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It's Not Too Late to Trim Your 2019 Tax Bill – Year-end Tax Planning Strategies for Individuals

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As the end of 2019 approaches, additional guidance continues to be released by the IRS relating to the Tax Cuts and Jobs Act (TCJA), as well as other areas not necessarily impacted by the landmark tax reform act. While one of the claimed benefits of tax reform was the simplification of filing and the lowering of income tax rates, there are still many steps that individuals can take to lower their tax bills. Planning during the final weeks and months of this year involves much more, including traditional year-end strategies and those developed in response to developments that have taken place over the last few years. Here are some points to consider:

Data gathering. Year-end planning should start with data collection and a review of prior year returns. This includes information on losses or other carryovers, estimated tax installments, and

unusual items. Conversations regarding next year should include discussions of any significant purchases or disposition plans, as well as any possible life cycle events.

Income tax rates. One of the most significant factors in tax planning for individuals is their tax brackets. The most direct control taxpayers have over their tax bracket rests in their ability to control the timing of income and deductible expenses. For example, taxpayers who expect to be in a lower tax bracket in 2020 should consider deferring income to 2020 and accelerating deductions into 2019. While tax brackets would seem, based on current projections, to suggest relative stability over the next few years, individual circumstances could mean a shift in brackets from year to year.

Investments. Taxpayers holding investments, whether in the form of securities, real estate, collectibles, or other assets, often have an opportunity to reduce their overall tax bill by some strategic buying and selling toward the end of the year (tax loss harvesting), as well as exchanging appreciated assets for like-kind property in order to defer gains. Tax rates on investments are also impacted by the total amount of your income, so a determination should be made of the best time to sell investments. Balancing tax considerations with other factors is part of the challenge in dealing with investments, including the ordinary income tax rates, the net investment income tax rate, the capital gain rates, and the alternative minimum tax (AMT).

Portfolio rebalancing. We recommend that taxpayers who target a specific asset mix (e.g. 60% stock and 40% bonds) consider rebalancing their portfolio at least annually. Domestic equities have significantly outperformed domestic bonds so far this year, which created a need for rebalancing in many portfolios. Rebalancing helps ensure that taxpayers' asset allocations remain appropriate for individual risk tolerance and cash needs. Taxpayers who adjust asset allocations may also wish to consider the location of their investments to achieve the most tax efficient mix for their portfolios. For example, consider shifting growth-oriented stocks into a taxable account and income-oriented investments into a tax-deferred account. Monthly premium payments may be higher for Medicare recipients if their portfolios generate significant income in taxable accounts.

Charitable donations. Taxpayers should consider donating a portion of their IRA Required Minimum Distributions (RMDs) directly to a qualified charitable organization as this may reduce the overall tax liability. Up to $100,000 can be directed from an IRA to charities. This technique avoids paying tax at ordinary income rates and may help to reduce future Medicare premiums depending on gross income. An alternative approach is to donate appreciated stock to charitable organizations which may benefit taxpayers from both tax and investment perspectives. Depending on each client's specific circumstances, CBM frequently discusses the bunching of deductions in a single year to maximize use of the standard deduction in alternate years.

Roth conversion and "back-door" Roth conversion. Taxpayers may wish to consider converting a portion of their Traditional IRA into the Roth IRA depending on their tax circumstances. This may reduce the client's tax liability in future years. Taxpayers no longer able to contribute into the Roth IRA because of income level may still have the option of utilizing the "back-door" Roth conversion strategy.

Gifting. The annual gift exclusion remains at $15,000/year per person. Taxpayers planning on gifting a larger amount, may find it beneficial to split it in two or more years, if possible.

Planning for small business 20% deduction. The Tax Cuts and Jobs Act introduced a 20% qualified business income (QBI) deduction for certain trade or businesses. The deduction is limited or phased out depending on the nature of the business activity and adjusted gross income. This presents planning opportunities to maximize the 20% QBI deduction. This planning has many moving parts.

Maximize pre-tax deferrals. Now is the time for taxpayers to check their wage statements to maximize pre-tax deferrals to retirement plans, health savings accounts and flex spending heath/dependent care accounts. The 2019 employee benefit plan limits are:

- $19,000 to 401(k), 403(b) & 457(b) plans with an additional $6,000 retirement plan catch-up contribution option for taxpayers 50 or older

- Health savings account contributions are $3,500 for single taxpayers, $7,000 for families with an additional $1,000 catch-up option for taxpayers older than 55. Health flexible spending accounts maximum amounts are $2,700 and dependent care accounts are $5,000.

- If you qualify to fund individual retirement accounts, the limits in 2019 are $6,000, with an additional $1,000 contribution option for taxpayers who are 50 or older.

Income caps on benefits. Monitoring adjusted gross income (AGI) at year-end can also pay dividends in qualifying for a number of tax benefits. Often, tax savings can be realized by lowering income in one year at the expense of realizing a bit more in another year.

Life events. The biggest variables impacting taxpayers' year-end tax planning are life events such as marriage, divorce, birth or the adoption of a child, a new job or the loss of a job, and retirement. These life events may, for instance, result in a change in filing status that will affect tax liability. The possibility of significant changes and/or significant or unusual items of income or loss should also be part of a year-end tax strategy. Additionally, taxpayers need to take a look into the future and predict, if possible, any events that could trigger significant income, losses, or deductions in future years

2019 tax law changes. Nearly all of the provisions of the TCJA came into effect during 2018. However, there are many new tax laws that came into effect in 2019 that individuals should be aware of.

- ***Alimony.*** One very significant change that came into effect January 1, 2019, is the treatment of alimony. For divorces and separation agreements that occurred starting 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 that occurred before 2019, nor those altered after 2018 where the changed method of taxation is not expressly stated to apply.

- ***Medical expenses.*** The floor for claiming deductions for medical expenses increased to 10 percent for 2019 after TCJA lowered it to 7.5 percent for all taxpayers for the previous two years.

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Remember that the below significant changes came into effect in 2018 under TCJA:

- ***State and local taxes.*** TCJA limits the deduction for state and local taxes to $10,000 per year.

- ***Increased standard deduction.*** One of the most broadly impactful provisions of TCJA was the near doubling of the standard deduction for all taxpayers. For 2019, the standard deduction amounts are $24,400 for joint filers, $18,350 for heads of households, and $12,200 for all other individual filers. This increased amount makes it less likely that it is more advantageous for individuals to itemize deductions.

- ***Miscellaneous itemized deductions.*** TCJA eliminated miscellaneous itemized deductions for individuals including deductions for unreimbursed employee expenses.

These new rules suggest that opportunities remain for taxpayers before the end of the year.

Withholding. TCJA significantly impacted employee withholding, and taxpayers who didn't make appropriate adjustments in 2018 found themselves with a larger-than-expected tax bill when filing returns in 2019 (compared to the previous year). The IRS gave some relief from penalties for not withholding enough during 2018, but it is unlikely to do so again for 2019. Time remains for taxpayers to review and correct their withholding status, but that time is quickly running out!

Timing rules. Timing, and the skilled use of timing rules to accelerate and defer certain income or deductions, is the linchpin of year-end tax planning. For example, timing year-end bonuses or year-end tax payments, or timing sales of investment properties to maximize capital gains benefits should be considered. Additionally, sometimes fairly sophisticated "like-kind exchange," "installment sale" or "placed in service" rules for business or investment properties come into play.

In other situations, however, implementation of more basic concepts is just as useful. For example, taxpayers can write a check or charge an item by credit card and treat these actions as payments. It often does not matter for tax purposes when the recipient 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."

With all of this in mind, clients and friends of the firm are encouraged to contact CBM so we can collaborate with you on year-end tax planning to help save on taxes. The country's tax laws operate largely within the confines of "the tax year" so once 2019 has passed, tax savings specific to the year may be gone forever.

Please contact CBM Tax Practice Director Richard Morris with any question about your tax situation at 301.986.0600 or via email at rmorris@cbmcpa.com.