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Year-End Planning After Tax Reform

Strategies to consider

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- It's important to explore your year-end planning opportunities in light of the sweeping changes made to virtually all areas of federal tax law that went into effect this year
- While tax planning is always top of mind, the end of the year is also a good time to look at your estate planning documents, your financial assets, and other important considerations

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As the end of the year grows near, it is time to finalize planning for taxes and the steps you need to take to help minimize them. With the passage of the 2017 Tax Cuts and Jobs Act (the Act), it's important to explore your year-end planning opportunities in light of the sweeping changes made to virtually all areas of federal tax law.

SIGNIFICANT PROVISIONS OF THE ACT

Most of the provisions of the Act are effective for tax years beginning after 2017. Many of the individual income and estate tax provisions that came into effect this year will expire after 2025. For a summary of the new tax law and round-up of important highlights, please read our *Issues and Insights*, ***Tax Reform Made Simple?***

YEAR-END PLANNING CONSIDERATIONS

The end of the year can be a very busy time, but you should take the time now to optimize your taxes for this year and the next. While tax planning is always top of mind, the end of the year is also a good time to look at your other planning

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documents, your financial assets, and your long-term plan. The following provides some tips on potential income tax savings strategies, as well as estate planning and other items that are important to consider.

Utilize income and deduction timing strategies

One planning strategy that applies every year is to examine whether it makes sense to defer income to the subsequent year. For individuals, income is taxable when it is received and expenses are deductible in the year that they are paid. It may be beneficial to accelerate or postpone income from year to year so that the income is taxed in a lower income tax bracket in a given year. If tax rates are expected to be lower in 2019 due to an expected drop in income, it is generally beneficial to defer income.

A common approach to income timing involves the sale of publicly traded securities. While the purchase or sale of a security should primarily be based on whether the timing is right for sale from an investment perspective, the timing of the sale also will have a tax impact. In years in which you have recognized capital losses, it can be advantageous to harvest capital gains to offset losses. If it is advisable to sell a security because of market conditions, it might be possible to delay the sale until right after the start of the New Year instead of the end of the current year to defer the tax payable until the following year. Of course, timing the sale of a security for tax purposes should never outweigh protecting the value of the security from downturns in the market. As detailed below, the timing of the sale of a security also can affect the Medicare surtax on net investment income. (Note that the Act did not change the capital gains rates or the 3.8% Medicare surtax.) If you sell stock or securities at a loss and wish to reacquire the same stock, you can do so if you wait for 30 days after the sale to repurchase the stock.

Another way to defer income includes waiting until after the end of the year to take discretionary distributions from Individual Retirement Accounts (IRAs). Generally, taxpayers over age 59½ may take discretionary distributions without penalty. Of course, if you are 70½ or older, you still must meet the required minimum distribution requirements for 2018.

Deduction timing is also an important part of year-end planning. In high income tax rate years, it may be advantageous to pay deductible expenses before the end of the year. If 2018 is a lower income tax rate year either because of lower income or reduced tax rates, it might be better to defer payment of those expenses until they are due in 2019. Conversely, if 2018 is a high income tax rate year, it might be advisable to pay expenses by December 31 even if the bill is not due until January. An example of this type of expense is the 2018 fourth quarter estimated state income taxes generally due on January 15, 2019. They could be paid on December 31 to obtain the deduction in 2018. However, careful consideration should be given to whether the payment of state income taxes will cause the alternative minimum tax (AMT) to be imposed. While AMT should always be considered, it may be less of an issue now because the deduction for state and local taxes is capped at $10,000 per year.

Plan for the Medicare surtax on net investment income

Every year we advise clients to review their portfolios to determine if losses should be harvested to offset capital gains. That review is even more important when the

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3.8% Medicare surtax on net investment income applies. The tax is on the lesser of net investment income or the amount by which modified AGI exceeds $200,000 (single) and $250,000 (married). This is a much lower threshold than the taxable income threshold for the highest capital gains and dividend rates.

The Medicare surtax, when added to the applicable capital gains tax rate of 15% or 20%, can result in a capital gains tax of 18.8% to 23.8%. Don't forget that capital gains also may be taxed at the state level. There are a few ways to reduce the Medicare surtax. One approach that may be appropriate if you have significant capital gains is to harvest capital losses before the end of the year, as referenced earlier. This will reduce the amount of your net investment income subject to the 3.8% surtax. Another method is to reduce your taxable investment income. Because municipal bond interest income is exempt from federal taxes, it is not included in the calculation of investment income. In planning for future investments, it may be appropriate to have some of your fixed income investments in municipal bonds.

Time your charitable contributions

While year end is a common time for charitable giving, it is important to consider how much of your contribution will be deductible, as the amount of the federal income tax deduction is limited to a percentage of AGI, ranging from 20% to 60%, depending on the kind of assets donated and whether the recipient is a public charity or a private foundation. Thus, charitable contributions can be timed to correspond with the level of income in any given year. The actual deduction for the contribution is subject to myriad complex rules.

However, the Act eliminated the phase-out of itemized deduction limitations which used to limit the deductibility of charitable contributions. The Act also provides a higher AGI limit for cash gifts to public charities, limiting deductions for such gifts to 60% of AGI, rather than the prior law's limit of 50% of AGI. Thus, donors making large gifts in 2018 could receive substantial tax benefits from giving. Since the standard deduction has nearly doubled under the new Act, and so many other deductions are eliminated, many donors may no longer be in a position to itemize, eliminating any tax savings from donations. Under the Act, an individual would need total itemized deductions to exceed $12,000, the Act's new standard deduction for individual taxpayers, up from $6,350 in 2017. Married couples would need deductions exceeding $24,000, up from $12,700 in 2017.

If you would fall into the standard deduction as a result of tax reform, losing the ability to itemize deductions, you may wish to consider making charitable gifts in a single year equivalent to what you would typically give over two to three years, and then not giving directly to charity for the next few years. As a result, the charitable gift should be large enough to itemize the deduction. However, making large gifts in some years while skipping giving in other years could have an adverse effect on the charities relying on gifts. In that case, it may be helpful to have a discussion with the charity, particularly if it is a small charity, to make clear that it should not rely on a similar sized gift every year, and that the next gift will not be made for several years. For more detailed information on the impact of tax reform on charitable giving, please read ***A donor's guide to the new law*** authored by my colleague, Carol Kroch, national director of philanthropic planning.

Generally, contributions can range from outright gifts of cash to transfers of stock and property directly to charity. Gifts of appreciated, publicly traded securities held for more than one year can be especially beneficial, as the deduction is based on the fair market value of the gift. Further, transfer of appreciated securities avoids the recognition of any capital gains that would have been recognized if the stock had been sold and the proceeds given to charity. More complex gifts can be structured through entities such as private foundations, donor advised funds, and split interest trusts, such as charitable remainder and lead trusts. Note that the asset donated can change the tax result. For example, the deduction

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for a gift of closely held stock to a private foundation is limited to basis, usually the initial purchase price. And a gift of property subject to debt, often the case with real estate, can turn the donation into a bargain sale with income tax consequences to the donor.

A gift to charity made by check need only be mailed by year end or charged to your credit card by December 31. But if you are making a gift of anything other than by check or credit card, be sure to allow enough time for completing the gift by year end. Remember to keep the required acknowledgement from the charity for gifts of $250 or more or your deduction can be disallowed. Non-cash gifts, other than publicly traded securities, may also be subject to detailed appraisal rules, in order to obtain the deduction.

Use the IRA charitable rollover

The IRA charitable rollover provision permits individuals aged 70½ or older to transfer up to $100,000 directly from an IRA to a "qualified" charity without recognizing income or taking a charitable contribution deduction. The amount transferred to charity also counts to satisfy all or part of the required minimum distribution.

The IRA charitable rollover can be very helpful to taxpayers who:

- Wish to minimize their AGI so as to stay below the threshold for the 3.8% Medicare surtax on net investment income (AGI of $200,000 single, $250,000 married)
- Do not itemize deductions or who have already maximized their permitted charitable contribution deductions
- Live in a state that does not permit charitable deductions from state income tax
- Can otherwise benefit from a lower amount of AGI

Maximize 401(k) retirement plan contributions

Regardless of your tax bracket, you should take full advantage of employer-provided retirement benefits. Make sure you have contributed the minimum amount necessary to your 401(k) plan to receive any matching contributions from your employer. In addition, high income earners should fully fund their 401(k) plans, including the catch-up contribution allowed for taxpayers over age 50. The 2018 maximum 401(k) contribution is $18,500 and the catch-up contribution for taxpayers over age 50 is $6,000. The 2019 401(k) contribution limit will increase to $19,000 while the catch-up contribution will remain the same.

Contribute to your Health Savings Account (HSA)

An HSA offers those in high-deductible health insurance plans the opportunity to save pretax dollars and to access them on a tax-free basis to pay for qualified medical expenses—with unused funds rolling over from one year to the next. When funds are used to pay for qualified medical expenses, the distribution of both principal and interest/growth is free of income tax and penalty no matter the account owner's age. Once an HSA owner reaches the age of 65, the money accumulated within the account may be used for any purpose without penalty; however, the distribution will be subject to income tax where used for non-qualified medical expenses.

Yearly contribution limits. The maximum contribution limits to an HSA is determined by the IRS. All HSA owners with a high-deductible health insurance plan may contribute up to these limits. The limit for 2018 is $3,450 for individuals and $6,900 for families, and

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$3,500 and $7,000, respectively, in 2019. Individuals age 55 and older can make an additional annual catch-up contribution of $1,000.

Review your estate plan

We recommend reviewing your estate plan periodically regardless of tax reform. There are many non-tax reasons to have an up-to-date plan. This review should include your will, any revocable trusts, your powers of attorney for financial and healthcare matters, as well as any existing irrevocable trusts. In addition to federal tax changes, there may have been changes in the trusts and estates laws for your state or jurisdiction. Check to see if the fiduciaries you have named are still the best parties to administer your estate, serve as guardian of a minor, serve as trustee, or act on your behalf if you become incapacitated. You should name fiduciaries in your estate planning documents who have sufficient time, knowledge, skill, and authority to effectively carry out your wishes.

Anyone named as the guardian for minor children and agent for a financial and medical power of attorney should be qualified and available. You should discuss the roles and responsibilities with each fiduciary and guardian and you should consider the relationship of the guardian to the beneficiary. Often a corporate executor and/or trustee would be appropriate as part of your fiduciary team. Reviewing these designations annually is an important step to take, as changes in families and in long-term wishes may dictate changes to your named fiduciaries.

Your healthcare power of attorney, advance directive, or living will can have a significant impact on your quality of life in the event of a catastrophic accident or debilitating illness. Even if you have selected the right agent to act on your behalf if you are unable to speak for yourself, you should determine if the guidance you have given the agent regarding the type of care you wish to receive is still appropriate. This care can include instances of advanced life support and nutrition and hydration.

There are other documents besides your estate planning documents that need to be reviewed on a regular basis. Beneficiary designations for insurance, qualified retirement plans, and IRAs should be examined to determine if the designated beneficiary is still appropriate. The end of the year is also a good time to review your life insurance coverage. Determine why you have the insurance and decide if it is still needed for that purpose. Examine whether there is sufficient coverage to meet the desired need and review the policy to make sure it is still performing as expected. If it is a term policy, note the date that it expires and determine if there will be a need for coverage beyond that date.

Examine the terms of the disposition of your assets to your intended beneficiaries. Determine if the beneficiaries are of the age and capacity to manage the amount of assets to be distributed to them. Other changes in life such as a marriage, divorce, birth of a child or grandchild, or even the purchase of real property in another state might be a reason to update your documents. While it is generally appropriate to designate a trustee for amounts payable to a minor, other options are available for smaller amounts. If a minor is to receive a small benefit, the best way to designate the beneficiary is to name a custodian under the Uniform Transfer to Minors Act or the Uniform Gift to Minors Act of the state where you live. This eliminates the need to have a guardian of the property of the minor appointed by a court.

Take advantage of low interest rates

Another planning strategy that benefits families is one family member lending money to another family member. The minimum interest rate that a family member must charge another family member—known as the Applicable Federal Rate (AFR)—remains historically low, and is significantly lower than commercial lending rates. Interest rates are rising and the Federal Reserve is expected to continue raising rates, which will eventually affect the AFR. The family member benefits

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from the reduced interest rate and will generally pay considerably less interest in the long term. You also may benefit because you might be generating more interest income from the loan than in a conventional interest-bearing account. The loan could be used for any reason, including the purchase of a home or starting a new business, but should be documented, and the terms respected and secured in the same manner as a conventional loan.

The current interest rate environment also makes some more complex estate and income tax planning techniques very attractive. The use of a Grantor Retained Annuity Trust (GRAT) provides an opportunity to transfer future appreciation in assets free of gift and estate tax to family members while retaining the right to receive income from the property for a term of years. If you are charitably inclined, a Charitable Lead Trust (CLT) provides an opportunity similar to a GRAT except the income interest of the CLT goes to a charity rather than the grantor, but the remainder interest still passes to family members.

Utilize annual exclusion gifts

The end of the year is a time when many focus on giving to family and friends. The most common method of tax-free giving is the annual exclusion gift. In 2018, each individual is permitted to make outright gifts of $15,000 in cash or property to an unlimited number of individuals without incurring any gift taxes or using part of the lifetime gift tax exemption amount. The gift must be delivered to the recipient by the end of the year to be considered a completed gift and qualify for the annual exclusion. It is beneficial to make the gifts earlier in the calendar year to move future income and appreciation sooner to the recipient and outside of your estate. The 2019 annual exclusion amount will remain at $15,000.

Individuals can also make direct payments of tuition to educational institutions and unreimbursed medical expenses to healthcare providers for any individual without incurring any liability for gift taxes.

Consider 529 Plan contributions

The end of the year is also a good time to create 529 Education Plans for any "new additions" to the family during the year, or to fund existing plans. Income accumulated in a 529 Plan is not subject to federal income tax and distributions are not taxed so long as the funds are used for qualified education expenses of the plan beneficiary.

Some states allow a deduction from the donor's state income tax for contributions to a 529 Plan created in the donor's home state. Special rules even allow a donor to transfer five times the annual gift exclusion amount ($75,000 in 2018) to the 529 Plan, but the donor will not be able to make annual exclusion gifts to that donee or to a 529 Plan for that beneficiary for five years to the extent of the gift allocated to that year. For tax years starting in 2018, the Act provides for an enhancement to section 529 Plans, permitting distributions of up to $10,000 per year per student for elementary and secondary school expenses.

Remember filing requirements for household staff

Someone providing household services to you such as housecleaning, child care, or yard work may be your employee, depending on the type of services rendered and how much control you have over how the person performs the service. If the service provider is an employee to whom you paid more than $2,000 during the year, you are liable for the Social Security

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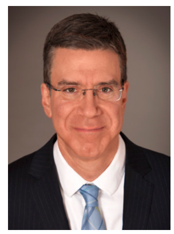
and Medicare taxes for that employee and must file a Form W-2 for the employee. The Form W-2 must be provided to the employee by January 31, 2019. Federal unemployment taxes also may be due if you paid an employee $1,000 or more during any calendar quarter. The taxes are paid with your income tax return. State unemployment taxes also may be payable based on the applicable state law. Also, review your homeowner's insurance policy to make sure a household employee is covered if there is an accident on the job.

Property and casualty insurance review

To protect against the damage that can be caused by natural disasters, as well as more common damages, review your property and casualty insurance to make sure that you have adequate coverage. Remember that floods are generally not covered by homeowner's insurance policies. Take the time to make sure that you have adequate replacement coverage for your home and its contents. And remember to look at your liability coverage for your home, automobiles, and watercraft to make sure that you have sufficient coverage against claims from third parties in the event of an accident. Consider getting a personal umbrella policy to provide coverage in excess of your policies' liability limits. The more assets you have, the more the coverage should be.

These are just some of the year-end steps you can consider to minimize your tax burden and be sure your estate plan is current, particularly now that the new tax law is in place. You should consult with your tax and wealth advisors to be sure your plan meets today's goals and is flexible for future change.



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