Kerber, Eck & Braeckel LLP
CPAs and Management Consultants

2019 YEAR-END

TAX PLANNING GUIDE

By now all 2018 income tax returns have been filed...even for those that had been extended. So, we've all had one year operating under changes in the Tax Cuts and Jobs Act (TCJA) passed in late December of 2017. As we head towards the end of the second year under these rules, it may be a good time to see what we learned in 2018.

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SIGNIFICANT CHANGES FOR INDIVIDUALS

- **New, Lower Income Tax Rates**
- **Substantially Increased Standard Deductions**
- **Severely Limited Itemized Deductions and No Personal Exemptions**

SHIFTING INVESTMENTS AND INCOME

While not new for 2019, higher-income earners must be wary of the 3.8% surtax on certain unearned income. As year-end nears, your approach to minimizing or eliminating the 3.8% surtax will depend on estimated income and NII for the year. The surtax is 3.8% of the lesser of: (1) net investment income (NII) or (2) your income over certain thresholds.

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

Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on your taxable income. The 0% rate generally applies to the excess of long-term capital gain over any short-term capital loss to the extent that it, when added to regular taxable income, is not more than the "maximum zero rate amount" (e.g., $78,950 for a married couple). If the 0% rate applies to long-term capital gains you took earlier this year—for example, you are a joint filer who made a profit of $5,000 on the sale of stock bought in 2009, and other taxable income for 2019 is $70,000—then before year-end, try not to sell assets yielding a capital loss because the first $5,000 of such losses won't yield a benefit this year. And, if you hold long-term appreciated-in-value assets, consider selling enough of them to generate long-term capital gains sheltered by the 0% rate.

Postpone income until 2020 and accelerate deductions into 2019, if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2019 that are phased out over varying levels of adjusted gross income (AGI). These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income is also desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances.

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DEDUCTIONS

Beginning in 2018, many taxpayers who used to itemize their deductions year after year no longer did so due to the basic standard deduction being doubled. In 2019, the standard deduction is $24,400 for joint filers, $12,200 for singles, $18,350 for heads of household, and $12,200 for marrieds filing separately. As you may recall, no more than $10,000 of state and local taxes may be deducted; miscellaneous itemized deductions (e.g., tax preparation and investment advisor fees) and unreimbursed employee expenses are no longer deductible; and personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster and only to the extent the $100-per-casualty and 10%-of-AGI limits are met. You can still itemize medical expenses to the extent that they exceed 7.5% of your adjusted gross income, state and local taxes up to $10,000, your charitable contributions, plus interest on a certain amount of qualifying residence debt, but payments of those items won't save taxes if they don't cumulatively exceed the new, higher standard deduction.

This higher standard deduction makes the "bunching strategy" more valuable. We have seen an increased use of Donor Advised Funds (DAF) these last two years. A DAF works similarly to bunching charitable donations in that it gets the deduction into the year the funds flow into the DAF. We've seen clients put 3-5 years of donations into the fund. The advantage of the DAF over simple bunching is that the DAF can distribute to the ultimate charity according to your normal process. You get the deduction in year one and the DAF distributes the funds over the next few years as if you had made annual donations.

Bunching of real estate taxes can still be a valuable strategy, depending on the amount of real estate taxes and other state and local taxes. Since Illinois continues to exempt retirement income from tax, we still see a benefit to pre-paying real estate taxes (keeping the $10,000 limit in mind) in the right circumstances, especially when state income tax liabilities are modest.

BUNCHING STRATEGY

A "bunching strategy" has always been an important strategy but, with the standard deduction doubled, it becomes particularly helpful.

For example, if a taxpayer knows he or she will not be able to itemize deductions in 2020, they may be able to make two years' worth of charitable contributions in 2019.

Health savings accounts are also valuable in obtaining deductions for medical expenses, given the current medical deduction hurdles.

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BUSINESS TOPICS FOR INDIVIDUALS

Self-employed taxpayers enjoy some benefits that employees do not receive under the new tax rules. Business expenses are still deductible to a sole proprietor, whereas employee business expenses have been eliminated. This may be a good time to remind you that the changes under the TCJA are temporary. Things are set to revert to the old rules in 2025. If you are an employee and can negotiate a lower salary in exchange for a reimbursement of expenses, your tax bill decreases accordingly—not just with income taxes, but with payroll taxes as well. And, of course, someone with a qualifying home office may be converting part of their real estate taxes to a business deduction; thus getting more of a deduction than the $10,000 state and local taxes limit.

A self-employed individual may also be entitled to a deduction of up to 20% (Section 199A/QBI deduction) of their net profit from the trade or business; something an employee does not receive.

While on that topic, the 20% Qualified Business Income (QBI) deduction under Section 199A was one of the most complicated, beneficial, and confusing provisions under the new law. Its intricacies are beyond the scope of a year-end letter but, if you own a business through a pass-through entity (including many rental properties), please call us for a year-end discussion. The deduction is available to some businesses, but not others. It is also income based, so simple things like maximizing your retirement contributions can be the difference in qualifying for this 20% deduction or not qualifying if you are right on the income threshold.

IRA PLANNING

Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retirement plan). RMDs from IRAs must begin by April 1 of the year following the year you reach the age of

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IRA PLANNING *(Continued)*

70-½. That start date also applies to company plans but employees who continue to work and do not own more than 5% of the companies they work for may defer RMDs until April 1, following the year they retire. Failure to take a required withdrawal can result in a very significant penalty. Thus, if you turn age 70-½ in 2019, you can delay the first required distribution to 2020 but, if you do, you will have to take a double distribution in 2020—the required 2019 amount plus the required 2020 amount.

Think twice before delaying 2019 distributions, as bunching income into 2020 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2020 if you will be in a much lower bracket.

If you are age 70-½ or older by the end of 2019, have traditional IRAs, and you can't itemize your deductions, consider making 2019 charitable donations via qualified IRA charitable distributions. Such distributions are made directly to charities from your IRAs and the contribution amount is neither included in gross income nor deductible on Schedule A. But the amount of the qualified charitable distribution reduces the amount of required minimum distribution; resulting in tax savings, especially without itemization.

If you are employed or have self-employment income and are younger than age 70-½ at the end of 2019, the following IRA and/or 401(k) technique may be helpful. Assuming that, in the year you turn 70-½ and later years, you won't itemize your deductions, contribute as much as you can into a deductible IRA. Then, when you reach age 70-½, take advantage of the QCD rules. This will allow you to convert nondeductible charitable contributions made after age 70-½ into deductible-in-2019 IRA contributions and reductions of gross income from age 70-½ and later year distributions from the IRAs. The same technique works with a 401(k), but you would need to roll part of the 401(k) into an IRA prior to making the QCD.

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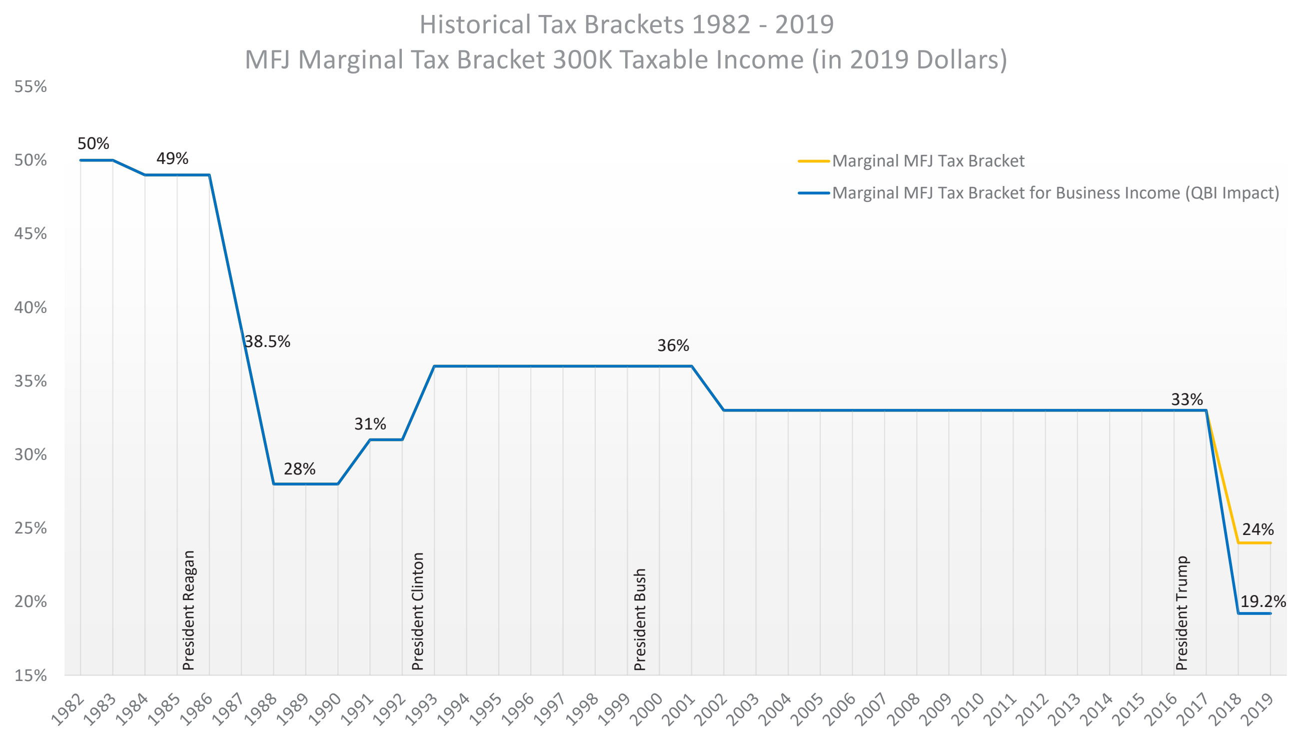
HISTORICALLY LOW TAX RATES

Tax planning is not just about reducing tax costs for the current tax year. For some, 2019 is a year to consider actually triggering taxable income such that low brackets are not wasted. A typical example here would be someone with a large deferred tax retirement account buildup. Especially, if the taxpayer finds himself or herself in that zone of having recently retired but not yet started drawing Required Minimum Distributions (< Age 70 ½) even though he or she has stopped working full time. A Roth IRA conversion can be implemented to convert what might otherwise have been taxed at a much higher future tax rate later into a relatively low current tax rate, and, having all future Roth IRA earnings growing tax-free.



For some perspective on how historically low our tax rates are for moderately high earners ($300,000 joint earnings for married couple), please refer to the above chart. Tax rates are always subject to change by Congress. We, of course, do not have a crystal ball but, based on the chart and our federal government's current level of deficit spending, what direction would you expect these rates to go in the future? If you believe your tax rates will be going up, why not take the bird in the hand versus two in the bush and lock in the low rate on your otherwise deferred taxable income.

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TAX REFORM PROVISIONS FOR BUSINESS OWNERS

Other than the QBI topic, other tax reform provisions can affect business. The corporate rate is a flat 21%. Generally, it helps larger entities but a number of C corporation clients have left $50,000 of taxable income in the corporation. Those taxes have now increased 40% (from 15% to 21%).

Since 2018, more small businesses have been able to use the cash method (as opposed to accrual). To qualify as a small business, one must satisfy a gross-receipts test. After Dec. 31, 2017, the test is satisfied if, during a 3-year testing period, average annual gross receipts don't exceed $25 million. These taxpayers may find it easier to shift income by delaying billings until 2020 or by paying bills early.

Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For 2019, the expensing limit is $1,020,000 and the investment ceiling limit is $2,550,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. For property placed in service in tax years beginning after Dec. 31, 2017, expensing is also available for qualified improvement property (generally, any interior improvement to a building's interior but not for enlargement of a building, elevators or escalators, or the internal structural framework), roofs, HVAC, fire protection, alarm, and security systems.

Businesses can also claim a 100% bonus first year depreciation deduction for machinery and equipment—bought used (with exceptions) or new—if purchased and placed in service this year. The 100% write-off is given without any proration based on the length of time that an asset is in service during the tax year. Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets. To qualify, the unit of property cost can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement and an independent CPA's report). Without AFS, the cost can't exceed $2,500.

SIGNIFICANT CHANGES FOR BUSINESSES

- **Corporate Tax Rate is 21%**
- **Largely Liberalized Expensing and Depreciation Rules**
- **New Deduction for Non-Corporate Taxpayers with Qualified Business Income from Pass-Through Entities**
  - **Generally for Individuals, but Trusts also Qualify**