

Are You Saving on Your Tax Bill this Year?

2019

YEAR END TAX PLANNING IDEAS

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YEAR END TAX PLANNING IDEAS FOR 2019

This document is intended to help you assess changes in the tax law and how these changes will affect your tax situation. It is designed to help you uncover tax planning opportunities that could help you reduce your 2019 taxes. It should serve as a guide to some of the changes that have taken place and provide ideas you can discuss with your tax advisor. It should not be considered a complete listing of tax changes or tax saving strategies and it's important to consult your tax advisor before taking any action. Tax planning is a complex task and before implementing any strategy it's best to review your situation with a tax professional.

FAMILY STRUCTURE

☐ Single ☐ Married

How many dependents _____ List dependent ages _____

MAJOR CHANGES SINCE LAST YEAR

INCOME SOURCES

Most taxpayers have income from multiple sources. Knowing the sources of your income will help you determine the types of tax planning moves that will be most beneficial to you.

- ☐ Salary / Wages ☐ Self Employment (Schedule C) ☐ Partnership
- ☐ Interest ☐ S-Corporation ☐ Trust
- ☐ Dividends ☐ Short-term investment gains ☐ Long-term investment gains
- ☐ Social Security ☐ IRA Distributions ☐ Pension Distributions
- ☐ Other Income _____

2019 Itemized Deductions vs Standard Deductions

Itemized Deductions		2019 Standard Deduction	
Medical expenses	Deductable to the extent they exceed 10% of AGI	Single	\$ 12,200
State and local taxes	Limited to \$10,000 unless MFS than \$5,000	Married Filing Jointly or Qualifying Widow	\$ 24,400
Mortgage interest	Maximum Mortgage Amount \$750,000*	Head of Household	\$ 18,350
Investment interest	Limited to total investment income	Married Filing Separately	\$ 12,200
Charitable contributions	\$250 or more required a written receipt		
Casualty and theft losses	Not allowed unless presidential declared disaster		
Miscellaneous deductions—2% limit	Not Allowed		

PLANNING TIP 1 – Time itemized deduction where possible into years where they will do the most good. For example, if you make charitable contributions in years you will be itemizing and avoid years that you will be using the standard deduction. Time tax payment so that you will get the maximum benefit of the deduction keeping in mind the maximum tax deduction allowed any year. Stack medical expenses into years you will itemize and that they will exceed 10% of AGI.

*If mortgage interest is limited to maximum debit of \$750,000 unless the mortgage was taken out before 12/15/17. Mortgages then taken out prior to 12/15/17 it is limited to \$1,00,000 of debt. Only debt used to acquire or improve a primary or second residence is deductible.

2019 Tax Brackets

Rate	Married Filing Separately	Single	Head of Household	Married Filing Jointly
10%	\$0 to \$9,700	\$0 to \$9,700	\$0 to \$13,850	\$0 to \$19,400
12%	\$9,701 to \$39,475	\$9,701 to \$39,475	\$13,851 to \$52,850	\$19,401 to \$78,950
22%	\$39,476 to \$84,200	\$39,476 to \$84,200	\$52,851 to \$84,200	\$78,951 to \$168,400
24%	\$84,201 to \$160,725	\$84,201 to \$160,725	\$84,201 to \$160,700	\$168,401 to \$321,450
32%	\$160,726 to \$204,100	\$160,726 to \$204,100	\$160,701 to \$204,100	\$321,451 to \$408,200
35%	\$204,101 to \$306,175	\$204,101 to \$510,300	\$204,101 to \$510,300	\$408,201 to \$612,350
37%	\$306,176+	\$510,301+	\$510,301+	\$612,351+

Note that taxable income is taxed at each rate until it exceeds the maximum for that tax rate or bracket, additional income is then taxed at the next rate or bracket until the maximum of that rate or bracket is reached. The highest bracket at which income is subject to tax is called the marginal rate bracket. It should also be noted that an additional Medicare surcharge of .9% will apply when wages exceed \$250,000 MFJ, \$200,000 SGJ/HH and \$200,000 MFS. Net Investment Income is also subject to an additional 3.8% tax when MAFI (Modified Adjusted Gross Income) exceeds \$250,000 MFJ, \$200,000 SGJ/HH and \$200,000 MFS.

PLANNING TIP 2 – Your marginal tax rate is the rate you pay on additional dollars of income, if you find that income has pushed you into a marginal tax that is equal to or higher than you will be in next year it may make sense to delay income or accelerate expenses to reduce the amount of income you have that is subject to the higher marginal rate. Delaying income even if it will be taxed at the same rate in the future allows you to hold on to the money you would pay in tax longer. Delaying income that is in a higher rate than it would be in the future not only delays payment but can also reduce the amount of taxes.

RETIREMENT PLANS & IRAS

Retirement Plans	Under 50	Over 50
IRA contribution limits	\$ 6,000	\$ 7,000
SIMPLE IRA elective deferral limits	\$ 13,000	\$ 16,000
401(k), 403(b), 457 and SARSEP elective deferral limits	\$ 19,000	\$ 25,000
Profit-sharing plans/SEPs		
Contribution limit		\$ 56,000
Compensation limit (for employer contributions)		\$ 280,000
Maximum contribution percentage (SE/employee)		20/25%

PLANNING TIP 3 – Maximizing your pension plan or IRA contribution is a great way to reduce your income and save on taxes. If you are self employed consider setting up a SIMPLE or 401(k) to maximize the amount you can put away. If you are not self employed be sure to maximize the deferral to your employer's plan or if your employer does not offer a plan to fund an IRA. IRA funding is limited to earned income from wages, self-employment or ownership income from a partnership. A spouse earning can be used to fund a spousal IRA when the spouse does not have their own earned income. For individuals covered by an employer plan, deductible IRA contributions are phased out when modified AGI (MAGI) reaches the following thresholds.

DEDUCTING IRA CONTRIBUTIONS

Individuals who are not covered by an employer-sponsored retirement plan can deduct contributions to a traditional IRA regardless of their income level. For individuals covered by an employer plan, deductible IRA contributions are phased out when modified AGI (MAGI) reaches certain thresholds.

IRA Deduction Phase-Out	
Individual or Spouse Covered by Employer Plan	
Filing Status	MAGI Phase-Out Range
MFJ (covered spouse) and QW	\$ 103,000 – 123,000
MFJ (non-covered spouse)	193,000 – 203,000
Single, HOH	64,000 – 74,000
MFS ¹	0 – 10,000
1 Individuals filing MFS and who live apart at all times during the year are treated as single.	

DON'T FORGET REQUIRED MINIMUM DISTRIBUTIONS

The required minimum distribution (RMD) rules limit the length of time retirement plan assets can grow tax-deferred by forcing qualified plan participants and IRA owners to begin taking plan distributions no later than their required beginning date and then every year thereafter.

Required Beginning Date (RBD)—Lifetime Distributions	
Type of Retirement Plan	RBD
Traditional IRA	April 1 of the year following the year the individual reaches age 70½.
Qualified plan, not a greater-than-5% owner of sponsoring employer	April 1 of the year following the later of the year the individual (1) reaches age 70½ or (2) retires.
Qualified plan, greater-than-5% owner of sponsoring employer	April 1 of the year following the year the individual reaches age 70½.

PLANNING TIP 4 – Taxpayers who are age 70½ or older can make tax-free distributions to a charity from an IRA of up to \$100,000 per year. These “qualified charitable distributions” aren’t subject to the charitable contribution percentage limits since they are neither included in gross income nor claimed as a deduction on the taxpayer’s return.

LONG TERM CAPITAL GAINS & QUALIFIED DIVIDENDS

A little planning when it comes to investments can save a lot when it comes to taxes. When it comes to stocks and many other investments the tax rate on long term gains can be as low as zero depending on your tax bracket. Even in the highest tax brackets the tax savings on long term capital gains over short term gains or ordinary income is 17%. Sometimes the difference between realizing this savings and not realizing it can be as little as one day. To qualify for the long-term capital gains, the investment must be held longer than one year, and must not be a collectible or real property subject to recapture of depreciation. The lower rate is also available on qualified dividends.

Long Term Capital Gains & Qualified Dividend Tax Rates				
Rate	Single & Married Filing Separately	Married Filing Jointly	Head of Household	Kiddie
0%	\$0 to \$39,375	\$0 to \$78,750	\$0 to \$52,750	\$0 to \$2,650
15%	\$39,775 to \$434,550	\$78,750 to \$488,850	\$52,750 to \$461,700	\$2,650 to \$12,950
20%	Over \$434,550	Over \$488,850	Over \$461,700	Over \$12,950
<i>The 3.8% NIIT also applies when modified AGI exceeds: \$250,000 for MFJ, QW; \$200,000 for Single, HOH; \$125,000 for MFS (see 3.8% Net Investment Income Tax).</i>				

PLANNING TIP 5 – Time long term gains so they will be taxed at the lowest rate possible; for example if a married couple filing a joint return times their long term capital gains into a year that their total taxable income was below \$78,750 they would not be subject to any tax on the gains. But if they had the same gains in a year in which their taxable income was over \$488,850, they would pay a 20% tax rate on their long-term capital gains.

PLANNING TIP 6 – When investing look for stocks that have qualified dividends as these dividends will be taxes at the lower long term capital gains rates.

PLANNING TIP 7 – Moving long-term assets to children subject to the Kiddie tax for liquidation could end up costing more in tax than just allowing the gain to be taxed on the parents return at the parent's rate as the zero and 15% tax brackets are so much smaller for those subject to the kiddie tax.

LONG-TERM GAINS NOT SUBJECT TO THE RATES ABOVE

The maximum rate when it comes to long term gains from collectables held more than one year, and the taxable portion of gain from the sale of qualified small business stock (QSBS) held more than five years is 28%. If the taxpayers regular tax rate is less than 28% the regular tax rate applies.

A maximum tax rate of 25% applies to unrecaptured Section 1250 gain on sales of depreciable real property held more than one year. To the extent a taxpayer is in a tax bracket below 25%, the lower tax rate applies.

CAPITAL LOSSES CAN BE USED TO OFFSET CAPITAL GAINS

Capital losses can be used to offset capital gains, losses in excess of gains of up to \$3,000 (\$1,500 Married Filing Separately) can be deducted from other income losses in excess of the \$3,000/\$1,500 are carried forward to future years.

INSTALLMENT SALES

Using an installment sale when it comes to a large gain on a business, rental or real property can help spread the tax consequences of that gain over a number of years. In an installment sale the purchase price is collected over a number of years delaying the tax on the portions of the gain not collected in the current year. Installment sales can be used to stretch out the time for payment of tax on both short term and long-term gains. However publicly traded assets such as stocks and bonds that are traded on exchanges are not permitted to use an installment sale to defer gain.

WARNING – Advisory and management fees that are charged separately from the actual cost of buying and selling securities are no-longer deductible as the deduction was eliminated in TJCA with all the miscellaneous deductions on Schedule-A subject to the 2% of gross income reduction.

SMALL BUSINESS SECTION 1244 STOCK

Sec. 1244 encourages new investment in small business by permitting investors to claim an ordinary (rather than a capital) loss on disposition (including worthlessness) of eligible small business stock. As an added benefit, any loss that qualifies as an ordinary loss under IRC Sec. 1244 is also treated as a trade or business loss in computing an individual's NOL. Thus, Section 1244 losses are allowed for NOL purposes without being limited to nonbusiness income.

The maximum deductible Section 1244 ordinary loss is \$50,000 per year (\$100,000 MFJ). Any loss in excess of the limit is a capital loss, subject to the capital loss rules.

Invested in a relative's business and received stock, or a start up with total equity capital of less than \$1,000,000 at the time of your investment? section 1244 is an opportunity to make the best of a bad situation if your investment goes bad or loses value upon liquidation.

PLANNING TIP 8 – If the potential loss exceeds the \$50,000 (\$100,000 if MFJ) limit, the stock should be disposed of in more than one year to maximize the ordinary loss treatment.

QUALIFIED SMALL BUSINESS STOCK

To qualify the stock must be issued by a C corporation with total gross assets of \$50 million or less at all times after August 10, 1993, and before it issued the stock. The corporation's gross assets immediately after it issued the stock must also be \$50 million or less. And it cannot be a: Domestic international sales corporation (DISC) or former DISC, or a Regulated investment company (RIC), or a Real estate investment trust (REIT), or a Real estate mortgage investment conduit (REMIC), or a Cooperative.

Original issue stock. The stock must be acquired by the taxpayer at its original issue in exchange for money, property other than stock or as compensation for services. The stock may also be acquired in a tax-free transaction such as a gift, inheritance, or partnership distribution.

QSBS Treatment of Gains—Options by Holding Period	
Holding Period	Gain Options
Six months or less	Short-term capital gain.
Over six months but not over one year	Short-term capital gain. Section 1045 gain rollover (elective).
Over one year but not over five years	Long-term capital gain. Section 1045 gain rollover (elective).
Over five years	Section 1045 gain rollover (elective). Section 1202 gain exclusion (50%-100%). Long-term capital gain (to the extent not subject to Section 1202 or Section 1045).

For more information and the additional rules that apply contact your tax professional before taking part in any transactions.

ROTH IRA CONVERSION

Roth conversions are a great way to take advantage of year with lower than normal income and or business net operation losses. While converting to a ROTH IRA creates taxable income, ROTHs have a host of benefits such as no required RMDs, tax free as opposed to tax differed growth and even withdrawal of taxable contributions penalty free while under 59 ½.

PLANNING TIP 9 – If you have an off year where income is down or non-existent or a year in which itemized deductions or the standard deduction will mean little or no taxable income, don't let those unused deductions go to waste, convert enough of your IRA to offset the unused deductions and maybe even use up the 10% and 15% tax brackets. Remember conversion is not an all or nothing strategy. You can convert as little or as much as it makes sense to convert in your particular tax situation.

WARNING – Roth conversions can no longer be undone once completed so converting right before a market drop could mean a greater tax liability with no chance to undo.

BASIS IS IMPORTANT

If you have an ownership interest in a partnership or S-Corporation that has losses for the year make sure that your capital account is large enough to give you the basis necessary to deduct your losses. Business losses are subject to rules that limit their deductions by owners if they have basis and capital at risk. While this area can be complex it's important to take action to make sure you have what it takes to deduct the losses that will pass through to you so that you can deduct them against your other income rather than carry them forward to a future year.

PLANNING TIP 10 – Adding to your basis can be as simple as making an additional capital contribution to the business.

PASSTHROUGH ENTITIES

Income and losses from Partnerships, S-corporations and Trusts are provided on form K1 to the owner and then is reported and taxed on the owner's personal tax return. In order to deduct losses as mentioned above you must have basis that is at risk. Income from these entities passes through in character for example interest and dividends pass through and are reported as interest and dividends on the 1040 tax return of the owner. Business income passes through as business income and certain expenses like charitable deductions and investment interest pass through in character as well. It should also be noted that partnership income from active conduct of a trade or business and or guaranteed payment to partners is subject to self-employment tax (Social Security and Medicare Taxes). It's also important that the owner/officers of S-Corporations receive reasonable compensation in the form of payroll.

Sole Proprietorships

Any business that is not set-up under state law and has only one owner is a sole proprietorship. The only requirement is that the owner have a profit motive. A Sole Proprietorship reports income and expenses on schedule C. Profits of a sole proprietorship are taxable and subject to self-employment tax (Social Security and Medicare Taxes). Losses are deductible.

Hobby Income

The IRS sees any business that does not make a profit, three-out-of-five years as a hobby. But the IRS three-out-of-five years test is not definitive as the courts have found that behavior of the owner outweighs this simple test.

To preserve for-profit status, the sole proprietor should conduct the activity in a businesslike manner. The following suggestions can help preserve business losses on the tax return. 1) Keep thorough and businesslike books. 2) Use a separate business checking account. 3) Record both business and personal use of assets (such as a charter boat or photography equipment) in a log book. 4) Use separate credit cards for business and personal purchases. 5) Research market/technology trends used in similar businesses. 6) Consult with reputable advisors in the field. 7) Obtain the insurance, registration, certification, proper license, etc., customarily needed for the type of business. 8) Make periodic operations changes to improve the business's profit-making ability. 9) Prepare a business plan. While not every factor is required to support your profit motive and claim that a business activity not a hobby is taking place, the more you have related to the activity you are involved in the better the chances of supporting the claim that your activity is a business not a hobby.

Hobby income is taxable however the deduction of hobby expenses can be severely limited, and losses from hobby's are considered personal expenses and not deductible.

PLANNING TIP 11 – Avoid having a business activity classified as a hobby by following as many of the steps above to as possible to show your profit-making intension. Many true business show losses for several years until they become established and the ability to deduct these losses will help reduce your taxes and allow your business to survive to profitability.

INCOME SHIFTING

While children may be subject to the kiddie tax when it comes to unearned income the kiddie tax does not apply when it comes to earned income for children. For those in a high tax bracket who own a business they create a perfect opportunity to move income from a high tax bracket to a lower tax bracket. Now you can't just "give the kids money and call it wages". They have to preform real services and get paid in real money, but when they do the money they get paid moves from your return and tax bracket to their return and tax bracket. If your business is a sole proprietorship or partnership with you and your spouse as the only partners and the kids are under 18 you don't even have to pay the FICA taxes on what you pay them.

So, what can the kids do and how much can you pay them? They can answer phones, do filing, stuff envelopes or empty trash cans, almost anything that is of value to the business. As to how much you can pay them it's limited by reasonable compensation for the value of what they do and what you would have to pay someone else to do it.

For example, a Highschool or college student could keep up the web site for your business provide IT support or other services and easily earn \$6,000 to 10,000 per year. But remember what they earn is their money not yours and while you can encourage them to save for college, pay their own auto or dating costs or even put some away in a ROTH IRA, you can't have them give it back to you so you can pay your bills.

PLANNING TIP 12 – Most of us that own business, have our kids providing services and over time those services become more valuable what might start off as a few dollars to empty the trash or stuff envelopes at minimum wage could become IT support as the kids get older at \$20.00 per hour. Not only will paying the kids for what they do help lower the tax burden it will also help teach the kids good work habits and the value of a dollar.

QUILIFIED BUSINESS INCOME DEDUCTION (SEC 199A)

The Qualified Business Income Deduction, gives those that operate a trade of business through a partnership, LLC, S-Corporation or Sole Proprietorship a deduction of up to 20% of the qualifying income from a Qualifying trade or business (net income from business operations).

Deduction is taken at the individual level (1040), and is limited to the lessor of 20% taxable income before the deduction or 20% of the qualified business income. The deduction requires that the business if an S-Corporation pay officer's and working shareholders reasonable compensation as payroll.

Income threshold phases out for those is Specified Service Trades or Business. Including: Health, Law, Accounting, Actuarial Science, Performing Arts, Consulting, Athletics, Financial Services, Brokerage Services, Investing and Investment Management, Trading, Dealing. For all others it reduces the deduction based on total payroll and the value of business assets before depreciation.

Taxable income before QBI deduction			Qualified trade or business	Specified service trade or business
Single, HOH	MFS	MFJ		
\$0 – 160,700	\$0 – 160,725	\$0 – 321,400	20% deduction	20% deduction
\$160,701 – 210,700	\$160,726 – 210,725	\$321,401 – 421,400	Wage/investment limit phases in	Deduction phases out ¹
Over \$210,700	Over \$210,725	Over \$421,400	Subject to wage/investment limit	No deduction

¹ Technically, this is the phase-in of the exclusion of an SSTB from the definition of qualified trade or business. Also, the wage/investment limit can impact the phase-out.

PLANNING TIP 13 – A little planning can go a long way when it comes to this new deduction which for the first time in history reduces taxes without requiring the business to make any investment to take advantage of the deduction. Assuring that you get the largest benefit possible does require some pre year end planning. This planning includes making sure reasonable compensation is paid to owner shareholders, review of guaranteed payments to LLC members and partners and dealing with taxable income phaseout thresholds. Now is the time to review these and other important items with your tax professional.

PLANNING TIP 14 – If income may be approaching the phase out points for QBID consider delaying business or personal income and accelerating expenses to reduce the taxable income below the phaseout. Remember if your business is a Specified Service Trades or Business there is no QBID once the top limit of the phase out is reached.

ESTIMATED TAX PAYMENTS

Taxpayers are subject to a penalty if they do not make adequate estimated tax payment throughout the year. Total payment through withholding and estimated payment must equal the smaller of 90% of the current years taxes that will be shown on your 2019 tax return or 100% of the prior years taxes as shown on the 2018 tax return. Checking your payments to be sure you are not underpaid requires adding withholding to date and anticipated through year end to estimated tax payments made plus the amount of any payments to be made at year end. If this amount is equal to 100% of the 2018 tax total shown on your 2018 return, no penalty should apply. If the amount is less than the 2018 tax amount, and you believe your 2019 tax bill is less than your 2018 tax bill you can estimate your 2019 tax bill and determine if the amount paid is greater than 90% of the projected tax bill.

PLANNING TIP 14 – If you have not made the required estimated payments the shortage can be made up through additional withholding on wages, pension distribution and or IRA distributions to avoid the penalty. Penalties can also be reduced by showing that a greater share of the year's income was received in the last quarter of the year than in the prior quarters.

ABOUT OUR TAX PROFESSIONALS

The tax professionals at RMS Accounting are enrolled to practice before the IRA. They are enrolled agents; this makes them part of a select group of tax professionals that specialize in income tax and can represent clients at all administrative levels of the Internal Revenue Service.

The firm has over 30 years of experience assisting clients with tax planning, tax preparation and tax representation. In addition to tax services the firm offers a full suite of accounting, bookkeeping, business consulting, payroll and tax services.

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