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YEAR END TAX CONSIDERATIONS
DEC. 2018
INDIVIDUALS

Cozby & Company
Year End Tax Planning Considerations for the Individual

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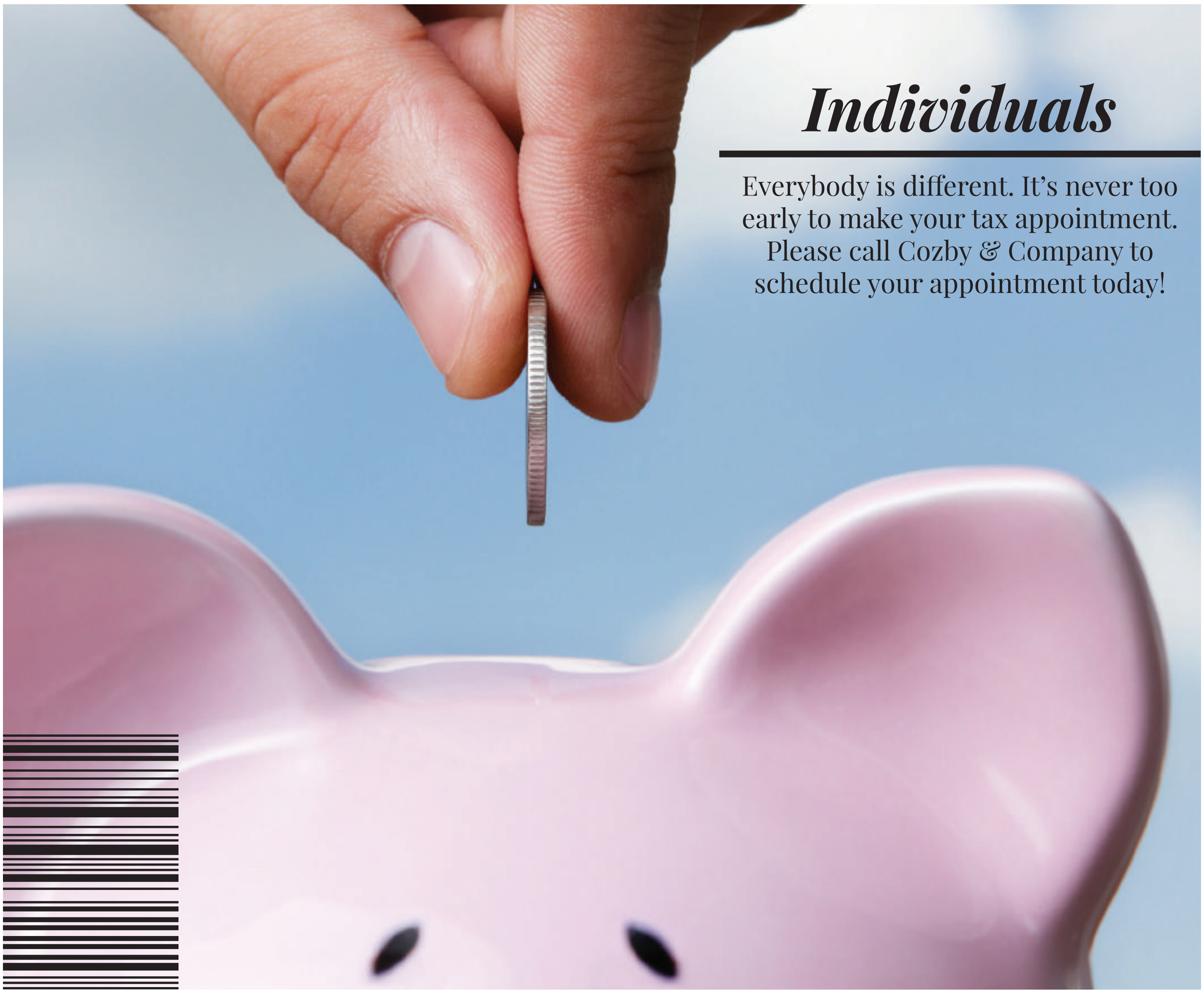


Individuals

Everybody is different. It's never too early to make your tax appointment. Please call Cozby & Company to schedule your appointment today!

Take Advantage of Lower Tax Rates and Investment Gains

Under the TCJA, 2018 ordinary tax rates are generally lower than those for 2017. For example, the top rate has been reduced from 39.6% to 37%. (The remaining six rates are 10%, 12%, 22%, 24%, 32%, and 35%.) Also, the top rate now applies to joint filers whose taxable income is over $600,000 (as opposed to $470,700 for 2017). Some taxpayers who were taxed at 39.6% in 2017 may now find themselves in the 35% tax bracket. In other good news, the TCJA didn't change the capital gains rate structure. Therefore, most categories of long-term capital gain are taxed at 0%, 15%, or 20%. The maximum 20% rate applies to joint filers with 2018 taxable income (including long-term gains) above $479,000. Higher income individuals also can be hit with the 3.8% Net Investment Income Tax (NIIT). The bottom line is that taxpayers falling outside of the top ordinary tax bracket of 37% can be subject to the maximum capital gains rate of 20%.

As you evaluate investments held in your taxable brokerage firm accounts, consider the tax impact of selling appreciated securities (currently worth more than you paid for them) before the end of this year. For most taxpayers, the tax rate on long-term capital gains is still much lower than the rate on short-term gains. Therefore, it often makes sense to hold appreciated securities for at least a year and a day before selling to qualify for the lower long-term gain tax rate. Also, taxpayers who expect to be subject to a higher capital gain rate after 2018 should consider selling profitable long-term investments in 2018 to take advantage of this year's rate. The proceeds and tax savings could be used to help fund a traditional IRA (possibly deductible) or Roth IRA to postpone or eliminate future taxes.

New Standard Deduction versus Itemized Deductions

For 2018, joint filers can enjoy a standard deduction of $24,000 (versus $12,700 for 2017). The new standard deduction for heads of household is $18,000, and single taxpayers (including married taxpayers filing separately) can claim a standard deduction of $12,000. However, the TCJA suspends the deduction for personal exemptions.

If you typically claim the standard deduction (as opposed to itemizing deductions), chances are your tax bill will decrease for 2018. Although personal exemption deductions are no longer available, a larger standard deduction, combined with lower tax rates and an increased child tax credit (see later discussion), may result in less taxes. However, if you usually itemize deductions, the larger standard deduction may change this. Also, the TCJA eliminates or limits many of the itemized deductions. We are available to analyze your particular tax situation to determine if you will pay more or less under the TCJA. Note: Depending on your circumstances, we may need to adjust your estimated quarterly tax payments. Also, this is a good time to check if you're on track to have the right amount of federal income tax withheld from your paychecks in 2018. You can correct any discrepancies by turning in a new Form W-4 (Employee's Withholding Allowance Certificate) to your employer.

IRS shoots down states' SALT limitation workaround.

For 2018 through 2025, the Tax Cuts and Jobs Act (TCJA) limits an individual taxpayer's annual SALT (state and local tax) deductions to a maximum of $10,000, with no carryover for taxes paid in excess of that amount. (The SALT deduction limit doesn't apply to property taxes paid by a trade or business or in connection with the production of income.) As a result of this change, many taxpayers will not get a full federal income tax deduction for their payments of state and local taxes. Following the TCJA's passage, some high-tax states implemented workarounds to mitigate the effect of the SALT deduction limit for their residents. One method used was the establishment of charitable funds to which taxpayers can contribute and receive a tax credit in exchange. The IRS has issued proposed regulations, which would apply to contributions after Aug. 27, 2018, that effectively kill this workaround. The regulations would provide that a taxpayer who makes payments to or transfers property to an entity eligible to receive tax deductible contributions must reduce his or her charitable deduction by the amount of any state or local tax credit the taxpayer receives or expects to receive. IRS also clarified that the proposed regulation crackdown on the SALT limitation workaround doesn't apply to businesses. In other words, a business generally can deduct a payment to a charitable or governmental entity if the payment is made with a business purpose.

IRS clarifies who is a qualifying relative for family credit purposes.

Under the TCJA, effective for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, you can't claim a dependency exemption for dependents, including qualifying relatives, but you may be eligible for a $2,000 credit for each qualifying child and a $500 credit (called the "family credit") for each qualifying non-child dependent, including qualifying relatives. One of the conditions for being a qualifying relative is that the person's gross income for the year can't be more than the exemption amount. That condition remains the same in the Tax Code, but the exemption amount has been reduced to zero because the dependency exemption has has been eliminated. The IRS has clarified that the gross income limit for a qualifying relative for tax credit purposes (as well as for other purposes, such as head-of-household status), is determined by reference to what the exemption amount would have been if it hadn't been reduced to zero by the TCJA. Thus, after 2017 and before 2026, the gross income limit is $4,150, adjusted for inflation after 2018.

Home Sweet Home

Maximize Home Mortgage Interest Deductions

Before the TCJA, taxpayers could deduct interest paid on up to $1 million ($500,000 if married filing separately) of home acquisition debt (debt used to buy or substantially improve a first or second home). Also, taxpayers could deduct interest paid on up to $100,000 ($50,000 if married filing separately) of home equity debt, regardless of how the proceeds were used. The TCJA cuts those numbers back significantly. For 2018–2025, the TCJA reduces the limit on home acquisition debt to $750,000. For married taxpayers filing separately, the debt limit is halved to $375,000. Also, the TCJA generally disallows home equity debt interest. However, the IRS recently advised homeowners that interest paid on home equity loans and lines of credit may be deductible if the funds are used to buy, build, or substantially improve the taxpayer's home that secures the loan. In other words, such loans will be treated as home acquisition debt subject to the new $750,000/$375,000 limits. Thanks to a set of grandfather rules, the new limits don't apply to home acquisition debt that was taken out on or before 12/15/17 (or taken out on or before that date and refinanced later). This is good news for existing homeowners. However, if you have a home equity loan or line of credit, we will need to trace how the proceeds were used to determine if the interest is still deductible under the new law.

In addition, it may be beneficial to refinance your home using an interest-only mortgage. For example, if you refinance $1 million of pre-TCJA home acquisition debt with a new $1 million interest-only loan, you can continue to deduct all the interest under the grandfather rules. In contrast, if you gradually make principal payments on your $1 million of pre-TCJA home acquisition debt, you won't be able to treat any portion of an additional home loan taken in 2018–2025 as home acquisition debt because your existing loan will absorb the entire $750,000 TCJA limit.

Take Advantage of the New Child Tax Credit

Under pre-TCJA law, the child tax credit was $1,000 per qualifying child, but it was reduced for married couples filing jointly by $50 for every $1,000 (or part of $1,000) by which their Adjusted Gross Income (AGI) exceeded $110,000. (The threshold was $55,000 for married couples filing separately and $75,000 for unmarried taxpayers.)

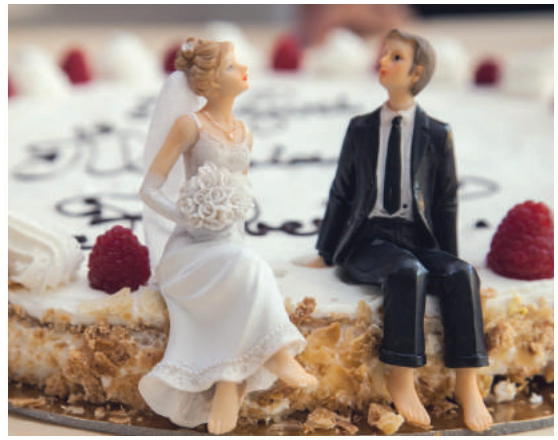
Starting in 2018, the TCJA doubles the child tax credit to $2,000 per qualifying child under age 17. It also allows a new $500 credit (per dependent) for any of your dependents who aren't qualifying children under 17. There is no age limit for the $500 credit, but the tax tests for dependency must be met. The TCJA also substantially increases the "phase-out" thresholds for the credit. Starting in 2018, the total credit amount allowed for a married couple filing jointly is reduced by $50 for every $1,000 (or part of $1,000) by which their AGI exceeds $400,000. The threshold is $200,000 for all other taxpayers. So, if you were previously prohibited from taking the credit because your AGI was too high, you may now be eligible to claim the credit.

Bunch Charitable Contributions through Donor-advised Funds

The TCJA temporarily increases the limit on cash contributions to public charities and certain private foundations from 50% to 60% of AGI. However, as we mentioned earlier, the standard deduction has almost doubled. Combined with the capping of the state and local tax deduction at $10,000 per year ($5,000 for a married taxpayer filing a separate return), changes to the home mortgage interest deduction, and the elimination of miscellaneous itemized deductions, it's likely that fewer taxpayers will be itemizing in 2018. One way to combat this is to bunch or increase charitable contributions in alternating years. This may be accomplished by donating to donor advised funds. Also known as charitable gift funds or philanthropic funds, donor-advised funds allow donors to make a charitable contribution to a specific public charity or community foundation that uses the assets to establish a separate fund. Taxpayers can claim the charitable tax deduction in the year they fund the donor-advised fund and schedule grants over the next two years or other multiyear periods. This strategy provides a tax deduction when the donor is at a higher marginal tax rate while actual payouts from the account can be deferred until later. If you have questions or want more information on donor-advised funds, please give us a call. We welcome the opportunity to help you put together a charitable giving plan that suits your goals.

Revisit Your Qualified Tuition Plans

Although the details of Qualified Tuition Plans (QTPs) can vary widely, they generally allow parents and grandparents to set up college accounts for children and grandchildren before they reach college age. Once established, QTPs qualify for favorable federal (and often state) tax benefits, which can ease the financial burden of paying for college. QTPs may be particularly attractive to higher income parents and grandparents because there are no AGI-based limits on who can contribute to these plans.
Under pre-TCJA law, the earnings on funds in a QTP could be withdrawn tax-free only if used for qualified higher education at eligible schools. Eligible schools included colleges, universities, vocational schools, or other postsecondary schools eligible to participate in a student aid program of the Department of Education.
Thanks to the TCJA, qualified higher education expenses now include tuition at an elementary or secondary public, private, or religious school, up to a $10,000 limit per tax year. So, you may want to revisit your QTPs if you have children or grandchildren who attend elementary or secondary schools.



Watch out for New Alimony Rules

Under the TCJA, certain future alimony payments will no longer be deductible by the payer. Also, alimony will no longer be considered income to the recipient. Therefore, for divorces and legal separations that are executed (that come into legal existence due to a court order) after 2018, the alimony-paying spouse won't be able to deduct the payments, and the alimony-receiving spouse doesn't include them in gross income or pay federal income tax on them. It's important to emphasize that pre-TCJA rules apply to already-existing divorces and separations, as well as divorces and separations that are executed before 2019. However, under a special rule, if taxpayers have an existing (pre-2019) divorce or separation decree, and they have that agreement legally modified, then the new rules don't apply to that modified decree unless the modification expressly provides that the TCJA rules are to apply. There may be situations where applying the TCJA rules voluntarily is beneficial for the taxpayers, such as a change in the income levels of the alimony payer or the alimony recipient.
If you're considering a divorce or separation (or modification of an existing divorce decree), please let us know so we can determine the tax consequences.

Consider Investing in Qualified Opportunity Zones

Tucked away in the TCJA is the creation of Qualified Opportunity Zones (QO Zones). These are low-income communities that meet certain requirements. Investing in QO Zones can result in two major tax breaks: (1) temporary deferral of gain from the sale of property and (2) permanent exclusion of post-acquisition capital gains on the disposition of investments in QO Zones held for ten years. The IRS has already announced the designation of QO Zones in over 20 states and U.S. possessions. It will make future designations as submissions by states are received and certified. The IRS also plans to issue additional information on QO Zones in the future. If you're looking to defer taxable gains while revitalizing low-income communities, QO Zones may be the way to go.

Monitor State Response to Tax Reform

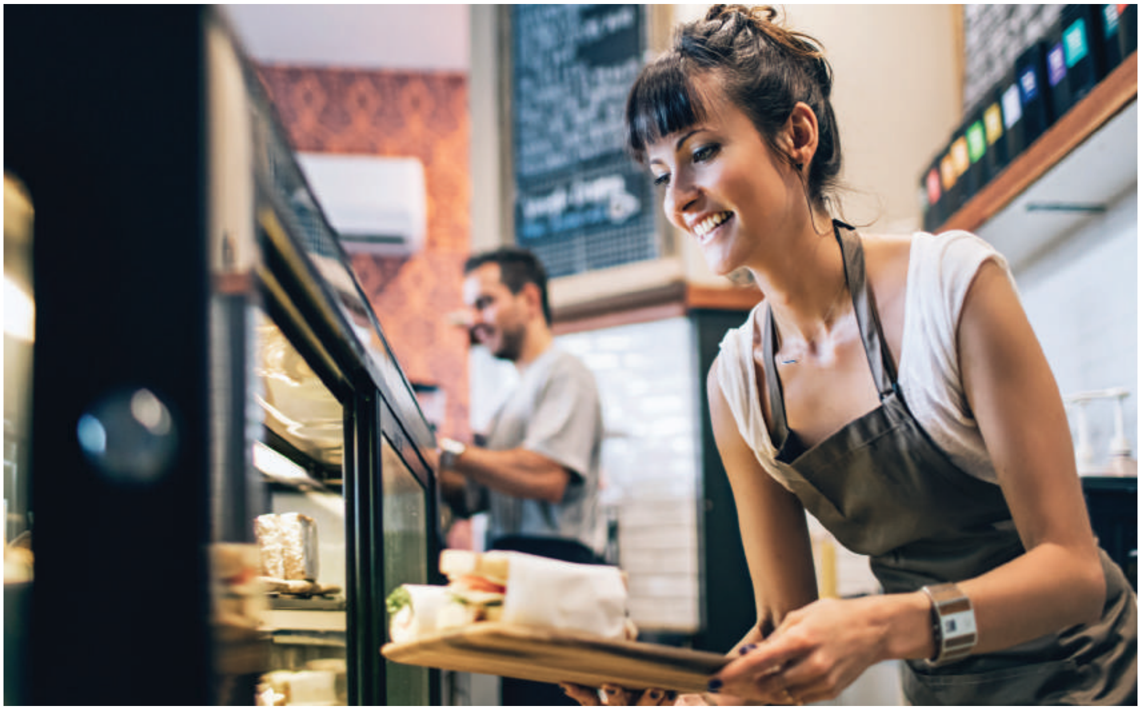
States react differently to changes to federal tax law. For example, some states automatically conform to federal tax law as soon as legislation is passed. Other states require their legislatures to adopt federal tax law as of a fixed date. This generally occurs on an annual basis. There are some states, however, that pick and choose which federal provisions to adopt. Because of this, your state income tax rules may be drastically different than the federal income tax rules. For example, you may be better off claiming the standard deduction for federal tax purposes but itemizing for state income tax purposes. We have monitored your state's response to the TCJA and will help you minimize your state income tax bill.

Beware of the Alternative Minimum Tax

As tax reform efforts progressed late last year, there were high hopes that the individual Alternative Minimum Tax (AMT) would be repealed. Unfortunately, it still exists under the TCJA. The good news is that you are allowed a relatively generous AMT exemption, which is deducted in calculating your AMT income. The TCJA significantly increases the AMT exemptions for 2018–2025. The exemption is phased out when your AMT income surpasses the applicable threshold, but the TCJA greatly increases those thresholds for 2018–2025. This means that less people will be subject to the AMT rules.

Maximize Your Qualified Business Income Deduction

You may have heard a lot of talk in the news about a new deduction for "pass-through" income, but it's actually available for qualified business income from a sole proprietorship (including a farm), as well as from pass-through entities such as partnerships, LLCs, and S-corporations. Under the TCJA, individuals may deduct up to 20% of their qualified business income; however, the deduction is subject to various rules and limitations. Although there is some uncertainty surrounding this new deduction, there are some planning strategies we can consider. For example, there are ways to adjust your business's W-2 wages to maximize your qualified business income deduction. Also, it may be helpful to convert your independent contractors to employees, assuming the benefit of the deduction outweighs the increased payroll tax burden. Other planning strategies include investing in short-lived depreciable assets, restructuring the business, and leasing or selling property between businesses. We will work with you to determine which strategies produce the best outcome.



IRS explains 20% deduction for qualified business income

The IRS has issued regulations on the new 20% deduction for qualified business income (QBI) created by the TCJA, also known as the pass-through deduction. Here's a summary of the basic rules:

For tax years beginning after Dec. 31, 2017, taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income (QBI) from a domestic business operated as a sole proprietorship, or through a partnership, S corporation, trust or estate. This deduction can be taken in addition to the standard or itemized deductions. In general, the deduction is equal to the lesser of:

A. 20% OF QBI PLUS 20% OF QUALIFIED REAL ESTATE INVESTMENT TRUST (REIT) DIVIDENDS AND QUALIFIED PUBLICLY TRADED PARTNERSHIP (PTP) INCOME, OR

B. 20% OF TAXABLE INCOME MINUS NET CAPITAL GAINS.

QBI generally is the net amount of qualified items of income, gain, deduction, and loss, from any qualified trade or business. But QBI doesn't include capital gains and losses, certain dividends and interest income, reasonable compensation paid to the taxpayer by any qualified trade or business for services rendered for that trade or business, and any guaranteed payment to a partner for services to the business. Generally, the deduction for QBI can't be more than the greater of:

A. 50% OF THE W-2 WAGES FROM THE QUALIFIED TRADE OR BUSINESS; OR

B. 25% OF THE W-2 WAGES FROM THE QUALIFIED TRADE OR BUSINESS PLUS 2.5% OF THE UNADJUSTED BASIS OF CERTAIN TANGIBLE, DEPRECIABLE PROPERTY HELD AND USED BY THE BUSINESS DURING THE YEAR FOR PRODUCTION OF QBI.

But this limit on the deduction for QBI doesn't apply to taxpayers with taxable income below a threshold amount ($315,000 for married individuals filing jointly, $157,500 for other individuals, indexed for inflation after 2018), with a phase-in for taxable income over this amount.

A qualified trade or business doesn't include performing services as an employee.

Additionally, a qualified trade or business doesn't include a trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investing and investment management, trading, dealing in certain assets or any trade or business where the principal asset is the reputation or skill of one or more of its employees. This exception only applies if a taxpayer's taxable income exceeds $315,000 for a married couple filing a joint return, or $157,500 for all other taxpayers; the benefit of the deduction is phased out for taxable income over this amount.

The IRS's new regulations explaining the 20% deduction for QBI are highly detailed and complex. A sampling of the important guidance contained in the guidance follows:

Partnership guaranteed payments are not considered attributable to a trade or business and thus do not constitute QBI.

To the extent that any previously disallowed losses or deductions are allowed in the tax year, they are treated as items attributable to the trade or business for that tax year. But this rule doesn't apply for losses or deductions that were disallowed for tax years beginning before Jan. 1, 2018; they are not taken into account for purposes of computing QBI in a later tax year.

Generally, a deduction for a net operating loss (NOL) is not considered attributable to a trade or business and therefore,is not taken into account in computing QBI. However, to the extent the NOL is comprised of amounts attributable to a trade or business that were disallowed under a specialized excess business loss limitation for noncorporate taxpayers, the NOL is considered attributable to that trade or business.

Interest income received on working capital, reserves, and similar accounts is not properly allocable to a trade or business. In contrast, interest income received on accounts or notes receivable for services or goods provided by the trade or business is not income from assets held for investment, but income received on assets acquired in the ordinary course of trade or business.

The 20% deduction for QBI does not reduce net earnings from self-employment or net investment income under the rules for the 3.8% surtax on net investment income.

Where a business (or a major portion of it, or a separate unit of it) is bought or sold during the year, the W-2 wages of the individual or entity for the calendar year of the acquisition or disposition are allocated between each individual or entity based on the period during which the employees of the acquired or disposed-of trade or business were employed by the individual or entity.

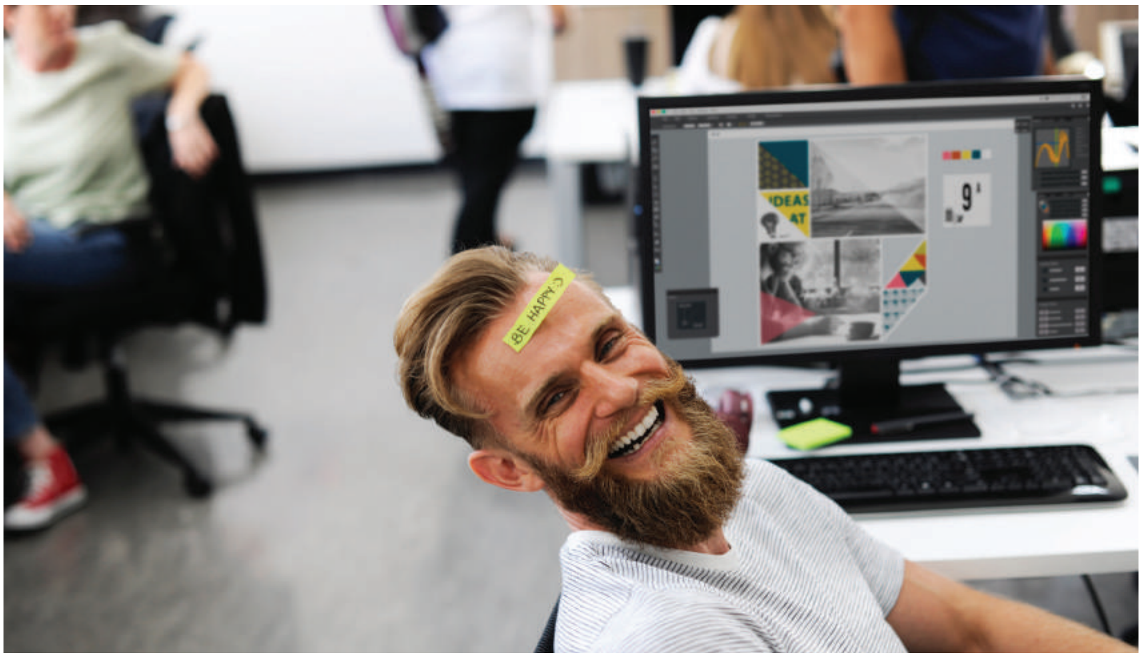
The rule generally barring a health services business from being a qualified trade or business doesn't include the provision of services not directly related to a medical field, even though the services may purportedly relate to the health of the service recipient. For example, the performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers, payment processing, or research, testing, and manufacture and/or sales of pharmaceuticals or medical devices.

The rule generally barring the performance of services in the field of actuarial science from being a qualified trade or business does not include the provision of services by analysts, economists, mathematicians, and statisticians not engaged in analyzing or assessing the financial costs of risk or uncertainty of events.

The rule barring consulting from being a qualified trade or business doesn't apply to consulting that is embedded in, or ancillary to, the sale of goods if there is no separate payment for the consulting services. For example, a company that sells computers may provide customers with consulting services relating to the setup, operation, and repair of the computers, or a contractor who remodels homes may provide consulting prior to remodeling a kitchen.

Year End

Tax Planning Considerations For The Individual



1 Higher-income earners must be wary of the 3.8% surtax on certain unearned income. The surtax is 3.8% of the lesser of:

1. NET INVESTMENT INCOME (NII), OR

2. THE EXCESS OF MODIFIED ADJUSTED GROSS INCOME (MAGI) OVER A THRESHOLD AMOUNT ($250,000 FOR JOINT FILERS OR SURVIVING SPOUSES, $125,000 FOR A MARRIED INDIVIDUAL FILING A SEPARATE RETURN, AND $200,000 IN ANY OTHER CASE).

As year-end nears, a taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on his estimated MAGI and NII for the year. Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than NII, and other individuals will need to consider ways to minimize both NII and other types of MAGI.

2 The 0.9% additional Medicare tax also may require higher-income earners to take year-end actions. It applies to individuals for whom the sum of their wages received with respect to employment and their self-employment income is in excess of an unindexed threshold amount ($250,000 for joint filers, $125,000 for married couples filing separately, and $200,000 in any other case). Employers must withhold the additional Medicare tax from wages in excess of $200,000 regardless of filing status or other income. Self-employed persons must take it into account in figuring estimated tax. There could be situations where an employee may need to have more withheld toward the end of the year to cover the tax. For example, if an individual earns $200,000 from one employer during the first half of the year and a like amount from another employer during the balance of the year, he or she would owe the additional Medicare tax, but there would be no withholding by either employer for the additional Medicare tax since wages from each employer don't exceed $200,000.

3 Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on the taxpayer's taxable income. The 0% rate generally applies to the excess of long-term capital gain over any short term capital loss to the extent that it, when added to regular taxable income, is not more than the "maximum zero rate amount" (e.g., $77,200 for a married couple). If the 0% rate applies to longterm capital gains you took earlier this year—for example, you are a joint filer who made a profit of $5,000 on the sale of stock bought in 2009, and other taxable income for 2018 is $70,000—then before year-end, try not to sell assets yielding a capital loss because the first $5,000 of such losses won't yield a benefit this year. And if you hold long-term appreciated-in-value assets, consider selling enough of them to generate long-term capital gains sheltered by the 0% rate.

4 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 (AGI). These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2018. For example, that may be the case where a person will have a more favorable filing status this year than next (e.g., head of household versus individual filing status), or expects to be in a higher tax bracket next year.

5 If you believe a Roth IRA is better than a traditional IRA, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA if eligible to do so. Keep in mind, however, that such a conversion will increase your AGI for 2018, and possibly reduce tax breaks geared to AGI (or modified AGI).

6 It may be advantageous to try to arrange with your employer to defer, until early 2019, a bonus that may be coming your way. This could cut as well as defer your tax.

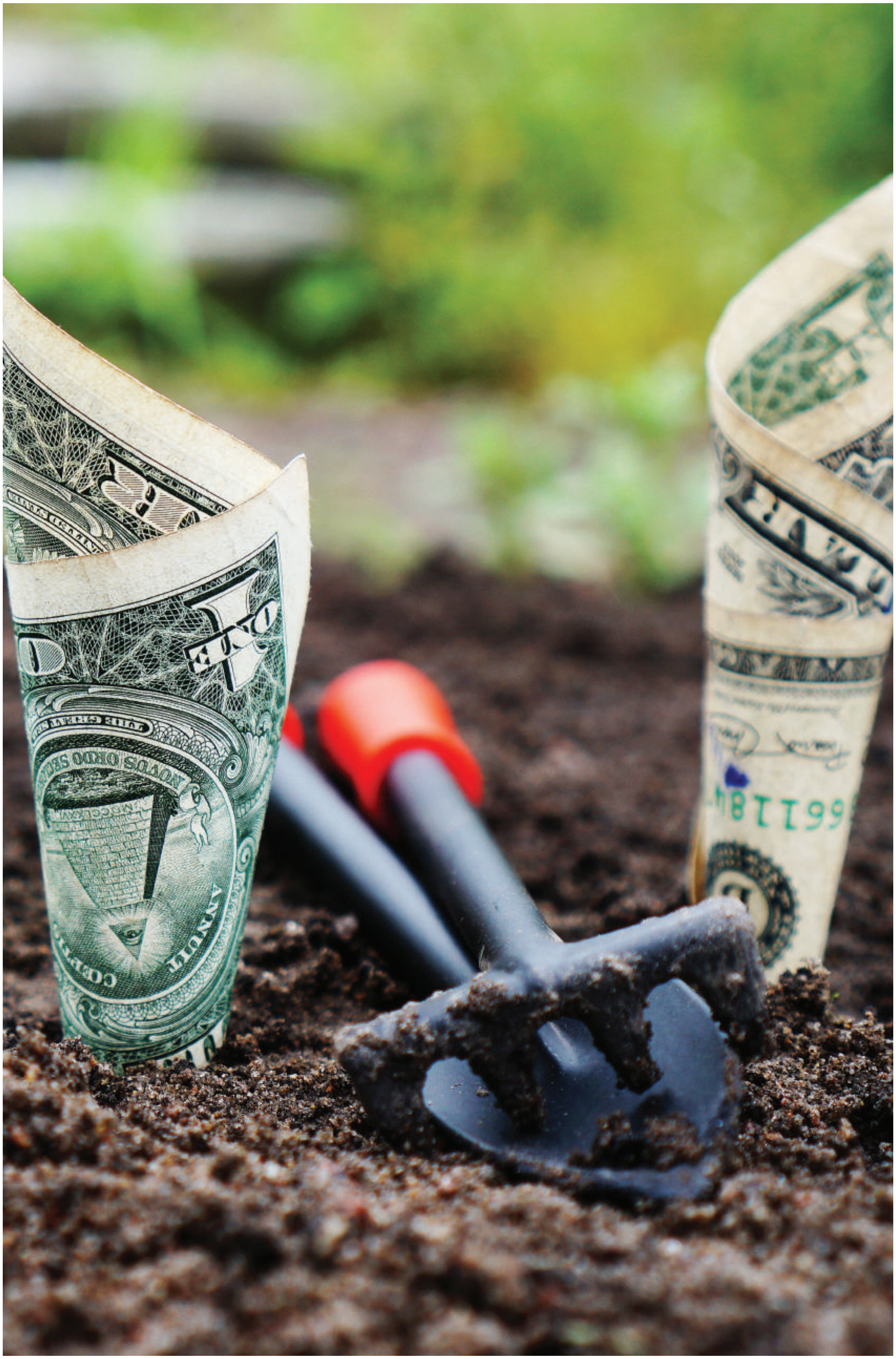
7 Some taxpayers may be able to work around the new reality by applying a "bunching strategy" to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, if a taxpayer knows he or she will be able to itemize deductions this 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.

8 Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retirement plan). RMDs from IRAs must begin by April 1 of the year following the year you reach age 70-½. (That start date also applies to company plans, but non-5% company owners who continue working may defer RMDs until April 1 following the year they retire.) 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 70-½ 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-the amount required for 2018 plus the amount required for 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.

9 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 on Schedule A, Form 1040. But the amount of the qualified charitable distribution reduces the amount of your required minimum distribution, resulting in tax savings.

10 If you were younger than age 70-½ at the end of 2018, you anticipate that in the year that you turn 70-½ and/or in later years you will not itemize your deductions, and you don't have any traditional IRAs, establish and contribute as much as you can to one or more traditional IRAs in 2018. If the immediately previous sentence applies to you, except that you already have one or more traditional IRAs, make maximum contributions to one or more traditional IRAs in 2018. Then, when you reach age 70-½, do the steps in the immediately preceding bullet point. Doing all of this will allow you to, in effect, convert nondeductible charitable contributions that you make in the year you turn 70-½ and later years, into deductible-in-2018 IRA contributions and reductions of gross income from age 70-½ and later year distributions from the IRAs.

11 Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and estate taxes. The exclusion applies to gifts of up to $15,000 made in 2018 to each of an unlimited number of individuals. You can't carry over unused exclusions from one year to the next. Such transfers may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.



It's never too early to make your tax appointment. We can always add a final brokerage statement or K-1 to your return once you receive it. Please call Cozby & Company to schedule your appointment today.

COZBY & COMPANY

CORPORATE OFFICE:

124 Long Pond Road
Suite 12
Plymouth, MA 02360
Office: (508) 830-0007
Fax: (508) 830-0099

AT THE PINEHILLS:

One Village Green
North
Suite 122
Plymouth, MA 02360
Office: (508) 830-0007
Fax: (508) 830-0099

ONLINE

info@cozbycpa.com
www.cozbycpa.com