TCJA = Tax Cuts and Jobs Act

2018 TAX PLANNING TIPS

Last minute strategies to reduce your 2018 tax bill

RETIREMENT CONTRIBUTION PLANNING:

- **IRA:** Remember to plan your cash flow to make an IRA contribution by April 15, 2019. The maximum 2018 IRA contribution is $5,500 ($6,000 in 2019). If you are age 50 or older by December 31, 2018, the maximum amount is $6,500. Roth IRA contributions are restricted to adjusted gross income phaseout amounts, with complete phaseout at $135,000 for single taxpayers and $199,000 for married taxpayers. IRA plans can be set up as late as April 15, 2019.

- **401K:** The maximum 2018 contribution to your 401K is $18,500 ($19,000 in 2019). If you are age 50 or older by December 31, 2018 and your plan has been amended to allow it, the maximum amount is $24,500.

- **SEP:** The maximum 2018 SEP contribution is $55,000 ($56,000 in 2019). You have until the due date of your tax returns, including extensions, in which to make the 2018 contribution and to set up the plan.

- **Roth IRA rollover:** There is no adjusted gross income limitation that restricts the rollover of a regular IRA into a Roth IRA. Funds rolled over from a regular IRA to a Roth IRA will be taxed under the regular IRA distribution rules, but no penalties will apply. ***Effective 1/1/18 under TCJA, a Roth conversion can no longer be recharacterized. This means that any type of plan converted to a Roth IRA (including a traditional IRA, SEP, SIMPLE, 401(k) or 403(b)) cannot be undone. Be cautious of this if you make a non-deductible traditional IRA contribution that your broker immediately converts to a Roth. If your earned income was not sufficient enough to make this Roth contribution, you will be unable to recharacterize it back to a traditional IRA contribution and will be subject to penalties.***

- **IRA One-Rollover-Per-Year Rule:** You are allowed only one rollover from an IRA to another (or the same) IRA in any 12-month period, regardless of the number of IRAs you own. This applies to all IRAs including SEP and SIMPLE IRAs and traditional or Roth IRAs. Transfers that are not limited include trustee-to-trustee transfers between IRAs and rollovers from traditional IRAs to Roth IRAs.

- **Required minimum distribution (RMD):** Required minimum distributions must be made in 2018 for taxpayers that have reached age 70 ½. Failure to take a required withdrawal by 12/31/18 could result in a penalty up to 50% of the amount not withdrawn. You do have the option of delaying the required distribution to April 1, 2019 (this only applies to the year in which you turn 70 ½), but if so you will need to take a double distribution in 2019.

- **Tax-free distributions for charity:** Taxpayers over age 70 ½ are allowed to exclude IRA distributions from their gross income if they are donated to a qualified charity. This is now a permanent provision of the law.

DEDUCTION AND CREDIT PLANNING:

- **Medical expenses:** Prior to the passage of TCJA, medical expenses were only deductible if they exceeded 10% of your adjusted gross income for most taxpayers. TCJA repealed this and returned the threshold back down to **7.5% for all taxpayers.** Only expenses that are paid or charged on a credit card by December 31, 2018 are eligible.

- **Charitable contributions:** Be sure to ask for receipts to substantiate all amounts for both non-cash donations and cash donations. Cash donations can also be substantiated by canceled checks or bank statements that verify the charity's name, date and amount. Donations charged on a credit card by December 31, 2018 are eligible as a deduction for 2018, even if you don't pay the credit card balance until 2019. Donations of cars, boats, and airplanes need to be reported at their fair market value. If fair market value is more than $500 and the charity does not keep the vehicle, your deduction is limited to the amount for which the charity later sells the vehicle. Charitable contributions have varied limitations based on your adjusted gross income. Any amounts not eligible due to these limitations can be carried forward for five years. Any donation deduction amount for cars, boats and airplanes of more than $500 requires your tax return to include a statement from the charity identifying the vehicle and stating the amount for which it was sold. Be sure to obtain these statements from the charity and include them with your organizer package. ***The TCJA increased the limit on charitable contributions from 50% to 60% of your adjusted gross income. This will increase the deductible amount of charitable contributions for very limited taxpayers. There were no other changes to charitable contributions.***

Deduction "bunching"

With the dramatic increase of the standard deduction, many taxpayers that previously itemized will now be better off taking the standard deduction. However, by applying a "bunching strategy", taxpayers can accelerate or defer their discretionary medical expenses and/or charitable contributions into the tax year where it might actually create a tax benefit. For example, if you know that you will be able to itemize in 2018 but not in 2019, it would be more beneficial to do two years' worth of charitable contributions in 2018, instead of spreading out the donations over the two years.

- **Health savings accounts:** Health Savings Account (HSA) contribution limits for 2018 are $3,450 if single ($3,500 in 2019) or $6,900 for a family ($7,000 in 2019). For taxpayers aged 55 or older, the limits are $4,450 if single and $7,900 for a family.

- **Taxes:** State taxes are deductible on your federal tax return. State estimated income tax payments and property taxes that are due in 2019 can be paid in 2018. *CAUTION*: If you are subject to AMT (alternative minimum tax), there is no tax benefit by prepaying these taxes in 2018. ***TCJA limits the total deduction of state and local income taxes, property taxes and personal property taxes to a combined total of $10,000. For many taxpayers, there is no longer an advantage to pre-paying your state taxes. NOTE - For rental property owners, there is NO limit to the amount of property taxes that can be deducted as a rental expense (however, overall rental losses could still be limited based on passive loss rules).***

- **Mortgage interest:** Mortgage interest is deductible to the extent the proceeds were used to acquire, construct or improve your personal residence(s) to a maximum principal amount of $750,000 ($1,000,000 for debts acquired prior to December 15, 2017). Interest paid on home equity loans for which the proceeds were **not** used to acquire, construct or improve your personal residence is no longer deductible after the passage of the TCJA, even if the loan was acquired prior to December 15,

2017. Previously, you were allowed to deduct interest on a home equity loan up to $100,000 regardless of what the proceeds were used for. Refinancing a mortgage and taking cash proceeds may impact the amount of interest that is deductible. No part of a home equity loan is deductible for AMT purposes to the extent that it is not used to acquire, construct or improve a residence. ***The TCJA dramatically changed the mortgage interest deduction. Please see our separate sheet on TCJA changes.***

- **Miscellaneous itemized deductions:** From the passage of the TCJA, there is no longer a deduction for miscellaneous itemized deductions which were formerly deductible to the extend they exceeded 2% of your adjusted gross income. This category included tax preparation costs, investment/broker fees, union dues, unreimbursed employee expenses and safety deposit boxes. For taxpayers that incur high broker fees, consider discussing alternative options with your broker. For taxpayers with unreimbursed employee business expenses, consider discussing reimbursement options with your employer.

- **Energy *efficient* improvements:** The Bipartisan Budget Act of 2018 (BBA) reinstated the 10% credit for certain energy efficient home improvements, including extra insulation, energy saving windows or doors, or installing an energy efficient furnace. Previously this had expired in 2016. The credit has a combined limit of $500 for all tax years after 2005 ($200 limit for windows). ***Note – If you incurred any of these costs in 2017, the BBA retroactively reinstated this credit to be allowed in 2017. Please contact our office to discuss the benefits of amending your 2017 federal tax return.***

- **Energy *generating* equipment**: This credit is equal to 30% of the total cost for property such as solar electric panels or solar water heaters (excluding solar heaters installed for heating a swimming pool or hot tub). This credit was extended through 12/31/2021, but is reduced to 26% in 2020 and 22% in 2021. To receive the credit in 2018, the solar property must be placed in service before 1/1/19 (even if the project is financed or paid in future years).

- **Electric vehicle credit:** The maximum federal credit for buying an electric vehicle is $7,500, with phaseout beginning once the automaker sells 200,000 qualifying vehicles. California offers a rebate unrelated to your tax return that is applied for online at https://cleanvehiclerebate.org. For states other than California, please contact us. ***There have been no changes to the electric vehicle credit under TCJA.***

BUSINESS EXPENSE PLANNING:

- **Health insurance premiums:** As a self-employed person, you are able to deduct 100% of health insurance premiums paid for yourself, your spouse, and your dependents. This also includes dental and vision insurance, plus limited amounts for long-term care insurance. It does not include disability or life insurance.

- **Depreciation:**
  - *"Section 179 deduction"* Equipment purchases are eligible for a "Section 179 deduction" of up to $1,000,000 for 2018 (previously $510,000 in 2017). The equipment must be "placed in service" by December 31, 2018. Note that purchasing too much equipment (over $2,500,000) will restrict your total "Section 179 deduction".
  - *Bonus depreciation* The TCJA increased bonus depreciation to a 100% first-year deduction for qualified new and used property placed in service after September 27, 2017 and before 2023. Pre-act law provided for only a 50% bonus depreciation deduction and was to be phased out after 2017. Pre-act law also only allowed bonus depreciation on new property.

INVESTMENT PLANNING:

- **<u>Capital gains and losses:</u>** Income that results from the sales of stock, investment property, and rental property (above depreciation recapture) is considered capital. Long-term gains result from sales that have been held over one year. The federal income tax rate on long-term capital gains is limited to 20% in 2018. The Medicare surtax of 3.8% on investment income for taxpayers with income exceeding certain thresholds also took effect in 2013. Losses are deductible to the extent of gains plus $3,000. Any excess loss is carried over to subsequent years for an unlimited amount of time. *CAUTION*: If you are subject to AMT (alternative minimum tax), the capital gains tax rate benefit may be partially offset by an increased AMT liability amount. ***There were no changes to the capital gains tax rates under TCJA.***

- **<u>Sale of home:</u>** When selling your principal residence, you may exclude up to $500,000 of capital gain if married or $250,000 of capital gain if single. A sale of a home in 2018 (and beyond) could trigger the increased capital gain rate and the 3.8% Medicare surtax if there is a taxable gain. Since there is no exclusion for the sale of a second home, vacation home, or rental property, the entire capital gain could be subject to these higher rates for sales in 2018 and beyond. ***There were no changes related to the sale of your home under TCJA.***

- **<u>Gifts</u>:** Amounts transferred up to $15,000 per person per year in 2018 are considered exempt from gift taxation. Amounts given above this amount require the "giver" to file a gift tax return and either elect to use part of their "life-time exclusion" or to pay a gift tax. This tax return is due April 15, 2019 or October 15, 2019 if an extension is filed. There are no requirements for the recipient of the gift. The 2019 limit is $15,000.

- **<u>Social security:</u>** Up to 85% of social security benefits may be taxable depending on your modified adjusted gross income. For one-time events you should give consideration to the year of receipt. Please call us for an individualized analysis.

- **<u>Net operating loss (NOL):</u>** A net operating loss occurs if certain non-personal income and expenses create a negative amount. Under pre-TCJA law, the loss was first carried back to the previous two years and then forward for twenty years and there was no limit to the amount of loss available to be used. The TCJA repealed the net operating loss carryback (with limited exceptions), but is still allowed to be carried forward indefinitely (there is no longer a 20-year expiration). The TCJA also limited the amount of the NOL that is available for use to 80% of the taxpayer's taxable income.

ALTERNATIVE MINIMUM TAX:

- Some of the standard year-end planning ideas will not reduce tax liability if you are subject to the alternative minimum tax (AMT) because different rules apply. Because of the complexity of the AMT, we recommend a personalized analysis of your AMT exposure, which will include the preparation of a tax projection report. ***Please see our separate sheet regarding TCJA changes to AMT.***