Villanueva & Company PC
Certified Public Accountants

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To Our Much Beloved Clients:

As the end of the year approaches, it is a time to think of planning moves that could help to lower your tax bill for this year and possibly the next.

Year-end planning for 2018 takes place against the agony of a new tax law, the "Tax Cuts and Jobs Act" or TCJA, which makes major changes in the tax rules for individuals and businesses. As usual, do not believe the title as it both cuts and increases taxes depending on individual factual situations. In other words, there are winners and losers which include both the super wealthy and the middle class. The poor are a special class that receive tax refunds but don't pay income taxes (Please don't ask for an explanation).

The following is a checklist of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a friend) may benefit from many of them. If a friend or family member benefits from these ideas, be sure to take the credit and maybe you can get a free meal from them.

Because of the scope of the changes for 2018, we recommend that you contact us to review your overall tax strategy if you believe the changes will have a significant impact on you. We can narrow down the specific actions to tailor a particular plan. In the meantime, please review the following list and call us if you see an opportunity. Who knows? You may get a free lunch out of the effort from us.

<u>Year-End Tax Planning Moves for Individuals</u>

- Obama's Legacy: Higher-income earners must be wary of the 3.8% surtax on certain unearned income (i.e., interest, dividends, capital gains, rentals, income from passive investments). The surtax is 3.8% of the lesser of your net investment income (NII) or the excess of modified adjusted gross income (MAGI) over a threshold amount ($250,000 for joint filers, $125,000 for married separate filers, and $200,000 for single filers). If your income will be over the threshold amounts, then consider ways to minimize (e.g., through deferral) NII or MAGI.

  What the Hell did they just say?

- The other Obama Legacy: Higher-income earners must also be wary of the 0.90% Medicare surtax on certain earned income (i.e., wages and income from self-employment). The tax applies to individuals whose earned income exceeds a threshold amount ($250,000 for joint filers, $125,000 for married separate filers, and $200,000 for single filers).

  Damn it, they just said it again!

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The last "No" that Senator McCain cast stopped the repeal of Obama Care which would have repealed the two non-income taxes mentioned above. So perhaps they should be named the Obama-McCain Legacy Non-Income Tax tax.

- Long-term capital gains are taxed at either 0%, 15% or 20%, depending on the taxpayer's taxable income (after deductions). The 0% rate generally applies to any net long-term capital gains, which when added to regular taxable income, is not more than the “maximum zero rate amount” ($77,200 for married filers, $51,700 for head of household, and $38,600 for single filers). If you believe your taxable income will be below the threshold amounts in 2018, and you have unrealized long-term capital gains, then consider selling enough of them to generate long-term capital gains sheltered by the 0% rate.

  If you understood the last paragraph, you don't need us, we need you. The short suggestion is you have potential capital gains, let's analyze them to see if it is time to sell them.

- Postpone income until 2019 and accelerate deductions into 2018 if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2018 that are phased out over varying levels of adjusted gross income. We know it is much easier to postpone deductions than income but try to think in reverse.

- It may be advantageous to try to arrange with your employer to defer, until early 2019, a bonus that may be coming your way. Good luck with this one, my staff doesn't do it.

- Beginning in 2018, many taxpayers who previously claimed itemized deductions will no longer be able to do so due to an increase in the standard deduction and limitations on certain types of itemized deductions. For 2018, the standard deduction has been increased to $24,000 for joint filers, $12,000 for singles, $18,000 for heads of household, and $12,000 for married separate filers. In addition, the maximum deduction allowable for state and local taxes is $10,000, interest expense on home equity indebtedness is no longer deductible, and certain miscellaneous itemized deductions (i.e., tax preparation fees, investment expenses, unreimbursed employee expenses) are no longer deductible.

  Not tax preparation fees!?!

- Some taxpayers may be able to work around the new reality by applying a “bunching strategy” to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, if a taxpayer knows he or she will be able to itemize deductions this year but not next year, the taxpayer may be able to make two years' worth of charitable contributions this year, instead of spreading out donations over 2018 and 2019. The good news is this will greatly increase your mail from every charitable organization known to mankind.

- Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2018 deductions even if you don't pay your credit card bill until after the end of the year. What's in your wallet?

- Be sure to take all required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retirement plan). RMDs from IRAs must begin by April 1st of the year following the year you reach age 70½. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. Thus, if you turn age 70½ in 2018, you can delay the first required distribution to 2019, but if you do, you will have to take a double distribution in 2019. Think twice before delaying 2018 distributions to 2019, as bunching income into 2019 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2019 if you will be in a substantially lower bracket that year. Maybe you should, maybe you shouldn't; see why you should call us?

- If you are age 70-½ or older by the end of 2018, have traditional IRAs, and particularly if you can't itemize your deductions, consider making 2018 charitable donations via qualified charitable distributions from your IRAs. Such distributions are made directly to charities from your IRAs, and the amount of the contribution is neither included in your gross income nor deductible as an itemized deduction. But the amount of the qualified charitable distribution reduces the amount of your required minimum distribution, resulting in tax savings. This is actually the only good thing about getting old.

- If you have not paid sufficient taxes for 2018 via withholding or estimated tax payments, and are facing a penalty for underpayment of estimated tax, then consider taking an eligible rollover distribution from a qualified retirement plan before the end of 2018. You can apply up to 100% of the distribution to withholding. You will then have 60 days to deposit the full amount of the distribution, including the withholding, to a traditional IRA. No part of the distribution will be includible in income for 2018, but the withheld tax will be applied pro rata over the full 2018 tax year to reduce any underpayments of tax in previous quarters.
  This is easy to do by calling your custodian and ruining his day.

- If you become eligible in December of 2018 to make health savings account (HSA) contributions, you can make a full year's worth of deductible HSA contributions for 2018.
  Prepay illness!

<u>Year-End Tax-Planning Moves for Businesses</u>

- For tax years beginning after 2017, taxpayers other than corporations may be entitled to a deduction of up to 20% of their “qualified” business income or QBI. However, if taxable income exceeds certain thresholds ($315,000 for married filers and $157,500 everyone else), then the deduction may be limited based on the type of business (certain service businesses don’t qualify for the deduction), the amount of W-2 wages paid by the business, and the depreciable basis of qualified property held by the business. Did you get it? No? Call us.

- Taxpayers may be able to achieve significant savings by deferring income or accelerating deductions so as to come under the dollar thresholds (or be subject to a smaller phase-out of the deduction) for 2018. Depending on their business model, taxpayers also may be able increase the new deduction by increasing W-2 wages before year-end. These rules are quite complex, so we strongly advise you to call us before making any moves to try and maximize the 20% deduction. For those of you still reading, we are still talking about the previous paragraph.

- More “small businesses” are able to use the cash (as opposed to accrual) method of accounting in 2018 and later years than were allowed to do so in earlier years. To qualify as a “small business” a taxpayer must, among other things, satisfy a gross receipts test. Effective for tax years beginning after December 31, 2017, the gross-receipts test is satisfied if, during a three-year testing period, average annual gross receipts don't exceed $25 million. Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings till next year or by accelerating expenses, for example, paying bills early or by making certain prepayments. This is a new thought but still confusing.

- Businesses should consider making expenditures that qualify for the liberalized business property expensing option (Section 179). For tax years beginning in 2018, the expensing limit is $1,000,000, and the investment ceiling limit is $2,500,000. Expensing is generally available for most depreciable property (other than buildings), and off-the-shelf computer software. For property placed in service in tax years beginning after December 31, 2017, expensing also is available for qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems. Let there be Freedom for expenditures! Ahh, Freedom for certain expenditures! Free the elevators, Damn the escalators, Full Speed Ahead!

- Businesses also can claim a 100% bonus first year depreciation deduction for machinery and equipment, on both new and used (in most cases) property, if purchased and placed in service this year. Trust us, this is better, it used to be 50%.

- Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2018. This was a little gift to CPA's for taking away the tax prep deduction.

These are just some of the year-end steps that can be taken to save taxes. Again, by reaching out to us, we can tailor a particular plan that will work best for you and maybe make a buck for you and us.

Very truly yours,

Villanueva & Co.

Villanueva & Company, P.C.