-through entities so that you can deduct current year losses.
4. Convert a traditional IRA to a Roth IRA.
5. Defer bonuses until 2020, if your employer will allow it.
6. Spread out recognition of gain from the sale of property through the use of an installment sale.
7. Consider disposing of a passive activity to allow you to deduct suspended losses.
8. Make charitable gifts directly from your IRA, if you are age 70½ or older.
9. Track purchases and sales of cryptocurrency to comply with updated and clarified rules and provide audit defense.
10. Invest in Qualified Opportunity Funds before the year-end to maximize gain exclusions.

10 Deduction Quick-Strike Strategies

1. Prepay as many medical expenses in 2019 as possible if your unreimbursed medical expenses are close to exceeding 10 percent of adjusted gross income (AGI) for 2019.
2. Defer payment of state and local taxes (income, sales and property) where possible if these payments already exceed $10,000 in 2019.
3. Ensure that you are maximizing your retirement savings contributions in 2019 to reduce income in the current year and to achieve tax-deferred growth.
4. Consider making 529 plan contributions for the education expenses of children and grandchildren prior to year-end to maximize potential state tax deductions.
5. Consider using a credit card to prepay expenses that can generate deductions for this year while holding onto the cash until the bill is due next year.
6. Purchase qualified plug-in electric vehicles before year-end, if you are in the market for such a vehicle.
7. Apply a bunching strategy to itemized deductions such as medical expenses, charitable contributions and mortgage interest.
8. Consider purchasing qualified business property to take advantage of the $1,020,000 business property expensing option or to increase your QBI deduction.
9. Contribute to a donor advised fund to maintain separate control of charitable contributions and deduction timing.
10. Donate appreciated stock in lieu of selling the stock, recognizing the gain and contributing the proceeds.

Words of Caution

While reviewing this guide, please keep the following in mind:

Manage Your Tax Bracket

Whether you should accelerate taxable income or defer deductions between 2019 and 2020 largely depends on your projected highest (aka marginal) tax rate for each year. While the highest official marginal tax rate for 2019 is again 37 percent, even if your income is similar when compared to 2018, you might pay more tax due to differences in deductions, credits or sources of income.

The chart below summarizes the 2019 tax rates together with corresponding taxable income levels. Effective management of your tax bracket can provide meaningful tax savings, as often a change of $1 in taxable income can catapult you into the next higher or lower bracket. These differences can be further exacerbated by other income thresholds throughout the code, which are discussed in this guide, such as those for determining eligibility for the child tax credit and qualified business income deductions, among others. Income deferral and acceleration, while being mindful of bracket thresholds, can be accomplished through numerous income strategies discussed in this guide, such as retirement distribution planning, bonus acceleration or deferral and harvesting of capital gains and losses.

2019 Federal Income Tax Rate Schedule

Tax Rate	Single	Head of Household	Joint/Surviving Spouse	Married Filing Separate	Estates and Trusts
10%	$0 - $9,700	$0 - $13,850	$0 - $19,400	$0 - $9,700	$0 - $2,600
12%	$9,701 - $39,475	$13,851 - $52,850	$19,401 - $78,950	$9,701 - $39,475	N/A
22%	$39,476 - $84,200	$52,851 - $84,200	$78,951 - $168,400	$39,476 - $84,200	N/A
24%	$84,201 - $160,725	$84,201 - $160,700	$168,401 - $321,450	$84,201 - $160,725	$2,601 - $9,300
32%	$160,726 - $204,100	$160,701 - $204,100	$321,451 - $408,200	$160,726 - $204,100	N/A
35%	$204,101 - $510,300	$204,101 - $510,300	$408,201 - $612,350	$204,101 - $306,175	$9,301 - $12,750
37%	Over $510,300	Over $510,300	Over $612,350	Over $306,175	Over $12,750

The Tax Tail Should not Wag the Financial Dog

This guide is intended to help you achieve your personal and business financial objectives in a "tax efficient" manner. It is important to note that proposed transactions should make economic sense in addition to saving on taxes. Therefore, you should review your entire financial position prior to implementing changes. Various nontax factors can influence your year-end planning, including a change in employment, your spouse reentering the work force, the adoption or birth of a child, a death in the family or a change in your marital status. Never let the tax tail wag the dog, so to speak. Always assess economic viability. It is best to look at your tax situation for at least two years at a time with the objective of reducing your tax liability for both years combined, not just for 2019 in isolation. In particular, multiple years should be considered when implementing "bunching" strategies, as discussed on page 21.

Reverse, Reverse

While the traditional strategies of deferring taxable income and accelerating deductible expenses are the focus of this guide, with exceptions, you can often achieve overall tax efficiency by reversing this technique. For example, you should consider deferring deductions and accelerating income if you expect to be in a higher tax bracket next year, you have charitable contribution carryovers to absorb, your marital status will change next year, or your head of household or surviving spouse filing status ends this year. This analysis can be complex, and you should consult with us before implementation.

Time Value of Money

Any decision to save taxes by accelerating income must consider the possibility that this means paying taxes on the accelerated income earlier, which would require you to forego the use of money that could have been otherwise invested. Accordingly, the time value of money can make a bad decision worse or, hopefully, a good decision better.

Be Flexible and Nimble

While there are always uncertainties in the stock market, economy and tax environments, we recommend the prudent approach of planning now and revising those plans as the need arises.

Urgency Is Good

We recommend that you examine your tax situation now and consult with us.

With these words of caution in mind, following are observations and specific strategies that can be employed in the waning days of 2019 regarding income and deductions for the year, where the tried-and-true principles of deferring taxable income and accelerating deductible expenses will result in maximum tax savings.

Tax Planning Strategies for Individuals

Find Ways to Defer Income

If you expect to be in the same or lower tax bracket in 2020, it may be beneficial to employ the proven technique of deferring taxable income until next year. For example, if you own a business and use the cash method of accounting, you can wait until the end of the year to issue invoices to ensure you won't receive payments until 2020. If you are still working and do not own 5 percent or more of the business employing you, you can postpone required minimum distributions (RMDs) from your employer's qualified plan (*e.g.*, 401(k)) until you retire. This "still working exception" does not apply to RMDs from IRAs or plans of employers where you no longer work. Another deferral strategy includes contributing up to $19,000 to a 401(k), 403(b) and most governmental plans in 2019 ($25,000 if you are age 50 or older). There are also increased contribution limits for IRAs, SEPs and defined benefit pension plans, subject to certain phaseout rules. See the chart later in this guide and contact us for details. To the extent possible, employees may also consider deferring bonuses normally paid at the end of the year until the beginning of 2020. You can also postpone taxable income by accelerating some deductible expenses into 2019. This may be helpful if you're affected by unfavorable phaseout rules that reduce or eliminate various tax breaks (higher education tax credits, for example).

Consider Installment Sale Treatment for Sales of Gain Property

Income may also be deferred through an installment sale. When property is sold, a gain is generally included in income when the asset is sold at a profit. The installment method is required in cases where there is a sale of property and the seller receives at least one payment after the year in which the sale occurs. Under the installment method, the gain is recognized ratably over multiple years to the extent payments are made on the installment note, subject to a gross profit computation. This method allows gains to be recognized only to the extent of payments actually received and is a valuable method to defer income. Utilizing the installment sale method may also yield reductions in net investment income, which may reduce or eliminate the 3.8 percent tax on net investment income.

OBSERVATION
An election is available to "elect out" of installment sale treatment. In addition, not all states recognize this type of gain treatment, so the state tax effects also need to be considered.

Participate in Health and Dependent Care Flexible Spending Accounts

Flexible Spending Accounts, also known as FSAs or IRC Section 125 Accounts, enable employees to set aside funds on a pretax basis for (1) medical expenses that are not covered by insurance, (2) dependent care costs up to $5,000 (married filing jointly, head of household and single) and $2,500 (married filing separately) per year and (3) adoption assistance of up to $14,080 per year. Funds contributed by employees are free of federal income tax (at a maximum rate of 37 percent), Social Security and Medicare taxes (at 7.65 percent) and most state income taxes (at maximum rates as high as 13.3 percent), resulting in potential tax savings of up to 57.95 percent. Paying for these expenses with after tax dollars, even if taxpayers meet various AGI requirements to claim an itemized medical deduction or dependent care credit, is more costly under the current tax rate structure. Since many restrictions apply, such as the "use it or lose it" rule, review this arrangement before making the election to participate.

›› ILLUSTRATION

Taxpayer participation in FSAs often boast significant tax savings. Let us assume a family contributes $5,000 for uncovered medical costs and $5,000 for qualified daycare expenses. Assuming a 37 percent tax rate, the family creates a tax savings of about $4,465 ($3,700 in federal income taxes and $765 in Social Security/Medicare taxes, not including any potential reductions in state income taxes).

> **Planning Tip**
> *Section 125 plans, also known as cafeteria plans, often adopt a 2.5-month grace period during which employees who participate in the Section 125 plan can incur expenses that can be treated as 2019 qualified expenses. Thus, for distributions of 2019 contributions, employees can incur expenses until March 15, 2020. Accordingly, this can potentially reduce employee contributions that would otherwise be subject to forfeiture.*

> **Planning Tip**
> *Married couples who both have access to flexible spending accounts (FSAs) will need to decide whose FSA to use. Assuming one spouse's salary is likely to be higher than the FICA wage limit ($132,900 for 2019) and the other spouse's salary will be less, the one with the smaller salary should fund as much of the couple's FSA needs as possible. This is because FSA contributions by the spouse whose income is higher than the FICA wage limit will not reduce the 6.2 percent Social Security tax portion of the FICA tax, but FSA contributions by the lower-earning spouse will reduce it. This planning tip also applies to HSAs mentioned below.*
>
> *For example, if Shawn's salary is $460,000 and Heather's salary is $50,000, FSA contributions of $10,000 by Shawn will not reduce his Social Security tax (since, even reflecting the FSA contributions, his Social Security wages exceed $132,900). However, FSA contributions of $10,000 by Heather will save her approximately $600 in Social Security tax.*

Using an HSA to Deduct Medical Expenses

For 2019, unreimbursed medical expenses are deductible as an itemized deduction only if they exceed 10 percent of a taxpayer's adjusted gross income. In some cases, since the standard deduction may now exceed a taxpayer's itemized deduction, taxpayers may be missing out on deductions they may have benefited from in the past, such as a large medical bill (often the only silver lining to that situation). One tactic to combat the increased difficulty of deducting medical expenses is to set up a health savings account, better known as an HSA. Taxpayers can deduct contributions to an HSA, and then use the HSA funds to cover medical expenses. It is important to note that HSA funds are not forfeitable, like an FSA discussed above.

In order to qualify for an HSA, the taxpayer must have a health insurance policy known as a high deductible health plan (HDHP), which generally have lower premiums but higher deductibles, increasing annual out of pocket costs for taxpayers. The HSA was developed to allow taxpayers to be able to pay these increased out of pocket costs with pre-tax funds. In recent years, employers and insurers have been marketing HDHPs as "consumer driven health plans" or CDHPs. These plans are usually similar to HDHPs in terms of their premiums and deductibles, often making them eligible coverage for taxpayers to qualify for an HSA.

> **OBSERVATION**
> HSA contributions count as a deduction against gross income up to a maximum amount, which is adjusted yearly. For 2020, the HSA contribution deduction limit is $3,550 for individuals with self-only coverage, and $7,100 for those with family coverage. This is a slight increase from 2019's figures of $3,500 and $7,000, respectively.

Tax-Efficient Investment Planning

Income from an investment held for more than one year is generally taxed at preferential capital gains rates. Those rates are zero percent, 15 percent and 20 percent for most investments. (Higher-income individuals may be subject to an additional 3.8 percent net investment income tax.) The rate that applies is determined by your taxable income. For example, the zero percent rate applies if your 2019 taxable income doesn't exceed $78,750 for joint filers, $52,750 for heads of household or $39,375 for single filers. The 20 percent rate kicks in when taxable income exceeds $488,850 for joint filers, $461,700 for heads of household or $434,550 for single filers.

If your taxable income hovers around these threshold amounts, there are ways to reduce your income to take advantage of a lower capital gains rate. For example, you could make deductible IRA contributions or reduce taxable wages by deferring bonuses or contributing to employer retirement plans. With proper planning, you may be able to qualify for the zero percent rate.

Reduce Recognized Gain or Increase Recognized Loss Through Specific Identification of Shares

When selling stock or mutual fund shares, the general rule is that the shares acquired first are the ones deemed sold first. However, you can elect to specifically identify the shares to sell if you are not divesting your entire holding of a stock or mutual fund. By notifying your broker of the shares you want sold, the gain or loss from the sale is based solely on the identified shares. This sales strategy gives you better control over the amount of your gain or loss, and whether it is long-term or short-term. Once the specific identification method is chosen, however, you may not use a different method (*e.g.*, average cost method or first in, first out method) for the particular security you have specifically identified or throughout the life of the fund, unless you obtain permission from the IRS.

> **Planning Tip**
> *In order to use the specific identification method, you must ask the broker or fund manager to sell the shares you identify and maintain records that include both dated copies of letters ordering your fund or broker to sell specific shares as well as written confirmations that your orders were carried out.*

Gifting to Lower Tax Rate Individuals

Gifting stock to relatives with lower tax rates is a tax reduction strategy worth considering. Taxpayers should be on the lookout for opportunities to take advantage of the zero percent tax rate on investment income. For example, taxpayers electing single status may be taxed at a zero percent income tax rate on long-term capital gains and qualified dividends if their taxable income is $39,275 or less. Similar rules apply to heads of household and married couples filing jointly, when their taxable incomes are less than $52,750 and $78,750, respectively.

While many taxpayers exceed these thresholds, some family members, particularly children and other dependents, may qualify. High-net-worth taxpayers should considering gifting appreciated stock to not only shift the tax burden to those with lower tax rates, but also to allow the relative to be taxed at the zero percent rate. As the recipient's holding period is carried over from the donor, gains will be categorized as long-term providing that the donor's holding period plus the recipient's holding period exceeds one year.

OBSERVATION

Keep in mind when gifting securities to anyone under the age of 24 that you may have just opened the door to the world of "the kiddie tax."

The kiddie tax occurs when a child's net unearned income of $2,200 or more is taxed at trust rates, is no longer automatically taxed at the parent's marginal rate and could be taxed as high as 37 percent. Unfortunately, this could create a negative outcome where the additional income pushes the child into a higher tax rate than donor's original rate. Certain situations may apply in which the parent may report the child's unearned income on their tax return, avoiding the trust rates. In certain cases, if applicable, taking that route may be more advantageous.

Moral of the story: Gifting to individuals under the age of 24 may trigger the kiddie tax and taxation at higher rates, completely eliminating the benefit of the zero percent income tax rate. Also, one has to be mindful of potential gift tax consequence if the transfer of assets exceeds $15,000 during 2019. Please contact us for guidance in this complex area.

Take Advantage of Your Capital Losses

It always makes sense to periodically review your investment portfolio to see if there are any "losers" you should sell. This is especially true with the present market volatility and threats of recession. As year-end approaches, so does your last chance to shelter capital gains recognized during the year and take advantage of the $3,000 ($1,500 for married separate filers) limit on deductible net capital losses. However, one must be mindful not to run afoul of the wash-sale rule.

An often overlooked rule, the wash-sale rule provides that no deduction is allowed for a loss if you acquire identical, or substantially identical securities within a 61-day period beginning 30 days before the sale and ending 30 days after the sale. Instead, the disallowed loss is added to the cost basis of the new stock. However, there are ways to avoid this rule. For example, you could sell securities at a loss and use the proceeds to acquire similar, but not substantially identical, investments. If you wish to preserve an investment position and realize a tax loss, consider the following options:

- Sell the loss securities and then purchase the same securities no sooner than 31 days later. The risk inherent in this strategy is that any appreciation in the stock that occurs during the waiting period will not benefit you.
- Sell the loss securities and reinvest the proceeds in shares of a mutual fund that invests in securities similar to the one you sold or reinvest the proceeds in the stock of another company in the same industry. This approach considers an industry as a whole, rather than a particular stock. After 30 days, you may wish to repurchase the original holding. This method may reduce the risk of missing out on any anticipated appreciation during the waiting period.
- Buy more of the same security (double up), wait 31 days and then sell the original lot, thereby recognizing the loss. This strategy allows you to maintain your position but also increases your downside risk. Keep in mind that the wash sale rule typically will not apply to sales of debt securities (such as bonds) since such securities usually are not considered substantially identical due to different issue dates, rates of interest paid and other terms.

OBSERVATION
To implement one of these three strategies, action is required by November 29, 2019, in order to allow 31 days to lapse prior to year-end, thus allowing you to capitalize on the loss for 2019.

Another, less-costly method to avoiding the wash sale would be to purchase a call option on the stock you want to sell. Again, the cutoff would be November 29. Note that call options are often much less expensive than investing in a large number of shares and they carry significantly less risk.

Diligent portfolio management can provide taxpayers with numerous benefits, including the ability to reduce taxable income. "Losers" is a term affectionately used to describe stocks whose market values are less than the cost to acquire such assets. However, there is great benefit to taking advantage of losers for tax purposes: namely, the ability to reduce taxable income. Sales generating losses are first used to offset taxable gains. Then, if there are any unused losses remaining, the excess losses can be used to reduce the overall taxable income reported. The maximum reportable loss is $3,000, but any loss in excess of $3,000 can then be carried forward indefinitely until the loss is completely absorbed.

❯❯ ILLUSTRATION

Suppose a taxpayer's portfolio generated $50,000 of capital gains as of December 1, 2019, then on December 20, the taxpayer sold a separate, unrelated investment for a loss of $30,000. The net reportable capital gain would be $20,000 because the losses offset the previously generated gain.

However, if a taxpayer had a $55,000 capital gain followed by a loss of $57,000, the net reportable capital loss would be $2,000, reducing the taxpayer's total taxable income. Similarly, if a taxpayer had a $50,000 capital gain, then a loss of $60,000, the net reportable capital loss would be $3,000 because the maximum limit of $3,000 of capital loss would have been achieved. There would also be a carryover of $7,000 capital loss that would be carried forward indefinitely until it can be used.

Track Purchases and Sales of Cryptocurrency

Cryptocurrency is continuing to gain the attention and scrutiny of the IRS in 2019 and beyond. See our *Alert* on this topic. Earlier this year, the IRS sent letters to taxpayers to ensure they are accurately reporting virtual currency/crypto transactions (think Bitcoin, among others). For the first time, on the 2019 tax return, the IRS will be asking each taxpayer if he or she received, sold, sent, exchanged or otherwise acquired any interest in virtual currency in 2019.

While tracking may prove difficult and time-consuming, proper record keeping would allow taxpayers to take advantage of losses from cryptocurrency. Much like any other capital investment, sales of cryptocurrency are treated as property and will be subject to the capital gain and loss rules, unless you are a professional virtual currency trader, in which case, your gains are subject to tax as trade or business income at ordinary income rates. Any gains or losses generated will be used to offset other capital losses or gains, and could possibly reduce ordinary income. The most important takeaway is that cryptocurrency investments will be treated as any other capital investment, and taxpayers need to manage their accounts to ensure they are reporting all gains and losses to their tax preparers.

Reporting is fairly straightforward if you converted U.S. dollars to Bitcoin and then converted the virtual currency back to U.S. dollars for a profit. However, what happens if instead, you use appreciated Bitcoins to purchase a new car, desk or television? In this instance, such transactions are treated as if the Bitcoin had been converted back to cash in a deemed sale, and the gain would be taxed as capital gain or

ordinary income depending on the professional/nonprofessional status of the owner. The rules are complex and burdensome, without significant precedent. Thus, utilizing virtual currency as an actual currency is not without its pitfalls – taxpayers need to take care that their recordkeeping is immaculate.

Avoiding Mutual Fund Capital Gains Distributions

If you are planning to invest in a mutual fund prior to February 2020, you should contact the fund manager to determine if 2019 dividend payouts are expected. It is common for mutual funds to make capital gain distributions near the end of the year, but the fund companies often make specific dates public. If such payouts take place, you may be taxed in 2019 on part of your investment. You need to avoid such payouts, especially if they include large capital gain distributions. In addition, certain dividends from mutual funds are not "qualified" dividend income and therefore are subject to tax at the taxpayer's marginal income tax rate, rather than at the preferential 20 percent, 15 percent or even zero percent rate. One easy way to avoid these capital gain distributions is to sell the fund before the date of distribution.

In the event you have received a capital gain distribution, you can avoid increasing your tax by holding your investment in the fund. If your fund is more valuable now than it was at the time of purchase, you can avoid additional tax by holding your position and not selling. Additional capital gains would be triggered only by a sale of the investment.

›› ILLUSTRATION

If you receive a dividend of $25,000, the value of your original shares declines by approximately $25,000 – the dividend payment. Furthermore, if you are in the automatic dividend reinvestment plan, so that the $25,000 dividend purchases new shares, the value of your fund should now be about the same as your original investment. However, the $25,000 dividend payout is subject to the preferential tax rates. If it is not a "qualified" dividend, it is subject to tax of up to 37 percent. If you had invested after the dividend date, you would own about the same shares but would have paid no tax!

Plan to Maximize Losses

Planning before year-end may allow you to maximize realized losses for 2019 and ultimately minimize your tax burden in the short term. There are a number of steps you can take to ensure your losses are maximized in 2019.

Increase your basis in partnerships or S corporations to take advantage of any losses generated by the pass-through entities. Losses generated by pass-through entities are limited to an individual's investment or basis. Therefore, an owner is only permitted to take losses to the extent of their basis. Keep in mind that loans made by a third party lender to an S corporation and guaranteed by an S corporation shareholder do not increase the shareholder's basis. The loan must be made directly from the S corporation shareholder to the S corporation in order to increase his or her basis.

Determine your level of participation in activities to either avoid or qualify for passive activity loss treatment. In general, if an individual spends more than 500 hours participating in an activity during the year, the individual will be deemed to be an active member of the entity. There are other exceptions, as well.

For real estate professionals, eligible taxpayers may deduct losses and credits from rental real estate activities in which they materially participate. Because they are not treated as passive investments, any losses produced may be used to offset nonpassive income. An eligible taxpayer, for these purposes, spends more than 750 hours of services during the tax year in real property trades or businesses. Thus, in

the waning days of the year, it may be valuable to spend additional hours in these activities as necessary to meet these thresholds in order to qualify for this beneficial treatment. In addition, a taxpayer's personal use or rental to others of a vacation home during the last few days of the year may have a substantial tax impact, so mind personal activity over the holidays that may negatively affect your tax situation.

Do not overlook the advantages of selling passive activities to free up suspended losses. Typically, passive losses can only be used to offset passive income. However, passive losses can be used to offset nonpassive income in the year you dispose of or abandon your entire interest in the activity in a taxable transaction, regardless of whether the transaction results in a gain or a loss.

Invest in Municipal Bonds

Tax exempt interest is not included in adjusted gross income (AGI). Therefore, any deductions or credits which may be limited based on a taxpayer's AGI are not adversely affected by the receipt of tax-exempt interest. While maintaining a well-diversified portfolio remains important, greater weight in municipal bonds may prove advantageous from a tax-planning perspective. However, be mindful of the AMT impact on income from private activity bonds, which is still a tax preference item for AMT purposes. In general, a private activity bond is a municipal bond issued after August 7, 1986, whose proceeds are used for a private (*i.e.*, nonpublic) purpose. Accordingly, review the prospectus of the municipal bond fund to determine if it invests in private activity bonds. While the scope of the AMT has greatly diminished over the past two years, due to increased and permanent AMT exemptions as well as the reduction or elimination of certain itemized deductions that previously caused an AMT liability, anyone subject to the AMT, particularly those with incentive stock options, should avoid these funds.

Determine Worthless Stock in Your Portfolio

In the year that stock becomes worthless, your basis in the stock is generally deductible (generally as a capital loss). However, you may be required to obtain a professional appraiser's report or other evidence to prove the stock has no value, and it lost its value in the current tax year. Instead, you may wish to consider selling the stock to an unrelated person for at least $1. You have now eliminated the need for an appraiser's report and are almost guaranteed a loss deduction.

Invest in a Qualified Small Business Corporation

Investing in a qualified small business corporation (QSBC) can generate significant tax savings. Under the TCJA, C corporations, including QSBCs, received a huge tax cut – from a top rate of 35 percent to a flat 21 percent tax rate. QSBCs are domestic corporations in specific industries with assets of less than $50 million. In addition, 80 percent or more of the corporation's assets must be used in the active conduct of a qualified business. There are other requirements as well. Contact us for further information.

To reap the greatest tax benefit from an investment in a QSBC, one must hold the investment for five years or more. After this period, when the QSBC stock is sold the entire gain can be excluded from tax. If the investment is held for less than five years, it will be subject to either long or short-term capital gain treatment, depending on the length of time the investment was held.

Another perk of investing in a QSBC is the rollover provision. The rollover provision allows an investor who held QSBC stock for at least six months to sell their interest and reinvest in the stock of another QSBC within 60 days without paying tax on the gain from the original sale. This allows a taxpayer to sell their original QSBC stock, defer gain on the sale and continue to accrue the holding period until the five-year holding period requirement has been met. Once five years has elapsed from the purchase of the original

QSBC stock, the gain on the initial sale will be ultimately excluded from tax. When combined with the new 21 percent tax rate, these benefits can make operating a business as a QSBC more tax-efficient than operating it as a pass-through entity such as a sole proprietorship, partnership, LLC or S corporation.

Invest in a Qualified Opportunity Fund

Added by the TCJA, qualified opportunity funds (QOFs) are entities that invest in certain low-income communities (known as qualified opportunity zones). They provide unique planning opportunities for investors who have gains to defer. Exercise caution, however, as opportunity zone investments are not for everyone. While the tax incentives are valuable, the investments are new, complex and not without risk.

There are two major tax benefits of investing in qualified opportunity zones. The first is an election to temporarily defer and partially exclude gain from the sale of property if such gain is reinvested in a QOF. Gains may be deferred until the taxpayer sells their interest in the QOF, or December 31, 2026, whichever occurs first. Additionally, taxpayers may be eligible for exclusion of up to 15 percent of these deferred capital gains. However, the amount of the exclusion is contingent on how long the QOF is held. If the taxpayer maintains the investment for five years, the taxpayer would be eligible to exclude 10 percent of the capital gains generated by sales in the QOF. By holding the QOF investment for two additional years (seven years total), the taxpayer would be eligible to exclude an additional 5 percent (15 percent total) of the deferred capital gain.

Another advantage of a QOF investment is an election to permanently exclude from income the total gain from the appreciation of the QOF itself. In order to qualify for this permanent exclusion, the investment in the QOF must be maintained for at least 10 years. QOFs are a hot, and quite complex, topic right now, so please contact us if you are considering an investment of this type.

> **Planning Tip**
> *Please be aware that December 31, 2019, is the last day that taxpayers can invest in a QOF and be eligible for the 15 percent gain exclusion. After this date, any QOF investment will only be eligible for the 10 percent exclusion.*

Consider Stock Elections to Defer Income

Stock elections could prove a valuable tool for tax planning as a means of reducing your 2019 tax bill.

In the event you received restricted stock grants in 2019, you can make the 83(b) election that could decrease your potential gain. The 83(b) election must be made within 30 days of the grant, and you will be forced to pay income taxes currently on the spread between the market price (the value of the stock) and the grant price (the amount you paid for the stock). The benefit, however, is that you are able to defer taxation on future appreciation in the value of the restricted stock until the stock is sold. An additional benefit of the 83(b) election is that the post-election increase in the stock's value is taxed at the lower capital gain rates rather than the much higher ordinary income rates. The election does not come without risk. In the event that the market price of the stock declines by the vesting date, you will have then prepaid income tax on an unrealized gain. The rules governing restricted stock awards are technically complex and call for some careful and well-thought-out tax planning strategies.

A qualified employee of a privately held company may elect under Section 83(i) to defer the income attributable to qualified stock transferred to the employee by the employer. This election is an alternative to being taxed in the year in which the property vests under Code Section 83(a) or in the year in which it is received under Code Section 83(b). As was the case for the 83(b) election, the election must be made no

later than 30 days after the first date the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier.

If a qualified employee elects to defer income inclusion, the employee must include the income at the earliest of the following dates:

1. The first date the qualified stock becomes transferable, including transferable to the employer;
2. The date the employee first becomes an excluded employee;
3. The first date on which any stock of the employer becomes readily tradable on an established securities market;
4. The date five years after the earlier of the first date the employee's right to the stock is transferable or is not subject to a substantial risk of forfeiture; or
5. The date on which the employee revokes his or her inclusion deferral election.

Establish a Qualified Tuition Plan and Take Advantage of Expanded Features

Although the particulars of qualified tuition plans (QTPs) can vary widely, they generally allow parents and grandparents to set up college savings accounts for children and grandchildren before they reach college age. Once established, QTPs qualify for favorable federal (and often state) tax benefits, which can ease the financial burden of paying for college. QTPs may be particularly attractive to higher-income parents and grandparents because there are no income-based limits on who can contribute to these plans.

Under pre-TCJA law, the earnings on funds in a QTP could be withdrawn tax-free only if used for qualified higher education at eligible schools. Eligible schools included colleges, universities, vocational schools or other postsecondary schools eligible to participate in a student aid program of the Department of Education.

The TCJA expanded qualified higher education expenses to include tuition at elementary or secondary private or religious schools up to a $10,000 limit per tax year. As a result, this is the perfect time to set up a QTP if you have children or grandchildren attending elementary or secondary schools.

Plan for State Tax Treatment of 529 Plan Contributions

Thirty-two states (including the District of Columbia) allow a deduction for contributions to a 529 plan, while nine states do not. Three other states allow a credit against taxes paid in lieu of a deduction. As each state's law contains varying limits on deductible amounts and how the state deduction or credit is calculated, it is important to plan for these contributions before you make them. Additionally, only seven states that allow for a deduction will allow for a deduction from any state's plan. Most states require you to contribute to that state's 529 plan in order for you to be able to deduct the contributions. If you end up moving to a new state, your contribution to a 529 plan may not be deductible in your new resident state. Please contact us so we can help ensure that you retain maximum benefits for your education savings.

> **Planning Tip**
> *If you are about to write a check to university or a private high school, consider depositing the money into a 529 plan and paying the school from the 529 account. If your state allows a deduction for 529 plan contributions, the deduction and corresponding tax savings are effectively free money.*

Reevaluate Your Deduction Strategy

In most scenarios, it is advantageous to itemize your deductions if you have significant deductible expenses and these expenses, taken together, exceed your standard deduction. If itemizing is not an option, however, you can utilize the standard deduction. For the 2019 tax year, joint filers can utilize a standard deduction of $24,400. The standard deduction for heads of household is $18,350, and single taxpayers (including married taxpayers filing separately) can claim a standard deduction of $12,200. There are additional standard deduction amounts available based on age and certain health statuses.

Unfortunately, the TCJA suspended or limited many of the itemized deductions. Most notably, the deduction for state and local taxes is now limited to $10,000 ($5,000 if married filing separately).

The TCJA temporarily increased the limit on cash contributions to public charities and certain private foundations from 50 percent to 60 percent of adjusted gross income. However, with the increased standard deduction and limits on itemized deductions, it is likely that fewer taxpayers will be eligible to deduct charitable contributions for 2019 without some advanced tax planning.

As a reminder, the TCJA also eliminated most deductions subject to the 2 percent AGI limitation, such as investment expenses and unreimbursed employee business expenses, among others.

Defer Your State and Local Tax Payments into 2020

Possibly the most attention grabbing provision of the TCJA has been the limitation on the state and local tax deduction. As we saw over the past year, the deduction for state and local income or sales, and property taxes, is now only allowed up to a limit of $10,000 per joint return ($5,000 in the case of a married individual filing separately). As a result, many taxpayers have been and will continue to be severely limited in their deductions going forward.

OBSERVATION
While House Democrats are expected to introduce a bill next week changing the $10,000 limitation on state and local taxes, either by lifting the cap for three years or increasing the dollar limit of the cap, the chances of such a bill progressing through both houses and being signed by the president are slim. As state and local taxes tend to be highest in "blue" states with large constituencies of Democrats, Republicans are largely uninterested in allowing greater deductions for state and local taxes. Thus, the success of such a bill likely hinges on Democratic control of the legislative and executive branches.

Prepay your January Mortgage Payment if You Will Be Under the Mortgage Interest Limitation

As you may recall, the TCJA reduced the mortgage interest deduction to interest incurred on up to $750,000 of debt ($375,000 in the case of a married individual filing a separate return), for acquisition indebtedness incurred after December 15, 2017. However, the mortgage interest from both a taxpayer's primary and secondary residences remains deductible, up to this balance limit on new debt. Keep in mind, home equity indebtedness not used to substantially improve a qualified home is no longer deductible as of 2018. Also, debt existing prior to December 15, 2017, is still limited to the prior law amounts of $1 million (married filing jointly) and $500,000 (married filing separately).

Planning Tip
If you hold a home equity loan that was used for a purpose other than improving your home, such home equity interest will not be deductible going forward. If you are planning to refinance and your total mortgage balance will exceed $750,000, please contact us to ensure you retain maximum deductibility and do not conflict with certain rules related to refinancing mortgage indebtedness.

Consider "Bunching" Itemized Deductions

You may wish to consider paying certain itemized deductions, such as state and local taxes, mortgage interest, medical expenses, charitable gifts, etc. (subject to limits noted within this guide), in the same year as opposed to spreading the payments over two years. By bunching deductions and deferring taxable income along with using AGI reducing techniques, you increase the value of all deductions and reduce your overall tax liability.

In considering this strategy, however, keep in mind that if you pay a deductible expense in December 2019 instead of in January 2020, you reduce your 2019 tax instead of your 2020 tax, but you also forfeit the use of your money for one month. Generally, this will be to your advantage, unless you have an alternative use for the funds that will produce a rate of return in that one month that will exceed the tax savings. In other words, you must decide whether the cash used to pay the expense early should be for something more urgent or more valuable than the increased tax benefit.

Planning Tip
With interest rates expected to rise in the near future, consider refinancing your mortgage to take advantage of the current lower rates. Any points you paid on a previous refinancing that have not been fully amortized would be deductible in full in 2019 as long as the previous mortgage is paid off by the end of the year. In addition, while the interest paid on a lower rate mortgage would be less and would result in a smaller tax deduction, it would also improve your monthly cash flow. In other words, as noted above, use logical economic planning for your situation rather than viewing every transaction solely in terms of its tax effect.

High Medical Expenses? Pay Attention to Filing Status

For married couples, filing a joint return usually produces the best tax results. However, if one spouse has substantial unreimbursed medical expenses, he or she may pay less tax by choosing a "married filing separately" status (assuming deductions are itemized by both spouses on their respective returns). That's because for 2019, only unreimbursed medical expenses that exceed 10 percent of adjusted gross income are deductible, rather than 7.5 percent as in prior years. By filing separately, the spouse with high medical expenses generally lowers his or her adjusted gross income, which allows a larger deduction for medical expenses. Please note that if you live in one of the nine community property states (Louisiana, Arizona, California, Texas, Washington, Idaho, Nevada, New Mexico and Wisconsin) this strategy may not work for you as income and expenses must be split equally unless attributable to separate funds.

Bunch Medical Expenses to Maximize Deduction

In years of high medical costs, pay careful attention should be paid to bunching as many medical expenses as possible into the year. As previously stated, unreimbursed medical expenses are only allowable to be used as an itemized deduction to the extent they exceed 10 percent of your adjusted gross income. In years of high medical expenses, steps to reduce adjusted gross income (*i.e.*, retirement contributions,

qualified charitable distributions, deferring income, etc) and increase medical expenses by bunching into one year will result in the largest allowable medical deduction. If you are experiencing or expecting to experience high medical costs, please consult us immediately.

Additionally, medical expenses are no longer a preference item for AMT as the 10 percent floor is the same for both regular and AMT purposes.

OBSERVATION
As a side note, for 2019, the effectiveness of the individual mandate requiring individuals to carry health insurance or face a penalty has been diminished as the penalty has been reduced to zero. You will still have to report to the IRS whether or not you have health insurance, but there is no penalty for failure to maintain acceptable coverage.

Planning Tip
As you may recall, premiums paid on a qualified long-term care insurance policy are deductible as medical expenses. The maximum amount of the deduction is based on the taxpayer's age. For example, the deduction for such premiums paid for an individual age 40 or younger is limited to $420, while the deduction for an individual age 71 or older is limited to $5,270. These limitations are per person, not per tax return, so a married couple where both husband and wife are 71 or older would be entitled to a maximum deduction of $10,540, subject to the 10 percent of AGI floor noted above.

OBSERVATION
A divorced parent generally can deduct medical payments incurred for his or her child even though the other parent claims the dependency exemption. Also, a child may be entitled to a deduction for the medical expenses paid on behalf of a parent, even though he or she cannot claim the parent as a dependent.

Consider Deducting State and Local Sales Taxes (SALT) in Lieu of Income Taxes

Instead of deducting state and local income taxes, taxpayers are able to choose to deduct state and local sales taxes by either (1) accumulating receipts or (2) using IRS sales tax tables and adding actual sales taxes paid for major items, such as vehicles. Accordingly, to the extent possible, and to the extent your state and local income taxes will not exceed $10,000, accumulate the receipts reflecting sales taxes you have paid this year and compare the total to the state income taxes paid this year. Keep in mind that the deduction for state and local sales taxes includes the amount provided in IRS tables plus the amounts of general state and local sales taxes paid on the purchase of motor vehicles, boats and airplanes. For 2019, the state and local sales tax deduction is limited to $10,000, just as for income taxes.

OBSERVATION
This provision is attractive to taxpayers residing in states without an income tax, such as Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming; states that tax only dividends, such as New Hampshire and Tennessee; and in lower tax rate jurisdictions in order to maximize the state and local tax deduction.

TAG
Tax Accounting Group
of Duane Morris LLP

OBSERVATION
Several high property tax states, including Connecticut, New York and New Jesery, attempted to develop SALT cap workarounds to allow residents to make contributions to state and local agencies or charitable funds in exchange for state and local tax credits. Hence, a so-called workaround of the $10,000 cap. As suspected, the IRS has ended state-run charitable contribution strategies that are intended to work around the federal limit on itemized state and local tax deductions for years 2018 through 2025. See our *Alert* on this topic.

Make Charitable Contributions That Work for You

Charitable contributions remain one of the most claimed itemized deductions after passage of the TCJA. The types of property contributed to charity are generally divided into two main categories: cash and noncash. Cash contributions are straightforward – they are contributions of money made to qualified charities, which are fully deductible to the extent they do not exceed 60 percent of your AGI (increased from a limit of 50 percent prior to the TCJA).

Planning Tip

Collect substantiation for cash contributions. Charitable contributions of money must be supported by a canceled check, bank record or receipt from the donee organization showing the name of the organization, the date of the contribution and the amount of the contribution. Charitable contributions in excess of $250 must have a written acknowledgment from the organization.

Avoid deduction limits for noncash charitable contributions. Donations of noncash property remain deductible at a limit of 50 percent of AGI. In addition, the charitable deduction for airplanes, boats and vehicles may not exceed the gross proceeds from their resale. In such cases, Form 1098-C must be attached to tax returns claiming these types of noncash charitable contribution. Furthermore, donations of used clothing and household items, including furniture, electronics, linens, appliances and similar items, must be in "good" or better condition to be deductible. You should maintain a list of such contributions together with photos to establish the item's condition. To the extent they are not in "good condition," you will need to secure a written appraisal to deduct individual items valued at more than $500.

OBSERVATION
Substantiation of charitable contributions has grown in importance in the eyes of the courts and the IRS. If you are thinking of making a large noncash charitable contribution that is not in the form of publically traded stock, make sure you acquire and maintain the correct documentation needed to substantiate your deduction. The chart below is a useful guide for determining what you need to obtain and maintain in order to deduct your noncash charitable contribution.

TAG
Tax Accounting Group
of Duane Morris LLP

Noncash Contribution Substantiation Guide

Type of Donation	Amount Donated			
	Less than $250	$250 to $500	$501 to $5,000	Over $5,000
Publicly traded stock	-Receipt -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records
Nonpublicly traded stock	-Receipt -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records -Qualified appraisal -Form 8283 Section B
Artwork	-Receipt -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records	-Acknowledgment -Written Records -Qualified Appraisal -Form 8283 Section B
Vehicles, boats and airplanes	-Receipt -Written records	-1098-C or -Acknowledgment	-1098-C and -Written records	-1098-C -Written records -Qualified appraisal -Form 8283 Section B
All other noncash donations	-Receipt -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records -Qualified appraisal -Form 8283 Section B
Volunteer out-of-pocket expenses	-Receipt -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records

Consider donations of appreciated property. Noncash donations also include securities, like stocks, bonds, and mutual funds. Donations of appreciated securities to qualified charities have significant tax benefits over cash. When you donate appreciated securities, (securities that have increased in value since you purchased or received them), you are able to exclude a potential gain, while also claiming a charitable deduction equal to the fair market value of your contribution. Consider the below example of owning securities with a fair market value of $100,000 and an original purchase price of $50,000 and the differences between selling those securities and then gifting or gifting the appreciated securities directly to the charity.

The Benefits of Donating Appreciated Securities Directly

	Sell stock then contribute proceeds	Contribute the stock directly to the charity
Fair market value of stock	100,000	100,000
Tax on gain (at 20% long-term capital gains rate)	(10,000)	--
Post-tax amount available for contribution	90,000	100,000
Tax savings (assuming a top marginal rate of 37%)	33,300	37,000

As the chart shows, in addition to the charity receiving $10,000 more, the taxpayer also receives an additional tax benefit of $3,700 from the additional $10,000 deduction when contributing the appreciated stock. It is also important to note that donations of appreciated property are subject to a 30 percent of adjusted gross income limitation for both public charities and private operating foundations and a 20 percent limitation for contributions to private nonoperating (grant-making) foundations.

Planning Tip

Do not donate "loser" stocks, or stocks that are currently trading at an unrealized loss. Instead, sell the stock and donate the proceeds, while claiming the capital loss on your return.

Utilize donor-advised funds to strategically time donation. One way to remain charitable while enjoying related tax benefits is to bunch or increase charitable contributions in alternating years. This may be accomplished by donating to donor-advised funds. Also known as charitable gift funds or philanthropic funds, donor-advised funds allow donors to make a charitable contribution to a specific public charity or community foundation that uses the assets to establish a separate fund. Taxpayers can claim the charitable tax deduction in the year they fund the donor-advised fund and schedule grants over the next two years or other multiyear periods. This strategy provides a tax deduction when the donor may be subject to a higher marginal tax rate while actual payouts from the account can be deferred until later.

Bunching charitable contributions in alternating years should be done hand-in-hand with income deferral planning. For example, if you are unable to defer income into 2020, you can make a large donor advised fund contribution in 2019 when your income is projected to be higher in 2020. You will take the donation as a charitable deduction for 2019 when your income is higher and reduce the amount of income subjected to higher rates. If you are then successful in deferring income into 2021 you will save your next donor-advised fund contribution to 2021.

Additionally, most major brokerage advisory firms have donor-advised funds already set up which can simplify making direct transfers of appreciated securities to avoid the capital gain tax that would have been realized upon sale. You may also be able to take advantage of the donor-advised fund strategy through the use of payroll deductions, a relatively new trend, essentially creating your own donor-advised fund which is funded through your payroll deductions.

The use of donor advised funds requires accurate, precise and multiyear planning. If you are considering the use of donor advised funds, contact us so that we can have a full understanding of your entire tax situation.

Charge charitable contributions. Charitable contributions charged to a credit card are deductible in the year charged, not when payment is made on the card. Therefore, charging charitable contributions to your credit card before year-end enables you to increase your 2019 charitable contributions deduction even if you are temporarily short on cash or simply want to defer payment until next year. Note, however, that any interest paid with respect to the charge is not deductible.

Mind Changes to Alimony Rules in 2019

Prior to 2019, alimony payments were an includable income item for the recipient, while payments were fully deductible by the payer. However, the TCJA adjusted the treatment of alimony payments, which greatly benefits recipients of alimony. For all divorce decrees issued after December 31, 2018, alimony payments are no longer reportable as income or as a deduction. This change also applies to some agreements existing prior to December 31, 2018 and subsequently modified after December 31, 2018. If both parties agree to change the terms of the alimony, *and* state that the alimony is no longer deductible/includable, the alimony payments would be excluded from both parties' tax returns, regardless of when the original agreement or decree occurred. However, if both conditions are not met, the alimony will remain as includable items on both tax returns.

ILLUSTRATION

If a divorce decree entered into on January 1, 2018 requires a taxpayer to pay $10,000 per month to an ex-spouse for every month for the next 10 years, $120,000 would be includable in income for the ex-spouse and reportable as a deduction on the taxpayer's tax returns annually until the alimony ends.

If the same agreement was entered into on January 1, 2019, no payments would be reported on the tax returns of either person.

If the divorce decree was entered into on January 1, 2018, but was amended on January 1, 2020, all payments made prior to the amendment would be reportable for both the taxpayer and spouse. However, any alimony payments made after the date of amendment, assuming both parties agree to exclude the payments, would neither be includable in the income of the ex-spouse nor deductible for the taxpayer.

Planning for Retirement

Whether saving for retirement, or several years into retirement, it is important to ensure that your nest egg affords you the opportunity to accomplish all of things you have planned for your golden years. The strategies below will help ensure that you can achieve your goals, while also protecting your legacy.

Establish and/or Maximize Contributions to a Tax-Favored Retirement Plan

If you are self-employed and you do not already have a retirement plan, now might be the time to take the plunge. Current retirement plan rules allow for significant deductible contributions for the self-employed. For example, if you set up a SEP IRA, you can contribute up to 20 percent of your net self-employment earnings, with a maximum contribution of $56,000 for 2019. If you are employed by your own corporation, up to 25 percent of your salary can be contributed with a maximum contribution of $56,000.

Other small business retirement plans include the solo 401(k) plan (which can be set up for just one person), the defined benefit pension plan and the SIMPLE IRA. Depending on your circumstances, these other plans may allow larger deductible contributions.

For a sole proprietorship, a SEP IRA may be set up and funded at any time prior to the extended due date of the business owner's tax return. Thus, for the 2019 tax year, a taxpayer who extends his return can set up and make deductible contributions to the SEP IRA any time up until October 15, 2020. Other types of plans generally must be established by December 31, 2019, if you want to make a deductible contribution for the 2019 tax year, while the deadline for the contribution itself may be as late as the extended due date of your 2019 return. However, in order to make a SIMPLE IRA contribution for 2019, you must have set up the plan by October 1, 2019.

Contact us for more information on small business retirement plan alternatives, and be aware that if your business has employees, you may have to cover them too.

OBSERVATION
While many taxpayers are aware of the benefits of maximizing retirement contributions, many are unaware that they can often contribute on behalf of their spouse as well. For example, even if one spouse is retired, the spouse that is still working can often contribute up to the maximum limit for the retired spouse as well, effectively doubling up the contribution. Of course, the working spouse must meet certain requirements, so contact us to review the best way to maximize the benefits of this strategy.

Select Annual Retirement Plan Contribution Limits

Type of Plan	2018	2019	2020
Traditional and Roth IRAs Catch-up contributions (ages 50+) for traditional and Roth IRAs	$5,500 $1,000	$6,000 $1,000	$6,000 $1,000
Roth and traditional 401(k), 403(b) and 457 plans Catch-up contributions (ages 50+) for 401(k), 403(b) and 457 plans	$18,500 $ 6,000	$19,000 $ 6,000	$19,500 $ 6,500
Simple plans Catch-up contributions (ages 50+) for simple plans	$12,500 $3,000	$13,000 $3,000	$13,500 $3,000
SEPs and defined contribution plans SEP maximum compensation	$55,000 $275,000	$56,000 $280,000	$57,000 $285,000
Social Security taxable wage base	$128,400	$132,900	$137,700

TAG
Tax Accounting Group of Duane Morris LLP

Convert Traditional IRAs into Roth Accounts

The best time for the Roth conversion strategy is when you expect to be in the same or higher tax bracket during your retirement years and you are currently in a low-income year, as a conversion from a traditional IRA to a Roth is includable in income.

The current tax hit from a conversion may turn out to be a relatively small price to pay for completely avoiding potentially higher future tax rates. In addition, the account's earnings can grow and be distributed tax free, assuming certain requirements are met. In effect, a Roth IRA can insure part or all of your retirement savings against future tax rate increases. Finally, Roth IRAs do not have an RMD requirement like traditional IRAs do.

> **Planning Tip**
> *In limited circumstances, the increase in taxable income resulting from a Roth IRA conversion can actually increase the QBI deduction available for pass through income. As the QBI deduction is limited to the lesser of taxable income (less long-term capital gains) or QBI, increasing taxable income can be particularly beneficial in instances where taxable income is primarily from qualified businesses, itemized or other above-the-line deductions are large relative to income, or there are large capital gains as a percentage of income. In such cases, converting a traditional IRA to a Roth might be considered to increase the QBI deduction and obtain the benefits of a Roth IRA, while minimizing the tax hit of the conversion.*

Consider Optimal Timing for Retirement Plan Distributions

If you are age 70½ or older, you are normally subject to the minimum distribution rules with regard to your retirement plans. Under these rules, you must receive at least a certain amount each year from your retirement accounts. You can always take out more than the required amount, but anything less is subject to a 50 percent penalty on the shortfall amount. Therefore, if you have not taken your RMD for 2019, do so before year-end to avoid a hefty penalty.

If you have reached age 70½ in 2019, you can delay your 2019 required distribution until April 1, 2020, if you choose. However, waiting until 2020 will result in two required distributions in 2020: the amount required for 2019 plus the amount required for 2020. While deferring income is normally a sound tax strategy, here it may result in bunching income into 2020, which may or may not push you into a higher tax bracket or have a detrimental impact on other tax deductions you normally claim. A careful timing assessment is needed. "Crunching the numbers" for 2019 and 2020 will help you to determine the optimal timing of the distributions.

> **OBSERVATION**
> Certain individuals still employed at the age of 70½ are not required to begin receiving minimum required distributions from qualified retirement plans (401(k), profit sharing, defined benefit plans, 403(b)s, etc.) until after they retire, representing another often overlooked method of deferral of tax on retirement savings. However, these individuals are still required to take their RMDs for traditional IRAs.

Utilize Qualified Charitable Distributions for those over 70½

You can also lower your taxable income by directing RMDs from a retirement account other than a SEP or simple IRA to a charity. By converting your RMD into a qualified charitable distribution (QCD) you can exclude up to $100,000 of your RMD (per taxpayer) from taxable income by having the retirement distribution payable directly to a qualified charity, subject to certain rules. This allows you to remain

charitable and lower your taxable income, while simultaneously utilizing the higher standard deduction available under the TCJA.

Tax Payments, Tax Liabilities and Credits

After the amount of income and deductions are determined, a number of factors determine the total tax owed. Consider the following strategies to reduce your overall tax bill come tax time.

Consider Adjusting Tax Withholding or Estimated Payments

Some taxpayers were surprised they owed taxes for the 2018 tax year, or were similarly surprised when they received a substantially lower refund than in previous years. In many cases, this was because they did not adjust their tax withholding or estimated payments as a result of tax reform. In other cases, underpayment was due to adjustments made to the withholding tables used by employers after the TCJA. Regardless of the cause of the underpayment, for those accustomed to receiving refunds every year, an unexpected tax bill cannot only be surprising, but can be a real hardship. Fortunately, there is still time to make sure the right amount of federal income tax is being withheld from your paychecks for 2019.

IRS Form W-4 instructs your employer how much tax to withhold from each paycheck. If you had a balance due with your 2018 tax return, you may want to decrease the number of allowances claimed on Form W-4. While the IRS recommends using its "Withholding Estimator" available at www.irs.gov, we recommend a more precise approach. A 2019 tax projection prepared by a qualified tax professional is the best and most accurate way to evaluate the status of your withholding and any required estimated tax payments, particularly if you have investment income and capital gains or are self-employed and earn income that is not subject to withholding.

Please keep in mind the IRS made changes to the 2018 threshold for the imposition of penalties for underwithholding by reducing required tax payments to 80 percent (as opposed to 90, 100 or 110 percent depending on your level of income) of your ultimate tax liability paid in via withholding or estimated payments. We believe it is unlikely the IRS will make those same concessions for the 2019 tax year. If you received underpayment penalty relief in 2018, you may not receive the same benefit in 2019.

If you believe you underwithheld for 2019, you may still have time to correct the issue. Unlike estimated payments, withholding is considered paid ratably throughout the tax year. If you are currently underpaid for the first through third quarters of 2019 you may wish to file an updated W-4 with your employer to increase withholding for your remaining 2019 pay periods and any related year-end bonuses.

Another strategy is to make a direct distribution (not a trustee-to-trustee distribution) from a qualified retirement account and withhold a high amount of tax from the distribution. Then, using other preexisting funds, payback the full amount (including the amount that was withheld and sent to the IRS) of the distribution within a 60-day period. This results in zero taxable income and additional withholding to be ratably spread throughout the year. You can only perform this 60-day rollover strategy once per 12-month period and it should only be reserved for correcting large underpayments in earlier quarters. As the rules are quite strict and penalties lurk for the unwary, again, this plan is best executed with assistance from us.

Qualify for Plug-In Energy Tax Credits

The qualified plug-in electric drive motor vehicle credit allows a nonrefundable credit to taxpayers in the year of purchase of specified four-wheeled vehicles built by qualified manufacturers and meeting certain battery and kilowatt requirements. The base amount of the credit is $2,500 per vehicle. The allowable

credit is increased by an additional $5,000 per vehicle based on a formula that increases the credit by $417 for every kilowatt-hour of battery capacity in excess of five, for a total maximum credit of $7,500. It is important to note that this credit is not subject to any income phaseouts for high-earning taxpayers.

PLANNING TIP

For taxpayers considering purchasing any Tesla model, it is important to keep in mind that Tesla, as the first manufacturer to sell 200,000 cars eligible for this credit, has had the tax credits pertaining to its vehicles reduced during 2019. Beginning January 1, 2019, the credit pertaining to the luxury brand was reduced to a maximum value of $3,750. On July 1, 2019, the credit was further slashed, down to $1,875. However, effective January 1, 2020, no Tesla vehicles purchased will be eligible for tax credits. Thus, taxpayers have until December 31, 2019, to not only secure a state of the art, luxury vehicle, but also claim electric vehicle tax savings before they diminish for good. For vehicles produced by General Motors, the maximum credit was similarly reduced to $3,750 on April 1, 2019, and $1,875 on October 1, 2019. GM vehicles will remain eligible for a credit of up to $1,875 until March 31, 2020. For electric vehicles produced by other manufacturers, the tax credits have not yet been reduced, so maximum credits are still available, subject to the battery and kilowatt requirements discussed above.

OBSERVATION

Last week, House Democrats released a draft bill entitled the Growing Renewable Energy and Efficiency Now Act of 2019 (aka the GREEN Act). The draft includes provisions extending the credits for electric vehicles beyond 200,000 sold, with a maximum credit of $7,000 available up to 600,000 vehicles. In addition, the bill adds a credit of up to $2,500 for used electric vehicles and extends credits for solar, wind, biodiesel and hydropower. Perhaps most significantly, the package also increases and retroactively extends the nonbusiness energy property credit that originally expired at the end of 2017. Of course, this legislation is far from its final form, so any changes to energy credits are quite speculative as of this point. Nonetheless, we are monitoring the situation and will advise on developments should any reforms occur.

Manage Your Nanny Tax

When considering hiring a household employee, such as a nanny, it is important to keep in mind the ramifications that come along with it. The key consequence of having a household employee is that the employer must likely withhold and/or pay Social Security taxes, Medicare taxes and federal unemployment taxes, particularly for cash wages of $2,100 or more paid. Such withholdings must also be reported on Schedule H of the employer's federal income tax return. In addition, certain state and local taxes and filings may also apply.

A Note on Estate Planning

In 2018, the TCJA established an estate and gift tax exemption of nearly double the amount in place for 2017. For 2019, the exemption is $11.4 million, or $22.8 million for married couples. However, in 2026, the large estate and gift tax exemption is scheduled to revert back to the previous, much lower rates. There is a chance Congress could make that change sooner, or alternatively, Congress could extend the exemption. At this time, it is not known what the outcome could be, or if or when to expect a change. Any choice regarding to your estate involves an element of speculation, as the estate and gift taxes remain a perennial "easy" target of politicians to raise revenue.

TAG Tax Accounting Group of Duane Morris LLP

Take Advantage of the $15,000 Annual Gift Exclusion and Unlimited Medical and Education Expense Exclusion

The maximum annual gift exclusion remains unchanged for 2019 and 2020, at $15,000, or $30,000 for any recipient provided the donor is married and the gift is split with their spouse. Therefore, a donor may make a gift in these amounts without using any of their unified credit or incurring a gift tax. Further, medical and education expenses paid directly to a providing institution are not subject to gift tax. In addition, as indicated in the education planning section, contributions to Section 529 plans may also qualify for special gift tax treatment. A substantial tax reduction can be achieved by making gifts to fund your child or grandchild's education.

Tax Planning Strategies for Small Businesses

If you own a business, consider the following strategies to minimize your 2019 tax bill.

Maximize Your Section 199A Qualified Business Income Deduction

One of the most impactful pieces of the TCJA was the Section 199A deduction. Because of this legislation, business owners may deduct up to 20 percent of their qualified business income from sole proprietorships and pass-through entities such as partnerships, LLCs and S corporations. Taxpayers with qualified REIT dividends and qualified PTP income can take advantage of the deduction as well. The deduction is complex and subject to various rules and limitations based on your taxable income, the type of business you operate and your business' W-2 wages and property. Planning strategies should be considered now to maximize your deduction.

The Section 199A deduction can be limited or completely phased out when taxable income exceeds certain thresholds. For 2019, taxpayers with taxable income below $321,400 for joint filers, $160,700 for single and head-of-household filers and $160,725 for married filing separately filers qualify for the Section 199A deduction without being subject to any limitations. Taxpayers with taxable income exceeding $421,400 for joint filers, $210,700 for single and head-of-household filers and $210,725 for married filing separately filers will be subject to the wage and property limitations or phased out completely if they are owners of a specified service trade or business (SSTB). SSTBs are service-based businesses in the fields of law, health, accounting, actuarial science, performing arts, consulting and financial services, where the principal asset of the trade or business is the reputation or skill of one or more of its owners or employees. Taxpayers with taxable income falling between the lower and upper thresholds can still take advantage of the deduction, but will be subject to the wage and property limitations and a much more complex calculation of their deduction amount.

New for 2019, the Section 199A deduction will be calculated on a separate, designated form. A draft version of Form 8995 was released by the IRS in July and will be used to calculate a taxpayer's Section 199A deduction for the 2019 return, replacing impromptu worksheets devised by taxpayers, computer software providers and the IRS during the 2018 filing season.

OBSERVATION

Engineers and architects are specifically excluded from the definition of SSTBs as reflected in the statute. Therefore, taxpayers with QBI from engineering and architecture services will remain eligible for the QBI deduction even if their taxable income exceeds the upper threshold amounts. They will, however, remain subject to the wage and property limitations.

Planning for the QBI Deduction

As the end of 2019 approaches, there are several planning tools available to taxpayers attempting to maximize their Section 199A deduction. First, if possible, taxpayers should aim to keep taxable income below the lower threshold for their filing status. With taxable income below the lower threshold, the Section 199A deduction will not be subject to the wage or property limitations, and the QBI deduction will be allowed even if the income is derived from a SSTB. In order to achieve this, business owners should consider purchasing equipment, vehicles or other property that could be expensed immediately under Section 179. For cash-basis taxpayers, the receipt of income could also be delayed until 2020 and expenses could be accelerated into 2019. You could also consider reducing your taxable income by:

- contributing to an employer retirement plan,
- making deductible IRA contributions,
- contributing to a health savings account, or
- using donor-advised funds (see above) to effectively deduct charitable donations for several years within a single tax year.

If it seems likely the Section 199A deduction will be subject to the wage or property limitations, the taxpayer may be able to increase the amount of wages paid or the basis in qualified property, potentially allowing for a more favorable deduction. Wages can be increased by increasing year-end bonuses or converting independent contractors to employees – assuming the benefit of the QBI deduction outweighs the increased payroll tax burden. Further, basis in qualified property can be increased by making equipment or other capital purchases. Lastly, S corporation owners might consider paying themselves less through W-2 wages and shifting more income to their K-1 to maximize the deduction. Please keep in mind however, that the S corporation owner's wages must still meet the reasonable compensation standard so the IRS receives its cut of payroll taxes.

Qualified Business Deduction for Real Estate Activities

If you own rental real estate, your activities may qualify for the QBI deduction. Under recent guidance issued by the IRS, safe harbor rules for rental real estate enterprises have been established to provide these activities an opportunity to qualify for the Section 199A deduction even if they do not rise to the level of a trade or business under Section 162. Taxpayers seeking to qualify for the safe harbor have until the end of 2019 to meet the following requirements:

1. Separate books and records must be maintained reflecting the income and expenses for each rental real estate enterprise.
2. Each year, 250 or more hours of rental services must be performed for rental real estate enterprises that have been in existence for less than four years. For rental real estate enterprises in existence for four years or more, 250 or more hours of rental services must be performed in at least three of the past five years.
3. The taxpayer must maintain contemporaneous records, including time reports or logs tracking the hours of all services performed, description of all services performed, dates on which services were performed and who performed the services. This requirement does not apply to the 2019 tax year, but will be in effect for all tax years beginning on or after January 1, 2020. However, taxpayers are reminded that they bear the burden of showing the right to any claimed deductions in all taxable years.

4. The taxpayer or relevant pass-through entity (RPE) must attach a statement to a timely filed original return (or an amended return for the 2018 tax year only) for each tax year in which the taxpayer or RPE relies on the safe harbor.

Also, in order to qualify for the safe harbor, residential and commercial properties must be treated as separate enterprises. Taxpayers with interests in a mixed-use property can either treat the property as a single rental real estate enterprise or split the property into its residential and commercial components.

If you do not meet the above requirements, it is still possible that your rental activities qualify for the deduction. Further analysis and planning is advised to ensure the activities rise to the level of a trade or business.

Acquiring Assets to Reduce Tax Liability

Making an investment in business assets may be a good tax planning strategy, depending upon the businesses' situation. The TCJA enhanced several depreciation related tax breaks. Thoughtful tax planning includes the integration of multiple strategies such as Section 179 expensing, bonus depreciation and tangible asset repair regulations. The following are some strategies you may employ to help reduce business tax liability.

Write-Off Asset Purchases with the Section 179 Deduction

Your business may be able to take advantage of generous Section 179 deduction rules. Under these rules, businesses can deduct 100 percent of qualifying assets, rather than recovering their cost over multiple years through depreciation. The maximum amount that can be expensed for 2019 is $1.02 million. This amount is reduced (but not below zero) by the amount by which the cost of qualifying property exceeds $2.55 million. Some qualifying assets include business equipment, computers and business related vehicles. Further, the TCJA expanded qualifying assets to include improvements to nonresidential buildings placed in service subsequent to the building being placed in service. These assets include qualified improvement property, roofs, HVAC, fire protection and security systems. In addition, in order to qualify for Section 179 treatment, the business must be in a positive income position and not operating at a net loss.

OBSERVATION
Please note that if the qualified improvement property either exceeds the Section 179 limit or is not eligible for the Section 179 deduction due to a glitch in the drafting of the TCJA, this property must be depreciated over 39 years, rather than 15 years, as intended. While this was one of the most anticipated "fixes" to be addressed by technical corrections legislation, its status remains in limbo due to the current political stalemate in Washington.

Utilize Bonus Depreciation

Above and beyond the Section 179 deduction, your business also can claim first-year bonus depreciation. The TCJA established a 100 percent first-year deduction for qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for certain property with longer production periods). Unlike under prior law, this provision applies to new and used property. This deduction is allowed even if the business yields a net loss for the year.

TAG
Tax Accounting Group of Duane Morris LLP

Enhance Your QBI Deduction by Acquiring Assets

A way for taxpayers to maximize the QBI deduction is by increasing the unadjusted basis immediately after acquisition (UBIA). As UBIA considers the fixed assets owned at year-end, in order to maximize the QBI deduction, business owners may want to consider acquiring additional assets if they have the wherewithal do so. The UBIA of qualified property essentially equals the cost of tangible property subject to depreciation that satisfies the following criteria:

- The property is held by *and* available for use in the trade or business at the close of the tax year;
- The property is used during the tax year in the production of the trade or business's QBI; and
- The property's depreciable period has not ended before the close of the taxpayer's tax year.

Keep in mind, the asset must be owned at the end of the year to be considered in the UBIA; therefore, disposal of assets should be deferred until the following year.

Planning Tip

For planning purposes, in order to maximize the UBIA of qualified property, you may wish to consider foregoing the annual de minimis *safe-harbor election, which allows the taxpayer to deduct fixed assets up to $2,500 ($5,000 if the taxpayer has an applicable financial statement) per item or invoice. By foregoing this election, and claiming depreciation instead, the business would have more fixed assets and a higher UBIA, which may lead to a larger QBI deduction.*

Select the Appropriate Business Automobile

The TCJA also greatly enhanced the depreciation available for business vehicles. For business passenger cars first placed in service in 2019, the ceiling for depreciation deductions has increased to $10,100. Higher deductible amounts apply for certain trucks and vans (passenger autos built on a truck chassis, including SUVs and vans). Vehicles such as SUVs and vans with gross vehicle weight ratings between 6,000 pounds and 14,000 pounds are restricted to a first-year deduction of $3,560, in addition to the $25,000 that is permitted to be expensed under IRC Section 179. Automobiles that are used 100 percent for business are also eligible for bonus depreciation of $8,000. For vehicles placed in service in 2019 and later, the depreciation limitation for passenger automobiles is $10,100 for the year the automobile is placed in service, $16,100 for the second year, $9,700 for the third year and $5,760 for the fourth year and later years in the recovery period.

Defer Taxes with Cost Segregation

Property that is placed in service after September 27, 2017, and has a class life of up to 20 years will generally qualify for 100 percent bonus depreciation. Real estate that is nonresidential property is generally regarded as 39-year property and is not eligible for bonus depreciation. A cost segregation analysis allows for the appropriate allocation of costs amongst various class lives and may permit the owners to take advantage of greater depreciation deductions (including 100 percent bonus depreciation). Further, by frontloading allowable depreciation deductions to the early years of the property's life, reclassification can result in significantly shorter tax lives and greater tax deferrals.

Maximize Your Deductions

Increase Your Home Office Deduction by Figuring Actual Expenses Rather than Using the Simplified Method

One of the largest and most controversial changes instituted by the TCJA was the state and local tax (SALT) deduction cap of $10,000. Because of this change, many taxpayers are limited in the amount of property taxes they can claim as an itemized deduction. Therefore, taxpayers with business income who are claiming the home office deduction may want to reevaluate whether it is more beneficial to use the actual-expense method rather than the simplified method. If the actual-expense method is used, a greater portion of the real estate taxes paid, which are limited on Schedule A, may be shifted to offset business income on Schedule C or E.

When using the simplified method to calculate the home office deduction, the square footage of the home office, up to a maximum of 300 square feet, is multiplied by $5, resulting in a maximum home office deduction of $1,500. This method is simpler because there is no requirement to document actual expenses and an allocation factor of the percentage of the home exclusively dedicated to the office does not need to be determined.

Although greater effort may be required when using the actual-expense method, a greater home office deduction may also be achieved. Under the actual-expense method, direct business expenses may be deducted in full and indirect business expenses, such as mortgage interest and real estate taxes, are allocated based on the percentage of the home exclusively dedicated to the office. Instead of deducting real estate taxes on Schedule A and being limited by the $10,000 cap on SALT, which may have already been reached with other taxes paid, it may be more beneficial for some taxpayers to report their real estate taxes as an indirect home office expense.

Also, when using the actual-expense method, expenses such as utilities, insurance, security and repairs can be deducted. Any increases in the home office deduction may also decrease self-employment income and self-employment tax, thus enhancing the benefit of the deduction. One downfall of the actual-expense method compared to the simplified method is that any depreciation taken must be recaptured as ordinary income when the home is sold.

Be Sure to Receive Maximum Benefit for Business Interest

Thanks to the TCJA, the interest expense for businesses is now limited to 30 percent of the adjusted taxable income of the business plus business interest income and floor financing interest paid by certain vehicle dealers. Certain smaller businesses (with less than $26 million in average annual gross receipts for the three-year tax period ending with the prior tax period) are exempt from this limitation. In addition, real property trades or businesses can elect out of the limitation if they use the alternative depreciation system (ADS) to depreciate applicable real property used in a trade or business. Thus, if you are regularly near the income threshold for the small business exception, a little tax planning at year-end may allow you to avoid this limitation in some or all tax years.

Involve Your Children in the Family Business

If you are self-employed, consider hiring your child (or grandchild) as an employee. This would shift income (which is not subject to the kiddie tax) from you to the child, who is likely in a lower tax bracket or may avoid tax entirely due to the standard deduction. There also may be payroll tax savings since wages paid by sole proprietors to their children age 17 and younger are exempt from Social Security, Medicare

and federal unemployment taxes. However, regardless of the age of the child, wages are subject to income tax withholding.

Please remember, payroll savings apply to children being employed by sole proprietors, meaning there are certain instances in which payments for the services of a child are not only subject to federal withholding but also subject to Social Security, Medicare and FUTA taxes. For example, if a corporation employs the child, the child will face applicable taxes even if their parent controls the corporation. Similarly, if a partnership employs the child, the child will likely be subject to withholding and payroll taxes unless *each* partner is a parent of the child.

OBSERVATION
When employing your child or grandchild, keep in mind that any wages paid must be reasonable given the child's age and work skills. Also, if the child is in college or entering soon, excessive earned income may have a detrimental impact on the student's eligibility for financial aid.

Jumpstart Retirement Savings for Your Children

Employing your children has the added benefit of providing them with earned income, which enables them to contribute to an IRA. While teens and college students are rarely thinking of their own retirement, starting a retirement account early gives them a great head start. With over 40 years of compounding, the beginnings of a nest egg can grow considerably. The limit for contributions to an individual retirement account (IRA) is $6,000 in 2019 and 2020 for those under 50, which would require $6,000 of earned income. So, if an 18-year-old has $6,000 in his or her IRA, by age 65, assuming no further contributions were made, the account would grow to over $140,000, assuming a 7 percent annual rate of return. As the child would likely be in a low tax bracket, contributions to a Roth IRA, rather than a traditional IRA, are more advantageous, as the tax-free earnings in retirement would likely be a greater benefit than the deduction on the contribution now.

Establish a Tax-Efficient Business Structure

Businesses may operate under various structures, including general partnership, limited liability company, limited liability partnership, S corporation, C corporation and sole proprietorship. To maximize tax savings, selecting the proper entity is critical. Of course, other factors drive entity selection as well, such as the level of protection desired for personal assets, the number and type of possible owners and administrative ease. With the passage of the TCJA, the 20 percent QBI deduction is now available for pass-through entities such as S corporations, partnerships and sole proprietorships. In a corresponding move, C corporations were afforded a tax cut under the TCJA, with a flat 21 percent corporate tax rate. These two recent, major changes could make this an opportune time to reevaluate your entity selection for an already existing business or rethink previous understandings for entity selection of a business you may want to open in the near future. The decision should be analyzed by you and your team of legal and tax advisers. The following chart highlights some of the advantages and disadvantages of possible entity structures.

Entity Selection Attributes

Type of Entity	Advantages	Disadvantages
Sole proprietorship	Easy to setup Simplified ownership structure Eligible for QBI deduction	Unlimited personal liability (unless formed as an LLC) Can only have one owner Difficult to raise investment capital
S corporation	Income not subject to self-employment tax Protection of personal assets Eligible for QBI deduction	Restrictions on type and number of owners Officers must be paid reasonable compensation Only permitted to have one class of stock
C corporation	New decreased 21% flat corporate tax rate Unlimited amount of shareholders Different classes of stock available	Double taxation on dividend distributions Losses only deductible at corporate level Not eligible for QBI deduction
Partnership	No limit on number or type of owners Eligible for QBI deduction	Dissolution upon death of a partner At least one owner has unlimited personal liability

Use S Corporations to Develop Property

Individuals who develop property are generally treated as real estate “dealers” under the tax code, with the profit earned by developing and selling land treated as ordinary income from inventory. At current rates, ordinary income can be taxed at up to 37 percent, plus a net investment income tax of 3.8 percent, resulting in an effective tax rate of 40.8 percent. While the gain resulting from the development must always be taxed at ordinary rates, there is no need to taint any predevelopment gain by selecting the wrong entity for the transaction. Rather, you can sell an appreciated property to an S corporation, and have the S corporation develop the property. While the S corporation’s profits will be subject to ordinary rates, the sale of property held for investment to the S corporation is a capital transaction and, provided that it was held for more than one year, would be subject to a maximum rate of 23.8 percent.

TAG’s Perspective

As we enter the second year of the new tax regime – the most sweeping tax overhaul in a generation – the IRS continues to release guidance on the new law. However, due to the current political climate, and projected congressional inaction, we have a reasonable degree of certainty as to how the 2019 and 2020 tax years may look from a legislation perspective. With only one month remaining in the year, now is the time to focus on planning opportunities to minimize your tax obligations. By investing a little time before year-end, you may discover significant and immediate tax-saving opportunities, which will disappear on January 1. Don’t let yourself learn of missed possibilities when your 2019 tax returns are being prepared

in 2020. If anything in this guide has sparked a question, inspired to act, made you realize you need assistance, or motivated you to explore an idea you've wanted to implement for far too long, please feel free to consult us. The Tax Accounting Group listens and offers our insights and recommendations to help clients create a tax-minimizing strategy crafted to their unique needs and goals.

For Further Information

If you would like to discuss the tax law changes indicated herein, or for more information about this topic or your own unique situation, please contact Michael A. Gillen, Steven M. Packer, John Frederick, or any of the practitioners in the Tax Accounting Group.

For information about other pertinent tax topics, please visit our publications page.

To learn more about TAG, please visit www.TaxAccountingGroup.com.

Disclaimer: This Tax Planning Guide has been prepared and published for informational purposes only and is not offered, nor should be construed, as legal advice. For more information, please see the firm's full disclaimer.