

# 2018 Year-End Tax Planning

November 8, 2018

## Highlights

- ✓ Uncertain Legislative Future
- ✓ Stable Rates Into 2019
- ✓ Maximizing Itemized Deductions
- ✓ Life-Cycle Considerations
- ✓ Timing Techniques

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### SPECIAL REPORT

## Tax Cuts and Jobs Act Creates New Planning Opportunities, Eliminates Old Tactics

Year-end 2018 presents challenges and opportunities for tax planning that have not been present before. With 2018 seeing the implementation of the vast majority of the Tax Cuts and Jobs Act (TCJA) provisions, tax professionals will have to be ready to adopt new strategies to assist taxpayers in maximizing tax savings under the new laws. The IRS also released guidance on the new provisions that presents opportunities. These changes on top of standard year-end planning, and potential legislation, could make for a busy end to 2018. And now, with the mid-term elections in the rearview mirror, and the House flipping to Democratic control with an expanded GOP majority in the Senate, legislative action during the lame duck session and beyond is unpredictable.

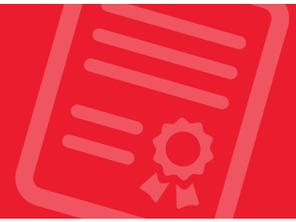
### TAX CUTS AND JOBS ACT

The TCJA is the most significant tax legislation in over 30 years. Just about every taxpayer type is affected by the changes to the Internal Revenue Code, and action may have to be taken in 2018 to take advantage of lower rates, new tax benefits, and new approaches to entity taxation. However, the TCJA eliminated many long-standing tax benefits that taxpayers may have come to rely upon, so keeping clients abreast of what has changed and what to expect is also important.

#### Individuals

**Income Tax Rates.** The most noticeable change coming from the TCJA was reduction in rates. For 2018, the new rate structure on ordinary income includes seven brackets, as for tax years before 2018, but those effective rates have significantly dropped. With the prospect of tax reform, taxpayers may have deferred income at the end of 2017 with the hope of taking advantage of these lower rates in 2018. With a new political landscape in 2019 and beyond, 2018 may be the year to take advantage of lower income tax rates.

**Capital Gains Tax Rates.** While the determination of applicable capital gains rates is different under TCJA, with the rate structure tied to taxable income “breakpoints” instead of tax brackets, there is actually no difference in the effect of those changes. Long-term capital gains that were taxed at zero, 15, or 20 percent in 2017 based on taxable income will be taxed at the same rate for 2018.



**Inflation Adjustments.** One significant change that does affect both ordinary income and long-term capital gain tax rates is the switch from the Consumer Price Index (CPI-U) to the Chained Consumer Price Index (C-CPI-U) in calculating annual inflation adjustments. The C-CPI-U makes much lower annual adjustments. As a result, “bracket creep,” or the movement from one tax bracket to a higher tax bracket due to increased income resulting from inflation pressures only, and not from any effective increase in earnings, could affect taxpayers near the higher end of rate brackets. Although there is not much that can be done at year end other than standard deferral techniques, taxpayers should be aware of the possible effect.

*Tax professionals will have to be ready to adopt new strategies to assist taxpayers in maximizing tax savings under the new laws.*

**Divorce.** Nearly all of the changes to the Internal Revenue Code coming out of TCJA took effect January 1, 2018. However, one very significant change that comes into effect January 1, 2019, is the treatment of alimony. Beginning with divorces and separation agreements entered into after December 31, 2018, alimony or separate maintenance payments are no longer deductible by the payor, nor includible in the income of the payee. This change does not affect divorce or separation agreements entered into before 2019, nor those altered after 2018 where the changed method of taxation is not expressly stated to apply.

 **IMPACT.** *Taxpayers who are currently in the final stages of negotiating a divorce or separation agreement should take this change into account when determining whether to quickly finalize negotiations before January 1, 2019.*

**Medical Expenses.** TCJA lowered the floor for claiming deductions for medical expenses to 7.5 percent of AGI for **all** taxpayers, not just those aged 65 or higher, applicable to 2017 and 2018 only.

 **IMPACT.** *Individuals who have the ability to accelerate medical procedures from 2019 to 2018 should consider doing so. In 2019, the floor returns to 10 percent, making the deduction harder to claim.*

**Increased Standard Deduction.** One of the most broadly impactful provisions of TCJA was the near doubling of the standard deduction for all taxpayers. For 2018, the standard deduction amounts are \$24,000 for joint filers, \$18,000 for heads of households, and \$12,000 for all other individual filers. This increased amount makes it less likely that it is more advantageous for individuals to itemize deductions. This could result in individuals making fewer charitable contributions, since the deduction is less likely to be claimed.

One way of working around this is to stagger charitable contributions to every other year. Individuals could consider letting their regular charitable contribution budget accumulate for a year, then effectively make a double contribution in the following year. This strategy may also be available for property taxes. The IRS has released guidance that allows taxpayers to deduct prepaid property taxes in the year they are assessed, and not due for payment. Thus, if a taxpayer lives in a jurisdiction where property taxes are assessed at the end of the year prior to being due, the individual may be able to claim a deduction for two years' worth of taxes every other year, subject to the \$10,000 limit on the deduction for state and local taxes.

## Businesses

There isn't much opportunity for year-end planning related to changes made by TCJA directly, as the changes are largely permanent cuts to tax rates that apply to businesses, either through the reduction in the corporate tax rate or the new 20-percent qualified business income deduction under Code Sec. 199A. However, in the nearly 11 months since the TCJA was enacted, the IRS has issued a large body of guidance that may create some opportunities for year-end planning, including actions that must be taken before the end of the year, as well as getting a head start on important information-gathering.

**Depreciation and Expensing.** Similar to the items for individuals, many of the tax benefits for businesses do not necessarily have to be done before the end of 2018, but 2018 is the first year in which it becomes more advantageous to act under the new law. For example, 100-percent bonus depreciation made a return for 2018, allowing business to immediately deduct the costs of depreciable assets in 2018. Similarly, increases in the amount of the Code Sec. 179 expensing limitation, as well as the investment limitation, to \$1 million and \$2.5 million respectively, allow for even more immediate write-offs of expenses.

 **IMPACT.** *As indicated, these increases do not apply to 2018 only, so there is time to take advantage of them in later years. However, if a business has been considering expanding capacity*

or acquiring new equipment, there has never been a better time to do so than in 2018, from a tax benefit standpoint.

**Transition Tax.** TCJA amended Code Sec. 965 to create a one-time tax on the post-1986 earnings and profits that have accumulated with a foreign corporation. The tax rate is 15.5 percent on cash and cash equivalents, and eight percent on all other items. Generally, these amounts must be included on a 2018 return, although a fiscal-year taxpayer must account for them in the last tax year beginning before January 1, 2018. For such fiscal-year taxpayers the filing deadline may still be approaching.

In the immediate aftermath of TCJA's enactment, the IRS began issuing guidance, culminating in the release of proposed regulations in August 2018. The guidance is far too comprehensive for this Briefing, but there are some actions that taxpayers can still take before the end of 2018.

- Taxpayers who have yet to take into account the inclusion amount have the option to elect to pay the transition tax over eight installments.
- S corporation shareholders can elect to defer the tax
- Real estate investment trusts can elect to include income over an eight-year period
- Taxpayers may elect to not apply the net operating loss deduction

**IMPACT.** Each of these elections must be made by the due date of the return, including extension. There is no relief for a late election. The proposed regulations and the draft Form 965 should be considered before making (or choosing not to make) any of these elections.

**Reportable Corporations.** TCJA also expanded reporting requirements and increased the penalties for reporting failures for reportable corporations. A reportable corporation is a 25-percent foreign-owned U.S. corporation or a foreign corporation engaged in a trade or business in the United States. Draft Form 5472 now requires that information be included on the Code Sec. 59A BEAT tax, Code Sec. 267A deduction disallowance, and the deduction for foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI).

**IMPACT.** The penalty for failure to furnish information or maintain records is increased from \$10,000 to \$25,000.

**Paid Family Leave Credit.** TCJA also created a new credit for employers that provide employees with paid family

leave. The credit is as high as 25 percent of the amount paid to employees. The credit is available to employers beginning in 2018, but requires a written policy to be in place in order for the credit to apply. IRS transition guidance for 2018 allows the credit to be retroactively applicable to all of 2018, if the employer has a written policy in place by December 31, 2018.

**IMPACT.** Employers who already have paid family leave under Family Medical Leave Act policies should act quickly to get a written policy in place before December 31, 2018.

**Employee Compensation and Benefits.** Finally, TCJA eliminated or altered several deductions related to employee benefits, including deductions for transportation expenses, meals and entertainment expenses, moving expenses, and employee awards. Employers should take the time to review their internal policies with regard to all employee benefits to ensure they align with the new requirements.

## TAX REFORM 2.0

In September, after spending much of the summer talking about it, GOP leadership in the House released a package of bills referred to as "Tax Reform 2.0." The trio of bills came on the heels of lukewarm public approval

### Life Cycle Changes Important To Year-End Planning

While tax considerations are important, sometimes life gets in the way. Year-end tax strategies should also consider personal circumstances that changed during 2018 as well as what may change in 2019. These "life cycle" changes include:

- Change in filing status: marriage, divorce, death or head of household status
- Birth of a child
- Child no longer young enough for child credit
- Child who has outgrown the "kiddie" tax
- Casualty losses
- Changes in medical expenses
- Moving/relocation
- College and other tuition expenses
- Employment changes
- Retirement
- Personal bankruptcy
- Large inheritance
- Business successes or failures



of TCJA. The bills make permanent the provisions of TCJA that are set to expire after 2025, enhance tax benefits that are available to start-up companies, and encourage retirement savings by younger families by creating more tax benefits for contributions by both employers and employees. Of the three bills, only the one relating to retirement savings enjoys any bipartisan support.

 **COMMENT.** *It is unclear what the fate of these bills is overall, but it is unlikely that anything will happen with them in a lame duck session. The political benefits of making permanent individual tax cuts no longer exist after Election Day, and the other two bills are not time-sensitive, so they could wait until 2019.*

## EXTENDERS

As has been the case over the past decades, many tax benefits are scheduled to expire on an annual or biannual basis. These provisions, known as tax extenders, are often extended one or two years by Congress, often very late in the year. Many of these provisions have been made permanent, but some still are subject to regular expiration. Congress last extended these in the Bipartisan Budget Act of 2018 in February 2018, but they were only extended to apply to the 2017 tax year and, thus, are not currently available for 2018. These extenders include:

- Tuition and fees deduction
- Exclusion of discharged principal residence indebtedness
- Mortgage premium insurance deduction
- Shorter recovery periods for racehorses and racetracks
- Several energy credits

It is unclear when, or even if, these provisions will be extended to 2018. A lame duck Congress is not necessarily under any compulsion to act on them, so they may slip to 2019.

 **IMPACT.** *Taxpayers should not take actions relying upon these extended breaks. But, they may want to be positioned to act quickly to take advantage should they be extended before year end with little notice. For example, in prior years, it was prudent to prepay in the current the first three months' college tuition for the next year if the deduction was no longer available. However, given that there is no guarantee the deduction will be extended for 2018, this may not be a priority.*

## TRADITIONAL TIMING TECHNIQUES

Effective year-end tax planning by its nature requires the correct execution of specific timing rules under the tax code. Taxpayers must be prepared to implement timing strategies well into December.

- For businesses, the IRS and the courts generally require use of the accrual method whenever inventories are used. For an accrual-basis taxpayer, the right to receive income, rather than actual receipt, determines the year of inclusion in income.
- Under the cash receipts and disbursements method (cash method), all items constituting income, whether in the form of cash, property, or services, must generally be included in income for the tax year in which the items are actually or constructively received; and deductions are generally taken into account for the tax year in which actually paid.

The cash method, which is required to be used by almost all individual taxpayers, generally allows a cash-basis taxpayer to exercise some control over the year of income or deduction by accelerating or deferring receipts and payments.

Note also that under TCJA, the limit on gross receipts for a C corporation to be considered a “small business” and qualify to use the cash method of accounting has been increased to \$25 million, so the increased year-end flexibility may be available to more taxpayers.

**Income acceleration/deferral.** Taxpayers using the cash method basis of accounting can defer or accelerate income using a variety of strategies. For example:

- Sell or hold appreciated assets
- Accelerate or delay bonuses
- Use installment contracts
- Qualify for (or purposely fail) like-kind exchange treatment
- Manage year-end bills and receipts
- Manage debt forgiveness income
- Declare special dividend and
- Consider Roth conversions.

**Deduction acceleration/deferral.** A cash basis taxpayer generally deducts an expense in the year it is paid, although prepayment of an expense generally will not accelerate a deduction (there are exceptions). Some techniques to accelerate or defer deductions and credits are to:

- Don't delay bill payments until 2019
- Pay last state estimated tax installment in 2018
- Contribute to retirement plans
- Don't delay economic performance
- Watch AGI limitations on deductions/credits

- Watch net investment interest restrictions
- Match passive activity income and losses

**Year-end payments.** It is not necessary to use cash to qualify for a deduction or other tax benefit for 2018. More frequently, taxpayers can write a check or can charge an item by credit card and treat these actions as immediate payments. It does not matter, for example, when the recipient—whether a business or a charity—receives a check mailed by the payor, when a bank honors the check, or when the taxpayer pays the credit card bill, as long as it is done or delivered “in due course.”



**COMMENT.** *The same treatment applies to a gift (up to \$15,000 for 2018, expected to stay at \$15,000 for 2019) — sending a check is treated as a payment in the year sent or presented. For the 2018 holiday season, for example, a taxpayer can give \$30,000 gift-tax free under the annual gift tax exclusion, spread out by a \$15,000 check on December 31 and another \$15,000 check on January 1st (double for spouses “splitting” the gift). Gifts of marketable securities, on the other hand, must be timed with either wire transfers or physical certificates.*