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YEAR-END TAX PLANNING LETTER

To Our Clients and Friends:

With year-end approaching, now is the time to take steps to cut your 2019 tax bill. Here are some relatively foolproof year-end tax planning strategies to consider, assuming next year's general election doesn't result in retroactive tax changes that could affect your 2020 tax year.

Year-end Planning Moves for Individuals

Generous Standard Deduction Allowances. For 2019, the standard deduction amounts are \$12,200 for singles and those who use married filing separate status, \$24,400 for married joint filing couples, and \$18,350 for heads of household. If your total annual itemizable deductions for 2019 will be close to your standard deduction amount, consider making additional expenditures before year-end to exceed your standard deduction. That will lower this year's tax bill. Next year, you can claim the standard deduction, which will be increased a bit to account for inflation.

The easiest deductible expense to accelerate is included in your house payment due on January 1. Accelerating that payment into this year will give you 13 months' worth of interest in 2019. Also, consider state and local income and property taxes that are due early next year. Prepaying those bills before year-end can decrease your 2019 federal income tax bill because your itemized deductions will be that much higher. However, the maximum amount you can deduct for state and local taxes is \$10,000 (\$5,000 if you use married filing separate status).

Accelerating other expenditures could cause your itemized deductions to exceed your standard deduction in 2019. For example, consider making bigger charitable donations this year and smaller contributions next year to compensate. Also, consider accelerating elective medical procedures, dental work, and vision care. For 2019, medical expenses are deductible to the extent they exceed 10% of Adjusted Gross Income (AGI), assuming you itemize.

Carefully Manage Investment Gains and Losses in Taxable Accounts. If you hold investments in taxable brokerage firm accounts, consider the tax advantage of selling appreciated securities that have been held for over 12 months. The maximum federal income tax rate on long-term capital gains recognized in 2019 is only 15% for most folks, although it can reach a maximum of 20% at higher income levels. The 3.8% Net Investment Income Tax (NIIT) also can apply at higher income levels.

To the extent you have capital losses that were recognized earlier this year or capital loss carryovers from pre-2019 years, selling winners this year will not result in any tax hit. In particular, sheltering net short-term capital gains with capital losses is a sweet deal because net short-term gains would otherwise be taxed at higher ordinary income rates.

What if you have some loser investments that you would like to unload? Biting the bullet and taking the resulting capital losses this year would shelter capital gains, including high-taxed short-term gains, from other sales this year.

If selling a bunch of losers would cause your capital losses to exceed your capital gains, the result would be a net capital loss for the year. No problem! That net capital loss can be used to shelter up to \$3,000 of 2019 ordinary income from salaries, bonuses, self-employment income, interest income, royalties, and whatever else (\$1,500 if you use married filing separate status). Any excess net capital loss from this year is carried forward to next year and beyond.

In fact, having a capital loss carryover into next year and beyond could turn out to be a pretty good deal. The carryover can be used to shelter both short-term and long-term gains recognized next year and beyond. This can give you extra investing flexibility in those years because you won't have to hold appreciated securities for over a year to get a preferential tax rate. Since the top two federal rates on net short-term capital gains recognized in 2020 are 35% and 37% (plus the 3.8% NIIT, if applicable), having a capital loss carryover into next year to shelter short-term gains could be a very good thing.

Key Point: If you still have a capital loss carryover after 2020, it could come in handy if the general election results in increased tax rates for 2021 and beyond.

Take Advantage of 0% Tax Rate on Investment Income. For 2019, singles can take advantage of the 0% income tax rate on long-term capital gains and qualified dividends from securities held in taxable brokerage firm accounts if their taxable income is \$39,375 or less. For heads of household and joint filers, that limit is increased to \$52,750 and \$78,750, respectively.

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who will be in the 0% bracket. If so, consider giving them appreciated stock or mutual fund shares that they can sell and pay 0% tax on the resulting long-term gains. Gains will be long-term, as long as your ownership period plus the gift recipient's ownership period (before the sale) equals at least a year and a day.

Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 0% rate bracket, they will be federal-income-tax-free.

Warning: If you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting capital gains and dividends to be taxed at the higher rates that apply to trusts and estates. That would defeat the purpose. Please contact us if you have questions about the Kiddie Tax.

Give away Winner Shares or Sell Loser Shares and Give away the Resulting Cash. If you want to make gifts to some favorite relatives and/or charities, they can be made in conjunction with an overall revamping of your taxable account stock and equity mutual fund portfolios. Gifts should be made according to the following tax-smart principles.

Gifts to Relatives. Don't give away loser shares (currently worth less than what you paid for them). Instead, you should sell the shares and book the resulting tax-saving capital loss. Then, you can give the sales proceeds to your relative.

On the other hand, you should give away winner shares to relatives. Most likely, they will pay lower tax rates than you would pay if you sold the same shares. As explained earlier, relatives in the 0% federal income tax bracket for long-term capital gains and qualified dividends will pay a 0% federal tax rate on gains from shares that were held for over a year before being sold. (For purposes of meeting the more-than-one-year rule for gifted shares, you can count your ownership period plus

the gift recipient's ownership period.) Even if the winner shares have been held for a year or less before being sold, your relative will probably pay a much lower tax rate on the gain than you would.

Gifts to Charities. The principles for tax-smart gifts to relatives also apply to donations to IRS-approved charities. You should sell loser shares and collect the resulting tax-saving capital losses. Then, you can give the sales proceeds to favored charities and claim the resulting tax-saving charitable deductions (assuming you itemize). Following this strategy delivers a double tax benefit: tax-saving capital losses plus tax-saving charitable donation deductions.

On the other hand, you should donate winner shares instead of giving away cash. Why? Because donations of publicly traded shares that you have owned over a year result in charitable deductions equal to the full current market value of the shares at the time of the gift (assuming you itemize). Plus, when you donate winner shares, you escape any capital gains taxes on those shares. This makes this idea another double tax-saver: you avoid capital gains taxes while getting a tax-saving donation deduction (assuming you itemize). Meanwhile, the tax-exempt charitable organization can sell the donated shares without owing anything to the IRS.

Convert Traditional IRAs into Roth Accounts. The best profile for the Roth conversion strategy is when you expect to be in the same or higher tax bracket during your retirement years. Given the current political environment, that's certainly a reasonable expectation for many folks! The current tax hit from a conversion done this year may turn out to be a relatively small price to pay for completely avoiding potentially higher future tax rates on the account's earnings. In effect, a Roth IRA can insure part or all of your retirement savings against future tax rate increases.

A few years ago, the Roth conversion privilege was a restricted deal. It was only available if your modified AGI was \$100,000 or less. That restriction is gone. Even billionaires can now do Roth conversions!

Take Advantage of Principal Residence Gain Exclusion Break. Home prices are on the upswing in many areas. More good news: Gains of up to \$500,000 on the sale of a principal residence are completely federal-income-tax-free for qualifying married couples who file joint returns. \$250,000 is the gain exclusion limit for qualifying unmarried individuals and married individuals who file separate returns. To qualify for the gain exclusion break, you normally must have owned and used the home as your principal residence for a total of at least two years during the five-year period ending on the sale date. You'll definitely want to take these rules into consideration if you're planning on selling your home in today's improving real estate environment.

Don't Overlook Estate Planning. Thanks to the Tax Cuts and Jobs Act (TCJA), the unified federal estate and gift tax exemption for 2019 is a historically huge \$11.4 million, or effectively \$22.8 million for married couples. Even though these big exemptions may mean you're not currently exposed to the federal estate tax, your estate plan may need updating to reflect the current tax rules.

Warning: In 2026, the estate and gift tax exemption is scheduled to revert to the much-lower pre-TCJA level. Depending on political developments, that could happen much sooner than 2026. However, late last year, the IRS issued proposed regulations that would protect estates that make large gifts while the ultra-generous TCJA exemption is in place. These rules haven't been finalized, so place your bets and act accordingly. We can help you assess the various risks.

Year-end Planning Moves for Small Businesses

Establish a Tax-favored Retirement Plan. If your business doesn't already have a retirement plan, now might be the time to take the plunge. Current retirement plan rules allow for significant

deductible contributions. For example, if you're self-employed and set up a SEP-IRA, you can contribute up to 20% of your self-employment earnings, with a maximum contribution of \$56,000 for 2019. If you're employed by your own corporation, up to 25% of your salary can be contributed with a maximum contribution of \$56,000.

Other small business retirement plan options include the 401(k) plan (which can be set up for just one person), the defined benefit pension plan, and the SIMPLE-IRA. Depending on your circumstances, these other types of plans may allow bigger deductible contributions.

The deadline for setting up a SEP-IRA for a sole proprietorship and making the initial deductible contribution for the 2019 tax year is 10/15/20 if you extend your 2019 return to that date. Other types of plans generally must be established by 12/31/19 if you want to make a deductible contribution for the 2019 tax year, but the deadline for the contribution itself is the extended due date of your 2019 return. However, to make a SIMPLE-IRA contribution for 2019, you must have set up the plan by October 1. So, you might have to wait until next year if the SIMPLE-IRA option is appealing.

Contact us for more information on small business retirement plan alternatives, and be aware that if your business has employees, you may have to cover them too.

Take Advantage of Generous Depreciation Tax Breaks. 100% first-year bonus depreciation is available for qualified new and used property that is acquired and placed in service in calendar-year 2019. That means your business might be able to write off the entire cost of some or all of your 2019 asset additions on this year's return. So, consider making additional acquisitions between now and year-end. Contact us for details on the 100% bonus depreciation break and what types of assets qualify.

Claim 100% Bonus Depreciation for Heavy SUVs, Pickups, or Vans. The 100% bonus depreciation provision can have a hugely beneficial impact on first-year depreciation deductions for new and used heavy vehicles used over 50% for business. That's because heavy SUVs, pickups, and vans are treated for tax purposes as transportation equipment that qualifies for 100% bonus depreciation. However, 100% bonus depreciation is only available when the SUV, pickup, or van has a manufacturer's Gross Vehicle Weight Rating (GVWR) above 6,000 pounds. The GVWR of a vehicle can be verified by looking at the manufacturer's label, which is usually found on the inside edge of the driver's side door where the door hinges meet the frame. If you are considering buying an eligible vehicle, doing so and placing it in service before the end of this tax year could deliver a juicy write-off on this year's return.

Claim First-year Depreciation Deductions for Cars, Light Trucks, and Light Vans. For both new and used passenger vehicles (meaning cars and light trucks and vans) that are acquired and placed in service in 2019, the luxury auto depreciation limits are as follows:

- \$18,100 for Year 1 if bonus depreciation is claimed.
- \$16,100 for Year 2.
- \$9,700 for Year 3.
- \$5,760 for Year 4 and thereafter until the vehicle is fully depreciated.

Note that the \$18,100 first-year luxury auto depreciation limit only applies to vehicles that cost \$58,500 or more. Vehicles that cost less are depreciated over six tax years using percentages based on their cost. Contact us for details.

Time Business Income and Deductions for Tax Savings. If you conduct your business using a pass-through entity (sole proprietorship, S corporation, LLC, or partnership), your shares of the business's income and deductions are passed through to you and taxed at your personal rates. Assuming the current tax rules will still apply in 2020, next year's individual federal income tax rate brackets will be the same as this year's (with modest bumps for inflation). In that case, the traditional strategy of deferring income into next year while accelerating deductible expenditures into this year makes sense if you expect to be in the same or lower tax bracket next year. Deferring income and accelerating deductions will, at a minimum, postpone part of your tax bill from 2019 until 2020.

On the other hand, if you expect to be in a higher tax bracket in 2020, take the opposite approach. Accelerate income into this year (if possible) and postpone deductible expenditures until 2020. That way, more income will be taxed at this year's lower rate instead of next year's higher rate. Contact us for more information on timing strategies.

Key Point: If tax rates are increased for 2021 and beyond, the standard income deferral strategy might not work next year. You might have to take the opposite approach and accelerate income from 2021 into 2020. Stay tuned for developments and stay in touch with us for tax-saving strategies.

Maximize the Deduction for Pass-through Business Income. For 2019, the deduction for Qualified Business Income (QBI) can be up to 20% of a pass-through entity owner's QBI, subject to restrictions that can apply at higher income levels and another restriction based on the owner's taxable income. The QBI deduction also can be claimed for up to 20% of income from qualified REIT dividends and 20% of qualified income from publicly-traded partnerships.

For QBI deduction purposes, *pass-through entities* are defined as sole proprietorships, single-member LLCs that are treated as sole proprietorships for tax purposes, partnerships, LLCs that are treated as partnerships for tax purposes, and S corporations. The QBI deduction is only available to noncorporate taxpayers (individuals, trusts, and estates).

Because of the various limitations on the QBI deduction, tax planning moves (or nonmoves) can have the side effect of increasing or decreasing your allowable QBI deduction. So, individuals who can benefit from the deduction must be really careful at year-end tax planning time. We can help you put together strategies that give you the best overall tax results for the year.

Watch out for Business Interest Expense Limit. Thanks to an unfavorable TCJA change, a taxpayer's deduction for *business interest expense* for the year is limited to the sum of (1) business interest income, (2) 30% of adjusted taxable income, and (3) floor plan financing interest paid by certain vehicle dealers. This limit is a permanent change that can potentially affect all types of businesses—corporate and noncorporate alike. The rules for businesses conducted as partnerships, LLCs treated as partnerships for tax purposes, and S corporations are especially complicated.

Fortunately, many businesses are exempt from the interest expense limit rules under the *small business exception*. Under this exception, a taxpayer is generally exempt from the limit if average annual gross receipts are \$25 million or less for the three-tax-year period ending with the preceding tax year. The gross receipts threshold is adjusted annually for inflation. For 2019, the threshold is \$26 million.

Certain real estate and farming businesses with average annual gross receipts above the threshold also are exempt if they choose to limit their depreciation deductions.

Key Point: Businesses that have fluctuating annual gross receipts may qualify for the small business exception for some years, but not for others. For instance, if your business has three good years, it may be subject to the interest expense limit rules for the following year. However, if it has a bad year, it may qualify for the small business exception for the following year. If average annual receipts are typically over the applicable threshold (\$26 million for 2019), but not by much, some judicious year-end tax planning may allow your business to qualify for the small business exception for at least some years. We can help with that. Contact us for details if you think your business might be affected by the interest expense limit.

Claim 100% Gain Exclusion for Qualified Small Business Stock. There is a 100% federal income tax gain exclusion privilege for eligible sales of Qualified Small Business Corporation (QSBC) stock that was acquired after 9/27/10. QSBC shares must be held for more than five years to be eligible for the gain exclusion break. Contact us if you think you own stock that could qualify.

Conclusion

This letter only covers some of the year-end tax planning moves that could potentially benefit you, your loved ones, and your business. Please contact us if you have questions, want more information, or would like us to help in designing a year-end planning package that delivers the best tax results for your particular circumstances.

Sincerely,

DUFFY KRUSPODIN, LLP