



Dear Clients and Friends:

As the end of the year approaches, it is a good time to think of planning moves that will help lower your tax bill for this year and possibly the next. Year-end planning for 2019 takes place against the backdrop of recent major changes in the rules for individuals and businesses. For individuals, these changes include lower income tax rates, a boosted standard deduction, severely limited itemized deductions, no personal exemptions, an increased child tax credit, and a watered-down alternative minimum tax (AMT). For businesses, the corporate tax rate has been reduced to 21%, there is no corporate AMT, there are limits on business interest deductions, and there are very generous expensing and depreciation rules. Non-corporate taxpayers with qualified business income from pass-through entities may be entitled to a special deduction.

Despite these major changes, the time-tested approach of deferring income and accelerating deductions to minimize taxes still works for many taxpayers, along with the tactic of "bunching" expenses into this year or the next to get around deduction restrictions.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make:

Year- End Tax Planning Moves for Individuals

- Higher-income earners must be wary of the 3.8% surtax on certain unearned income. The surtax is 3.8% of the lesser of: (1) net investment income (NII), or (2) the excess of modified adjusted gross income (MAGI) over a threshold amount (\$250,000 for joint filers or surviving spouses, \$125,000 for a married individual filing a separate return, and \$200,000 in any other

case). As year-end nears, a taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on his estimated MAGI and NII for the year. Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than NII, and other individuals will need to consider ways to minimize both NII and other types of MAGI.

• **Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on the taxpayer's taxable income. The 0% rate generally applies to the excess of long-term capital gain over any short-term capital loss to the extent that it, when added to regular taxable income, is not more than the "maximum zero rate amount" (e.g., \$78,750 for a married couple).** If the 0% rate applies to long-term capital gains you took earlier this year - for example, you are a joint filer who made a profit of \$5,000 on the sale of stock bought in 2009, and other taxable income for 2019 is \$70,000 - then before year-end, try not to sell assets yielding a capital loss because the first \$5,000 of such losses won't yield a benefit this year. And if you hold long-term appreciated-in-value assets, consider selling enough of them to generate long-term capital gains sheltered by the 0% rate.

• **Postpone income until 2020 and accelerate deductions into 2019 if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2019** that are phased out over varying levels of adjusted gross income (AGI). These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2019. For example, that may be the case where a person will have a more favorable filing status this year than next (e.g., head of household versus individual filing status), or expects to be in a higher tax bracket next year.

• If you believe a Roth IRA is better than a traditional IRA, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA in 2019 if eligible to do so. Keep in mind, however, that such a conversion will increase your AGI for 2019, and possibly reduce tax breaks geared to AGI (or modified AGI).

- It may be advantageous to try to arrange with your employer to defer, until early 2020, a bonus that may be coming your way. This could cut as well as defer your tax.
- Many taxpayers won't be able to itemize because of the high basic standard deduction amounts that apply for 2019 (\$24,400 for joint filers, \$12,200 for singles and for marrieds filing separately, \$18,350 for heads of household), and because many itemized deductions have been reduced or abolished. No more than \$10,000 of state and local taxes may be deducted; miscellaneous itemized deductions (e.g., tax preparation fees and unreimbursed employee expenses) are not deductible; and personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster and only to the extent the \$100-per-casualty and 10%-of-AGI limits are met. You can still itemize medical expenses but only to the extent they exceed 10% of your adjusted gross income, state and local taxes up to \$10,000, your charitable contributions, plus interest deductions on a restricted amount of qualifying residence debt, but payments of those items won't save taxes if they don't cumulatively exceed the standard deduction amount that applies to your filing status.

Some taxpayers may be able to work around these deduction restrictions by applying a "bunching strategy" to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, if a taxpayer knows he or she will be able to itemize deductions this year but not next year, the taxpayer will benefit by making two years' worth of charitable contributions this year, instead of spreading out donations over 2019 and 2020.

• **Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2019 deductions even if you don't pay your credit card bill until after the end of the year.**

- If you expect to owe state and local income taxes when you file your return next year and you will be itemizing in 2019, consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2019. But remember that state and local tax deductions are limited to \$10,000 per year, so this strategy is not a good one to the extent it causes your 2019 state and

local tax payments to exceed \$10,000.

•Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retirement plan). RMDs from IRAs must begin by April 1 of the year following the year you reach age 70½. (That start date also applies to company plans, but non-5% company owners who continue working may defer RMDs until April 1 following the year they retire.) Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. Thus, if you turn age 70½ in 2019, you can delay the first required distribution to 2020, but if you do, you will have to take a double distribution in 2020-the amount required for 2019 plus the amount required for 2020. Think twice before delaying 2019 distributions to 2020, as bunching income into 2020 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2020 if you will be in a substantially lower bracket that year.

• If you are age 70½ or older by the end of 2019, have traditional IRAs, and particularly if you can't itemize your deductions, consider making 2019 charitable donations via qualified charitable distributions from your IRAs. Such distributions are made directly to charities from your IRAs, and the amount of the contribution is neither included in your gross income nor deductible on Schedule A, Form 1040. But the amount of the qualified charitable distribution reduces the amount of your required minimum distribution, which can result in tax savings.

• If you are younger than age 70½ at the end of 2019, you anticipate that in the year that you turn 70½ and/or in later years you will not itemize your deductions, and you don't have any traditional IRAs, establish and contribute as much as you can to one or more traditional IRAs in 2019. If these circumstances apply to you, except that you already have one or more traditional IRAs, make maximum contributions to one or more traditional IRAs in 2019. Then, when you reach age 70½, make your charitable donations by way of qualified charitable distributions from your IRA. Doing all of this will allow you to, in effect, convert nondeductible charitable contributions that you make in the year you turn 70½ and later years, into deductible-in-2019 IRA contributions and reductions of gross income from age 70½ and later year distributions from the IRAs.

- Take an eligible rollover distribution from a qualified retirement plan before the end of 2019 if you are facing a penalty for underpayment of estimated tax and having your employer increase your withholding is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2019. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2019, but the withheld tax will be applied pro rata over the full 2019 tax year to reduce previous underpayments of estimated tax.
- Consider increasing the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year.
- If you become eligible in December of 2019 to make health savings account (HSA) contributions, you can make a full year's worth of deductible HSA contributions for 2019.
- Make gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may save gift and estate taxes. The exclusion applies to gifts of up to \$15,000 made in 2019 to each of an unlimited number of individuals. You can't carry over unused exclusions from one year to the next. Such transfers may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

Year-End Tax-Planning Moves for Businesses & Business Owners

- **Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income.** For 2019, if taxable income exceeds \$321,400 for a married couple filing jointly, \$160,700 for singles and heads of household, and \$160,725 for marrieds filing separately, the deduction may be limited based on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the trade or business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business. The limitations are phased in—for example, the phase-in applies to joint filers with taxable income between \$321,400 and \$421,400 and to single taxpayers with taxable income between \$160,700 and \$210,700.

Taxpayers may be able to achieve significant savings with respect to this deduction, by deferring income or accelerating deductions so as to come under the dollar thresholds (or be subject to a smaller phaseout of the deduction) for 2019. Depending on their business model, taxpayers also may be able to increase the new deduction by increasing W-2 wages before year-end. The rules are quite complex, so don't make a move in this area without consulting your tax adviser.

- More "small businesses" are able to use the cash (as opposed to accrual) method of accounting in than were allowed to do so in earlier years. To qualify as a "small business" a taxpayer must, among other things, satisfy a gross receipts test. For 2019, the gross-receipts test is satisfied if, during a three-year testing period, average annual gross receipts don't exceed \$26 million (the dollar amount was \$25 million for 2018, and for earlier years it was \$5 million). Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings till next year or by accelerating expenses, for example, paying bills early or by making certain prepayments.

- Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2019, the expensing limit is \$1,020,000, and the investment ceiling limit is \$2,550,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems. The generous dollar ceilings that apply this year mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. The fact that the expensing deduction may be claimed in full (if you are otherwise eligible to take it) regardless of how long the property is held during the year can be a potent tool for year-end tax planning. Thus, property acquired and placed in service in the last days of 2019, rather than at the beginning of 2020, can result in a full expensing deduction for 2019.

- Businesses also can claim a 100% bonus first year depreciation deduction for machinery and

equipment-bought used (with some exceptions) or new - if purchased and placed in service this year. The 100% write-off is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 100% bonus first-year write-off is available even if qualifying assets are in service for only a few days in 2019.

- Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't exceed \$5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed \$2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2019.

- A corporation (other than a "large" corporation) that anticipates a small net operating loss (NOL) for 2019 (and substantial net income in 2020) may find it worthwhile to accelerate just enough of its 2020 income (or to defer just enough of its 2019 deductions) to create a small amount of net income for 2019. This will permit the corporation to base its 2020 estimated tax installments on the relatively small amount of income shown on its 2019 return, rather than having to pay estimated taxes based on 100% of its much larger 2020 taxable income.

- To reduce 2019 taxable income, consider deferring a debt-cancellation event until 2020.

- To reduce 2019 taxable income, consider disposing of a passive activity in 2019 if doing so will allow you to deduct suspended passive activity losses.

Other topics

Fraudulent activity remains a significant threat

Our firm takes security very seriously and we think you should as well. Fraudsters continue to refine their techniques and tax identity theft remains a significant concern. Beware if you:

- Receive a notice or letter from the Internal Revenue Service (IRS) regarding a tax return, tax bill

or income that doesn't apply to you;

- Get an unsolicited email or another form of communication asking for your bank account number or other financial details or personal information;
- Receive a robocall insisting you must call back and settle your tax bill.

Make sure you're taking steps to keep your personal financial information safe. Let us know if you have questions or concerns about how to go about this.

Be sure your retirement planning is up to date

We recommend you review your retirement situation at least annually. That includes making the most of tax-advantaged retirement saving options, such as traditional IRAs, Roth IRAs and company retirement plans. We can help you determine whether you're on target to reach your retirement goals.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,

MORGENSTERN WAXMAN ELLERSHAW, LLC