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# 2019 Year-End Tax Planning

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## Highlights

- ✔ Continued Rate Stability
- ✔ Bunching Itemized Deductions
- ✔ Taking Advantage of Business Expensing
- ✔ Check Withholding

## Inside



# Planning Strategies and Techniques Available Through End of Year

Over 2018 and 2019, tax professionals have been grappling with the new landscape of taxation under the Tax Cuts and Jobs Act. Laptop batteries have drained, reams of paper have been used, and eyes have gone dry all across the country in researching ways to help clients maximize their tax savings.

As was said last year, many of the old strategies for advising clients at year-end have been blunted by the landmark tax reform act. However, there are still numerous steps to take in late 2019 and early 2020 to boost the refund, or reduce the amount due, on returns filed in 2020. Many of the classic deferral and acceleration tactics can still produce results, but in new and different ways.

And there is still time to take care of them, if you act fast!

## MINIMIZING INDIVIDUAL TAXES

The key to any year-end planning strategy is to minimize taxes. This is done by either reducing the amount of income received or increasing the amount of deductions, which is all easier said than done. However, there are a few simple things that can be done in the waning weeks of 2019 to accomplish this.

### Delaying/Reducing Income and Gains

Ordinary income is taxed at seven rates, depending upon the amount of income. Taxes on capital gains also apply at different rates depending upon the amount of taxable income. For 2019, the long-term capital gains rates are as follows:

**2019 Long-Term Capital Gains and Qualified Dividends Rates**

| | 0% | 15% | 20% |
|---|---|---|---|
| MFJ/SS | $0 - $78,750 | $78,751 - $488,850 | over $488,850 |
| MFS | $0 - $39,375 | $39,376 - $244,425 | over $244,425 |
| HoH | $0 - $52,750 | $52,751 - $461,700 | over $461,700 |
| Single | $0 - $39,375 | $39,376 - $434,550 | over $434,550 |
| E&T | $0 - $2,650 | $2,651 - $12,950 | over $12,950 |

As discussed below, there is little chance of legislation during 2020, so tax rates are not likely to increase in 2020. Thus, there is little advantage to post-poning ordinary income to 2020, as rates are not likely to go lower. Further, given the political landscape, tax rates are likely to not ever be lower than they are now. Thus, it may be more expeditious to maximize the amount of income now in anticipation of rates increasing in the future, either because a new Congress and President may increase tax rates, or simply allow the rate reductions under the Tax Cuts and Jobs Act to expire.

*Many of the classic deferral and acceleration tactics can still produce results, but in new and different ways.*

That said, for taxpayers whose income tends to fluctuate from year to year, it would be wise to examine the impact of sales of investment items. For taxpayers who think they may have lower income in 2020, it would be smart to hold off on a sale of a capital gains item if their income is at or near a threshold for a higher capital gains bracket.

This type of consideration is not limited to capital gain taxes, but also applies to the net investment income (NII) tax. The 3.8% NII tax kicks in at $200,000 of modified adjusted gross income for single and head-of-household filers, $250,000 for joint filers, and $125,000 for married taxpayers filing separately.

**IMPACT.** *Since the NII thresholds fall right in the middle of the 15% capital gains bracket, a taxpayer to whom the NII applies because of a sale of a capital item would likely not be able to reduce the tax to 0%. But, a taxpayer who is barely in the 20% bracket could defer a sale and get into the 15%, meaning a sale of a capital item would only be taxed at 18.8% instead of 23.8%.*

## Maximizing Deductions

The Tax Cuts and Jobs Act nearly doubled the amount of the standard deduction; for 2019, the inflation adjusted amounts are $24,400 for joint filers, $18,350 for heads of households, and $12,200 for all other filers. Further, the amount of state and local taxes that can be claimed as an itemized deduction is capped at $10,000. The result is a drastic reduction in the number of taxpayers who itemize deductions, as it is difficult to have enough itemized deductions to exceed the standard deduction amount.

One of the best ways to maximize the amount of deductions is to develop a bunching strategy. This involves accumulating charitable contributions, or even medical expenses, from two or more years into one year. For example, a taxpayer may have not made any of his or her normal charitable contributions in 2018, and then made double the normal amount in 2019 in order to help surpass the standard deduction amount.

The same strategy can be employed for deductible medical expenses where the timing is somewhat flexible, such as for elective procedures (remember that purely cosmetic procedures are not deductible). However, the floor for deductible medical expenses in 2019 is 10%, whereas the floor was 7.5% in 2018, so any medical expenses may have already been accelerated at the end of 2018, making the timing of bunching critical. It is much easier to use a bunching strategy to beat the standard deduction amount if both medical expense deductions and charitable contributions are bunched into the same year, so working out a plan that maximizes both is crucial.

**IMPACT.** *Bunching can be a very worthwhile strategy, but it has to be effectively used, and potentially planned out two or three years in advance to maximize the benefit.*

## Other Year-End Strategies

A number of other traditional year-end strategies may still apply even after the Tax Cuts and Jobs Act. These include:

- Maximizing Education Credits – Individuals can claim a credit for tuition paid in 2019 even if the academic period begins in 2020, as long as the period begins by the end of March (but, see below for a possible benefit to delaying payment if the tuition and fees deduction returns)
- Increasing 401(k) Contributions – Adjusted gross income (AGI) can be reduced if individuals increase the amount of their 401(k) contributions
- IRA Contributions – Individuals eligible for deductions for IRA contributions can claim deductions, and thus reduce AGI, for amounts contributed through April 15, 2020
- Teacher deductions – Educators can claim a deduction for up to $250 of classroom expenses (such as books, supplies, computer equipment), and should maximize those expenses by year-end

# YEAR-END BUSINESS STRATEGIES

## Qualified Business Income Deduction

One of the biggest changes from the Tax Cuts and Jobs Act was the allowance of a 20-percent deduction of qualified business income for owners of sole proprietorships and passthrough entities. This is the qualified business income deduction, and it can apply very generally to most types of businesses, but there are some restrictions.

One of the most significant restrictions limits the amount of the deduction for businesses in certain specified areas. Where the business involves the performance of services in health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investing and investment management, trading, dealing in certain assets or any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners, the amount of the deduction is phased out where the taxpayer's taxable income exceeds certain thresholds.

For 2019, those thresholds begin at $312,400 for joint filers, $160,725 for married taxpayers filing separately, and $160,700 for all others. Taxpayers in one of these specified areas may want to explore ways to defer income to 2020 if they are near the phase-out threshold.

## Depreciation and Expensing

The Tax Cuts and Jobs Act provided very generous depreciation and expensing limitations. Businesses may want to take advantage of 100-percent first-year depreciation on machinery and equipment purchased during the year. Additionally, Code Sec. 179 expensing has an investment limitation of $2,550,000 for 2019, with a dollar limitation of $1,020,000.

**IMPACT.** *These provisions do not apply to 2019 only, so there is time to take advantage of them in later years. However, if a business is considering expanding capacity or acquiring new equipment, there has never been a better time to do so than in 2019, from a tax benefit standpoint.*

# WITHHOLDING AND PENALTIES

## Estimated Tax Penalty

The tax filing season in 2019 was the first be impacted by the Tax Cuts and Jobs Act. As the filing season went on, many individual taxpayers were shocked to discover that the withholding they employed prior to the implementation of tax reform was wildly inadequate under the revised tax system. As a result, many taxpayers who formerly received large refunds found themselves with large tax bills when they filed.

So extreme was the underwithholding for 2018 that the IRS announced that it would only impose a penalty on individuals for underpayment of estimated tax if less than 80 percent of taxes were withheld during 2018 (normally, the penalty applies if less than 90 percent of taxes are withheld).

It is unlikely that the IRS will grant this kind of relief for 2019. Taxpayers still have time before the end of the year to adjust their withholding if they discover that they are still underwithholding. The IRS provides a calculator on its website to determine if enough taxes are being withheld.

**COMMENT.** *Because the relief granted to taxpayers for their 2018 taxes may have simply resulted in taxpayers just paying their taxes due and moving on without adjusting for 2019, taxpayers could be in for a double surprise in 2020 if they have to pay the taxes due* and *a penalty.*

### Life Cycle Changes Important To Year-End Planning

While tax considerations are important, sometimes life gets in the way. Year-end tax strategies should also take into account personal circumstances that changed during 2019 as well as what may change in 2020. These "life cycle" changes include:

- Change in filing status: marriage, divorce, death or head of household status
- Birth of a child
- Child too old for child credit
- Child who has outgrown the "kiddie" tax
- Casualty losses
- Changes in medical expenses
- Moving/relocation
- College and other tuition expenses
- Employment changes
- Retirement
- Personal bankruptcy
- Large inheritance
- Business success or failure

### Required Minimum Distributions

Individuals who have reached age 70½ during 2019 and are retired should make sure that they are making their required minimum distributions (RMDs) from IRAs. The first RMDs must be made by April 1, 2020. Failure to take the RMD could result in a penalty equal to 50% of the RMD amount.

## TAX LEGISLATION

Several bills have been proposed during 2019, but none of them have seen much advancement. Congress came close to passing the SECURE Act, which would have made changes to retirement savings and employer retirement contributions provisions, but that has stalled in the Senate. There has also been talk of a technical corrections bill, as well as Tax Reform 2.0, but given the divided Congress, as well as the current political climate, it is unlikely that there will be any progress on either bill before the end of 2019 or even in 2020.

Of most significance for year-end planning are the so-called tax extenders. This slate of more than 30 taxpayer-friendly provisions was last in effect for 2017. It includes a number of energy-related business credits, as well as the above-the-line deduction for tuition and fees, the treatment of mortgage insurance premiums as acquisition interest, and the exclusion of cancelation of indebtedness income on primary residences.

Although there is still significant Congressional support for these provisions, the political will is lacking. These provisions have not been extended to 2018 or 2019, and the longer the extenders are delayed, the less likely it is they will be enacted retroactively. However, that does not mean that they could not come back and be effective for future years. As such, if it is possible to delay tuition bills, or even a mortgage default, to 2020, there may be an advantage to doing so.

**IMPACT.** *Extenders have been controversial for many years because of arguments over whether they really act to incentivize the actions they are meant to benefit if they can't even be relied upon year-to-year. On the other hand, Congress regularly acted on them for decades. It has been only in the last four or five years that they extended them retroactively, so they could essentially be relied upon. Now, we see what happens when the extenders are ignored for several years. The best action by taxpayers is to not rely on the benefits of extenders and just treat them like a bonus for regular activity.*