YEAR-END TAX PLANNING GUIDE FOR 2018

Top 100 Tax Strategies to Consider

It has been almost a year since passage of the most sweeping tax legislation, known as the Tax Cuts and Jobs Act ("TCJA"), in more than 30 years. This legislation represented the most comprehensive change to the tax code in a generation and greatly modified the income, estate, gift and generation-skipping taxes for individuals, businesses, estates and trusts. While this new tax code is complex and guidance and interpretation continue to evolve, there is still time to position yourself to take advantage of the opportunities presented by tax reform, including identification and execution, before year-end to reduce your 2018 tax liability. Our annual Tax Planning Guide herein is designed to highlight select tax provisions and potential planning opportunities to consider for 2018, and in some cases, 2019.

Prior to the midterm elections, a new 10 percent middle-income tax cut was expected to be advanced in 2019, which could have affected tax planning for 2018. However, with the Democrats gaining control of the U.S. House of Representatives in the election last month, bipartisan agreement on future tax cuts seems unlikely. Republicans would have needed to retain control of both chambers of Congress for any predictable chance of approving further individual tax cuts or making permanent those enacted under the TCJA.

Separately, the House approved its "Tax Reform 2.0" package in September 2018, which includes measures to enhance various savings accounts and business innovation opportunities, while making permanent the TCJA's individual tax cuts, many of which were set to expire within seven years. The Senate has showed little interest in taking up the package as a whole before the end of the year, though consideration of the retirement and savings measure in the lame-duck session still remains a possibility.

In late November 2018, House Ways and Means Committee Chairman Kevin Brady (R-TX) released a 297-page tax bill that includes a number of technical corrections to the 2017 TCJA and more than 30 "tax extender" provisions dealing with expired or expiring tax provisions as well as tax provisions related to disaster relief, retirement issues, and innovation incentives for start-up businesses. While the House is expected to pass the Brady tax package, likely along party lines, we feel its chances of success "as is" in the Senate are doubtful.

Thus, separate and apart from the Treasury's continuing issuance of regulatory guidance and technical changes to correct identified errors in the TCJA, we anticipate limited legislative changes on the horizon, especially as the congressional calendar provides limited opportunities for new tax legislation. Furthermore, with the upcoming focus on the 2020 election, we expect more gridlock than tax code progress.

As a result and due to the volatile nature of the stock market, economy, and tax environments, we recommend the prudent approach of planning now, based on current law, and revising those plans as the need arises. So, please check in with us and keep a watchful eye on our tax *Alerts,* which are published throughout the year and contain information on tax developments that are designed to keep you informed of significant changes in those environments.

In this **2018 Year-End Tax Planning Guide** prepared by the Tax Accounting Group (TAG) of Duane Morris, we walk you through the steps needed to assess your personal and business tax situation in light of the new law and identify actions needed before year-end to reduce your 2018 tax liability.

We hope you find this complimentary guide valuable and invite you to consult with us regarding any of the topics covered or your own unique situation. For additional information, please contact John I. Frederick at 215.979.1649 or jifrederick@duanemorris.com, Steven M. Packer at 215.979.1697 or smpacker@duanemorris.com or me at 215.979.1635 or magillen@duanemorris.com, or the practitioner with whom you are in regular contact.

We wish you a joyous holiday season and a healthy and prosperous New Year.

Michael A. Gillen
Tax Accounting Group

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In addition to legal services, Duane Morris is a pioneer in establishing in-depth, nonlegal services to complement and enhance the representation of our clients. The firm has independent affiliates employing approximately 100 professionals engaged in other disciplines, such as the tax, accounting and litigation consulting services offered by the Tax Accounting Group.

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TAG maintains one of the largest tax, accounting and litigation consulting groups within any law firm in the United Sates and has an active and diverse practice with over 60 services lines in more than 45 industries. To learn more about our service lines and industries served, please refer to our **Quick Reference Service Guide**.

TAG's certified public accountants, certified fraud examiners, financial consultants and advisers provide a broad range of cost-effective tax compliance, planning and consulting services as well as accounting, financial and management advisory services to individuals, businesses, partnerships, estates, trusts and nonprofit organizations. TAG also provides an array of litigation consulting services to lawyers and law firms representing clients in regulatory and transactional matters and throughout various stages of litigation.

As the entrusted adviser to our clients in nearly every state and 25 foreign countries, TAG, year after year, continues to enjoy impressive growth, in large part because of our clients' continued expressions of confidence and referrals. Our one-of-a-kind platform allows us to deliver the flexibility, customization and specialization that assures our clients have the resources required to meet each of their unique needs, all with the convenience of a single-source provider.

Our service mission is to enthusiastically provide effective solutions that exceed client expectations. What allows us to fulfill our mission and maintain long-term client relationships is the passion, objectivity and deep experience of our talented professionals. Our senior staff has an average of over 20 years working together as a team within our group (with a few having more than 30 years on our platform). These professionals, who are intimately familiar with and take a personal interest in our clients' needs, work very hard to justify the trust placed in us.

Introduction

Achieving tax savings is a universal financial goal. With tax year 2018 rapidly coming to an end, it is time once again to consider and, where appropriate, implement year-end tax planning strategies available to you, your family and your business. With tax law constantly changing, new tax-savings strategies are always emerging and this year is no exception.

So while you can depend on us for cost-effective tax compliance, planning and consulting services, as well as for critical advocacy and prompt action in connection with your long-term personal and business objectives, we are also available for any immediate or last-minute needs you may have or Congress may create.

This year, with many of the TCJA's provisions becoming effective for 2018, many taxpayers are left wondering how tax reform will affect their tax situation, both current and prospective. With provisions changing the income tax for individuals, businesses, tax-exempt organizations, estates and trusts, nearly all taxpayers will be affected by these changes – some favorably, some unfavorably. Many of our clients engaged us to prepare special tax projections and modelling earlier this year to determine if they will be winners or losers under the tax reform act and, if the latter, develop a plan to make them winners. With minor exceptions, this month is the last time to act for tax year 2018 to develop and implement your tax plan.

For individuals, wholesale changes to the tax rate tables have lowered tax rates for nearly everyone. However, lower tax rates may be somewhat offset by an increase in taxable income for many taxpayers. Taxable income may increase for these taxpayers because many deductions have been eliminated or reduced, including: the new $10,000 limitation on state and local income, sales and use, and property taxes; the lower indebtedness limitation on the mortgage interest deduction for mortgages originated in 2018; and the elimination of other miscellaneous itemized deductions, including investment adviser fees and tax preparation fees. In addition, the impact of the alternative minimum tax (AMT) will be reduced for many individuals due to larger exemptions and higher income phaseouts of these exemptions.

For businesses, the corporate tax rate has been lowered significantly, from 35 percent to 21 percent. Additionally, corporate taxes have been simplified by virtue of the permanent repeal of the corporate AMT. For pass-through entities, tax rates for certain pass-through income (*e.g.*, partnerships, S corporations and sole proprietorships) have been effectively reduced in tandem with the corporate rate cut by virtue of a deduction based on pass-through income. In 2018, a deduction of up to 20 percent of certain pass-through income is allowed, provided the income and ownership interest meet certain other criteria (discussed in depth at item 60). Further, the thresholds for accelerated and bonus depreciation are increased for 2018, allowing more businesses to immediately deduct a greater percentage of their capital expenditures. Finally, the move to a territorial tax system (as opposed to the previous tax system based on worldwide income) will have large implications for businesses with international operations.

The impact of certain tax provisions that have become effective in 2018 should be considered now in order to ensure that you take advantage of any tax savings opportunities available.

This guide provides tax planning strategies for corporate executives, businesses, individuals, nonprofit entities and trusts. We hope that this guide will help you leverage the tax benefits available to you or reinforce the tax savings strategies you may already have in place.

As income tax rates are not expected to dramatically shift from 2018 to 2019, the traditional tried and true tax planning strategies of accelerating deductions and deferring income, in general, will continue to be an effective method of minimizing your tax obligation.

For your convenience, below is a quick reference guide of action steps that can help you reach your tax-minimization goals, as long as you act before the clock strikes midnight on January 1, 2019. Not all of the action steps will apply in your particular situation, but you could likely benefit from many of them. Taxpayers may want to consult with us to develop and tailor a customized plan, and to focus on the specific actions that should be taken. We will be pleased to help you analyze the options and decide on the strategies that are most effective for you, your family, and your business.

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Year-End Tax Planning Quick Reference Action Steps

For your convenience, below is a quick and easy reference guide of action steps that can help you reach your tax-minimization goals, as long as you act before the clock strikes midnight on January 1, 2019. Not all of the action steps will apply in your particular situation, but you could likely benefit from many of them. Consultation with us to develop and tailor a customized plan and to focus on the specific actions that should be taken is paramount.

- ✓ Defer income to 2019 and accelerate deductions into 2018. (*See* discussion in "Strategies to Implement Throughout the Year.")
- ✓ Consider a comprehensive review of entertainment expenses in December 2018 to break out deductible business meals from nondeductible entertainment expenses. (*See* item 65.)
- ✓ Prepay as many medical expenses in 2018 as possible if your unreimbursed medical expenses are close to exceeding 7.5 percent of adjusted gross income (AGI) for 2018. (*See* item 3.)
- ✓ Defer payment of state and local taxes (income, sales and property) where possible if these payments already exceed $10,000 in 2018. (*See* item 4.)
- ✓ Ensure that you are maximizing your retirement savings contributions in 2018 to reduce income in the current year and to achieve tax-deferred growth. (*See* items 27 and 28.)
- ✓ Consider making 529 plan contributions for the education expenses of children and grandchildren prior to year-end to maximize potential state tax deductions. (*See* item 23.)
- ✓ Coordinate timing your capital gains and losses to minimize tax on your gains and maximize the tax benefit from your losses. (*See* item 8.)
- ✓ Increase your tax basis in pass-through entities so that you can deduct current year losses. (*See* item 42.)
- ✓ Consider using a credit card to prepay expenses that can generate deductions for this year while holding onto the cash until the bill is due next year. (*See* item 47.)
- ✓ Purchase qualified plug-in electric vehicles before year-end, particularly Tesla models, if you are in the market for such a vehicle. (*See* item 48.)
- ✓ Defer bonuses until 2019, if your employer will allow it. (*See* discussion in "Strategies to Implement Throughout the Year.")
- ✓ Spread out recognition of gain from the sale of property through the use of an installment sale. (*See* item 89).
- ✓ Apply a bunching strategy to itemized deductions such as medical expenses, charitable contributions and mortgage interest. (*See* item 39.)
- ✓ Postpone gifts until 2019. Doing so may reduce gift and estate taxes. (*See* item 94.)
- ✓ Consider disposing of a passive activity to allow you to deduct suspended losses. (*See* item 41.)
- ✓ Make charitable gifts directly from your IRA, if you are age 70½ or older. (*See* item 35.)
- ✓ Consider purchasing qualified business property to take advantage of the $1,000,000 business property expensing option. (*See* item 66.)
- ✓ Contribute to a donor advised fund to maintain separate control of charitable contributions and deduction timing. (*See* item 6).
- ✓ Track purchases and sales of cryptocurrency. (*See* item 22).
- ✓ Prepare for greater sales tax exposure. (*See* item 62).

Look Before You Leap: Words of Caution

Whether you should accelerate taxable income or defer deductions between 2018 and 2019 largely depends on your projected highest (aka "marginal") tax rate for each year. While the highest official marginal tax rate for 2018 is currently 37 percent, you might pay more tax than in 2017, even if you were in a higher tax bracket, as a result of the limitations on itemized deductions and the disallowance of personal exemptions.

The chart below summarizes the 2018 tax rates together with corresponding taxable income levels. Effective management of your tax bracket can provide meaningful tax savings, as often a change of $1 in taxable income can catapult you into the next higher or lower bracket. These differences can be further exacerbated by other income thresholds throughout the code, and discussed in this guide, such as those for determining eligibility for the child tax credit and qualified business income deductions, among others. Income deferral and acceleration, while being mindful of bracket thresholds, can be accomplished through numerous income strategies discussed in this guide, such as retirement distribution planning, bonus acceleration or deferral and harvesting of capital gains and losses.

2018 Federal Income Tax Rate Schedule

Tax Rate	Single	Head of Household	Joint/Surviving Spouse	Married Filing Separate	Estates and Trusts
10%	$0 - $9,525	$0 - $13,600	$0 - $19,050	$0 - $9,525	$0 - $2,550
12%	$9,526 - $38,700	$13,601 - $51,800	$19,051 - $77,400	$9,526 - $38,700	N/A
22%	$38,701 - $82,500	$51,801 - $82,500	$77,401 - $165,000	$38,701 - $82,500	N/A
24%	$82,501 - $157,500	$82,501 - $157,500	$165,001 - $315,000	$82,501 - $157,500	$2,551 - $9,150
32%	$157,501 - $200,000	$157,501 - $200,000	$315,001 - $400,000	$157,501 - $200,000	N/A
35%	$200,001 - $500,000	$200,001 - $500,000	$400,001 - $600,000	$200,001 - $300,000	$9,151 - $12,500
37%	Over $500,000	Over $500,000	Over $600,000	Over $300,000	Over $12,500

While reviewing this guide, please keep the following in mind:

- This guide is intended to help you achieve your personal and business financial objectives in a "tax efficient" manner. It is important to note that proposed transactions should make economic sense in addition to saving on taxes. Therefore, you should review your entire financial position prior to implementing changes. Various nontax factors can influence your year-end planning, including a change in employment, your spouse reentering the work force, the adoption or birth of a child, a death in the family or a change in your marital status. Never let the tax tail wag the dog, so to speak. Always assess economic viability.

- It is best to look at your tax situation for at least two years at a time with the objective of reducing your tax liability for both years combined, not just for 2018 in isolation. In particular, multiple years should be considered when implementing “bunching” strategies, as discussed in items 2 and 39.
- While the traditional strategies of deferring taxable income and accelerating deductible expenses are the focus of this guide, with exceptions, you can often achieve overall tax efficiency by reversing this technique. For example, you should consider deferring deductions and accelerating income if you expect to be in a higher tax bracket next year, you have charitable contribution carryovers to absorb, your marital status will change next year, or your head of household or surviving spouse filing status ends this year. This analysis can be complex, and you should seek professional guidance before implementation.
- Any decision to save taxes by accelerating income must consider the possibility that this means paying taxes on the accelerated income earlier, which would require you to forego the use of money used to satisfy tax liabilities that could have been otherwise invested. Accordingly, the time value of money can make a bad decision worse or, hopefully, a good decision better.
- While there are always uncertainties in the stock market, economy and tax environments, we recommend the prudent approach of planning now and revising those plans as the need arises.
- We recommend that you examine your tax situation now and consult with us.

With these words of caution in mind, following are observations and specific strategies that can be employed in the waning days of 2018 regarding income and deductions for the year, where the tried and true principles of deferring taxable income and accelerating deductible expenses will result in maximum tax savings.

Tax Planning Strategies for Individuals (Items 1 to 59)

1. **Beware of alternative minimum tax.** AMT is on life support, but it's not dead yet. While this sneaky tax was eliminated in initial versions of the TCJA, it survived in the final version of the legislation. In 2018, the exemption amount has increased from $84,500 to $109,400 for joint filers ($54,300 to $70,300 for single filers). Further, the income levels that benefit from these exemptions increase to $1 million for Married Filing Jointly and surviving spouses, and $500,000 for all other taxpayers. This reduces the number of taxpayers subject to AMT in 2018 and decreases the AMT liability for those who are subject to AMT, but it does not eliminate it entirely.

Planning Tip

Many of the adjustments or preferential items that have been part of the alternative minimum taxable income calculation have been eliminated or reduced for the regular tax in 2018. Also, since the AMT exemption has been dramatically increased in 2018, you may want to consider exercising at least a portion of incentive stock options (ISO) since the favorable regular tax treatment for ISOs has not changed for 2018. However, careful tax planning may be needed with respect to large ISO lots, as exercising ISOs could still produce an AMT. If you would not be subject to the AMT in 2018, the guiding philosophy of postponing income until 2019 and accelerating deductions (especially charitable contributions) into 2018 rings true.

2. **Review the increased standard deduction and the elimination of the personal exemption.** In 2018, the standard deduction is nearly doubled from previous levels to $24,000 for a joint return and $12,000 for a single return. All personal exemptions you receive for yourself, your spouse and any dependents have been eliminated for 2018.

Standard Deduction (Based on Filing Status)	2017	2018
Married Filing Jointly	$12,700	$24,000
Head of Household	$9,350	$18,000
Single (Including Married Filing Separately)	$6,350	$12,000
Personal Exemption for Each Taxpayer, Spouse and Dependent	$4,050	$0**

**Enhanced child tax credits are available in 2018, which, instead of reducing taxable income, like an exemption, reduce tax liability on a dollar for dollar basis.

Planning Tip

With the higher standard deductions in 2018, many taxpayers who previously itemized may find their total itemized deductions close to or below the standard deduction amount. In such cases, a "bunching" strategy may be necessary to postpone or accelerate payments, which would increase itemized deductions, allowing taxpayers to claim the itemized deduction in alternating years, thus maximizing deductions and minimizing taxes over a two-year period. For a more in-depth discussion of "bunching," see item 39.

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3. **Pay any medical bills in 2018.** The TCJA reduced the medical expense deduction floor to 7.5 percent of AGI for both 2017 and 2018. In addition, the deduction is no longer an AMT preference item, meaning that even taxpayers subject to the AMT in 2018 would benefit from deductible medical expenses. These are favorable changes to taxpayers with high medical costs. However, this deduction will revert to a 10 percent floor and being an AMT preference item in 2019. While this is a politically popular deduction on both sides of the aisle, and either the lame-duck or the new Congress may extend the lower deduction floor to 2019, it has not yet been extended.

Planning Tip

Pay all medical costs for you, your spouse and any qualified dependents in 2018, if, with payment, your medical expenses are projected to exceed 7.5 percent of your 2018 AGI, as this will lower your tax liability for 2018. You also may wish to accelerate elective qualified medical procedures into 2018 if appropriate and deductible.

4. **Defer your state and local tax payments into 2019.** Possibly the most attention getting provision of the TCJA is the limitation of the state and local tax deduction. In 2018, the deduction for state and local income or sales, and property taxes, is only allowed up to a limit of $10,000 per return ($5,000 in the case of a married individual filing separately). As a result, many taxpayers will be severely limited in their deductions beginning in 2018.

OBSERVATION

After the implementation of the TCJA, many states have implemented or considered municipal charitable funds to accept donations from taxpayers in exchange for a credit against either state income or property taxes. The idea of these programs was to replace state tax payments with charitable contributions, in an effort to circumvent the TCJA's $10,000 state and local tax limitation. We recommend that taxpayers tread carefully when evaluating such state programs. On August 23, 2018, the IRS issued proposed regulations to disallow some of these programs. The proposed regulations specifically target the type of programs that grant a credit against state income tax for a charitable contribution by requiring a reduction in the charitable deduction to the extent a credit is allowed for state tax purposes. These new rules took effect as of August 27, 2018, but are still subject to final approval. Further developments are expected in this area, as on July 17, 2018, four states (Connecticut, Maryland, New Jersey and New York) filed a lawsuit against the federal government challenging the constitutionality of the state tax deduction limitation.

Planning Tip

If you live in a state with either high income, sales or real estate taxes and you are not subject to AMT, this could significantly change your tax calculation. Many taxpayers in these states will be over the $10,000 limitation well before they have even read this guide. Thus, for many taxpayers, prepaying state and local taxes will be of no benefit in 2018. With the Democrats now in control of the U.S. House of Representatives, this is one of the areas that may be on the bargaining table – potentially allowing for a larger state and local tax deduction for 2019.

5. **Prepay your January mortgage payment if you will be under the mortgage interest limitation.** The TCJA reduces the mortgage interest deduction to interest incurred on up to $750,000 of debt ($375,000 in the case of a married individual filing a separate return), for acquisition indebtedness incurred after December 15, 2017. The mortgage interest from both a taxpayer's primary and secondary residences remains deductible, up to this balance limit on new debt. Home equity indebtedness not used to substantially improve a qualified home is no longer deductible in 2018. Debt existing prior to December 15, 2017, is still limited to the prior law

amounts of $1 million for original mortgage debt and $100,000 for home equity debt used for substantial improvements.

Planning Tip

If you hold a home equity loan that was used for a purpose other than improving your home, such home equity interest will not be deductible in 2018. If you are planning to refinance and your total mortgage balance will exceed $750,000, please contact us to ensure you retain maximum deductibility and do not run afoul of certain rules related to refinancing mortgage indebtedness.

6. **Consider accelerating 2019 charitable pledges into 2018 whether by cash, marketable securities, credit card or donor advised funds.** Good news here for charitable giving: In 2018, the AGI limitation for cash contributions is raised from 50 percent to 60 percent, meaning that more prior year charitable carryovers or current year contributions are available as a deduction in 2018 and beyond. Contributions made to a donor advised fund will allow you to receive a tax deduction in the year contributed, while enabling you to retain control of the timing of disbursements to specific charities in a later period, at your direction.

Planning Tip

The increased limitation makes 2018 and future years a good time to give, as any amount which was disallowed in 2017 could potentially be freed up in 2018 due to the higher limits. In addition, if you expect to claim the standard deduction in 2019 due to the loss or limitation of deductions, consider "bunching" your charitable contributions into 2018 for maximum impact. As always, before making a large contribution, please consult with us to determine the impact on your unique situation.

7. **Take advantage of the enhanced child tax credit.** A major change in 2018 is the enhancement of the child tax credit. Now, the child tax credit is increased to $2,000 (from $1,000 in 2017), with the phaseouts of the credit drastically increasing. The child tax credit is phased out beginning at $400,000 for joint filers ($200,000 for all other filers), while in 2017, the credit was phased out beginning at income levels of $110,000 for joint filers and $75,000 for single filers. In addition, more of the child tax credit is refundable to lower income taxpayers without an income tax liability, up to $1,400. Also, nonqualifying child dependents (such as dependents over the age of 17, or those that do not meet the relationship test of a qualifying child) now qualify taxpayers for an additional $500 child tax credit per dependent.

	2017	2018
Credit Available Per Qualifying Child Dependent	$1,000	$2,000
Credit Available Per Nonqualifying Child Dependent	$0	$500
Income Levels Where Phaseout Begins		
Married Filing Jointly	$110,000	$400,000
Head of Household	$75,000	$200,000
Single	$75,000	$200,000
Married Filing Separately	$55,000	$200,000

> **Planning Tip**
> *Even if you have not previously benefitted from the child tax credit, the increased phaseout levels may allow the child tax credit to significantly reduce your 2018 tax liability depending on your income and family size.*

Tax-Efficient Investment Strategies

For 2018, the long-term capital gains and qualifying dividend income tax rates have been tied to income levels based on the previous tax schedule. Thus, taxpayers with similar income in 2018 and 2017 will have effectively the same capital gains tax rate, ranging from 0 to 20 percent, as indicated in the table below.

Long-Term Capital Gains Rate	Single	Married Filing Jointly	Head of Household	Married Filing Separately
0%	Up to $38,600	Up to $77,200	Up to $51,700	Up to $38,600
15%	$38,600 -$425,800	$77,200 -$479,000	$51,700 -$452,400	$38,600 -$239,500
20%	Over $425,800	Over $479,000	Over $425,400	Over $239,500

In addition, a 3.8 percent tax on net investment income applies to taxpayers with modified adjusted gross income (MAGI) that exceeds $250,000 for joint returns ($200,000 single). Here are some ways to capitalize on the lower rates as well as other tax planning strategies for investors.

> **Planning Tip**
> *The capital gains rates are largely untouched in 2018 with only small changes to the income thresholds to which the 0 percent, 15 percent and 20 percent rates are applied. Additionally, the capital gains rate of 0 percent for most taxpayers in the lowest two tax brackets (10 or 12 percent) is preserved. Therefore, taxpayers should consider: (1) deferring income into 2019 in order to reduce 2018 income, and thus qualify for the 0 percent capital gain rate in 2018, and/or (2) delaying the sale of long-term capital assets until 2019 if you will be within the 10 or 12 percent tax bracket in 2019, which again will qualify use of the 0 percent capital gain rate in 2019.*

8. **Maximize the benefit of lower tax rates on capital gains.** To be eligible for the lower 20, 15 or 0 percent capital gain rate, a capital asset must be held for at least one year. That is why it is important when disposing of your appreciated stocks, bonds, investment real estate and other capital assets to pay close attention to the holding period. If it is less than one year, consider deferring the sale so you can meet the longer-than-one-year period (unless you have short-term losses to offset). While it is generally not wise to let tax implications be your only consideration in making investment decisions, you should not ignore them either. Keep in mind that realized capital gains may increase AGI, which in turn may reduce your AMT exemption and therefore increase your AMT exposure, although to a much lesser extent given the increased AMT exemptions.

Planning Tip

To take maximum advantage of the spread between capital gain and individual income tax rates, you may wish to consider receiving qualified employer stock options in lieu of salary to convert ordinary compensation income to capital gain income.

9. **Reduce the recognized gain or increase the recognized loss.** When selling stock or mutual fund shares, the general rule is that the shares you acquired first are the ones deemed sold first. However, if you choose, you can specifically identify the shares you are selling when you sell less than your entire holding of a stock or mutual fund. By notifying your broker of the shares you want sold at the time of the sale, your gain or loss from the sale is based on the identified shares. This sales strategy gives you better control over the amount of your gain or loss and whether it is long-term or short-term. Once the specific identification method is chosen, however, you may not use a different method (*e.g.*, average cost method or first in, first out method) for the particular security you have specifically identified or throughout the life of the fund, unless you obtain permission from the IRS.

Planning Tip

In order to use the specific identification method, you must ask the broker or fund manager to sell the shares you identify and maintain records that include both dated copies of letters ordering your fund or broker to sell specific shares as well as written confirmations that your orders were carried out.

10. **Take advantage of your capital losses.** It always makes sense to periodically review your investment portfolio to see if there are any "losers" you should sell. This is especially true as year-end approaches, since that is your last chance to offset capital gains recognized during the year or to take advantage of the $3,000 ($1,500 for married separate filers) limit on deductible net capital losses. However, one must be mindful not to run afoul of the wash-sale rule, discussed at item 13.

11. **Take advantage of Section 1202 small business stock gain exclusion.** For taxpayers other than corporations, Section 1202 allows for the potential exclusion of up to 100 percent of the gain recognized on the sale of qualified small business stock (QSBS) that is held more than five years, depending upon when the QSBS was acquired. The gain eligible for exclusion cannot exceed the greater of $10 million, or 10 times the aggregate adjusted basis of QSBS stock disposed of during the year. As an alternative, if the stock is held for more than six months and sold for a gain, you can elect to roll over and defer the gain to the extent that new QSBS stock is acquired during a 60-day period beginning on the date of the sale.

    To qualify as QSBS, the following qualifications must be met: (a) the stock must be issued by a domestic C corporation with no more than $50 million in gross assets; (b) 80 percent of the assets of the business must be used in an active trade or business (certain personal services and businesses do not qualify); (c) the stock has to have been issued after August 10, 1993; (d) the

OBSERVATION

It's important to keep good records as to the acquisition of your QSBS. For example, acquisitions of QSBS from August 11, 1993, to February 17, 2009, would qualify for a 50 percent gain exclusion, while acquisitions from February 18, 2009, to September 27, 2010, would qualify for a 75 percent gain exclusion, and acquisitions after September 28, 2010, would qualify for 100 percent gain exclusion.

QSBS has to have been held by a noncorporate taxpayer; and (e) the QSBS has to have been acquired by the taxpayer on original issuance.

Planning Tip

Be aware that if you are harvesting losses to offset gains, the 1202 taxable gain will be less than what may have been anticipated. Accordingly, you need to keep the 1202 gain exclusion in mind so you do not sell too many losses, resulting in the inability to claim all the losses harvested in 2018.

12. **Be mindful of new "kiddie tax" rules.** In 2018, there are significant changes in the taxation of unearned income for children under 18 (or up to age 23, if a full-time student). Previously, unearned income of dependents in excess of $2,100 was taxed at a rate according to the parent's tax rate. In 2018, the unearned income of a child would be taxed independently of the parent's rates, but based on the lower thresholds used by trusts and estates, as seen below. This change will be effective until 2025 when it would revert back to 2017 law, and applies to the child's ordinary income and his or her income taxed at preferential rates.

Tax Rate on Unearned Income	Unearned Income
24% or 32%*	$0 - $9,150
35%	$9,151 - $12,500
37%	$12,501 and above

*Tax rate imposed will depend on the earned income of the child. The maximum amount of taxable income taxed at tax rates below 24 percent cannot exceed the child's earned income, plus $2,550.

Planning Tip

As the 37 percent top rate is effective for joint taxpayers with taxable incomes in excess of $600,000, this change would largely subject the children of parents whose income does not exceed $600,000 to higher rates on unearned income than the provisions under prior law. Because the benefits of recognizing unearned income on the child's return, rather than the parents' return, the utility of UGMA and UTMA accounts will be further diminished. Instead, parents may wish to hold investment assets in trust accounts.

Planning Tip

Various measures can be taken to avoid or minimize the kiddie tax. Among those measures, consider investing a child's funds in one or more of the following:

- Owners of Series EE and Series I bonds *may defer reporting any interest (i.e., the bond's increase in value) until the year of final maturity, redemption or other disposition. (If held in the parent's name and used for qualified higher education expenses, and assuming certain AGI requirements are met, the income is not taxed at all.)*
- Municipal bonds *produce tax-free income (although the interest on some specialized types of bonds may be subject to the AMT).*
- Growth stocks *that pay little dividends and focus more on capital appreciation should be considered. The child could sell them after turning 23 and possibly benefit from being in a low tax bracket. Selling them before then could convert a potential 0 percent income tax on the gain into a 20 percent income tax.*

- *Funds can be invested in* mutual funds *that concentrate on growth stocks and municipal bonds that limit current income and taxes. They may also limit risk through investment diversification.*
- Unimproved real estate *that will appreciate over time and does not produce current income will limit the impact of the kiddie tax.*
- 529 plans *offer investors the opportunity to experience tax-free growth, so long as distributions are used to fund qualified education expenses, discussed later at item 23. In addition, contributions to a 529 plan may qualify the donor for a deduction on his or her state income tax return.*

13. **Do not run afoul of the wash sale rule.** An often overlooked rule, the wash sale rule provides that no deduction is allowed for a loss if you acquire substantially identical securities within a 61-day period beginning 30 days before the sale and ending 30 days after the sale. Instead, the disallowed loss is added to the cost basis of the new stock. However, there are ways to avoid this rule. For example, you could sell securities at a loss and use the proceeds to acquire similar, but not substantially identical, investments. If you wish to preserve an investment position and realize a tax loss, consider the following options:
    - Sell the loss securities and then purchase the same securities no sooner than 31 days later. The risk inherent in this strategy is that any appreciation in the stock that occurs during the waiting period will not benefit you.
    - Sell the loss securities and reinvest the proceeds in shares in a mutual fund that invests in securities similar to the one you sold or reinvest the proceeds in the stock of another company in the same industry. This approach considers an industry as a whole, rather than a particular stock. After 30 days, you may wish to repurchase the original holding. This method may reduce the risk of missing out on any anticipated appreciation during the waiting period.
    - Buy more of the same security (double up), wait 31 days and then sell the original lot, thereby recognizing the loss. This strategy allows you to maintain your position but also increases your downside risk. Keep in mind that the wash sale rule typically will not apply to sales of debt securities (such as bonds) since such securities usually are not considered substantially identical due to different issue dates, rates of interest paid and other terms.

14. **Consider dividend-paying stocks.** The favorable capital gain tax rates (20, 15 or 0 percent) make dividend-paying stocks as attractive as ever, since their preferential lower rates are preserved in current tax reform legislation. This may cause you to reconsider the makeup of your investment portfolio. Keep in mind that to qualify for the lower tax rate on dividends the shareholder must own the dividend-paying stock for more than 60 days during the 121-day period beginning 60 days before the stock's ex-dividend date. For certain preferred stock, this period is expanded to 90 days during a 181-day period.

OBSERVATION

While dividends paid by domestic corporations generally qualify for the lower rate, not all foreign corporation dividends do. Only dividends paid by so-called "qualified foreign corporations," which include foreign corporations traded on an established U.S. securities market (including American Depositary Receipts or ADRs), corporations organized in U.S. possessions and other foreign corporations eligible for certain income tax treaty benefits are eligible for the lower rates. Finally, beware of certain investments marketed as preferred stocks that are really debt instruments (*e.g.*, trust preferred securities). Dividends received on these securities are not qualified dividends, and therefore do not qualify for the preferential capital gain tax rates.

Planning Tip

To achieve even greater tax savings, consider holding bonds and other interest-yielding securities inside qualified plans and IRAs, while having stocks that produce capital gains and qualified dividend income in taxable accounts. In addition, when a taxpayer is fast approaching retirement years, it may be more beneficial to invest in equities outside of the retirement accounts so they may take advantage of the more favorable capital gains rates when they decide to cash-in their investments to satisfy retirement-related expenses.

15. **Invest in municipal bonds.** Tax-exempt interest is not included in adjusted gross income, so deduction items based on AGI are not adversely affected. As long as your investment portfolio is appropriately diversified, greater weight in municipal bonds may be advantageous. However, be mindful of the AMT impact on income from private activity bonds, which is still a preference item for AMT purposes. In general, a private activity bond is a municipal bond issued after August 7, 1986, whose proceeds are used for a private (*i.e.*, nonpublic) purpose. Accordingly, review the prospectus of the municipal bond fund to determine if it invests in private activity bonds. Anyone subject to the AMT, including those with incentive stock options, should avoid these funds.
16. **Avoid mutual fund investment pitfall.** Before you invest in a mutual fund prior to February 2019, you should contact the fund manager to determine if year 2018 dividend payouts are expected. If such payouts take place, you may be taxed in 2018 on part of your investment. You need to avoid such payouts, especially if they include large capital gain distributions. In addition, certain dividends from mutual funds are not "qualified" dividend income and therefore are subject to tax at the taxpayer's marginal income tax rate, rather than at the preferential 20, 15 percent (or 0 percent) rate.

ILLUSTRATION

If you receive a payout of $5,000, the value of your original shares declines by $5,000 – the dividend payment. Furthermore, if you are in the automatic dividend reinvestment plan, so that the $5,000 dividend purchases new shares, the value of your fund should now be about the same as your original investment. However, the $5,000 dividend payout is subject to the preferential tax rates. If it is not a "qualified" dividend, it is subject to tax of up to 37 percent. If you had invested after the dividend date, you would own about the same shares but would have paid no tax!

17. **Determine whether you are a trader or investor.** Discount brokers and online trading have changed the way many people invest in the stock and securities markets. As a result, many individuals spend a considerable amount of time regularly trading stocks. If this describes you, the tax treatment of your income and expenses from your trading activity can differ dramatically depending on whether the tax law classifies you as a trader or an investor. Your status as a trader or investor may not be clear, so a careful analysis of your situation should be performed before year-end in order to determine your status and the tax planning opportunities that may exist. In general, an investor's activities are limited to occasional transactions for his own account, while a trader's activities must be substantial, frequent, regular and continuous.
18. **Determine worthless stock in your portfolio.** Your basis in stock that becomes worthless is deductible (generally as a capital loss) in the year it becomes worthless, but you may need a professional appraiser's report or other evidence to prove the stock has no value. Instead, consider selling the stock to an unrelated person for at least $1. You have now eliminated the need for an appraiser's report and are almost guaranteed a loss deduction.

19. **Invest in Qualified Opportunity Zones to save on capital gains.** Gains can be deferred on the sale of appreciated stock that is reinvested within 180 days into a Qualified Opportunity Fund. If the investment is held for over 10 years, the gain after acquisition can be entirely eliminated. The investment can be in the form of an investment interest in either a partnership or corporation that invests 90 percent of its assets in a Qualified Opportunity Zone. All states have communities that now qualify. Besides investing in a fund, one can also take advantage of this opportunity by establishing a business in the Qualified Opportunity Zone, or by investing in Qualified Opportunity Zone property.
20. **Maximize home-related exclusion.** Federal law (and many, but not all, states) provides that an individual may exclude, every two years, up to $250,000 ($500,000 for married couples filing jointly) of gain realized from the sale of a principal residence. The exclusion ordinarily does not apply to a vacation home. However, with careful planning, you may be able to apply the exclusion to both of your homes.

ILLUSTRATION

After selling your principal residence and claiming the allowable exclusion, convert your former vacation home into your new principal residence for at least two years. Establishing residency and use is critical to the success of this technique. Proper conversions result in an additional $250,000/$500,000 of tax-free gain. However, you may still have taxable gain to the extent of depreciation taken. The same strategy applies when two individuals are planning to get married and each owns his or her own principal residence. If they do not sell one of the residences before marrying, it may not qualify as a principal residence on a subsequent sale if the residency and use requirements are not met. The result could be a fully taxable sale. You may also qualify for partial gain exclusion in certain circumstances.

OBSERVATION

Gain on the sale of a principal residence cannot be excluded if the home was acquired in a like-kind exchange within five years from the date of sale. Therefore, an individual who owns a principal residence, which was originally acquired in a like-kind exchange, must wait five years before selling the property in order to exclude gain up to $250,000 ($500,000 for married couples filing jointly).

21. **Consider like-kind exchanges.** Like-kind exchanges for property other than real property are no longer available beginning in 2018. However, these exchanges can still be accomplished for real property sales.

OBSERVATION

Although a like-kind exchange is a powerful tax-planning tool, it includes certain risks. Simply put, it postpones the tax otherwise due on the property exchanged, but it does not eliminate it. The gain will eventually be recognized when the acquired property is sold. In addition, do not exchange property that is worth less than your tax basis in it, since the loss would also be deferred under the like-kind exchange rules. Instead, sell it and take the loss now.

22. **Track cryptocurrency transactions.** While most cryptocurrency exchanges are not required to issue formal tax documentation to traders, the IRS has already been requesting records from major exchanges and is cracking down on this industry as a whole. Gains and losses from the sale of cryptocurrencies, just like the sale of stock, are required to be reported on your tax return. As taxpayers are generally not provided with tax documents detailing sale prices and cost basis, taxpayers must track these items themselves to accurately report their income. Proper recording of basis in cryptocurrency can significantly decrease the capital gains, which

may be assessed in the future, should the IRS start requesting sales information from more exchanges.

Planning for Higher Education Costs

Many tax savings opportunities exist for education-related expenses. If you or members of your family are incurring these types of expenses now or will be in the near future, it is worth examining them in some detail. Here, in abbreviated form, are some strategies to consider as year-end approaches.

23. **Consider Section 529 qualified tuition plans.** Discussed below are the most important features of these plans.

    The ownership and control of the plan is with the donor (typically the parent or grandparent of the beneficiary student), not with the beneficiary, so the plan is not considered an asset of the student for financial aid purposes. Consequently, higher financial aid is possible. For federal income tax purposes, plan contributions are on an after-tax basis, although many states allow a deduction. Contributions and earnings on contributions that are subsequently distributed for qualified higher education expenses (including tuition, room and board, and other expenses) at accredited schools anywhere in the United States are free of federal income tax, and may be free of state income tax. Beginning in 2018, 529 plan owners can now use tax-free distributions for up to $10,000 of eligible expenses at elementary and secondary schools, in addition to colleges and universities. To the extent that distributions are not for qualified higher education expenses, regular income tax plus a 10 percent penalty may apply to the earnings portion of the distribution. As contrasted with the other education strategies discussed below, contributions may be made regardless of the donor’s AGI.

    An election can also be made to treat a contribution to a Section 529 plan as having been made over a five-year period; consequently, for 2018, a married couple can make a $150,000 contribution to a Section 529 plan without incurring any gift tax liability, since the annual gift exclusion for 2018 is $15,000 per donor and the contribution can be split with the donor’s spouse.

Planning Tip

If your resident state allows a deduction, make a contribution to a 529 plan and immediately take a qualified distribution to pay for college tuition. In effect, this will provide you with a discount on college costs at your marginal state income tax rate.

OBSERVATION

Currently, more than 30 states and Washington, D.C., allow a deduction for Section 529 plan contributions. Please make sure you have the appropriate 529 plan, as many states are particular about what type of plan can lead to a state deduction. For example, New York only allows deductions for 529 plans set up under New York law. If you have changed residency since setting up a 529 plan, review your options before contributing.

Finally, in general, to the extent that contributions to a Section 529 plan are not distributed for the benefit of the beneficiary, the account may be transferred to a member of the beneficiary’s family, penalty-free. As long as the amounts transferred are used for qualified education expenses, they will still be free from federal income tax, as noted above.

24. **Be familiar with the education credit options.** If you pay college or vocational school tuition and fees for yourself, your spouse or your children, you may be eligible for either the American Opportunity Tax Credit (AOTC) or the Lifetime Learning Credit. These credits reduce taxes dollar-for-dollar, but begin to phase out when 2018 AGI exceeds certain levels. The chart below provides a summary of the phaseouts.

Planning Tip

The credits are allowed for tuition paid during the year for education received that year or during the first three months of the next year. Consequently, consider paying part of 2019 tuition at the end of 2018 if you have not maximized the credit or reached the above income thresholds.

Planning Tip

Parents can shift an education credit from their return to the student's return by electing to forgo the child tax credit for the student. This strategy is a "no brainer" for high-income parents whose income prevents them from claiming the credit or from receiving any benefit from the child tax credit. To benefit from this strategy, however, the student must have sufficient income, and therefore tax liability, to take advantage of the credit. It might be necessary to shift income to the student as well, perhaps through gifts of appreciated property (that the student then sells at a gain) or employment in a family business, as discussed in item 78. However, be careful about the impact on a student's financial aid – shifting income to a student can have a detrimental impact on a student receiving or being eligible for financial aid.

25. **Remit additional student loan payments.** An "above the line" deduction of up to $2,500 is allowed for interest due and paid in 2018. The deduction is phased out when AGI exceeds certain levels. See chart below.
26. **Contribute to a Coverdell Education Savings Account.** These accounts must be established in a tax-exempt trust or custodial account organized exclusively in the United States. At the time the trust or account is established the designated beneficiary must be under 18 (or a special needs beneficiary), and all contributions must be made in cash and are not deductible. The maximum annual contribution is limited to $2,000 per year, and the contribution is phased out when AGI exceeds certain levels. Distributions from Coverdell Education Savings Accounts are excludable from gross income to the extent that the distributions do not exceed the qualified education expenses incurred by the designated beneficiary, which include kindergarten through grade 12 and higher education expenses. If distributions exceed qualified expenses, a portion of the distributions is taxable income to the designated beneficiary. Furthermore, to the extent that distributions are not used for educational expenses, a 10 percent penalty applies.

2018 Education Expense and Credit Summary			
Tax Benefit	Single filers (not including Married Filing Separately)	Joint filers	Maximum credit/ deduction/contribution
American Opportunity Tax Credit	$80,000 - $90,000	$160,000 - $180,000	$2,500 (credit)
Lifetime Learning Credit	$57,000 - $67,000	$114,000 - $134,000	$2,000 (credit)
Student loan interest deduction	$65,000 - $80,000	$135,000 - $165,000	$2,500 (deduction)
Coverdell Education Savings Account	$95,000 - $110,000	$190,000 - $220,000	$2,000 (contribution)

Planning Tip
Since Coverdell Education Savings Accounts provide the same tax benefit as a 529 plan, you may wish to consider converting the Coverdell to a 529 and take a state tax deduction, if your state allows a deduction for 529 contributions.

Strategies to Implement Throughout the Year

Virtually any cash-basis taxpayer can benefit from, and exercise a fair amount of control over, strategies that accelerate deductions or defer income based on the premise that it is generally better to pay taxes later rather than sooner (especially when income tax rates are not scheduled to increase). For example, a check you deliver or mail during 2018 generally qualifies as a payment in 2018, even if the check is not cashed or charged against your account until 2019. Similarly, payments of deductible expenses by credit cards are not deductible when you pay the credit card bill (for instance, in 2019), but when the charge is made (for instance, in 2018).

With respect to income deferral, cash-basis businesses, for example, can delay year-end billings so that they fall in the following year or accelerate business expenditures to the current year. On the investment side, income from short-term (*i.e.*, maturity of one year or less) obligations like Treasury bills and short-term certificates of deposit is not recognized until maturity, so purchases of such investments at this time will push taxability of such income into 2019. For a wage earner (excluding an employee-shareholder of an S corporation with a 50 percent or greater ownership interest) who is fortunate enough to be expecting a bonus, he or she may be able to arrange with his or her employer to defer the bonus (and his or her tax liability for it) until 2019. However, if any of this income becomes available to the wage earner, whether or not cash is actually received, the bonus will be taxable in 2018. This is known as the constructive receipt doctrine.

27. **Participate in and maximize payments to 401(k) plans, 403(b) plans, SEP (self-employed) plans, IRAs, etc.** These plans enable you to convert a portion of taxable salary or self-employed earnings into tax deductible contributions to the plan. In addition to being deductible themselves, these items increase the value of other deductions since they reduce AGI. Deductible contributions to IRAs are generally limited to $5,500 in 2018, while substantially higher amounts can be contributed to 401(k) plans, 403(b) plans and simplified employee pensions (SEPs). For 2018, the deduction for IRA contributions starts being phased out if you are covered by a retirement plan at work and your AGI exceeds $63,000 for single filers and $101,000 for married joint filers. In 2018, $18,500 may be contributed to a 401(k) plan as part of the regular limit of $55,000 that may be contributed to a defined contribution (*e.g.*, money purchase, profit-sharing) plan. These limits have both increased in 2018 and are reflected in the table below. Don't forget that additional catch-up contributions are allowed for those taxpayers ages 50 and above, as noted in the chart below.

    In addition, SEPs can be established and contributed to as late as the due date of your return, including extensions, or as late as October 15, 2019, for tax year 2018.

OBSERVATION

Roth 401(k) accounts can be established to take after-tax contributions, if the traditional 401(k) plan permits such treatment. Some or all of the traditional 401(k) contributions can be designated by the participant as Roth 401(k) contributions, subject to the maximum contributions that already apply to traditional 401(k) plans (including the catch-up contributions), as reflected in the table below. The Roth 401(k) contributions are not deductible, but distributions from the Roth 401(k) portion of the plan after the participant reaches age 59½ are tax-free.

With respect to recharacterizations, beginning in 2018, while contributions to one type of IRA can generally be recharacterized as a contribution to the other type of IRA, this is no longer allowed for a conversion contribution to a Roth IRA. Thus, recharacterization cannot be used to unwind a Roth conversion. However, recharacterization is still permitted with respect to other contributions.

Annual Retirement Plan Contribution Limits		
Type of Plan	2017	2018
Traditional and Roth IRAs	$5,500	$5,500
Catch-up contributions (ages 50+) for Traditional and Roth IRAs	$1,000	$1,000
Roth and traditional 401(k), 403(b) and 457 plans	$18,000	$18,500
Catch-up contributions (ages 50+) for 401(k), 403(b) and 457 plans	$ 6,000	$ 6,000
Simple Plans	$12,500	$12,500
Catch-up contributions (ages 50+) for Simple Plans	$3,000	$3,000
SEPs and defined contribution plans*	$54,000	$55,000

*Annual limits for compensation must be taken into account for each employee in determining contributions or benefits under a qualified retirement plan. For 2018, the limit, as adjusted for inflation, is $275,000.

28. **Contribute the maximum to a nonworking spouse's IRA.** As long as one spouse has $11,000 of earned income in 2018, each spouse can contribute $5,500 to their IRAs. The deductibility of the contributions depends on the AGI reflected on the tax return and on whether the working spouse is a participant in an employer-sponsored retirement plan. Keep in mind that an individual is not considered an active participant in an employer-sponsored plan merely because his or her spouse is an active participant for any part of the plan year. Thus, it is possible to have contributions to the working spouse's IRA that are nondeductible while having contributions to the nonworking spouse's IRA that are deductible, or to have contributions to both IRAs that are deductible. Any individual making an IRA contribution, whether it is deductible or not, may wish to make it sooner rather than later in order to maximize the tax-deferred income on the contributed amount. In addition, catch-up IRA contributions, described above, are also permitted.
29. **Consider purchasing annuities.** Once you have maximized the use of qualified retirement plans (*e.g.*, SEPs, Keoghs, 401(k)s) and IRAs, the purchase of annuities offers another opportunity for deferral of income, and thus, tax. Due to the time value of money, it is almost always better to pay tax on income later rather than sooner. When contemplating retirement, deferral of income is particularly beneficial in scenarios where income is expected to drop in retirement and will thus be subject to lower effective tax rates than those in effect during the comparatively higher income years of employment.
30. **Participate in health and dependent care flexible spending accounts (IRC Section 125 accounts).** These plans enable employees to set aside funds on a pretax basis for (1) medical expenses that are not covered by insurance, (2) dependent-care costs up to $5,000 per year and (3) adoption assistance of up to $13,810 per year. Funds contributed by employees are free of federal income tax (at a maximum rate of 37 percent), Social Security and Medicare taxes (at 7.65 percent) and most state income taxes (at maximum rates as high as 13.3 percent), resulting in a tax savings of as much as 57.95 percent. Paying for these expenses with after-tax dollars, even if they meet various AGI requirements, is more costly under the current tax rate structure. Since many restrictions apply, such as the "use it or lose it" rule, review this arrangement before making the election to participate.

ILLUSTRATION

The tax savings resulting from participation in FSAs are often significant. Assume a family contributes $5,000 for uncovered medical costs and $5,000 for qualified daycare expenses. Assuming a 37 percent tax rate, the family creates a tax savings of about $4,465 ($3,700 in income taxes and $765 in Social Security/Medicare taxes, not counting any potential reductions in state income taxes).

Planning Tip

Section 125 plans often adopt a two-and-a-half month grace period (to March 15, 2019) during which employees who participate in the Section 125 plan can incur expenses that can be treated as 2018 qualified expenses. Accordingly, this can potentially reduce employee contributions that would otherwise be subject to forfeiture.

Planning Tip

Married couples who both have access to flexible spending accounts (FSAs) will also need to decide whose FSA to use. If one spouse's salary is likely to be higher than the FICA wage limit ($128,400 for 2018) and the other spouse's salary will be less, the one with the smaller salary should fund as much of the couple's FSA needs as possible. This is because FSA contributions by the spouse whose income is higher than the FICA wage limit will not reduce the 6.2 percent Social Security tax portion of the FICA tax, but FSA contributions by the other spouse will reduce it. This planning tip also applies to HSAs mentioned below.

For example, if John's salary is $150,000 and Mary's salary is $50,000, FSA contributions of $10,000 by John will not reduce his Social Security tax (since, even reflecting the FSA contributions, his Social Security wages exceed $128,400), while FSA contributions of $10,000 by Mary will save her approximately $600 in Social Security tax.

31. **Participate in Health Savings Accounts (IRC Section 223 accounts).** Health Savings Accounts (HSAs) are another pretax medical savings vehicle that are currently highly favored in the marketplace by Congress. HSAs offer a tax-favorable way to set aside funds to meet future medical needs. The four key elements to an HSA include: (1) contributions you make to an HSA are deductible, within limits; (2) contributions your employer makes are not taxed to you; (3) earnings on the funds within the HSA are not taxed; and (4) distributions from the HSA to cover qualified medical expenses are not taxed.

    To be eligible for an HSA, you must be covered by a "high deductible health plan." You must also not be covered by a plan that (1) is not a high deductible health plan and (2) provides coverage for any benefit covered by your high deductible plan. For self-only coverage, the 2018 limit on deductible contributions is $3,450. For family coverage, the 2018 limit on deductible contributions is $6,900.

Planning Tip

The HSA is not a "use it or lose it" account like FSA, which means wiser choices can be made in long-term healthcare spending. Funds remaining in an HSA at year-end are not forfeited, but remain in the account tax-free until distributed for medical purposes. Like IRAs, an individual owns their HSA. It stays with the individual even after a job change making the HSA a very portable savings device.

32. **Consider optimal timing for retirement plan distributions.** If you are age 70½ or older, you are normally subject to the minimum distribution rules with regard to your retirement plans. Under these rules, you must receive at least a certain amount each year from your retirement accounts. You can always take out more than the required amount, but anything less is subject to a 50 percent penalty on the shortfall amount. Therefore, if you have not taken your required distribution for 2018, do so before year-end to avoid a hefty penalty.

    If you have reached age 70½ in 2018, you can delay your 2018 required distribution until April 1, 2019, if you choose. However, waiting until 2019 will result in two required distributions in 2019: the amount required for 2018 plus the amount required for 2019. While deferring income is normally a sound tax strategy, here it may result in bunching income into 2019, which may or may not push you into a higher tax bracket or have a detrimental impact on other tax deductions you normally claim. A careful timing assessment is needed. "Crunching the numbers" for 2018 and 2019 will help you to determine the optimal timing of the distributions.

OBSERVATION

Certain individuals still employed at the age of 70½ are not required to begin receiving minimum required distributions from qualified retirement plans (401(k), profit sharing, defined benefit plans, 403(b)s, etc.) until after they retire, representing another often overlooked method of deferral of tax on retirement savings.

33. **Carefully plan Roth conversions.** Taxpayers who decide to rollover or convert from a regular IRA to a Roth IRA and who also expect their AGI and tax bracket to remain more or less constant should consider staggering the total amount they plan to shift over a period of years. For example, a taxpayer who plans to convert a total of $85,000 from a regular IRA to a Roth IRA should consider converting $17,000 per year for five years. This strategy may prevent the conversion from pushing a taxpayer into a higher tax bracket, since the conversion is fully taxable on the amount converted.

Planning Tip

Before assets are transferred to a Roth IRA, a careful analysis should be performed to project which retirement investment vehicle will be more financially beneficial and the impact of the rollover or conversion on an older taxpayer's required minimum distribution (RMD) calculations. The goal is to generate more after-tax wealth as a result of the conversion for you and your heirs. It is important to note that the converted amounts do not count toward your RMD.

Planning Tip

Many taxpayers are prevented from making a Roth IRA contribution due to their AGI. For 2018, Roth contributions are prohibited for couples filing jointly whose AGI exceeds $199,000 and for singles and head of household filers whose AGI exceeds $135,000. However, this limitation can be worked around by making a so-called "backdoor Roth" contribution. A taxpayer can make nondeductible contributions to a traditional IRA and can subsequently convert these contributions into a Roth IRA without being subject to the AGI limitation. Any income earned on the account between the time the account was a nondeductible IRA and the time of conversion to a Roth would be required to be picked up as income, though many taxpayers contribute to the traditional IRA and convert to the Roth within a short period to avoid this treatment.

34. **Avoid deduction limits for charitable contributions.** The charitable deduction for airplanes, boats and vehicles may not exceed the gross proceeds from their resale. Form 1098-C must be attached to tax returns claiming these types of noncash charitable contribution. Furthermore, donations of used clothing and household items, including furniture, electronics, linens, appliances and similar items, must be in "good" or better condition to be deductible. You should maintain a list of such contributions together with photos to establish the item's condition. To the extent they are not in "good condition," you will need to secure a written appraisal to deduct individual items valued at more than $500.

Planning Tip

Collect substantiation for cash contributions. Charitable contributions of money must be supported by a canceled check, bank record or receipt from the donee organization showing the name of the organization, the date of the contribution and the amount of the contribution. Charitable contributions in excess of $250 must have a written acknowledgment from the organization.

OBSERVATION

Substantiation of charitable contributions has grown in importance in the eyes of the courts and the IRS. If you are thinking of making a large noncash charitable contribution that is not in the form of publically traded stock, make sure you acquire and maintain the correct information and forms needed to substantiate your deduction. The chart below is a useful guide for determining what you need to have in order to deduct your noncash charitable contribution.

Non-Cash Contribution Substantiation Guide				
Type of Donation	Amount Donated			
	Less than $250	$250 to $500	$501 to $5,000	Over $5,000
Publicly traded stock	-Receipt -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records
Nonpublicly traded stock	-Receipt -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records -Qualified appraisal -Form 8283 Section B
Artwork	-Receipt -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records	-Acknowledgment -Written Records -Qualified Appraisal -Form 8283 Section B
Vehicles, boats and airplanes	-Receipt -Written records	-1098-C or -Acknowledgment	-1098-C and -Written records	-1098-C -Written records -Qualified appraisal -Form 8283 Section B
All other noncash donations	-Receipt -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records -Qualified appraisal -Form 8283 Section B
Volunteer out-of-pocket expenses	-Receipt -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records	-Acknowledgment -Written records

35. **Make charitable contributions of up to $100,000 from 2018 IRA distributions.** Current law provides an exclusion from gross income for certain distributions of up to $100,000 per year from a traditional IRA, where the distribution is contributed directly to a qualified tax-exempt organization to which deductible contributions can be made. This special treatment, which was made permanent under the 2015 Protecting Americans from Tax Hikes (PATH) Act of 2015, applies only to distributions made on or after the date the IRA owner attains age 70½ and must be made directly from the IRA trustee to the charitable organization. Distributions that are excluded from income under this provision are not allowed as a deduction. Qualified charitable distributions (QCDs), as these are called, may be especially beneficial for those taxpayers who claim the standard deduction or whose taxable social security benefits are effected by AGI thresholds.

OBSERVATION

Excluding the IRA distributions from AGI also results in a lower AGI, which may make income or deductions affected by AGI (such as medical deductions) more valuable and may also reduce the amount of Social Security benefits that are subject to tax.

Planning Tip

Qualifying charitable distributions can be used to satisfy required minimum distribution (RMD) requirements, thus allowing taxpayers to exclude income they would otherwise be required to include. This may be particularly valuable for those attaining age 70 ½ and deferring their initial RMD until April of the following year. As a practical matter, however, such charitable distributions may not be made to a private foundation or donor advised fund.

36. **Make intelligent gifts to charities.** Do not give away loser stocks (those that are worth less today than what you paid for them). Instead, sell the shares and take advantage of the resulting capital loss to shelter your capital gains or income from other sources, as explained above. Then give cash to the charity. Since you just sold the stock, you will have the cash on hand. As for winner stocks, give them away to charity instead of donating cash. Under either situation, you recognize multiple tax benefits. When gifting appreciated stock to charity, you not only avoid paying capital gains taxes, gift and estate taxes, but you may also be able to deduct the value of the stock for income tax and AMT purposes. As always, be aware that gifts to political campaigns or organizations are not deductible.

Planning Tip

Consider making a qualified conservation contribution, which is a contribution of real property interests exclusively for conservation purposes, including remainder interests and use restrictions granted in perpetuity. The charitable deduction is taken in the year of the transfer even though the charity does not receive the property until a later time, if ever.

For example, you can donate an easement on scenic farmland next to a national park and continue to farm the property. You may have to grant some access to the public, depending on the circumstances, but this can be limited in a manner that permits your continued enjoyment of the property. The amount of the deduction is generally the present value of the remainder interest on the date of the gift. Like other charitable contributions, gifts of remainder interests are subject to the AGI limitations and other restrictions on charitable deductions, so contact us for details.

Another strategy to consider is a charitable remainder trust, where income-producing assets are transferred to an irrevocable trust. The donor or other noncharitable beneficiaries receive trust income for life or for a period of years. The donor receives an up-front charitable contribution equal to the present value of the remainder interest. The charity receives the remaining trust assets when the income interests end. Also, consider the use of donor advised funds, where you can contribute cash, securities or other assets. You can take a deduction and invest the funds for tax-free growth while recommending grants to any qualified public charity.

OBSERVATION

It is important to confirm that the donation you are considering is contributed to an organization that is eligible to receive tax-deductible donations (known as a "qualified charity"). The IRS website contains a search tool that assists in determining if the charity you are contemplating a gift to is a qualified charity.

37. **Consider deducting state and local sales taxes in lieu of deducting state income taxes.** For 2018, instead of deducting state and local income taxes, taxpayers are able to choose to deduct state and local sales taxes by either (1) accumulating receipts or (2) using IRS sales tax tables and adding actual sales taxes paid for major items, such as vehicles. Accordingly, to the extent possible, accumulate the receipts reflecting sales taxes you have paid this year and compare the total to the state income taxes paid this year. Keep in mind that the deduction for state and local sales taxes includes the amount provided in IRS tables plus the amounts of general state and local sales taxes paid on the purchase of motor vehicles, boats and airplanes. For 2018, the state and local sales tax deduction is limited to $10,000, just as for income taxes.

OBSERVATION

This provision is attractive to taxpayers residing in states without an income tax, such as Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming; states that tax only dividends, such as New Hampshire and Tennessee; and in lower tax rate jurisdictions.

38. **Charge charitable contributions.** Charitable contributions charged to a credit card are deductible in the year charged, not when payment is made on the card. Therefore, charging charitable contributions to your credit card before year-end enables you to increase your 2018 charitable contributions deduction even if you are temporarily short on cash or simply want to defer payment until next year. Note, however, that any interest paid with respect to the charge is not deductible.
39. **Consider paying state and local taxes, mortgage interest, medical expenses, charitable gifts, etc. (subject to limits noted within this Guide), in the same year as opposed to spreading the payments over two years.** By bunching deductions and deferring taxable income along with using AGI-reducing techniques, you increase the value of all deductions and reduce your overall tax liability.

    In considering the strategies noted below, however, keep in mind that if you pay a deductible expense in December 2018 instead of in January 2019, you reduce your 2018 tax instead of your 2019 tax, but you also lose the use of your money for one month. Generally, this will be to your advantage, unless you have an alternative use for the funds that will produce a rate of return in that one month that will exceed the tax savings. In other words, you must decide whether the cash used to pay the expense early should be for something more urgent or more valuable than the increased tax benefit.

Planning Tip

With interest rates expected to rise in the near term, consider refinancing your mortgage to take advantage of the current lower rates. Any points you paid on a previous refinancing that have not been fully amortized would be deductible in full in 2018 as long as the previous mortgage is paid off by the end of the year. In addition, even though the interest paid on a lower rate mortgage would be less and would result in a smaller tax deduction, it also would improve your monthly cash flow. In other words, as noted above, use sound economic planning in your decision-making process rather than viewing every transaction in terms of its tax effect.

The following chart illustrates the tax treatment of selected types of interest.

Interest Expense Deduction Summary*			
Type of debt	Not deductible	Itemized deduction	Business or above-the-line deduction
Consumer or personal	X		
Taxable investment[1]		X	
Qualified residence[2]		X	
Tax-exempt investment	X		
Trading and business activities			X
Passive activities[3]			X

*Deductibility may be subject to other rules and restrictions.
[1] Generally limited to net investment income.
[2] For 2018, including debt of up to $750,000 ($1.1 million for debt incurred prior to December 16, 2017) associated with primary and one secondary residence. Home equity loan interest deduction is suspended, unless the loan proceeds are used to buy, build or substantially improve the taxpayer's home securing the loan.
[3] Subject to passive activity rules.

Charitable contributions. As discussed in item 6 above, consider paying 2019 pledges in 2018 to maximize the "bunching" effect.

Investment interest. This is interest on loans used to purchase or carry property held for investment purposes (*e.g.*, interest on margin accounts, interest on debt used to purchase taxable bonds, stock, etc.). Investment interest is fully deductible to the extent of net investment income, unless incurred to purchase securities that produce tax-exempt income. Net investment income is equal to investment income less deductible investment expenses. Sources of investment income include income from interest, nonqualified dividends, rents and royalties. Investment expenses include depreciation, depletion, attorney fees, accounting fees and management fees. If you bunch your investment expenses in one year so that little or no investment interest is deductible, the nondeductible investment interest can be carried forward to a succeeding tax year.

You may be able to convert nondeductible interest to deductible investment interest by rearranging your borrowing. In addition, you may be able to increase your otherwise nondeductible investment interest by disposing of property that will generate a short-term capital gain. The extra investment interest deduction may even offset the entire tax on the gain. Disposing of property that will generate long-term capital gain will not increase your investment income unless you elect to pay regular income tax rates on the gain. Accordingly, you should review your debt and investment positions before disposing of such property.

Planning Tip

An election can be made to treat qualified dividend income as nonqualified. This would increase the amount of net investment income and consequently the amount of deductible investment interest. Although the election would result in qualified dividend income being taxed at the taxpayer's top marginal income tax rate, rather than, in general, at a 20 percent rate, tax savings could result. The only way to determine if this makes sense is to crunch the numbers and see if the overall tax liability decreases. Since investment interest is deductible for AMT purposes, making this election could reduce the AMT.

Medical and dental expenses. As discussed in item 3 above, a medical deduction is allowed in 2018 only to the extent that your unreimbursed medical outlays exceed 7.5 percent of your AGI. To exceed this threshold, you may have to bunch expenses into a single year by accelerating or deferring payment, as appropriate.

Planning Tip

Keep in mind that premiums paid on a qualified long-term care insurance policy are deductible as medical expenses. The maximum amount of the deduction is based on the taxpayer's age. For example, the deduction for such premiums paid for an individual age 40 or less is limited to $420, while the deduction for an individual age 71 or older is limited to $5,200. These limitations are per person, not per tax return, so a married couple where both husband and wife are 71 or older would be entitled to a maximum deduction of $10,400, subject to the 7.5 percent of AGI floor noted above.

OBSERVATION

A divorced parent generally can deduct medical payments incurred for his or her child even though the other parent claims the dependency exemption. Also, a child may be entitled to a deduction for the medical expenses paid on behalf of a parent, even though he or she cannot claim the parent as a dependent because the parent has gross income of at least $4,150 in 2018.

40. **Determine your level of participation in activities to either avoid or qualify for passive activity loss treatment.** In general, if an individual spends more than 500 hours participating in an activity during the year, the activity will not be considered passive. There are other exceptions, as well.

    As for real estate professionals, eligible taxpayers may deduct losses and credits from rental real estate activities in which they materially participate, since they will not be treated as passive and may be used to reduce nonpassive income. An eligible taxpayer for these purposes spends more than 750 hours of services during the tax year in real property trades or businesses. In addition, a taxpayer's personal use, or rental to others, of a vacation home during the last few days of the year may have a substantial tax impact.

41. **Do not overlook the advantages of selling passive activities to free up suspended losses.** Passive losses can be used to offset nonpassive income in the year you dispose of or abandon your entire interest in the activity in a taxable transaction, whether the transaction results in a gain or a loss.

Planning Tip

Dual tax benefit. *If you have sufficient capital gains, you can sell a passive activity for a capital loss, offset the capital loss against the capital gains and also deduct prior year suspended losses from that passive activity. Should the sale result in a gain, this may still be a sound strategy since the gain will be taxed at a rate lower than the ordinary tax rate permitted for the passive loss. Once again, crunch the numbers to determine the tax impact.*

42. **Increase your basis in partnerships or S corporations to take advantage of any losses generated by the pass-through entities.** Keep in mind that loans made by a third party lender to an S corporation and guaranteed by an S corporation shareholder do not increase the shareholder's basis. The loan must be made directly from the S corporation shareholder to the S corporation in order to increase his or her basis.
43. **Finalize your divorce before the year-end.** For divorce decrees, separation agreements and certain modifications entered into after December 31, 2018, alimony paid under these agreements must be treated as a nondeductible expense for the payor (and nontaxable to the recipient). For divorcing couples where the payor is in a higher tax bracket than the recipient, the value of the tax deduction often exceeds the additional tax due as a result of the inclusion of the alimony in income. While couples finalizing their divorce prior to year-end will be free to choose the tax treatment of alimony, after year end, it will be nondeductible and excluded from income.
44. **Take advantage of the $15,000 annual gift exclusion and unlimited medical and education expense exclusion.** A donor may make a gift of $15,000 to any one donee or $30,000 to any one donee provided the donor is married and the gift is split with his or her spouse, without using any of their unified credit or incurring a gift tax. Thus, a gift of $60,000 may be made by a husband and wife to another married couple. Medical and education expenses paid directly to the providing institution are not subject to gift tax. In addition, as indicated in the education planning section, contributions to Section 529 plans may also qualify for special gift tax exclusion treatment. A substantial tax reduction can be achieved by making gifts to your child or grandchild.

    For example, a parent can reduce the capital gains tax from the 20 percent rate to potentially 0 percent by gifting stock or certain mutual funds, in lieu of cash, to a child or grandchild who is in the 10 percent or 15 percent tax bracket.

OBSERVATION

Even gifts not covered by the exclusion, and thus taxable, may not result in a tax liability. This is so because a tax credit wipes out the federal gift tax liability on the first taxable gifts that you make in your lifetime, up to $11,180,000 (for 2018). However, to the extent you use this credit against a gift tax liability, it reduces (or eliminates) the credit available for use against the federal estate tax at your death. The TCJA doubled the unified credit for purposes of the estate, gift and generation-skipping tax to an inflation indexed $10 million ($11,180,000 for 2018).

Planning Tip

All of the strategies and observations noted in this guide are aimed at minimizing your income and gift tax costs. In other words, it is important that you ensure that your current and future wealth are not unduly diminished by those taxes. Although our focus is not on gift and estate tax planning, we strongly recommend that you consult with estate planning professionals to discuss such topics as gift, estate and generation-skipping transfer (GST) tax exemptions, the unlimited marital deduction, each spouse's exemption and related items.

45. **Increase federal tax withholding to avoid the underpayment of estimated tax penalty.** For taxpayers with AGI of more than $150,000, 110 percent of your prior year liability (or 90 percent of your current year liability) must be paid to avoid the penalty. Attempting to compute how much tax you will owe and when you must pay it to avoid underpayment penalties is the key to determining which of the two methods to use. Accordingly, minimizing 2018 taxable income will result in the lowest possible estimated tax payments in 2019, if using the prior year safe harbor method. In addition, since withholding is treated as being paid equally throughout the year, a penalty for an estimate that was paid late can be eliminated or mitigated through increased withholding. Similarly, you may wish to increase withholding of state and local taxes to avoid underpayment penalties and accelerate a federal tax deduction.

OBSERVATION

If you are not earning wages but are taking distributions from qualified plans or IRAs, federal tax withholding on those distributions could also assist in avoiding the underpayment of estimated tax penalty.

46. **Review your estate plan documents.** Despite the TCJA doubling the estate, gift and GST tax exemptions to $11.18 million per U.S. domiciliary, wealth transfer strategies are still important. If you have not examined your estate plan within the last two years, you should consider doing so immediately. While addressing your will, also consider the benefits of a living will, medical power of attorney and durable power of attorney and the appropriateness of your beneficiary designations on your retirement accounts and life insurance policies.
47. **Consider tax payments by credit card.** IRS accepts tax payments by credit and debit cards. Consequently, taxpayers may wish to pay tax payments with a credit card to earn frequent flyer miles, cash-back bonuses, reward points and other perks. The fees charged to you (on average 2.5 percent of the tax paid) by the card issuer, however, may exceed the benefits received.
48. **Qualify for plug-in energy tax credits.** The qualified plug-in electric drive motor vehicle credit is primarily for four wheeled vehicles that meet certain battery and kilowatt requirements. The base amount of the credit is $2,500 per vehicle. The allowable credit is increased by an additional $5,000 per vehicle based on a formula which increases the credit by $417 for every kilowatt hour of battery capacity in excess of five, for a total maximum credit of $7,500.

OBSERVATION

The credit is not subject to any income phaseouts for high-income taxpayers, which makes buying one of these qualified vehicles a perfect end of year tax-saving maneuver. Also for those taxpayers who are contemplating the purchase of any model Tesla, the energy credit available will be cut in half (to $3,750) for vehicle deliveries beginning January 1, 2019. On July 1, 2019, the available credit will be halved again (to $1,875), before being phased out entirely on January 1, 2020.

49. **Consider accelerating life insurance benefits.** Subject to certain requirements, an individual who is chronically or terminally ill may exclude payments received under a life insurance policy from income. Similarly, payments received from selling a life insurance policy to a viatical settlement provider, who regularly engages in the business of purchasing or taking assignments of such policies, may also be excluded.
50. **Exclude amounts received for physical injuries and deduct qualified legal fees against gross income.** Although amounts received as damages attributable to nonphysical injuries and punitive damages are gross income in the year received, amounts received for physical injuries as well as emotional distress attributable to physical injury or sickness are excluded from gross income. Legal fees attributable to employment-related unlawful discrimination lawsuits (as well as certain other actions) are chargeable against gross income. Finally, damages received by a

spouse, which are due to loss of consortium due to physical injuries of the other spouse, are also excluded from income. However, it is important to note that settlements must be properly structured in order to capitalize on these deductions and exclusions.

51. **Manage your nanny tax.** If you employ household workers, try to keep payments to each household worker under $2,100. If you pay $2,100 or more to a worker, you are required to withhold Social Security and Medicare taxes from them and remit those withholdings, along with matching employer payroll taxes, on your individual income tax return on Schedule H.

Special Considerations for Corporate Executives: Planning Tips

52. **Consider delaying the exercise of incentive stock options (ISOs), aka statutory options.** The special tax treatment afforded to taxpayers for regular tax purposes when an ISO is exercised includes: no taxation at the time the ISO is exercised; deferral of tax on the benefit associated with the ISO until disposition of the stock; and taxation of the entire profit on the sale of stock acquired through ISO exercise. It is also taxed at the lower long-term capital gain rates as long as you hold the option for more than two years from date of grant and one year from date of exercise. Employment taxes do not apply on the exercise of an ISO. Be aware that the exercise of an ISO may produce AMT tax, as discussed below.

OBSERVATION

This special treatment, however, is not allowed for AMT purposes. Under the AMT rules, you must include in your AMT income, in the year the ISO stock becomes freely transferable or is not subject to a substantial risk of forfeiture, the bargain purchase price, which is the difference between the ISO stock's value and the lower price you paid for it. For most taxpayers, this occurs in the year the ISO is exercised. Consequently, even though you are not taxed for regular tax purposes, you may still have to pay AMT on the bargain purchase price when you exercise the ISO, even though you did not sell the stock and even if the stock price declines significantly after you exercise the ISO. Under these circumstances, the tax benefits of your ISO will clearly be diminished. With the passage of the TCJA, the impact of the AMT has been diminished, though careful analysis of the tax environment and AMT exposure through the exercise of ISOs is necessary for maximum tax savings. A delayed exercise to 2019, or staggered exercise between two years, may prove beneficial.

Planning Tip

Retirees generally have 90 days after retirement to exercise the options that qualify as ISO. If you have recently retired or are approaching retirement, evaluate whether the exercise of remaining ISOs will be beneficial.

53. **Manage your AMT risk.** While exercising ISOs could trigger AMT, despite the increased AMT exemptions, the AMT may be avoided with careful planning. For example, for tax year 2018, the potential AMT harshness may be ameliorated by the availability of a partial refund for unused AMT credits that are more than three years old. In addition, disqualifying dispositions of incentive stock options can be used for AMT purposes. Assuming the exercise of the ISO creates an AMT liability, the sale of some or all of the securities obtained through the exercise of the ISO prior to the end of the year in which the options were exercised (otherwise known as a disqualifying disposition) may provide meaningful benefits. First, even though any gain on the sale would be subject to ordinary income tax, the amount of the ISO creating the AMT liability will be reduced and possibly eliminated. Secondly, the proceeds realized from selling the securities can be used to make an estimated tax payment to cover some or all of the AMT liability created by the exercise of the ISO. Incidentally, federal income tax withholding is not

required on disqualifying dispositions. As you can see, these technically complex ISO rules require careful tax planning strategies.

54. **Take advantage of deferred compensation contributions to maximize the benefits of deferring income.** Annual limits for compensation must be taken into account for each employee in determining contributions or benefits under a qualified retirement plan. For 2018, the limit, as adjusted for inflation, is $275,000. This means that for an executive earning $300,000 a year, deductible contributions to, for instance, a 15 percent profit-sharing plan are limited to 15 percent of $275,000, or $41,250. Nevertheless, there is a way to avoid this limitation that you might want to consider.

    Benefits that are not subject to the qualified plan limitations can be provided through nonqualified deferred compensation (NQDC) agreements. These deferred compensation agreements are contracts between an employer and an employee for the payment of compensation in the future – at retirement, on the occurrence of a specific event (such as a corporate takeover), or after a specified number of years, in consideration of continued employment by the employee.

    Unlike a qualified plan, these NQDC plans are funded at the discretion of the employer and are subject to the claims of creditors. Essentially, the trust is under the employer's control and, structured properly, will result in a deferral of income taxes for the employee on the amount of compensation deferred above the traditional limitations.

55. **Consider filing an IRC Section 83(b) election with regard to year-end restricted stock grants to preserve potential capital gain treatment.** If you make the election within 30 days of the grant, you will pay income taxes currently on the spread between the market price (the value of the stock) and the grant price (the amount you paid for the stock). The benefit, however, is that you defer taxation on the future appreciation in the value of the restricted stock until the stock is sold and the postelection increase in the stock's value is taxed at the lower capital gain rates rather than the higher ordinary income rates. The risk with making the election, however, is that the stock price might decline by the vesting date and you will have then prepaid income tax on an unrealized gain. The rules governing restricted stock awards are technically complex and call for some careful tax planning strategies.

56. **Consider filing an IRC Section 83(i) election with regard to qualified equity grants.** A qualified employee of a privately held company may elect to defer the income attributable to qualified stock transferred to the employee by the employer. This election is an alternative to being taxed in the year in which the property vests under Code Sec. 83(a) or in the year in which it is received under Code Sec. 83(b). The election to defer income inclusion for qualified stock must be made no later than 30 days after the first date the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier.

    If a qualified employee elects to defer income inclusion, the employee must include the income at the earliest of the following dates:

    - The first date the qualified stock becomes transferable, including transferable to the employer;
    - The date the employee first becomes an excluded employee;
    - The first date on which any stock of the employer becomes readily tradable on an established securities market;
    - The date five years after the earlier of the first date the employee's right to the stock is transferable or is not subject to a substantial risk of forfeiture; or
    - The date on which the employee revokes his or her inclusion deferral election.

57. **Opt for a lump-sum distribution of employer stock from a retirement plan.** Employer stock distributed as part of a lump-sum distribution from a qualified plan is taxed based on the plan's basis in the stock rather than on its value, unless a taxpayer elects otherwise. Consequently, assuming the value of the stock exceeds its cost, the tax on the unrealized appreciation is deferred until a later date when the stock is sold. This could be many years after receipt of the employer stock. As an added benefit, when the stock is sold at a later date, the gain is subject to tax at the more favorable long-term capital gains rate. Cash or other nonemployer stock distributed as part of the lump-sum distribution will be taxed at ordinary income tax rates.

58. **Implement strategies associated with international tax planning.** For executives on assignment in foreign countries, consider implementing strategies that will reduce your individual tax costs, such as maximizing the foreign earned income and housing exclusion provisions. The preparation of tax equalization calculations may be beneficial in determining the breakdown of compensation to maximize tax benefits associated with international assignments.

OBSERVATION

International employers typically have tax-equalization, reimbursement policies for their U.S. citizens and residents working abroad, and those with foreign nationals working in the U.S. While some workers may experience a tax savings as a result of the TCJA (and the employers tax reimbursement would similarly decrease), some workers may experience a federal income tax increase. As a result, international employers may wish to project how the TCJA could impact its tax equalization, reimbursement costs.

59. **Consider engaging a new tax service provider.** TAG administers a flexible Executive Tax Assistance Program (ETAP) designed for corporate executives, providing comprehensive, confidential and highly personalized individual and business tax preparation, planning and consulting services. The principal objectives of ETAP are to streamline interaction between the busy executive and needed advisers and to assist the executive in achieving tax, financial and related objectives. This is accomplished through a coordinated approach delivered by a primary core of specialists intimately familiar with, and taking a personal interest in, the executive's tax and related financial objectives. The result of our ETAP is more effective solutions and greater peace of mind for the busy executive without the conflict of interest risks presented by the dual activities of the employer company's auditors performing tax services for company personnel.

Tax Planning Strategies for Businesses (Items 60 to 89)

60. **Decrease your tax liability on pass-through income.** Business income from pass-through entities is currently taxed at the ordinary individual tax rates of the owners or shareholders. In 2018, taxpayers who receive qualified business income from a partnership, S corporation, sole proprietorship or rental property will be allowed a 20 percent deduction, subject to taxable income phaseouts and complex calculations, in arriving at taxable income. The deduction will also be afforded to taxpayers who receive qualified REIT dividends, qualified cooperative dividends and qualified publicly traded partnership income. For owners with taxable incomes over $315,000 (joint filers) or $157,500 (all other filers), this deduction is subject to reduction or elimination (*see* discussion below).

Expanded Discussion on Pass-Through Deduction Under the TCJA

Generally, with minor limitations, the deduction for qualified business income will be 20 percent of that income, whether or not from a specified service trade or business (such as lawyers, doctors, etc., *see* discussion below) until the taxpayer's taxable income reaches $315,000 for married individuals filing jointly and $157,500 for all other filers. If taxable income exceeds these thresholds and is below $415,000 for married individuals filing jointly and $207,500 for all other filers, the 20 percent deduction, whether income was from a specified service business or not, would be subject to additional limitations based on the owner's pro rata share of W-2 wages paid by the business and/or the business' basis in qualified property.

If a taxpayer's taxable income exceeds $415,000 for married individuals filing jointly and $207,500 for all other filers, owners of specified service businesses would no longer qualify for the deduction, while owners of other businesses would remain subject to the W-2 wage limitations.

A qualified trade or business is defined as any trade or business other than a specified service trade or business and other than the trade or business of being an employee. Specified services are defined as a trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services and brokerage services (investing and investment management, trading, dealing in securities, partnership interests or commodities, and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees). Notably absent from this list, and specifically excluded from the definition of specified services, are engineering and architectural services, as well as real estate agents and bankers.

PLANNING TIPS

There are certain planning strategies taxpayers can use in order to take advantage of these deductions. The service businesses listed above should consider methods to increase tax-deferred income or decrease taxable income at the entity level, so that owners close to the $157,500/$315,000 threshold can take full advantage of the pass-through deduction. Some methods of reducing taxable income to fall within these thresholds include:

- *Consider the current status of contractors/employees. If the taxpayer is within the phaseout range and subject to wage limitations, it may be beneficial to deem current contractors as employees subject to W-2 wages. This both increases the W-2 wage base and will provide entity level deductions for additional payroll taxes and benefits to reduce pass-through income to the shareholder/partner.*
- *Take full advantage of retirement vehicles, which serve to reduce taxable income at the shareholder/partner level.*
- *Partners and shareholders should plan to maximize above-the-line (such as retirement plan contributions, health insurance, among others) and itemized deductions for purposes of reducing taxable income.*
- *Combine qualified businesses and treat them as one aggregated business for the purpose of the Section 199A computation. The combination could result in a higher deduction than treating the businesses separately. Combining businesses can also help taxpayers meet the wage limitations that are part of the deduction computation.*
- *Qualified business income, for purposes of computing the 20 percent qualified business income deduction, does not include guaranteed payments to partners in a partnership. Reducing guaranteed payments and allocating profits to ordinary income could increase the deduction for certain partners. In order to do so, a careful review of the partnership agreement is advised, and may also require amending the partnership agreement to properly document the change.*
- *Investments in Real Estate Investment Trusts (REITs) and/or Publicly Traded Partnerships (PTPs) are eligible for a straight 20 percent qualified business income deduction. REITs and PTPs are not subject to the W-2 compensation or basis limitations, or limitations of specified trade or businesses.*
- *Perform an analysis to determine if it would be advantageous for married taxpayers to file separately to avoid the threshold limitations.*

OBSERVATION

The Internal Revenue Service has recently issued proposed regulations providing guidance on the new 20 percent deduction. The new regulations further define the meaning of specified service trade or business (SSTB) and also address various strategies being considered to avoid the deduction limitations associated with SSTBs. The limitations and analysis is complex. Be sure you consult with a qualified tax professional who is thoroughly versed in the new regulations so that you properly navigate these rules to ensure preservation of applicable deductions.

Don’t Let the Simple Rate Change Fool You

The change in the corporate tax rate is straightforward compared to the changes and related restrictions for pass-through entities. Despite the significant decrease in the corporate tax rate to 21 percent from 35 percent, the corporate tax structure may not be advantageous for closely held business owners currently established as S corporations, limited liability companies or partnerships. Beginning in 2018, corporations may enjoy a lower tax rate on their profits, but the shareholders will encounter a second tax on dividends distributed to them. The profit of a corporation is taxed to the corporation when earned, and then is taxed to the shareholders when distributed as dividends. This creates a double tax. The corporation does not receive a tax deduction when it distributes dividends to shareholders and shareholders cannot deduct any losses of the corporation. Alternatively, income earned by pass-through entities is taxed only once at the owner level.

Another benefit to the pass-through structure of limited liability companies and partnerships is their flexibility for allocating income/loss and distributing cash/assets. The owners must agree on the allocations and the allocations must have substantial economic effect. In addition, limited liability companies and partnerships are generally easier to form, manage and operate. They are less regulated in terms of laws governing the formation because the owners control the way the business operates.

Businesses, particularly those in service industries who are excluded from the proposed pass-through deduction, should consider if electing C corporation status would be a more favorable structure. Companies who generate significant income, reinvest in their business and do not distribute cash to investors could see a benefit of a lower corporate tax rate. Further, transitioning to a C corporation may be advantageous if you anticipate long-term ownership. However, owners considering a transition to a C corporation should also be mindful of the accumulated earning tax (20 percent tax on companies maintaining too much cash) and the personal holding company tax (25 percent penalty on undistributed passive income earned in a closely held C corporation).

61. **Take advantage of lower expected corporate rates**. Beginning in 2018, corporations are now subject to a flat 21 percent tax rate. The 21 percent rate will also apply to personal service corporations such as accounting firms and law firms.
62. **Prepare for greater sales tax exposure.** In light of the *South Dakota v. Wayfair, Inc.* Supreme Court decision, businesses need to review their operations to determine if they have sales and use tax exposure. This is a landmark case because the court effectively rejected a half century of precedent by killing the physical presence test for sales and use taxes. As a result, remote sellers have heightened exposure. Businesses that have large retail or ecommerce sales may be subject to sales or use taxes, even if they do not have a physical presence in the state or local jurisdiction. Accordingly, now is the time to perform an assessment of your business activities and make plans to become compliant (if warranted) in early 2019. Contact us for assistance with your exposure analysis.
63. **Consider new net operating loss limitations.** Beginning in 2018, net operating losses (NOLs) may only reduce 80 percent of a taxpayer’s taxable income. Losses that arose before 2018 are not subject to this 80 percent limitation. Accordingly, if a taxpayer has prior year losses that are being carried forward, coupled with a 2018 or later loss, they will need to separately track and distinguish between the two types of losses. The generally applicable two-year carryback period, as well as the longer carryback periods for special types of losses, are eliminated, effective for NOLs arising in tax years ending after 2017. NOLs, however, may now be carried forward indefinitely.

64. **Consider employer credit for paid family and medical leave.** Eligible employers are entitled to claim a credit for paid family and medical leave equal to 12.5 percent of wages paid to qualifying employees during any period in which such employees are on leave under the Family and Medical Leave Act (FMLA). The credit is part of the general business credit and only available for wages paid in tax years 2018 and 2019.

    In order to qualify for the credit, employers must have a written policy that provides at least two weeks paid FMLA leave, and the paid leave must equal or exceed 50 percent of the wages normally paid to the employee. In addition, employees must have been employed by the employer for at least one year.

65. **Review your plans to entertain clients.** In 2018, a business can no longer deduct 50 percent of the expenses incurred while entertaining clients for business purposes. However, business meals paid concurrently with the entertainment expenses are still deductible; provided these expenses are separately paid for or separately stated on the invoice.

PLANNING TIP

Entertainment activities with clients should be reviewed before year-end to determine their deductibility for 2018. The deduction for meals is preserved, so to the extent possible be sure to break out the food portion of any entertainment expense incurred and, as always, maintain contemporaneous logs or other evidence of the business purpose of all meals and entertainment expenditures. This may require enhanced general ledger reporting to minimize effort in segregating deductible and nondeductible meals and entertainment expenses.

66. **Strategically time purchases of business property.** For 2018, businesses can expense up to $1,000,000 of qualified business property purchased during the year. This $1,000,000 deduction is phased out, dollar for dollar, by the amount that the qualified property purchased exceeds $2,500,000. Additionally, bonus depreciation can be claimed on 100 percent of qualified new property placed in service during the year, and the first year bonus depreciation on passenger automobiles is currently $8,000. Bonus depreciation of 100 percent under the new law is available for property placed in service after September 27, 2017, and before January 1, 2023. The definition of qualified property for purposes of bonus depreciation has been expanded to include the purchase of used property, so long as the taxpayer has not previously used the property (such as in a sale-leaseback transaction).

    Qualified business property includes, but is not limited to equipment, tangible personal property used in business, business vehicles, computers and office furniture.

PLANNING TIP

If you are making multiple purchases of qualified property, pick assets with longer depreciable lives to expense. By doing this, you will depreciate your other assets over shorter recovery periods, thus accelerating and maximizing your depreciation deduction.

67. **Select the appropriate business automobile.** For business passenger cars first placed in service in 2018, the ceiling for depreciation deductions is $10,000. Higher deductible amounts apply for certain trucks and vans (passenger autos built on a truck chassis, including SUVs and vans). Vehicles such as SUVs and vans with gross vehicle weight ratings of between 6,000 pounds and 14,000 pounds are restricted to a first year deduction of $3,560, in addition to the $25,000 that is permitted to be expensed under IRC Section 179. Automobiles that are used 100 percent for business are also eligible for bonus depreciation of $8,000. For vehicles placed in service in 2018 and later, the depreciation limitation for passenger automobiles is $10,000 for the year the automobile is placed in service, $16,000 for the second year, $9,600 for the third year and $5,760 for the fourth year and later years in the recovery period.

Comparison of New Vehicle Depreciation in 2017 and 2018

	2017		2018	
	Passenger Automobiles	SUVs, Vans, Trucks	Passenger Automobiles	SUVs, Vans, Trucks
Maximum Section 179 Allowed	-0-	$25,000	-0-	$25,000
Maximum Bonus Depreciation Allowed	$8,000	$8,000	100%	100%
Year 1*	$3,160	$3,560	$10,000	$10,000
Year 2*	$5,100	$5,700	$16,000	$16,000
Year 3*	$3,050	$3,450	$9,600	$9,600
Year 4*	$1,875	$2,075	$5,760	$5,760

* Maximum amount of depreciation if electing out of or not qualifying for bonus depreciation.

❯❯ ILLUSTRATION

If you purchase an SUV that costs $75,000 before the end of 2018, assuming the SUV would qualify for the expensing election, you would be allowed a $25,000 deduction on this year's tax return. In addition, the remaining adjusted basis of $50,000 ($75,000 cost less $25,000 expensed under Section 179) would be eligible for a bonus depreciation deduction of $50,000 under the general depreciation rules, resulting in a total first year write-off of $75,000.

68. **Defer taxes with cost segregation.** Property that is placed in service after September 27, 2017, and has a class life of up to 20 years will generally qualify for 100 percent bonus depreciation. Real estate that is nonresidential property is generally regarded as 39-year property and is not eligible for bonus depreciation. A cost segregation analysis allows for the appropriate allocation of costs amongst various class lives and may permit the owners to take advantage of greater depreciation deductions (including 100 percent bonus depreciation). Further, by frontloading allowable depreciation deductions to the early years of the property's life, reclassification can result in significantly shorter tax lives and greater tax deferrals.
69. **Understand the benefits of dividend timing.** Under prior tax law, corporations could generally deduct dividends received from domestic subsidiaries at rates of 70 percent, 80 percent or 100 percent, depending on ownership percentage. Additionally, U.S. corporations were previously permitted only a limited deduction for dividends received from their foreign subsidiaries.

% Ownership	Deductible Portion of Dividends-Old Law	Deductible Portion of Dividends-New Law
0% - 19.99	70% Dividend Received Deduction	50% Dividend Received Deduction
20% - 79.99%	80% Dividend Received Deduction	65% Dividend Received Deduction
80% - 100%	100% Dividend Received Deduction	100% Dividend Received Deduction

For 2018, the 70 percent deduction for dividends received from domestic subsidiaries is reduced to 50 percent, and the 80 percent deduction for 20 percent or more owned corporations is reduced to 65 percent. These reductions, in combination with the lower corporate tax rate, will result in a slightly higher effective tax rate on dividends received by parent corporations. However, dividends received from foreign subsidiaries will now be 100 percent deductible.

70. **Be sure to receive maximum benefit for business interest**. Businesses that incur interest expense will have limited benefit in 2018. Now, the interest expense deduction is limited to 30 percent of the adjusted taxable income of the business, applicable at the entity level for partnerships and S corporations. Certain smaller businesses (less than $25 million in average annual gross receipts for the three-year tax period ending with the prior tax period) are exempt from this limitation. In addition, real property trades or businesses can elect out of the limitation if they use the Alternative Depreciation System (ADS) to depreciate applicable real property used in a trade or business.
71. **Spend less time worrying about accounting methods.** Prior tax law posed reporting complications for businesses with average gross receipts exceeding a certain threshold. In 2017, if average gross receipts exceed $5 million, taxpayers were not permitted to use the simpler cash method of accounting. Similarly, under prior tax law, businesses with average gross receipts of over $10 million were not able to account for inventories of materials and supplies, and taxpayers were forced to use uniform capitalization rules. Beginning in 2018, the thresholds for both accounting methods were increased to $25 million under the TCJA.

PLANNING TIP

If your business' income previously exceeded the thresholds, but falls beneath the higher thresholds for 2018, determine whether the increased thresholds under the new law would make considering a tax accounting change a useful strategy.

72. **Determine the merits of switching from the accrual method to the cash method of accounting.** Businesses that sell merchandise generally use the accrual (rather than the cash) method of accounting to account for revenue and inventory related to the merchandise. While this may provide a more complete picture of the financial status of a business, from a tax perspective it provides much less flexibility in terms of planning options and is more difficult to use than the cash method of accounting. The good news is that, beginning in 2018, businesses with average gross receipts over the last three years of $25 million or less that would otherwise be required to use the accrual method of accounting can elect to use the cash method. While there are some caveats to obtaining this relief, it is a tax-saving strategy worth considering if your business can meet the average gross receipts test and is currently using the accrual method of accounting.
73. **Select the most tax-efficient inventory method.** If your business tracks inventory, you may be able to realize meaningful income tax savings based on your selected inventory method. For

example, in a period of falling prices, the first in, first out (FIFO) method will provide larger tax savings since it assumes that higher priced inventory units purchased first are the first ones sold. Conversely, in a period of rising prices, the use of the last in, first out (LIFO) method can produce income tax savings since it assumes that the higher priced inventory units purchased last were the first ones sold. IRS approval may be needed. Call us for details.

74. **Establish a tax-efficient business structure.** Businesses may operate under various structures, including general partnership, limited liability company, limited liability partnership, S corporation, C corporation and sole proprietorship. Owner liability and income taxation are the primary factors that distinguish one from another, but it is prudent to consider other characteristics as well. The decision should be made between you and your team of legal and tax advisers.

75. **Consider the benefits of establishing a home office.** Expenses related to your home office are deductible as long as the portion of your home that qualifies as a home office is used exclusively and on a regular basis as a principal place of business or is used for administrative or management activities of a trade or business. A simplified home office deduction ($5 per square foot, up to 1,500 square feet) is also available to taxpayers, which minimizes expense tracking while providing a flat rate deduction per square foot of office space. In addition to claiming a deduction for home office expenses, the ability to qualify as a home office may enable you to deduct the cost of traveling between your home and other locations where you conduct business.

OBSERVATION

There is a potential downside for claiming home office deductions. For example, on the sale of your home, home office depreciation previously taken does not qualify for the exclusion of gain on the sale of a principal residence. Additionally, be sure you meet all the requirements for claiming a home office deduction, as this can be a red flag prompting IRS inquiry.

76. **Examine and properly classify your independent contractors and employees.** The question of whether a worker is an independent contractor or employee for federal income and employment tax purposes is a complex one. It is intensely factual, and the consequences of misclassifying a worker can be serious. In general, the person (or entity) who controls how a job is performed is the employer. There are many factors requiring assessment to properly determine degree of control, as discussed below. Therefore, if the worker has control, the worker is self-employed and an independent contractor, and is subject to self-employment taxes. On the other hand, if a worker is an employee, the company must withhold federal income and payroll taxes, pay the employer's share of Federal Insurance Contributions Act (FICA) taxes on the wages plus Federal Unemployment Tax Act (FUTA) tax, and often provide the worker with fringe benefits that are made available to other employees. There may be state tax obligations as well. Since these employer obligations do not apply for a worker who is an independent contractor, the savings can be substantial.

OBSERVATION

The IRS continues to intensely scrutinize employee/independent contractor status. If the IRS examines this situation and reclassifies the worker as an employee, not only are employment taxes due, but steep penalties will be assessed. The IRS' three-category approach (*i.e.*, behavioral control, financial control and type of relationship) essentially distills the 20-factor test the IRS had used to determine whether a worker was an employee or an independent contractor. Call us if you desire a review of your worker classifications.

77. **Establish an accountable expense reimbursement plan.** Employers are allowed to deduct, and employees are allowed to exclude from gross income, employer expense reimbursements if paid under an accountable plan. Accordingly, both the employer and employee benefit from establishing an accountable plan, which requires specific reporting, substantiation of business expenses and return of any excess cash advances.
78. **Consider the advantages of employing your child (or grandchild).** Employing your children (or grandchildren) shifts income from you to them, which typically subjects the income to the child's lower tax bracket and may actually avoid tax entirely (due to the child's standard deduction). There are also payroll tax savings since wages paid by sole proprietors to their children age 17 and younger are exempt from both Social Security and unemployment taxes. Employing your children has the added benefit of providing them with earned income, which enables them to contribute to a traditional IRA. Better yet, making contributions to Roth IRAs on income shielded by the child's standard deduction is tax-free now and, in general, will be tax-free upon distribution.

OBSERVATION

When employing your child or grandchild, keep in mind that any wages paid must be reasonable given the child's age and work skills. Also, if the child is in college or entering soon, excessive earned income may have a detrimental impact on the student's eligibility for financial aid.

79. **Don't overlook your business tax credits.** Credits are dollar-for-dollar reductions in tax and are much more valuable than deductions. Employers can claim the Work Opportunity Tax Credit, a 40 percent credit for the first $6,000 of wages paid to each employee, if they hire individuals from designated target groups. Other credits, such as the retirement plan tax credit, may also be available but certain actions must take place before year-end to qualify.
80. **Conduct a research and development (R&D) study to maximize your R&D tax credit.** As a result of tax reform, more industries and more activities now qualify for the R&D tax credit than ever before. For businesses of all sizes, accelerate research and development expenses, including qualified software development costs, prior to year-end.
81. **Generate payroll tax credits with the research and development (R&D) tax credit.** While it is generally known that the R&D tax credit can be applied to income taxes and the AMT (as long as certain requirements are met), qualified small businesses can also use the R&D tax credit against their Social Security payroll taxes. To qualify, a small business must: (a) have gross receipts of under $5 million for the current tax year; (b) have had gross receipts for five years or less, including the current year; (c) have qualifying research activities and expenditures; and (d) incur payroll tax liabilities. Businesses can generate up to $250,000 in payroll tax credits per year for five years, and any unused portion can be carried forward to future years. Contact us for assistance in determining the activities eligible for these incentives and the assessment of the appropriate documentation required to support your claim.
82. **Perform a compensation study.** Businesses can maintain deductibility, yet avoid payroll taxes, on compensation moved from salary to fringe benefits. Employees will enjoy the tax savings resulting from lower taxable compensation. Benefits typically shifted include medical insurance and employee discounts. This may be a positive way to attract and retain employees. It is important to note, however, that starting in 2018, transportation fringe benefits are not deductible by the employer, unless included in the employee's W-2 wages.

PLANNING TIP

Consider paying dividends in lieu of owner salaries in a family-owned C corporation. If you personally expect to be in the 32 percent or higher tax bracket for 2018 and you own a C corporation, you could net more cash after taxes by paying yourself some dividends in lieu of additional salary. This is because dividend income is subject to a maximum 20 percent tax rate, while your salary is subject to your 32 percent or higher tax rate, plus you and your corporation must pay payroll taxes on your salary.

OBSERVATION

Any dividends paid to you must be paid to other owners as well. This is ideal in the context of a family-owned C corporation, since a family recipient who is in the 10 percent or 12 percent tax brackets (which many children are) will not pay taxes on this dividend income. On the other hand, however, if there are multiple nonfamily member shareholders, paying dividends could alter the bottom-line cash flow available to the various shareholders, which may make this strategy unworkable in some situations.

83. **Establish health savings accounts (HSA) and other cafeteria plans (*i.e.*, Section 125 plans or flexible spending accounts).** These plans provide an IRS-approved way to lower taxes for both employers and employees, since they enable employees to set aside, on a pre-tax basis, funds from their paychecks for adoption expenses, certain employer-sponsored insurance premium contributions, dependent care costs and unreimbursed medical expenses. Furthermore, Section 125 plans are permitted to offer salary-reduction HSA contributions for eligible employees as part of the menu of plan choices. Thus, employers can sponsor the HSAs and employer contributions are not subject to income or employment taxes.

    Funds contributed by employees are free of federal income tax (at a maximum rate of 37 percent), Social Security and Medicare taxes (at 7.65 percent) and most state income taxes (at maximum rates as high as 13.3 percent), resulting in a tax savings of as much as 57.95 percent. The employer pays less in Social Security matching tax. Like an accountable expense reimbursement plan, it can assist an organization in achieving its strategic goals by enhancing its ability to attract and retain talented, experienced people. Since many restrictions apply, you should carefully review this arrangement before instituting a plan. Please contact us for details.

PLANNING TIP

Consider naming your spouse as beneficiary of your HSA, as the surviving spouse is not subject to income tax on distributions as long as they are used for medical expenses. Anyone other than your spouse will be taxed on the balance remaining in the HSA upon the owner's death.

84. **Consider the necessity of a succession plan**. It is important for business owners to create a strategy to transfer the business in the event of death, disability or retirement. Failure to properly transition the business can not only create a greater tax burden, but turn a successful business into a failed business. Together with your lawyer and financial advisers, you can transfer control as desired, develop a buy-sell agreement, create an employee stock ownership plan and carry out the succession of your business in an orderly fashion.
85. **Deduct your business bad debts.** Since business bad debts are treated as ordinary losses and can be deducted when either partially or wholly worthless, it is prudent to examine your receivables before year-end. Not getting paid for services or merchandise that you have sold is bad enough; do not pour salt into the wound by paying income tax on income you will never realize.

86. **Do not become trapped by the hobby loss rules.** If your business will realize a loss this year, you should address the so-called "hobby loss" rules to ensure that the loss will be deductible and thereby maximize the tax benefits of the loss.

87. **Sell your company's stock, rather than its assets.** If you are considering selling your business, try to structure the transaction as a sale of the company's stock, rather than as a sale of the company's assets. A sale of your company's stock will be treated as the sale of a capital asset and the preferential long-term capital gain rates will apply. A sale of the company's assets, on the other hand, will typically result in at least some of the gain being taxed at the much higher ordinary income tax rates. However, since the buyer will generally want to structure the transaction as a purchase of the company's assets, in order to increase his or her depreciation deductions, some negotiating by both parties should be expected.

88. **Consider the repeal of AMT for corporations.** Beginning in 2018, the corporate AMT has been repealed.

    A corporation's tentative minimum tax is zero ($0) for purposes of the minimum tax credit (AMT credit) beginning in 2018. As a result, a minimum tax credit claimed by a corporation beginning after 2017 is generally limited to the corporation's regular tax liability, reduced by other nonrefundable credits. The minimum tax credit is the corporation's AMT liability from tax years prior to its repeal and carried over to tax years after 2017. Any unused minimum tax credit is refundable for tax years beginning in 2018, 2019, 2020 and 2021.

    Since corporate AMT is repealed, a corporation's tentative minimum tax is zero ($0) after 2017 for purposes of the tax liability limitation of the general business credit. This means that a corporation may claim the credit to the extent it does not exceed 25 percent of its net regular tax liability above $25,000.

    The net result is that many corporations that have previously paid corporate AMT and disallowed general business credits may be able to claim more tax credits in 2018.

89. **Consider installment sale treatment for sales of property at a gain.** When property is sold, gain is generally included in income when the asset is sold. The installment method is required in cases where there is a sale of property and the seller receives at least one payment after the year in which the sale occurs. Under the installment method, gain is recognized ratably over multiple years on the sale to the extent payments are made on the installment note, subject to a gross profit computation. This method allows you to recognize gain only to the extent of payments actually received and is a valuable method to defer income.

OBSERVATION
An election is available to "elect out" of installment sale treatment. In addition, not all states recognize this type of gain treatment, so the state tax effects also need to be considered.

Tax Planning Strategies for Nonprofits (Items 90 to 93)

90. **Expect less favorable rules in calculating unrelated business taxable income.** Under prior law, nonprofit organizations (and nontaxable accounts, such as IRAs) were required to pay tax on unrelated business taxable income (UBTI) in excess of $1,000. With the new tax law in effect, nonprofits will see an increase in reportable UBTI. Starting in 2018, when calculating UBTI, organizations are not allowed a deduction for certain fringe benefits provided to employees (*i.e.*, transportation, on-premises gyms). The new law requires that organizations that carry on more than one unrelated business to separately calculate UBTI for each business. In essence, the deductions from one unrelated business could not be used to offset UBTI from another unrelated business.
91. **Executive employees of nonprofits could cost even more.** Prior law provided that the compensation of executives is taxable at standard individual income tax rates in effect at that time. However, beginning in 2018, there is an additional 21 percent excise tax on executive compensation. This additional tax will be assessed to the nonprofit, based on the organization's five highest paid employees with compensation in excess of $1 million.

PLANNING TIP

Accelerating executive compensation to be paid before year-end could lessen the impact of the additional 21 percent tax. Keep in mind, the rule applies to any employee over the $1 million threshold.

92. **Beware of recapture of tax benefit on property not used for an exempt purpose.** In general, for charitable contributions of tangible personal property for which a fair market value deduction is claimed and which is not used for exempt purposes, the donor may have their tax benefit adjusted. The provision applies to appreciated tangible personal property that is identified by the donee organization, for example on IRS Form 8283, as for a use related to the purpose or function constituting the donee's basis for exemption, and for which a deduction of more than $5,000 is claimed.

    Under the provision, if a donee organization disposes of applicable property within three years of the contribution of the property, the donor is subject to an adjustment of the tax benefit.

    A penalty of $10,000 applies to a person that identifies applicable property as having a use that is related to a purpose or function constituting the basis for the donee's exemption knowing that it is not intended for such use.
93. **Ensure that your private foundation meets the minimum distribution requirements.** A foundation is required to distribute approximately 5 percent of the average fair market value of its assets each year. Qualifying distributions meeting this requirement include grants and certain operating expenses. Penalties are imposed in the form of an excise tax on the foundation if it fails to make qualifying distributions within 12 months after the close of the tax year.

Tax Planning Strategies for Estates and Trusts (Items 94 to 97)

94. **Take advantage of increased gifting exclusions.** As discussed earlier in item 44, the annual gift tax exclusion has increased from $14,000 in 2017 to $15,000 in 2018. Also beginning in 2018, the estate and gift tax unified credit has increased from $5,490,000 to $11,180,000. For both simple and complex trusts, grantors should consider funding in 2018 as the gift tax limit has increased dramatically**.**

ILLUSTRATION

Gifts are generally only subject to the gift tax in very limited circumstances. For example, say Betty funds an irrevocable trust for the benefit of her grandchild. Betty was never married. In 2018, she contributes $7 million to the trust. The first $15,000 of any present interest gift in 2018 can pass freely to the recipient, without any gift tax reporting obligation. When the gift exceeds the annual exclusion amount, a gift tax return must be filed for the year, but no gift tax is paid unless the gift exceeds Betty's remaining lifetime unified credit. Since Betty has made no gifts exceeding the annual exclusion amount during her lifetime and has never filed a gift tax return to reduce her unified credit, she would reduce her $11.18 million credit by $6,985,000, resulting in no taxable gift, no tax liability, and the removal of appreciated assets from her estate. (The entire amount of the $7 million gift was offset by the unified credit.)

			2018
Gift		$	7,000,000
Annual Exclusion	Less:	$	15,000
Unified Credit	Less:	$	11,180,000
Taxable Gift		$	0
Gift Tax Due		**$**	**0**
Credit before gift		$	11,180,000
Credit used toward gift		$	6,985,000
Credit remaining		$	4,195,000

OBSERVATION

The TCJA effectively doubled the basic exclusion amount from an inflation-adjusted $5 million to an inflation-adjusted $10 million, but only until January 1, 2026. Thus, it is possible for certain taxpayers to gift more property during their lifetimes in excess of their exclusion entitlement upon death. After passage of the act, there was a certain fear that taxpayers passing away after 2025 who had gifted more than the inflation adjusted $10 million exclusion would face a "clawback" of the gift tax exclusion upon death. Fortunately, the IRS has recently released proposed regulations stating that, to the extent a higher basic exclusion amount was allowable as a credit in computing gift tax during the decedent's life, the sum of these credits used during life may be used as a credit in computing the decedent's estate tax. In the example above, suppose Betty made no further gifts during her lifetime and passed away in 2026. Under the proposed regulation, though the basic exclusion amount is set to revert to $5 million in 2026, Betty's estate would be entitled to an estate tax exclusion of $6.985 million due to the completed gifts she made during her lifetime, thus eliminating any "clawback" of the exclusion.

95. **Consider use of a grantor retained annuity trust (GRAT) for inter vivos wealth transfer.** In a GRAT, a grantor contributes assets to a trust, while retaining annuity payments for a defined period of time, with the remainder payable to beneficiaries. Depending on the structure of the GRAT, one can achieve maximum wealth transfer, with little to no gift tax effect or use of the lifetime exclusion. However, should the grantor pass away prior to the completion of the annuity payments under the GRAT, at least a portion, and possibly all, of the GRAT assets are includible in the grantor's estate. Thus, by terminating the annuity and trust before December 31, 2025, when the new higher federal estate tax threshold is currently set to expire, one can reap all of the benefits of a GRAT with minimal risk, all while retaining the use of the grantor's applicable exclusion amount.

96. **Minimize the income taxes applicable to estates and trusts.** The tax rates that apply to estates and trusts continue to be significantly compressed. Estate and trust taxable income (exclusive of long-term capital gain and qualified dividend income) of more than $12,500 for 2018 is taxed at a marginal tax rate of 37 percent. Consequently, it may be beneficial to distribute income from the estate or trust to the beneficiary for the purpose of shifting the income to a lower tax rate. Additionally, trusts and estates can minimize income taxes by employing many of the tax planning strategies that are applicable to individuals, including the "bunching" of deductions and deferral of income strategies noted above.

2018 Tax Rates Applicable to Estates and Trusts

Taxable Income	Tax Rate
$0 - $2,550	10%
$2,551 - $9,150	24%
$9,151 - $12,500	35%
Over $12,501	37%

97. **Consider an election under the 65-day rule.** Considering the compressed brackets with exceptionally high tax rates on income held within the estate or trust, it is feasible in many scenarios to lessen the total income tax hit by distributing income to be taxed at the beneficiary level, in lieu of the entity level.

    With an election under Section 663(b), complex trust and estate distributions made within the first 65 days of 2019 may be treated as paid and deductible by the trust or estate in 2018. The election of the 65-day rule is an invaluable tactic, giving the trustee the opportunity to distribute income after the end of the year, once the total taxable income of the trust can be more accurately determined.

Tax Planning Strategies for International Taxpayers (Items 98 to 100)

98. **Consider deferring foreign dividends received.** Under prior law, U.S. citizens, resident individuals and domestic corporations were generally taxed on all income, whether earned in the U.S. or abroad. The new law provides a 100 percent deduction for foreign-source portion of dividends received from "specified 10 percent owned foreign corporations" by U.S. corporate shareholders, subject to a one-year holding period. No foreign tax credit (or deduction for foreign taxes paid with respect to qualifying dividends) is permitted for foreign taxes paid or accrued with respect to a qualifying dividend.

OBSERVATION

The TCJA also repeals the active trade or business exception under Code Section 367, which generally disallows nonrecognition treatment for transfers of property to a foreign corporation.

In addition, the new law imposes a mandatory tax on post-86 accumulated foreign earnings held in cash or cash equivalents of 15.5 percent and on post-86 accumulated foreign earnings held in illiquid assets of 8 percent. Taxpayers would be able to elect to pay any resulting liability over an eight-year period.

99. **Mind new Subpart F rules.** Subpart F income has been modified in 2018, which generally applies to controlled foreign corporations (CFCs). A CFC, in short, is defined as a foreign corporation in which U.S. persons (shareholders) own more than 50 percent of the corporation's stock (measured by vote or value). The definition of U.S. shareholder has been expanded to include corporations. Additionally, foreign base income is no longer Subpart F income under Code Section 954.

OBSERVATION

Although the TCJA did not modify the CFC look-through rules, the stock attribution rules for determining CFC status were modified to treat a U.S. corporation as constructively owning stock held by its foreign shareholder. Also, a U.S. parent corporation must no longer control a foreign subsidiary for 30 days before Subpart F inclusions apply.

100. **Be aware of new foreign tax credit limitations.** To mitigate the effects of double taxation, the U.S. allows a credit or deduction for foreign income taxes paid designed to offset, in whole or in part, the U.S. tax owned on foreign income. The TCJA generally reduces the availability of the foreign tax credit for many taxpayers, by making it more complex and dividing foreign income into more categories, such as Global Intangible Low-Taxed Income ("GILTI"). In addition, foreign taxes paid on GILTI cannot be carried back or carried forward to other tax years, like other foreign taxes eligible for the credit. Due to the severe limitations surrounding taxes paid on GILTI, companies should assess the benefit of shifting income of CFCs away from the GILTI regime. The rules surrounding the foreign tax credit and GILTI are complex—contact us for guidance.

TAG'S Perspective

As is true every year, many of the 2018 tax savings opportunities will disappear after December 31, 2018. Now may be the last time to execute strategies that can both improve your 2018 tax situation and establish future tax savings. Without investing a little time before year-end, you may only discover tax saving opportunities when your tax return is being prepared—at which time it will likely be too late. If you would like to discuss the strategies indicated herein or have other concerns, please do not hesitate to contact John I. Frederick at 215.979.1649 or jifrederick@duanemorris.com; Michael A. Gillen at 215.979.1635 or magillen@duanemorris.com; Steven M. Packer at 215.979.1697 or smpacker@duanemorris.com or the practitioner with whom you are in regular contact. For information on other pertinent topics, please visit our publications page.

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