

2019 – 2020



# TAX PLANNING Guide

Year-round strategies to make the tax laws work for you

## Tax planning is as essential as ever



L

ast year, most of the provisions of the massive Tax Cuts and Jobs Act (TCJA) went into effect. They included small income tax rate reductions for most individual tax brackets and a substantial reduction for corporations. The TCJA also provided a large tax deduction for owners of pass-through entities, doubled the standard deduction and child credits, and significantly increased exemptions for the individual alternative minimum tax (AMT) and the estate tax.

But it wasn't all good news for taxpayers. The TCJA also eliminated or limited many tax breaks, and much of the tax relief provided is only temporary (unless Congress acts to make it permanent).

What does this all mean? Tax planning is as essential as ever.

This guide provides an overview of the most consequential changes under the TCJA and other key tax provisions you need to be aware of. It offers a variety of strategies for minimizing your taxes in the current tax environment. Use it to work closely with your tax advisor to identify the best strategies for your particular situation. He or she also can keep you apprised of any new tax law developments that occur this year that might affect you.

### Contents

Income & Deductions.....	2
Family & Education.....	6
Investing .....	10
Business.....	14
Retirement.....	22
Estate Planning .....	26
Tax Rates.....	30

## Deductions aren't what they once were, but tax-saving opportunities remain



**F**or many taxpayers, deductions aren't as powerful as they used to be, before several significant Tax Cuts and Jobs Act (TCJA) provisions went into effect last year. For example, the TCJA generally reduced tax rates, and deductions save less tax when rates are lower. The TCJA also reduced or eliminated many deductions. But proper timing of deductible expenses can still help maximize your tax savings. So can taking advantage of other breaks related to your home and your health care.

### Standard deduction vs. itemizing

Taxpayers can choose to either itemize certain deductions or take the standard deduction based on their filing status. Itemizing deductions when the total will be larger than the standard deduction saves tax, but it makes filing more complicated.

The TCJA nearly doubled the standard deduction for each filing status. Those amounts are to be annually adjusted for inflation through 2025, after which they're scheduled to drop back to the amounts under pre-TCJA law. (See Chart 1 for 2019 amounts.)

The combination of a higher standard deduction and the reduction or elimination of many itemized deductions means that some taxpayers who once benefited from itemizing are now better off taking the standard deduction.

### State and local tax deduction

Through 2025, your entire itemized deduction for state and local taxes — including property tax and the greater of income or sales tax — is limited to \$10,000 (\$5,000 if you're married filing separately).

**CHART 1** 2019 standard deduction

Filing status	Standard deduction <sup>1</sup>
Singles and separate filers	\$ 12,200
Heads of households	\$ 18,350
Joint filers	\$ 24,400

<sup>1</sup> Taxpayers age 65 or older or blind can claim an additional standard deduction: \$1,300 if married, \$1,650 if unmarried.

Deducting sales tax instead of income tax may be beneficial if you reside in a state with no, or low, income tax or you purchased a major item, such as a car or boat.

### Home-related breaks

Consider both deductions and exclusions in your tax planning:

**Property tax deduction.** As noted above, through 2025 your property tax deduction is subject to the limit on deductions for state and local taxes.



**Mortgage interest deduction.** You generally can claim an itemized deduction for interest on mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your principal residence also may be deductible. Through 2025, the TCJA reduces the mortgage debt limit from \$1 million to \$750,000 for debt incurred after Dec. 15, 2017, with some limited exceptions.

**Home equity debt interest deduction.** Through 2025, the TCJA effectively limits the home equity interest deduction to debt that would qualify for the home mortgage interest deduction. (Under pre-TCJA law, interest was deductible on up to \$100,000 of home equity debt used for any purpose, such as to pay off credit card debt or to buy a car.)

**Home office deduction.** If you're an employee and work from home, home office expenses aren't deductible through 2025, because of the suspension of miscellaneous itemized deductions subject to the 2% of adjusted gross income floor. (If you're self-employed, you may still be able to deduct home office expenses. See Case Study 5 on page 20.)

**Personal casualty and theft loss deduction.** Through 2025, this itemized deduction is suspended except if the loss was due to an event officially declared a disaster by the President.

**Rental income exclusion.** If you rent out all or a portion of your principal residence or second home for less than 15 days, you don't have to report the income. But expenses directly associated with the rental, such as advertising and cleaning, won't be deductible.

**Home sale gain exclusion.** When you sell your principal residence, you can exclude up to \$250,000 of gain (\$500,000 for married couples filing jointly) if you meet certain tests.

**Warning:** Gain that's allocable to a period of "nonqualified" use generally isn't excludable.

**Loss deduction.** If you sell your home at a loss and part of your home is rented out or used exclusively for your business, the loss attributable to that portion may be deductible.

**Moving expenses.** Through 2025, work-related moving expenses are deductible only by active-duty members of the Armed Forces (and their spouses or dependents) who move because of a military order that calls for a permanent change of station. (If you're eligible, you don't have to itemize to claim this deduction.)

### Charitable donations

Donations to qualified charities are generally fully deductible — but only if you itemize deductions. If itemizing no longer will save you tax because of the increased standard deduction, you won't get a federal income tax benefit from charitable gifts. However, you might benefit from "bunching" donations into alternating years if your total itemized deductions in those years would then surpass your standard deduction. You can then itemize just in those years.

For large donations, discuss with your tax advisor which assets to give and the best ways to give them. For example, appreciated publicly traded stock you've held more than one year can make one of the best charitable gifts because you can deduct the current fair market value and avoid the capital gains tax you'd pay if you sold the property. You can enjoy the capital gains tax savings whether or not you itemize deductions.

### Tax-advantaged saving for health care

You may be able to save taxes without having to worry about the medical expense deduction floor (see "What's new!" at right) by contributing to one of these accounts:

**HSA.** If you're covered by a qualified high-deductible health plan, you can contribute pretax income to an employer-sponsored Health Savings Account — or make deductible contributions to an HSA you set up yourself — up to \$3,500 for self-only coverage and \$7,000 for family coverage (plus \$1,000 if you're age 55 or older) for 2019. HSAs can bear interest or be invested, growing tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year, allowing the account to grow.

**WHAT'S  
NEW!****It may be harder to deduct  
medical expenses this year**

If medical expenses not paid via tax-advantaged accounts or reimbursable by insurance exceed a certain percentage of your adjusted gross income (AGI), you can claim an itemized deduction for the amount exceeding that “floor.” The

TCJA had reduced the floor from 10% to 7.5% for 2017 and 2018, but it will be 10% when you file your 2019 tax return unless Congress extends the 7.5% floor. (Check with your tax advisor for the latest information.)

Eligible expenses may include health insurance premiums, long-term-care insurance premiums (limits apply), medical and dental services, and prescription drugs. Mileage driven for health care purposes also can be deducted — at 20 cents per mile for 2019.

Consider bunching elective medical procedures (and any other services and purchases whose timing you can control without negatively affecting your or your family’s health) into alternating years if it would help you exceed the applicable floor and you’d have enough total itemized deductions to benefit from itemizing.

**FSA.** You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit — not to exceed \$2,700 in 2019. The plan pays or reimburses you for qualified medical expenses. What you don’t use by the plan year’s end, you generally lose — though your plan might allow you to roll over up to \$500 to the next year. Or it might give you a 2½-month grace period to incur expenses to use up the previous year’s contribution. If you have an HSA, your FSA is limited to funding certain permitted expenses.

### **Alternative minimum tax**

Before timing deductions, consider the AMT — a separate tax system that disallows some tax deductions, such as for state and local taxes, and treats certain income items differently, such as incentive stock option exercises. You must pay the AMT if your AMT liability exceeds your regular tax liability.

The TCJA substantially increases the AMT exemptions through 2025. (See Chart 9 on page 31.) Combined with other TCJA changes, the result is that very few taxpayers will be at AMT risk. Your tax advisor can help you determine if you’re among the small number of taxpayers who need to plan for the AMT. ■

## Make saving taxes a family tradition



**W**

hile the Tax Cuts and Jobs Act (TCJA) has reduced or eliminated many tax breaks for the next several years, most child- and education-related breaks remain intact. Some have even been enhanced. Be sure you and your family take advantage of available credits, deductions and other tax-saving opportunities to make saving taxes a family tradition.

### Child, dependent and adoption credits

Through 2025, the TCJA expands tax credits for families, doubling the child credit and adding a “family” credit for dependents who don’t qualify for the child credit. Tax credits reduce your tax bill dollar for dollar, so for many taxpayers these expanded credits will make up for the TCJA’s suspension of dependency exemptions:

- ▲ For each child under age 17 at the end of 2019, you may be able to claim a \$2,000 credit. The credit still phases out for higher-income taxpayers (see Chart 2), but the income ranges are much higher than before the TCJA. So more taxpayers are now benefiting from the credit.
- ▲ For each qualifying dependent other than a qualifying child (such as a dependent child age 17 or older or a dependent elderly parent), a \$500 family credit is now available. But it’s also subject to the income-based phaseout.

If you adopt in 2019, you may qualify for the adoption credit — or for an employer adoption assistance program income exclusion. Both are \$14,080 for 2019, but the credit is also subject to an income-based phaseout. (See Chart 2.)

### Dependent care breaks

A couple of tax breaks can help offset the costs of dependent care:

**Tax credit.** For children under age 13 or other qualifying dependents, you may be eligible for a credit for a portion of your dependent care expenses. Generally, the credit equals 20% of the first \$3,000 of qualified expenses for one child or 20% of up to \$6,000 of such expenses for two or more children. So, the maximum credit is usually \$600 for one child or \$1,200 for two or more children.

**FSA.** For 2019, you can contribute up to \$5,000 pretax to an employer-sponsored child and dependent care Flexible Spending Account. The plan pays or reimburses you for these expenses. You can't claim a tax credit for expenses reimbursed through an FSA.

### “Kiddie tax”

The “kiddie tax” generally applies to most unearned income of children under age 19 and of full-time students under age 24 (unless the students provide more than half of their own support from earned income). Before 2018, unearned income subject to the kiddie tax was generally taxed at the parents' tax rate.

Through 2025, the TCJA makes the kiddie tax harsher. Now a child's unearned income beyond \$2,200 (for 2019) will be taxed according to the tax brackets used for trusts and estates, which for 2019 are taxed at the highest marginal rate of 37% once taxable income exceeds \$12,750. (See Chart 8 on page 30.) In contrast, for a married couple filing jointly, the 37% rate doesn't kick in until their 2019 taxable income tops \$612,350. In other words, children's unearned income often will be taxed at *higher* rates than their parents' income.

**CHART 2**

### Child and education breaks<sup>1</sup>: Are you subject to a phaseout?

Tax break	MAGI <sup>2</sup> phaseout range	
	Single / Head of household <sup>3</sup>	Married filing jointly
Child credit	\$200,000 – \$240,000	\$400,000 – \$440,000
Adoption credit	\$211,160 – \$251,160	\$211,160 – \$251,160
American Opportunity credit	\$ 80,000 – \$ 90,000	\$160,000 – \$180,000
Lifetime Learning credit	\$ 58,000 – \$ 68,000	\$116,000 – \$136,000
Student loan interest deduction	\$ 70,000 – \$ 85,000	\$140,000 – \$170,000
ESA contribution	\$ 95,000 – \$110,000	\$190,000 – \$220,000

<sup>1</sup> Assumes one child or student. Amounts may vary for more than one child or student. Other rules and limits might reduce the break.

<sup>2</sup> Modified adjusted gross income.

<sup>3</sup> These ranges also apply to married taxpayers filing separately, except that separate filers aren't eligible for the American Opportunity or Lifetime Learning credit or the student loan interest deduction.



## 529 plans

If you're saving for education expenses, consider a Section 529 plan. You can choose a prepaid tuition plan to secure current tuition rates or a tax-advantaged savings plan to fund education expenses:

- ▲ Although contributions aren't deductible for federal purposes, any growth is tax-deferred. (Some states do offer breaks for contributing.)
- ▲ Distributions used to pay qualified postsecondary school expenses (such as tuition, mandatory fees, books, supplies, computer equipment, software, Internet service and, generally, room and board) are income-tax-free for federal purposes and typically for state purposes as well, making the tax deferral a permanent savings.
- ▲ The TCJA permanently allows tax-free distributions for elementary and secondary school tuition of up to \$10,000 per year per student.
- ▲ The plans usually offer high contribution limits, and there are no income limits for contributing.
- ▲ There's generally no beneficiary age limit for contributions or distributions.
- ▲ You can control the account, even after the child is of legal age.
- ▲ You can make tax-free rollovers to another qualifying family member.
- ▲ A special break for 529 plans allows you to front-load five years' worth of annual gift tax exclusions and make up to a \$75,000 contribution (or \$150,000 if you split the gift with your spouse) per beneficiary in 2019.

### CASE STUDY 1

### Why Roth IRAs are tax-smart for teens

Zach, 16, is starting his first part-time job this year. Zach's parents would like to get him in the habit of saving for the future, and they ask their tax advisor for the most tax-advantaged option. She suggests a Roth IRA, which can be perfect for teenagers because they likely have many decades to let their accounts grow tax-free.

Roth IRA contributions aren't deductible, but if Zach earns no more than the standard deduction for singles (\$12,200 for 2019) and has no unearned income, he'll pay zero federal income tax anyway. So the tax-free treatment of future qualified distributions will be well worth the loss of any current deduction.

If Zach doesn't want to invest too much of his hard-earned money, his parents could *give* him some of the amount he's eligible to contribute. For example, if Zach earns \$6,000 for the year, his parents could give him \$5,000 so he could contribute the full \$6,000 he's eligible to contribute but still have \$5,000 to spend as he wishes (or save for a shorter-term goal).

The biggest downsides of 529 plans may be that your investment options — and when you can change them — are limited.

### ESAs

Coverdell Education Savings Accounts are similar to 529 savings plans in that contributions aren't deductible for federal purposes, but plan assets can grow tax-deferred and distributions used to pay qualified education expenses are income-tax-free. ESAs are worth considering if you'd like to have direct control over how your contributions are invested or you want to pay elementary or secondary school expenses in excess of \$10,000 or that aren't tuition.

But the \$2,000 contribution limit is low, and it's phased out based on income. (See Chart 2 on page 7.) Also, contributions can generally be made only for beneficiaries under age 18. When the beneficiary turns age 30, the ESA generally must be distributed within 30 days, and any earnings may be subject to tax and a 10% penalty.

### Education credits and deductions

If you have children in college now, are currently in school yourself or are paying off student loans, you may be eligible for a credit or deduction:

**American Opportunity credit.** The tax break covers 100% of the first \$2,000 of tuition and related expenses and 25% of the next \$2,000 of expenses. The maximum credit, *per student*, is \$2,500 per year for the first four years of postsecondary education.

**Lifetime Learning credit.** If you're paying postsecondary education expenses beyond the first four years, you may benefit from the Lifetime Learning credit (up to \$2,000 *per tax return*).

**Student loan interest deduction.** If you're paying off student loans, you may be able to deduct the interest. The limit is \$2,500 *per tax return*.

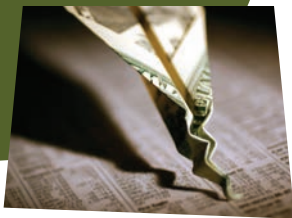
**Warning:** Income-based phaseouts apply to these breaks. (See Chart 2 on page 7.) If your income is too high for you to qualify, your child might be eligible.

### ABLE accounts

Achieving a Better Life Experience accounts offer a tax-advantaged way to fund qualified disability expenses for a beneficiary who became blind or disabled before age 26. For federal purposes, tax treatment is similar to that of Sec. 529 college savings plans.

Under the TCJA, through 2025, 529 plan funds can be rolled over to an ABLE account without penalty if the ABLE account is owned by the beneficiary of the 529 plan or a member of the beneficiary's family. Such rolled-over amounts count toward the overall ABLE account annual contribution limit (\$15,000 for 2019). ■

## Time to take another look at the impact of taxes on your portfolio



**W**hen it comes to investing, the focus is often on returns — without regard to their potential tax impact. Because tax rates have continued to be relatively low, it's not surprising that there's been more focus on stock market volatility than on tax consequences. But, while the Tax Cuts and Jobs Act (TCJA) didn't change the long-term capital gains rates, its changes to ordinary-income tax rates and tax brackets do affect the tax you pay on investments. So it's time to take another look at the impact of taxes on your portfolio.

### Capital gains tax and timing

Although time, not timing, is generally the key to long-term investment success, timing can have a dramatic impact on the tax consequences of investment activities. Your long-term capital gains rate can be as much as 20 percentage points lower than your ordinary-income tax rate, even with the reductions to most ordinary-income rates under the TCJA. The long-term gains rate applies to investments held for more than 12 months and remains at 15% for middle-bracket taxpayers. A 20% long-term capital gains rate still applies to higher-income taxpayers.

Because of TCJA-related changes to the brackets, through 2025, the 20% rate kicks in before the top ordinary-income rate does. (See Chart 3 on page 11 and Chart 9 on page 31.) Higher rates also still apply to certain types of assets. (See Chart 3.) But taxpayers in the bottom two brackets generally continue to enjoy a 0% long-term capital gains rate.

Holding on to an investment until you've owned it more than one year may help substantially cut tax on any gain. Here are some other tax-saving strategies related to timing:

**Use unrealized losses to absorb gains.** To determine capital gains tax liability, realized capital gains are netted against realized capital losses. Both long- and short-term gains and losses can offset one another. If you've cashed in some big gains during the year and want to reduce your 2019 tax liability, look for unrealized losses in your portfolio and consider selling them before year end to offset your gains.

**Avoid wash sales.** If you want to achieve a tax loss with minimal change in your portfolio's asset allocation, consider the wash sale rule. It prevents you from taking a loss on a security if you buy a substantially identical security (or an option to buy such a security) within 30 days before or after you sell the security that created the loss. You can recognize the loss only when you sell the replacement security.

Fortunately, there are ways to avoid triggering the wash sale rule and still achieve your goals. For example, you can immediately buy securities of a different company in the same industry or shares in a mutual fund that holds securities much like the ones you sold. Or, you can wait 31 days to repurchase the same security. Alternatively, before selling the security, you can purchase additional shares of that security equal to the number you want to sell at a loss, and then wait 31 days to sell the original portion.

**Swap your bonds.** With a bond swap, you sell a bond, take a loss and then immediately buy another bond of similar quality and duration from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical. Thus, you achieve a tax loss with virtually no change in economic position.

### CHART 3 What's the maximum 2019 capital gains tax rate?

Type of gain	Rate <sup>1</sup>
Short-term (assets held 12 months or less)	Taxpayer's ordinary-income tax rate
Long-term (assets held more than 12 months)	15%
<b>Some key exceptions</b>	
Long-term gain of certain higher-income taxpayers	20% <sup>2</sup>
Most long-term gain that would be taxed at 10% or 12% based on the taxpayer's ordinary-income rate	0%
Long-term gain on collectibles, such as artwork and antiques	28%
Long-term gain attributable to certain recapture of prior depreciation on real property	25%

<sup>1</sup> In addition, the 3.8% NIIT applies to net investment income to the extent that modified adjusted gross income (MAGI) exceeds \$200,000 (singles and heads of households), \$250,000 (married filing jointly) or \$125,000 (married filing separately).

<sup>2</sup> The 20% rate applies to taxpayers with taxable income exceeding \$434,550 (singles), \$461,700 (heads of households), \$488,850 (joint filers) or \$244,425 (separate filers).

**CASE  
STUDY 2****Turning a capital loss  
into a tax-saving opportunity**

Miriam's year-to-date net realized losses are \$13,000. Her portfolio includes \$20,000 of stock that she paid only \$10,000 for. Miriam has been thinking about selling it to diversify her portfolio, but she's been concerned about the capital gains tax.

Her tax advisor suggests that now might be a good time to sell the stock because her \$10,000 gain would essentially be tax-free: The gain would absorb \$10,000 of losses, leaving Miriam with a \$3,000 net loss that she could use to offset ordinary income.

**Mind your mutual funds.** Mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you more tax dollars because of the lower long-term rates.

Also pay attention to earnings reinvestments. Unless you or your investment advisor increases your basis accordingly, you may report more gain than required when you sell the fund. Brokerage firms are required to track (and report to the IRS) your cost basis in mutual funds acquired during the tax year.

Finally, beware of buying equity mutual fund shares late in the year. Such funds often declare a large capital gains distribution at year end. If you own the shares on the distribution's record date, you'll be taxed on the full distribution amount even if it includes significant gains realized by the fund before you owned the shares.

### Loss carryovers

If net losses exceed net gains, you can deduct only \$3,000 (\$1,500 for married taxpayers filing separately) of the net losses per year against other income (such as wages, self-employment and business income, dividends and interest).

You can carry forward excess losses until death. Loss carryovers can be a powerful tax-saving tool in future years if you have a large investment portfolio, real estate holdings or a closely held business that might generate substantial future capital gains.

### Income investments

Some types of investments produce income in the form of dividends or interest. Here are some tax consequences to consider:

**Dividend-producing investments.** Qualified dividends are taxed at the favorable long-term capital gains tax rate rather than at your higher ordinary-income tax rate.

**Interest-producing investments.** Interest income generally is taxed at ordinary-income rates. So stocks that pay qualified dividends may be more attractive taxwise than other income investments, such as CDs and taxable bonds. But also consider nontax issues, such as investment risk, rate of return and diversification.

**Bonds.** These also produce interest income, but the tax treatment varies:

- ▲ Interest on U.S. government bonds is taxable on federal returns but exempt by federal law on state and local returns.
- ▲ Interest on state and local government bonds is excludable on federal returns. If the bonds were issued in your home state, interest also may be excludable on your state return.
- ▲ Tax-exempt interest from certain private-activity municipal bonds can trigger or increase the alternative minimum tax (AMT), but the AMT now occurs more rarely. (See page 5.)
- ▲ Corporate bond interest is taxable for federal *and* state purposes.
- ▲ Bonds (except U.S. savings bonds) with original issue discount build up “interest” as they rise toward maturity. You’re generally considered to earn a portion of that interest annually — even though the bonds don’t pay this interest annually — and you must pay tax on it.

### 3.8% NIIT

Taxpayers with modified adjusted gross income (MAGI) over \$200,000 per year (\$250,000 if married filing jointly and \$125,000 if married filing separately) may owe the net investment income tax, in addition to other taxes already discussed here. The NIIT equals 3.8% of the lesser of your net investment income or the amount by which your MAGI exceeds the applicable threshold. Net investment income can include capital gains, dividends, interest, rental income and other investment-related income (but not business income or self-rental income from an active trade or business).

Many of the strategies that can help you save or defer income tax on your investments can also help you avoid or defer NIIT liability. And because the threshold for the NIIT is based on MAGI, strategies that reduce your MAGI could also help you avoid or reduce NIIT liability.

### Nontax considerations

Although tax considerations are important, don’t let them control your investment decisions. Also consider your investment goals, time horizon, risk tolerance, factors related to the investment itself, and fees and charges that apply to buying and selling securities. ■

## Businesses may need to adjust their tax strategies



**T**he Tax Cuts and Jobs Act (TCJA) included a multitude of business-related provisions, most of which went into effect last year. Although the changes are no longer brand new, the TCJA's complexities mean that businesses are still figuring out the exact impact — and how to adjust their tax strategies accordingly.

### Business structure

Income taxation and owner liability are the main factors that differentiate one business structure from another. Many businesses choose entities that combine pass-through taxation with limited liability, namely limited liability companies (LLCs) and S corporations. But TCJA changes warrant revisiting the tax consequences of business structure.

The now-flat corporate rate (21%) is significantly lower than the top individual rate (37%), providing significant tax benefits to C corporations and helping to mitigate the impact of double taxation for their owners. In addition, the corporate alternative minimum tax (AMT) has been repealed, while the individual AMT remains (though it will affect far fewer taxpayers — see page 5). But, the TCJA also introduced a powerful deduction for owners of pass-through entities. (See the next page.)

For tax or other reasons, a structure change may be beneficial in certain situations. But there also may be unwelcome tax consequences that effectively prevent such a change.

**CHART 4** 2019 income tax differences based on business structure

Flow-through entity or sole proprietorship	C corporation
One level of taxation: The business's income flows through to the owner(s).	Two levels of taxation: The business is taxed on income, and then shareholders are taxed on any dividends they receive.
Losses flow through to the owner(s).	Losses remain at the corporate level.
The top individual tax rate is 37%, but, for eligible taxpayers, up to 20% of qualified business income is deductible.	The flat corporate tax rate is 21%, and the top rate on qualified dividends is 20%.

## Sec. 199A deduction for pass-through businesses

Through 2025, the TCJA provides the Sec. 199A deduction for sole proprietorships and owners of pass-through business entities, such as partnerships, S corporations, and LLCs that are treated as sole proprietorships, partnerships or S corporations for tax purposes. The deduction generally equals 20% of qualified business income (QBI), subject to limitations that can begin to apply if taxable income exceeds the applicable threshold — \$160,700 or, if married filing jointly, \$321,400 (\$160,725 for separate filers). The limits fully apply when taxable income exceeds \$210,700 and \$421,400 (\$210,725), respectively.

QBI is generally defined as the net amount of qualified items of income, gain, deduction and loss that are effectively connected with the conduct of a U.S. business. QBI doesn't include certain investment items, reasonable compensation paid to an owner for services rendered to the business, or any guaranteed payments to a partner or LLC member treated as a partner for services rendered to the partnership or LLC.



The 199A deduction isn't allowed in calculating the owner's adjusted gross income, but it reduces taxable income. In effect, it's treated the same as an allowable itemized deduction (though you don't have to itemize to claim it).

When the income-based limit applies to owners of pass-through entities, the 199A deduction generally can't exceed the greater of the owner's share of:

- ▲ 50% of the amount of W-2 wages paid to employees by the qualified business during the tax year, or
- ▲ The sum of 25% of W-2 wages plus 2.5% of the cost of qualified property.

Qualified property is the depreciable tangible property (including real estate) owned by a qualified business as of year end and used by the business at any point during the tax year to produce qualified business income. Additional rules apply.

Another limitation for taxpayers subject to the income-based limit is that the 199A deduction generally isn't available for income from "specified service businesses." Examples include businesses that involve investment-type services and most professional practices (other than engineering and architecture).

The W-2 wage and property limitations and the service business limitation don't apply if your taxable income is under the applicable threshold. In that case, you should qualify for the full 20% deduction.



## Projecting income

Projecting your business's income for this year and next can allow you to time income and deductions to your advantage. It's generally — but not always — better to defer tax, so consider:

**Deferring income to next year.** If your business uses the cash method of accounting, you can defer billing for products or services at year end. If you use the accrual method, you can delay shipping products or delivering services.

**Accelerating deductible expenses into the current year.** If you're a cash-basis taxpayer, you may pay business expenses by Dec. 31, so you can deduct them this year rather than next. Both cash- and accrual-basis taxpayers can charge expenses on a credit card and deduct them in the year charged, regardless of when the credit card bill is paid.

**Warning:** Don't let tax considerations get in the way of sound business decisions. For example, the negative impact of these strategies on your cash flow or customers may not be worth the potential tax benefit.

**Taking the opposite approach.** If your business is a flow-through entity and it's likely you'll be in a higher tax bracket next year, accelerating income and deferring deductible expenses may save you more tax over the two-year period.

## Depreciation

For assets with a useful life of more than one year, you generally must depreciate the cost over a period of years. In most cases, the Modified Accelerated Cost Recovery System (MACRS) will be preferable to other methods because you'll get larger deductions in the early years of an asset's life.

But if you make more than 40% of the year's asset purchases in the last quarter, you could be subject to the typically less favorable midquarter convention. Careful planning can help you maximize depreciation deductions in the year of purchase.

Other depreciation-related breaks and strategies may be available and, in many cases, have been enhanced by the TCJA:

**Section 179 expensing election.** This allows you to deduct (rather than depreciate over a number of years) the cost of purchasing eligible new or used assets, such as equipment, furniture, off-the-shelf computer software, and, under the TCJA, qualified improvement property, certain depreciable tangible personal property used predominantly to furnish lodging, and the following improvements to nonresidential real property: roofs, HVAC equipment, fire protection and alarm systems, and security systems.

CASE  
STUDY 3

## Demystifying vehicle-related deductions



Julia is considering buying some new vehicles for her business this year. She wants to know how the tax breaks available to her might be affected by the type of vehicle she buys or how the vehicle is used. So she consults her tax advisor.

He tells Julia that purchases of *new* or *used* vehicles may be eligible for Sec. 179 expensing, and she may want to buy a large truck or SUV to maximize her deduction. The normal Sec. 179 expensing limit (see page 16) generally applies to vehicles with a gross vehicle weight rating of more than 14,000 pounds. A \$25,000 limit applies to vehicles (typically SUVs) rated at more than 6,000 pounds, but no more than 14,000 pounds.

But even if Julia prefers to buy a smaller vehicle, she can still potentially enjoy a valuable first-year deduction. Vehicles rated at 6,000 pounds or less are subject to the passenger vehicle limits, and for 2019 the first-year depreciation limit is \$18,000 (\$10,000 plus \$8,000 bonus depreciation).

Julia's advisor also explained that, if she uses a vehicle for business and personal purposes, the associated expenses, including depreciation, must be allocated between deductible business use and nondeductible personal use. He also warns her that, if business use is 50% or less, she won't be able to use Sec. 179 expensing or the accelerated regular MACRS; she'll have to use the straight-line method.

For qualifying property placed in service in 2019, the expensing limit is \$1.02 million. The break begins to phase out dollar for dollar when asset acquisitions for the year exceed \$2.55 million. (These amounts are annually adjusted for inflation.)

**Bonus depreciation.** This additional first-year depreciation is available for qualified assets, which include new tangible property with a recovery period of 20 years or less (such as office furniture and equipment), off-the-shelf computer software, and water utility property. But due to a drafting error in the TCJA, qualified improvement property will be eligible for bonus depreciation only if a technical correction is issued. (Check with your tax advisor for the latest information.)

Under the TCJA, through Dec. 31, 2026, the definition has been expanded to include used property and qualified film, television and live theatrical productions. For qualified assets placed in service through Dec. 31, 2022, bonus depreciation is 100%. For 2023 through 2026, bonus depreciation is scheduled to be gradually reduced. For certain property with longer production periods, these reductions are delayed by one year.

**Warning:** Under the TCJA, in some cases a business may not be eligible for bonus depreciation. Examples include real estate businesses that elect to deduct 100% of their business interest and dealerships with floor-plan financing, if they have average annual gross receipts of more than \$25 million for the three previous tax years.

### Employee benefits

Offering a variety of benefits not only can help you attract and retain the best employees, but also may save tax because you generally can deduct your contributions:

**Qualified deferred compensation plans.** These include pension, profit-sharing, SEP and 401(k) plans, as well as SIMPLEs.

You take a tax deduction for your contributions to employees' accounts. (For information on the benefits to employees, see page 22.) Certain small employers may also be eligible for a credit when setting up a plan. (See page 21.)

**HSAs and FSAs.** If you provide employees with a qualified high-deductible health plan (HDHP), you can also offer them Health Savings Accounts. (See page 4.) Regardless of the type of health insurance you provide, you can offer Flexible Spending Accounts for health care. (See page 5.) If you have employees who incur day care expenses, consider offering FSAs for child and dependent care. (See page 7.)

#### CASE STUDY 4

### Entertainment, meals and transportation: What's deductible?



Andre used to regularly claim business deductions for meal, entertainment, vehicle and travel expenses, as well as employee reimbursements of such expenses. He knew that some of these deductions were eliminated under the Tax Cuts and Jobs Act, but he wasn't sure which ones. So he consulted his tax advisor. Here's what she told him:

**Entertainment.** These expenses are no longer deductible.

**Meals.** Meal expenses incurred while traveling on business are still 50% deductible. However, the 50% disallowance rule now also applies to meals provided via an on-premises cafeteria or otherwise on the employer's premises for the convenience of the employer.

**Transportation.** Employer deductions for the cost of providing commuting transportation to an employee (such as hiring a car service) are no longer allowed, unless the transportation is necessary for the employee's safety. Also eliminated are employer deductions for the cost of providing qualified employee transportation fringe benefits (for example, parking allowances, mass transit passes and van pooling). However, those benefits are still tax-free to recipient employees. Transportation expenses for business travel are still 100% deductible, provided they meet the applicable rules.

**HRAs.** A Health Reimbursement Account reimburses an employee for medical expenses up to a maximum dollar amount. Unlike an HSA, no HDHP is required. Unlike an FSA, any unused portion can be carried forward to the next year. But only the employer can contribute to an HRA.

**Fringe benefits.** Certain fringe benefits aren't included in employee income, yet the employer can still deduct the portion, if any, that it pays and typically also avoid payroll taxes. Examples are employee discounts, group term-life insurance (up to \$50,000 per person) and health insurance.

**Warning:** You might be penalized for not offering health insurance. The Affordable Care Act (ACA) can in some cases impose a penalty on “large” employers if they don't offer full-time employees “minimum essential coverage” or if the coverage offered is “unaffordable” or doesn't provide “minimum value.”

### Interest expense deduction

Generally, under the TCJA, interest paid or accrued by a business is deductible up to 30% of “adjusted taxable income.” Taxpayers (other than tax shelters) with average annual gross receipts of \$25 million or less for the three previous tax years are exempt from the interest expense deduction limitation.

Some other taxpayers are also exempt. For example, real property businesses can elect to fully deduct their interest, but then would be required to use the alternative depreciation system for real property used in the business.

### Loss deductions

A loss occurs when a business's expenses and other deductions for the year exceed its revenues. Tax treatment differs based on whether the business is a C corporation or a pass-through entity, and the TCJA made changes to the tax treatment of both types of losses:

**C corporation net operating losses (NOLs).** For NOLs that arise in tax years *starting* after Dec. 31, 2017, the maximum amount of taxable income that can be offset with NOL deductions is generally reduced from 100% to 80%. In addition, NOLs incurred in tax years *ending* after Dec. 31, 2017, generally can't be carried back to an earlier tax year but can be carried forward indefinitely (as opposed to the 20-year limit under pre-TCJA law). (Congress might make a technical correction to address the difference in effective dates. Check with your tax advisor for the latest information.)

**Pass-through entity “excess” business losses.** Through 2025, a limit applies to deductions for current-year business losses incurred by noncorporate taxpayers: Such losses generally can't offset more than \$255,000 (for 2019) of income from other sources, such as

**CASE  
STUDY 5****Many deductions  
available for the self-employed**

Nicole left her full-time job earlier this year to join the gig economy and had to begin making estimated tax payments for the first time in her life. To be sure she was doing everything correctly, she visited her tax advisor.

He let Nicole know that along with the extra tax-paying responsibilities come some additional tax deductions. First, while she has to pay both the employee and employer portions of employment taxes on her self-employment income, the employer portion (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible “above the line,” which means she doesn’t have to itemize to claim the deduction.

In addition, Nicole can deduct 100% of health insurance costs for herself, and if she were married or had children, she could deduct these costs for them, too. This above-the-line deduction is limited to net self-employment income. Nicole also can take an above-the-line deduction for contributions to a retirement plan (see page 22) and, if she’s eligible, an HSA (see page 4) for herself.

Nicole asks whether she can deduct her home office expenses. Her advisor explains that, if her home office is her principal place of business (or used substantially and regularly to conduct business) and that’s the only use of the space, she probably can deduct home office expenses from her self-employment income.

salary, self-employment income, interest, dividends and capital gains. The 2019 limit is \$510,000 for a married couple filing jointly. Disallowed losses are carried forward to later tax years and can then be deducted under the NOL rules.

### Tax credits

Tax credits reduce tax liability dollar for dollar, making them particularly beneficial:

**Research credit.** The research credit (often called the “research and development” credit) gives businesses an incentive to step up their investments in research. Certain start-ups (in general, those with less than \$5 million in gross receipts) can, alternatively, use the credit against their payroll tax. While the credit is complicated to compute, the tax savings can prove significant.

**Work Opportunity credit.** This credit is designed to encourage hiring from certain disadvantaged groups, such as certain veterans, ex-felons, the long-term unemployed and food stamp recipients. The maximum credit is generally \$2,400 per hire but can be higher for members of certain target groups — up to \$9,600 for certain veterans. The credit is scheduled to expire on Dec. 31, 2019. **Warning:** Certification from your State Workforce Agency generally must be requested within 28 days after the employee begins work.

**New Markets credit.** This gives investors who make “qualified equity investments” in certain low-income communities a 39% credit over a seven-year period. The credit is scheduled to expire on Dec. 31, 2019.

**Retirement plan credit.** Small employers (generally those with 100 or fewer employees) that create a retirement plan may be eligible for a \$500 credit per year for three years. The credit is limited to 50% of qualified start-up costs.

**Small-business health care credit.** The maximum credit is 50% of group health coverage premiums paid by the employer, provided it contributes at least 50% of the total premium or of a benchmark premium. For 2019, the full credit is potentially available for employers with 10 or fewer full-time equivalent employees (FTEs) and average annual wages of less than \$27,100 per employee. Partial credits may be available on a sliding scale to businesses with fewer than 25 FTEs and average annual wages of less than \$54,200. **Warning:** The credit can be taken for only two years, and they must be consecutive.

**Family medical leave credit.** For 2018 and 2019, the TCJA has created a tax credit for qualifying employers that begin providing paid family and medical leave to their employees. The credit is equal to a minimum of 12.5% of the employee’s wages paid during that leave (up to 12 weeks per year) and can be as much as 25% of wages paid. Ordinary paid leave that employees are already entitled to doesn’t qualify. Additional rules and limits apply.

## Sale or acquisition

Whether you’re selling your business or acquiring another company, the tax consequences can have a major impact on the transaction’s success or failure. Consider installment sales, for example. A taxable sale might be structured as an installment sale if the buyer lacks sufficient cash or pays a contingent amount based on the business’s performance. An installment sale also may make sense if the seller wishes to spread the gain over a number of years. This could be especially beneficial if it would allow the seller to stay under the thresholds for triggering the 3.8% NIIT (see page 13) or the 20% long-term capital gains rate (see page 10). But an installment sale can backfire on the seller. For example:

- ▲ Depreciation recapture must be reported as gain in the year of sale, no matter how much cash the seller receives.
- ▲ If tax rates increase, the overall tax could wind up being more.

With a corporation, a key consideration is whether the deal should be structured as an asset sale or a stock sale. If a stock sale is chosen, another important question is whether it should be a tax-deferred transaction or a taxable sale. ■

## Build and preserve your nest egg with tax-smart planning



**R**etirement planning is one area that was only minimally affected by the Tax Cuts and Jobs Act (TCJA). Nevertheless, you should revisit it in your tax planning this year. Tax-advantaged retirement plans can help you build and preserve your nest egg — but only if you contribute as much as possible, carefully consider your traditional vs. Roth options, and are tax-smart when making withdrawals.

### 401(k)s and other employer plans

Contributing to a traditional employer-sponsored defined contribution plan is usually a good first step:

- ▲ Contributions are typically pretax, reducing your taxable income.
- ▲ Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions.
- ▲ Your employer may match some or all of your contributions.

Chart 5 shows the 2019 employee contribution limits. Because of tax-deferred compounding, increasing your contributions sooner rather than later can have a significant impact on the size of your nest egg at retirement. Employees age 50 or older can also make “catch-up” contributions, however. If you didn’t contribute much when you were younger, this may allow you to partially make up for lost time.

If your employer offers a match, at *minimum* contribute the amount necessary to get the maximum match so you don’t miss out on that “free” money.

### More tax-deferred options

In certain situations, other tax-deferred saving options may be available:

**You’re a business owner or self-employed.** You may be able to set up a plan that allows you to make much larger contributions than you could make to an employer-sponsored plan as an employee. You might not have to make 2019 contributions, or even set up the plan, before year end.

**Your employer doesn’t offer a retirement plan.** Consider a traditional IRA. You can likely deduct your contributions, though your deduction may be limited if your spouse participates in an

employer-sponsored plan. You can make 2019 contributions until the April 2020 income-tax-return-filing deadline for individuals. Your annual contribution limit (see Chart 5) is reduced by any Roth IRA contributions you make for the year.

### Roth alternatives

A potential downside of tax-deferred saving is that you'll have to pay taxes when you make withdrawals at retirement. Roth plans, however, allow tax-free distributions; the tradeoff is that contributions to these plans don't reduce your current-year taxable income:

**Roth IRAs.** An income-based phaseout may reduce or eliminate your ability to contribute. But estate planning advantages are an added benefit: Unlike other retirement plans, Roth IRAs don't require you to take distributions during your lifetime, so you can let the entire balance grow tax-free over your lifetime for the benefit of your heirs.

**Roth conversions.** If you have a traditional IRA, consider whether you might benefit from converting some or all of it to a Roth IRA. A conversion can allow you to turn tax-deferred future growth into tax-free growth and take advantage of a Roth IRA's estate planning benefits. There's no income-based limit on who can convert to a Roth IRA. But the converted amount is taxable in the year of the conversion.

Whether a conversion makes sense depends on factors such as:

- ▲ Your age,
- ▲ Whether the conversion would push you into a higher income tax bracket or trigger the 3.8% NIIT (see page 13),
- ▲ Whether you can afford to pay the tax on the conversion,
- ▲ Your tax bracket now and expected tax bracket in retirement, and
- ▲ Whether you'll need the IRA funds in retirement.

**CHART 5** Retirement plan contribution limits for 2019

	Regular contribution	Catch-up contribution <sup>1</sup>
Traditional and Roth IRAs	\$ 6,000	\$1,000
401(k)s, 403(b)s, 457s and SARSEPs <sup>2</sup>	\$ 19,000	\$6,000
SIMPLEs	\$ 13,000	\$3,000

<sup>1</sup> For taxpayers age 50 or older by the end of the tax year.

<sup>2</sup> Includes Roth versions where applicable.

**Note:** Other factors may further limit your maximum contribution.



**WHAT'S  
NEW!****Could you be affected by  
retirement plan changes?**

As of this writing, legislation has been proposed that would make a variety of tax law changes related to retirement plans. Here are some of the most significant changes that could affect you:



- Allowing penalty-free IRA withdrawals for the birth or adoption of a child,
- Repealing the maximum age of 70½ for making traditional IRA contributions,
- Increasing the age for beginning required minimum distributions (RMDs) from age 70½ to age 72, and
- Reducing the time period for RMDs for most beneficiaries inheriting IRAs other than surviving spouses.

For the latest information on this retirement plan legislation, contact your tax advisor.

**Warning:** Unlike before the TCJA went into effect, you can't change your mind during the year and recharacterize a Roth conversion back to a traditional IRA.

**“Back door” Roth IRAs.** If the income-based phaseout prevents you from making Roth IRA contributions and you *don't* have a traditional IRA, consider setting up a traditional account and making a nondeductible contribution to it. You can then immediately convert the contributed amount to a Roth account with minimal tax impact.

**Roth 401(k), Roth 403(b), and Roth 457 plans.** Employers may offer one of these in addition to the traditional, tax-deferred version. You may make some or all of your contributions to the Roth plan, but any employer match will be made to the traditional plan. No income-based phaseout applies, so even high-income taxpayers can contribute.

### Early withdrawals

Early withdrawals from retirement plans should be a last resort. With a few exceptions, distributions before age 59½ are subject to a 10% penalty on top of any income tax that ordinarily would be due on a withdrawal. Additionally, you'll lose the potential tax-deferred future growth on the withdrawn amount.

If you must make an early withdrawal and you have a Roth account, consider withdrawing from that. You can withdraw up to your contribution amount without incurring taxes or penalties. Another option: If your employer-sponsored plan allows it, take a plan loan. You'll have to pay it back with interest and make regular principal payments, but you won't be subject to current taxes or penalties.

Early distribution rules also become important if you change jobs or retire. It's usually best to request a direct rollover from your old plan to your new plan or IRA.

If you receive a lump sum payout, you'll need to make an indirect rollover within 60 days to avoid tax and potential penalties.

**Warning:** The check you receive may be net of 20% federal income tax withholding. If you don't roll over the gross amount (making up for the withheld amount with other funds), you'll be subject to income tax — and potentially the 10% penalty — on the difference.

### Required minimum distributions

Historically, in the year in which a taxpayer reaches age 70½, he or she has had to begin to take annual RMDs from his or her IRAs (except Roth IRAs) and, generally, from any defined contribution plans. However, the age may be increased — see “What's new!” at left. If you don't comply with the RMD rules, you can owe a penalty equal to 50% of the amount you should have withdrawn but didn't. An RMD deferral is allowed for the initial year, but you'll have to take two RMDs the next year. And you can avoid the RMD rule for a non-IRA Roth plan by rolling the funds into a Roth IRA.

Waiting as long as possible to take distributions generally is advantageous because of tax-deferred compounding. But a distribution (or larger distribution) in a year your tax bracket is low may save tax. Be sure, however, to consider the lost future tax-deferred growth and, if applicable, whether the distribution could: 1) cause Social Security payments to become taxable, 2) increase income-based Medicare premiums and prescription drug charges, or 3) affect tax breaks with income-based limits.

If you've inherited a retirement plan, consult your tax advisor about the distribution rules that apply to you.

### IRA donations to charity

Taxpayers age 70½ or older are allowed to make direct contributions from their IRA to qualified charitable organizations up to \$100,000 per tax year. A charitable deduction can't be claimed for the contributions. But the amounts aren't included in taxable income and can be used to satisfy an IRA owner's RMD. A direct contribution might be tax-smart if you won't benefit from the charitable deduction. (See page 4.) ■

## Seize opportunities while they're available



**B**ecause the Tax Cuts and Jobs Act (TCJA) has put estate, gift and generation-skipping transfer (GST) tax exemptions at record-high levels, far fewer taxpayers are worrying about these taxes. But the high exemptions currently are available only through 2025. And Congress could pass legislation that reduces the limits sooner. So whether or not you'd be subject to estate taxes under the current exemptions, it's a good idea to consider if you can seize opportunities to potentially lock in tax savings today. Those same opportunities might not be available in the future.

### Estate tax

While the TCJA keeps the estate tax rate at 40%, it has doubled the exemption base amount from \$5 million to \$10 million. The inflation-adjusted amount for 2019 is \$11.4 million. (See Chart 6.)

Without further legislation, the estate tax exemption will return to an inflation-adjusted \$5 million in 2026. So taxpayers with estates in the roughly \$6 million to \$11 million range (twice that for married couples), whose estates would escape estate taxes if they were to die while the doubled exemption is in effect, still need to keep potential post-2025 estate tax liability in mind in their estate planning.

### Gift tax

The gift tax continues to follow the estate tax, so the gift tax exemption also has increased under the TCJA. (See Chart 6.) Any gift tax exemption used during your lifetime reduces the estate tax exemption available at death. Using up some of your exemption during your lifetime can be tax-smart, especially if your estate exceeds roughly \$6 million (twice that if you're married). (See Case Study 6.)

**CHART 6** 2019 transfer tax exemptions and rates

	Estate tax	Gift tax	GST tax
<b>Exemption</b>	\$11.4 million <sup>1</sup>	\$11.4 million	\$11.4 million
<b>Rate</b>	40%	40%	40%

<sup>1</sup> Less any gift tax exemption already used during life.

You also can exclude certain gifts of up to \$15,000 per recipient in 2019 (\$30,000 per recipient if your spouse elects to split the gift with you or you're giving joint or community property) without depleting any of your gift and estate tax exemption.

**Warning:** You need to use your annual exclusion by Dec. 31. The exclusion doesn't carry over from year to year. For example, if you don't make an annual exclusion gift to your grandson this year, you can't add \$15,000 to your 2020 exclusion to make a \$30,000 tax-free gift to him next year.

### **GST tax**

The generation-skipping transfer (GST) tax generally applies to transfers (both during your lifetime and at death) made to people more than one generation below you, such as your grandchildren. This is in addition to any gift or estate tax due. The GST tax continues to follow the estate tax, so the GST tax exemption also has increased under the TCJA. (See Chart 6.)

The GST tax exemption can be a valuable tax-saving tool for taxpayers with large estates whose children also have — or may eventually have — large estates. With proper planning, they can use the exemption to make transfers to grandchildren and avoid any tax at their children's generation.

### **State taxes**

Even before the TCJA, many states imposed estate tax at a lower threshold than the federal government did. Now the differences in some states are even more dramatic. To avoid unexpected tax liability or other unintended consequences, it's critical to consider state law. Consult a tax advisor familiar with the law of your particular state.

### **Exemption portability**

If one spouse dies and part (or all) of his or her estate tax exemption is unused at his or her death, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption. This exemption "portability" provides flexibility at the time of the first spouse's death, but it has some limits. Portability is available only from the most recently deceased spouse, doesn't apply to the GST tax exemption and isn't recognized by many states.

And portability doesn't protect future growth on assets from estate tax like applying the exemption to a credit shelter (or bypass) trust does. Such a trust offers other benefits as well, such as creditor protection, remarriage protection, GST tax planning and possible state estate tax benefits.

So married couples should still consider these trusts — and consider transferring assets to each other to the extent necessary to fully fund them at the first death. Transfers to a spouse (during life or at death) aren't subject to gift or estate tax as long as he or she is a U.S. citizen.

### Tax-smart giving

Giving away assets now will help reduce the size of your taxable estate. Here are some strategies for tax-smart giving:

**Choose gifts wisely.** Consider both estate and income tax consequences and the economic aspects of any gifts you'd like to make:

- ▲ To minimize *estate tax*, gift property with the greatest future appreciation potential.
- ▲ To minimize *your beneficiary's income tax*, gift property that hasn't appreciated significantly while you've owned it.
- ▲ To minimize *your own income tax*, don't gift property that's declined in value. Instead, consider selling the property so you can take the tax loss and then gifting the sale proceeds.

#### CASE STUDY 6

#### When "taxable" gifts save taxes



Carol has an estate of \$12 million. In 2019, she has already made \$15,000 annual exclusion gifts to each of her chosen beneficiaries. She's pleased that the gift and estate tax exemption has essentially doubled and, with future inflation adjustments, might be enough to protect her entire estate.

But she's in good health and believes she'll live beyond 2025. So she's concerned about having substantial estate tax exposure, especially considering that her assets likely will continue to appreciate. Her tax advisor suggests that she make some gifts beyond annual exclusion gifts this year.

So Carol uses \$6 million of her gift tax exemption to make additional "taxable" gifts. Therefore, her estate can't use that amount as an exemption. But she protects at least \$6 million from gift and estate tax, even if the exemption drops below \$6 million during her lifetime. She also removes the future appreciation from her estate. If the assets, say, double in value before Carol's death, the gift will essentially have removed \$12 million from her estate. This amount escapes the estate tax.

She does, however, need to keep in mind her beneficiaries' income tax. Gifted assets don't receive the "step-up" in basis that bequeathed assets do. This means that, if beneficiaries sell the assets, their taxable capital gains will be determined based on Carol's basis in the assets. So their capital gains tax could be higher than if they inherited the assets.

**Plan gifts to grandchildren carefully.** Annual exclusion gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers. For gifts to a grandchild that don't qualify for the exclusion to be tax-free, you generally must apply both your GST tax exemption and your gift tax exemption.

**Take advantage of valuation discounts.** If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts. So, for example, if the combined discount is 25%, in 2019 you can gift an ownership interest equal to as much as \$20,000 tax-free because the discounted value doesn't exceed the \$15,000 annual exclusion.

Another way to potentially benefit from valuation discounts is to set up a family limited partnership. You fund the FLP with assets such as public or private stock and real estate, and then gift limited partnership interests.

**Warning:** The IRS may challenge valuation discounts; a professional, independent valuation is recommended. The IRS also scrutinizes FLPs, so be sure to properly set up and operate yours.

**Pay tuition and medical expenses.** You may pay these expenses without the payment being treated as a taxable gift to the student or patient, as long as the payment is made directly to the provider.

**Make gifts to charity.** Donations to qualified charities aren't subject to gift tax. They may also be eligible for an income tax deduction, but this deduction may benefit fewer taxpayers than in the past. (See page 4.)

## Trusts

Trusts can provide significant tax savings while preserving some control over what happens to the transferred assets. For those with large estates, funding them now, while the gift tax exemption is high, may be particularly tax-smart. Here are some trusts to consider:

**A qualified personal residence trust (QPRT).** It allows you to give your home to your children today — removing it from your taxable estate at a reduced gift tax cost (provided you survive the trust's term) — while you retain the right to live in it for a certain period.

**A grantor-retained annuity trust (GRAT).** It works on the same principle as a QPRT, but allows you to transfer other assets; you receive payments back from the trust for a certain period.

**A GST — or “dynasty” — trust.** It can help you leverage both your gift and GST tax exemptions. And it can be an excellent way to potentially lock in the currently high exemptions while removing future appreciation from your estate. ■

## What's your marginal tax rate?



# Y

our marginal tax rate is the rate you'll pay on your next dollar of income, so in your planning it's important to know what it likely will be. Last year, the tax brackets underwent significant changes under the Tax Cuts and Jobs Act (TCJA).

### Pay attention to thresholds

Under the TCJA, graduated tax rates for corporations were replaced with one flat rate. (See Chart 7.) When businesses are structured as flow-through entities, income is taxed at the owners' individual rates. (See Chart 9.) So there are now some big differences between tax rates for corporations and pass-through entities (though a powerful deduction for pass-throughs is available; see page 15.)

For individuals, the taxable income thresholds vary significantly based on filing status. (See Chart 9.) The thresholds for estates and trusts are much lower. (See Chart 8.) There are also AMT rates to consider. (See Chart 9, and see page 5 to learn when the AMT might apply.)

**CHART 7** 2019 corporate income tax rates

Tax rate	Type of corporation
21%	C corporation
21%	Personal service corporation

**CHART 8** 2019 estate and trust income tax rate schedule

Tax rate	Tax brackets
10%	\$ 0 – \$ 2,600
24%	\$ 2,601 – \$ 9,300
35%	\$ 9,301 – \$ 12,750
37%	Over \$ 12,750

**CHART 9** 2019 individual income tax rate schedules

Tax rate	Regular tax brackets	
	Single	Head of household
10%	\$ 0 – \$ 9,700	\$ 0 – \$ 13,850
12%	\$ 9,701 – \$ 39,475	\$ 13,851 – \$ 52,850
22%	\$ 39,476 – \$ 84,200	\$ 52,851 – \$ 84,200
24%	\$ 84,201 – \$ 160,725	\$ 84,201 – \$ 160,700
32%	\$ 160,726 – \$ 204,100	\$ 160,701 – \$ 204,100
35%	\$ 204,101 – \$ 510,300	\$ 204,101 – \$ 510,300
37%	Over \$ 510,300	Over \$ 510,300
	Married filing jointly or surviving spouse	Married filing separately
10%	\$ 0 – \$ 19,400	\$ 0 – \$ 9,700
12%	\$ 19,401 – \$ 78,950	\$ 9,701 – \$ 39,475
22%	\$ 78,951 – \$ 168,400	\$ 39,476 – \$ 84,200
24%	\$ 168,401 – \$ 321,450	\$ 84,201 – \$ 160,725
32%	\$ 321,451 – \$ 408,200	\$ 160,726 – \$ 204,100
35%	\$ 408,201 – \$ 612,350	\$ 204,101 – \$ 306,175
37%	Over \$ 612,350	Over \$ 306,175
Tax rate	AMT brackets	
	Single	Head of household
26%	\$ 0 – \$ 194,800	\$ 0 – \$ 194,800
28%	Over \$ 194,800	Over \$ 194,800
Exemption	\$ 71,700	\$ 71,700
Phaseout <sup>1</sup>	\$ 510,300 – \$ 797,100	\$ 510,300 – \$ 797,100
<i>Note: Consult your tax advisor for AMT rates and exemptions for children subject to the “kiddie tax.”</i>		
	Married filing jointly or surviving spouse	Married filing separately
26%	\$ 0 – \$ 194,800	\$ 0 – \$ 97,400
28%	Over \$ 194,800	Over \$ 97,400
Exemption	\$ 111,700	\$ 55,850
Phaseout <sup>1</sup>	\$ 1,020,600 – \$ 1,467,400	\$ 510,300 – \$ 733,700

<sup>1</sup> The AMT income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.





This publication was developed by a third-party publisher and is distributed with the understanding that the publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters and recommend you consult an attorney, accountant, tax professional, financial advisor or other appropriate industry professional. This publication reflects tax law as of June 30, 2019. Some material may be affected by subsequent changes in the laws or in the interpretation of such laws. Therefore, the services of a legal or tax advisor should be sought before implementing any ideas contained in this publication. © 2019

