



2018  
2019

# TAX PLANNING GUIDE

YEAR-ROUND STRATEGIES TO MAKE THE TAX LAWS WORK FOR YOU





# It's a new day for tax planning

On Dec. 22, 2017, the most sweeping tax legislation since the Tax Reform Act of 1986 was signed into law. The Tax Cuts and Jobs Act (TCJA) makes small reductions to income tax rates for most individual tax brackets and substantially reduces the income tax rate for corporations. It also provides a large new tax deduction for owners of pass-through entities and significantly increases exemptions for the individual alternative minimum tax (AMT) and the estate tax.

It's not all good news for taxpayers, however. The TCJA also eliminates or limits many tax breaks, and much of the tax relief provided is only temporary (unless Congress acts to make it permanent). The combined impact of these changes will ultimately determine whether you see reduced taxes. It also will dictate which tax strategies will make sense for you this year, such as the best way to time income and expenses.

This guide provides an overview of the most consequential changes under the TCJA and other key tax provisions you need to be aware of. It offers a variety of strategies for minimizing your taxes in the new tax environment. It will be important to work closely with your tax advisor this year. He or she can help you identify which changes affect you and the best strategies for maximizing the new tax law's benefits and minimizing any negative tax ramifications. Plus, more tax legislation could be signed into law this year, and your tax advisor can keep you apprised of the latest information.

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## The TCJA rocks the foundation of planning for income and deductions

**T**he Tax Cuts and Jobs Act (TCJA) reduces the rates for all individual income tax brackets except 10% and 35%, which remain the same, and adjusts the income ranges each bracket covers. (See Chart 5 on page 16.) But the TCJA also makes a lot of changes to deductions and other breaks for individuals, reducing or eliminating some (such as many itemized deductions) while expanding others (such as the standard deduction). As a result, the income and deduction timing strategies you used to implement may no longer make sense. To time income and deductions to your tax advantage in 2018, you must consider the potential impact of the TCJA on your particular situation.

### State and local tax deduction

**New limits!** For 2018–2025, your entire deduction for state and local taxes — including property tax and either income or sales tax — is limited to \$10,000 (\$5,000 if you're married filing separately).

Deducting sales tax instead of income tax may be beneficial if you reside in a state with no, or low, income tax or you purchased a major item, such as a car or boat.

### Home-related breaks

The TCJA includes a lot of changes affecting tax breaks for home ownership. Consider both deductions and exclusions in your tax planning:

#### **New limits! Property tax deduction.**

As noted above, for 2018–2025 your property tax deduction is subject to the new limit on deductions for state and local taxes.

#### **New limits! Mortgage interest deduction.**

You generally can deduct interest on mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your principal residence also may be deductible. For 2018–2025, the TCJA

reduces the mortgage debt limit from \$1 million to \$750,000 for debt incurred after Dec. 15, 2017, with some limited exceptions.

#### **New limits! Home equity debt interest deduction.**

Before the TCJA, interest was deductible on up to \$100,000 of home equity debt used for any purpose, such as to pay off credit cards (for which interest isn't deductible). The TCJA effectively limits the home equity interest deduction for 2018–2025 to debt that would qualify for the home mortgage interest deduction.

**Rental income exclusion.** If you rent out all or a portion of your principal residence or second home for less

### WHAT'S NEW!

#### Dramatic changes to personal exemptions and the standard deduction

For 2017, taxpayers could claim a personal exemption of \$4,050 each for themselves, their spouses and any dependents. These exemptions could really add up for families with children and/or other dependents, such as elderly parents. For 2018–2025, the TCJA suspends personal exemptions. But increases to the child credit and a new family credit could offset this for some taxpayers. (See "What's new!" on page 4.)

Changes to the standard deduction could also help some taxpayers make up for the loss of personal exemptions. But it might not help a lot of taxpayers who typically itemize deductions. The TCJA nearly doubles the standard deductions for 2018 to \$12,000 for singles and separate filers, \$18,000 for heads of households, and \$24,000 for joint filers. (These amounts will be indexed for inflation through 2025. After that, they're scheduled to drop back to the amounts under pre-TCJA law.)

Taxpayers can choose to either itemize certain deductions or take the standard deduction based on their filing status. Itemizing deductions when the total will be larger than the standard deduction saves tax, but it makes filing more complicated. The combination of a higher standard deduction and the reduction or elimination of many itemized deductions will mean that some taxpayers who once benefited from itemizing will now be better off taking the standard deduction.

## WHAT'S NEW!

### Other individual deductions affected by the TCJA

In addition to the deduction changes impacting many home-related expenses, charitable donations and medical expenses discussed elsewhere in this section, the TCJA limits or eliminates other deductions that are valuable to many individual taxpayers:

**Moving expenses.** This deduction for work-related moving expenses is suspended for 2018–2025, except for active-duty members of the Armed Forces (and their spouses or dependents) who move because of a military order that calls for a permanent change of station.

**Miscellaneous itemized deductions subject to the 2% floor.** This deduction for expenses such as certain professional fees, investment expenses and unreimbursed employee business expenses is suspended for 2018–2025. If you're an employee and work from home, this includes the home office deduction. (If you're self-employed, see page 11.)

**Personal casualty and theft loss deduction.** For 2018–2025, this itemized deduction is suspended except if the loss was due to an event officially declared a disaster by the President.

But it's not all bad news for tax deductions. Under pre-TCJA law, if your adjusted gross income (AGI) exceeded the applicable threshold, certain itemized deductions were reduced by 3% of the AGI amount over the threshold (not to exceed 80% of otherwise allowable deductions). For 2018–2025, the TCJA suspends this reduction.

Consider bunching elective medical procedures (and any other services and purchases whose timing you can control without negatively affecting your or your family's health) into 2018 to take advantage of the 7.5% floor.

### Tax-advantaged saving for health care

You may be able to save taxes without having to worry about the medical expense deduction floor by contributing to one of these accounts:

**HSA.** If you're covered by a qualified high-deductible health plan, you can contribute pretax income to an employer-sponsored Health Savings Account — or make deductible contributions to an HSA you set up yourself — up to \$3,450 for self-only coverage and \$6,900 for family coverage (plus \$1,000 if you're age 55 or older) for 2018. HSAs can bear interest or be invested, growing tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year.

**FSA.** You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit — not to exceed \$2,650 in 2018. The plan pays or reimburses you for qualified medical expenses. What you don't use by the plan year's end, you generally lose — though your plan might allow you to roll over up to \$500 to the next year. Or it might give you a 2½-month grace period to incur expenses to use up the previous year's contribution. If you have an HSA, your FSA is limited to funding certain "permitted" expenses.

### Alternative minimum tax

Before timing income and deductions, consider the AMT — a separate tax system that disallows some tax deductions, such as for state and local taxes, and treats certain income items differently, such as incentive stock option exercises. You must pay the AMT if your AMT liability exceeds your regular tax liability.

**Enhancement!** The TCJA substantially increases the AMT exemptions for 2018–2025. (See Chart 5 on page 16.) Combined with other TCJA changes, the result is that very few taxpayers will be at AMT risk. Your tax advisor can help you determine if you're among the small number of taxpayers who need to plan for the AMT. ❖

than 15 days, you don't have to report the income. But expenses directly associated with the rental, such as advertising and cleaning, won't be deductible.

**Home sale gain exclusion.** When you sell your principal residence, you can exclude up to \$250,000 of gain (\$500,000 for married couples filing jointly) if you meet certain tests.

**Warning:** Gain that's allocable to a period of "nonqualified" use generally isn't excludable.

**Loss deduction.** If you sell your home at a loss and part of your home is rented out or used exclusively for your business, the loss attributable to that portion may be deductible.

### Charitable donations

If you itemize deductions, donations to qualified charities are generally fully deductible. And they may be the easiest deductible expense to time to your tax advantage.

However, because of the increased standard deduction (see "What's new!" on page 2), even if you typically itemized in the past, for 2018 you may be better off taking the standard deduction — in

which case you won't get a federal income tax benefit from charitable gifts. Instead, you might benefit from "bunching" donations into alternating years and itemizing just in those years.

For large donations, discuss with your tax advisor which assets to give and the best ways to give them. For example, appreciated publicly traded stock you've held more than one year can make one of the best charitable gifts because you can deduct the current fair market value and avoid the capital gains tax you'd pay if you sold the property.

### Medical expense deduction

**Enhancement!** Under the TCJA, if 2017 or 2018 medical expenses not paid via tax-advantaged accounts (see below) or reimbursable by insurance exceed 7.5% of your adjusted gross income (AGI), you can deduct the excess amount. The threshold had been 10%, and it's scheduled to return to 10% beginning in 2019. Eligible expenses may include health insurance premiums, long-term-care insurance premiums (limits apply), medical and dental services, and prescription drugs. Mileage driven for health care purposes also can be deducted — at 18 cents per mile for 2018.



## Can family and education breaks save you tax?

**R**aising children and helping them pursue their educational goals — or pursuing your own — can be highly rewarding. But it also can be expensive. So make sure that you and your family are taking advantage of the credits, deductions and other tax-saving opportunities that apply to you. Some have changed for 2018 under the Tax Cuts and Jobs Act (TCJA).

### Dependent care breaks

A couple of tax breaks can help offset the costs of dependent care:

**Tax credit.** For children under age 13 or other qualifying dependents, you may be eligible for a credit for a portion of your dependent care expenses. Generally, the credit equals 20% of the first \$3,000 of qualified expenses for one child or 20% of up to \$6,000 of such expenses for two or more children. So, the maximum credit is usually \$600 for one child or \$1,200 for two or more children.

**FSA.** For 2018, you can contribute up to \$5,000 pretax to an employer-sponsored child and dependent care Flexible Spending Account. The plan pays or reimburses you for these expenses. You can't claim a tax credit for expenses reimbursed through an FSA.

### Roth IRAs for teens

Roth IRAs can be perfect for teenagers because they likely have many years to let their accounts grow tax-free. The 2018 annual contribution limits are the lesser of \$5,500 or 100% of earned income, reduced by any traditional IRA contributions.

Roth IRA contributions aren't deductible, but if the child earns no more than the standard deduction for singles (\$12,000 for 2018, nearly double the 2017 amount)

and has no unearned income, he or she will pay zero federal income tax anyway. And if a child's earned income exceeds the standard deduction, the income likely will be taxed at a low rate. So the tax-free treatment of future qualified distributions will probably be well worth the loss of any current deduction.

### "Kiddie tax"

The "kiddie tax" generally applies to most unearned income of children under age 19 and of full-time students under age 24 (unless the students provide more than half of their own support from earned income). Before 2018, unearned income subject to the kiddie tax was generally taxed at the parents' tax rate.

**New!** The TCJA makes the kiddie tax harsher. For 2018–2025, a child's unearned income beyond \$2,100

#### WHAT'S NEW!

### The TCJA takes away exemptions but expands credits for dependents

Along with the personal exemption, the TCJA eliminates the dependent exemption (\$4,050 per dependent for 2017) for 2018–2025. But it expands tax credits for families during that period, increasing the child credit and adding a new "family" credit for dependents who don't qualify for the child credit.

Tax credits reduce your tax bill dollar for dollar, so they're particularly valuable. Under the TCJA:

- For each child under age 17 at the end of 2018, you may be able to claim a \$2,000 credit (up from \$1,000 for 2017). The credit still phases out for higher-income taxpayers (see Chart 1 on page 5), but the income ranges are much higher than before the TCJA, so more taxpayers will benefit.
- For each qualifying dependent other than a qualifying child (such as a dependent child age 17 or older or a dependent elderly parent), a \$500 family credit is now available. But it's also subject to the income-based phaseout.

Another piece of good news for some parents is that the adoption credit and employer adoption assistance program income exclusions, which had been proposed for elimination under previous versions of the TCJA, ultimately survived. Both are \$13,810 for 2018, but the credit is subject to an income-based phaseout. (See Chart 1 on page 5.)



(for 2018) will be taxed according to the tax brackets used for trusts and estates, which for 2018 are taxed at the highest marginal rate of 37% once taxable income exceeds \$12,500. (See Chart 7 on page 16.) In contrast, for a married couple filing jointly, the 37% rate doesn't kick in until their 2018 taxable income tops \$600,000. In other words, in many cases, children's unearned income will be taxed at *higher* rates than their parents' income.

## 529 plans

If you're saving for education expenses, consider a Section 529 plan, which the TCJA has enhanced. You can choose a prepaid tuition plan to secure current tuition rates or a tax-advantaged savings plan to fund education expenses:

- Although contributions aren't deductible for federal purposes, any growth is tax-deferred. (Some states do offer breaks for contributing.)
- Distributions used to pay qualified postsecondary school expenses (such as tuition, mandatory fees, books, supplies, computer equipment, software, Internet service and, generally, room and board) are income-tax-free for federal purposes and typically for state purposes as well, thus making the tax deferral a permanent savings.
- **New!** The TCJA has permanently expanded qualified expenses to include elementary and secondary school tuition. Tax-free distributions for such expenses, however, are limited to \$10,000 per year per student.
- The plans usually offer high contribution limits, and there are no income limits for contributing.
- There's generally no beneficiary age limit for contributions or distributions.
- You can control the account, even after the child is of legal age.
- You can make tax-free rollovers to another qualifying family member.
- A special break for 529 plans allows you to front-load five years' worth of annual gift tax exclusions and make up to a \$75,000 contribution (or \$150,000 if you split the gift with your spouse) in 2018.

The biggest downsides may be that your investment options — and when you can change them — are limited.

CHART 1

## Are you eligible for these 2018 tax breaks?

Tax break	Modified adjusted gross income phaseout range <sup>1</sup>	
	Single filer	Joint filer
Child credit <sup>2</sup>	\$200,000 – \$240,000	\$400,000 – \$440,000
Adoption credit	\$207,140 – \$247,140	\$207,140 – \$247,140
ESA contribution	\$ 95,000 – \$110,000	\$190,000 – \$220,000
American Opportunity credit	\$ 80,000 – \$ 90,000	\$160,000 – \$180,000
Lifetime Learning credit	\$ 57,000 – \$ 67,000	\$114,000 – \$134,000
Student loan interest deduction	\$ 65,000 – \$ 80,000	\$135,000 – \$165,000

<sup>1</sup> Taxpayers whose MAGIs are within the applicable phaseout range are eligible for a partial break — breaks generally are eliminated for those whose MAGIs exceed the top of the range.

<sup>2</sup> Assumes one child. The phaseout end is higher for families with more than one eligible child.

## ESAs

Coverdell Education Savings Accounts are similar to 529 savings plans in that contributions aren't deductible for federal purposes, but plan assets can grow tax-deferred and distributions used to pay qualified education expenses are income-tax-free. ESAs may be worth considering if you'd like to have direct control over how and where your contributions are invested or you want to pay elementary or secondary school expenses in excess of \$10,000 or beyond tuition.

But the \$2,000 contribution limit is low, and it's phased out based on income. (See Chart 1.) Also, contributions can generally be made only for beneficiaries under age 18. Amounts left in an ESA when the beneficiary turns age 30 generally must be distributed within 30 days, and any earnings may be subject to tax and a 10% penalty.

## Education credits and deductions

If you have children in college now, are currently in school yourself or are paying off student loans, you may be eligible for a credit or deduction:

**American Opportunity credit.** The tax break covers 100% of the first \$2,000 of tuition and related expenses and 25% of the next \$2,000 of expenses. The maximum credit, *per student*, is \$2,500 per year for the first four years of postsecondary education.

**Lifetime Learning credit.** If you're paying postsecondary education expenses beyond the first four years, you may benefit from the Lifetime Learning credit (up to \$2,000 *per tax return*).

**Student loan interest deduction.** If you're paying off student loans, you may be able to deduct the interest. The limit is \$2,500 *per tax return*.

**Warning:** Income-based phaseouts apply to these breaks. (See Chart 1.) If your income is too high for you to qualify, your child might be eligible.

## ABLE accounts

Achieving a Better Life Experience accounts offer a tax-advantaged way to fund qualified disability expenses for a beneficiary who became blind or disabled before age 26. For federal purposes, tax treatment is similar to that of Section 529 college savings plans.

**New!** Under the TCJA, for 2018–2025, 529 plan funds can be rolled over to an ABLE account without penalty if the ABLE account is owned by the beneficiary of the 529 plan or a member of the beneficiary's family. Such rolled-over amounts count toward the overall ABLE account annual contribution limit. Aggregate contributions are generally limited to \$15,000 for 2018. ❖



## Tax planning for investments involves many considerations

**Y**ou need to understand the potential tax consequences of buying, holding and selling any investment. And while the Tax Cuts and Jobs Act (TCJA) didn't change the long-term capital gains rates, its changes to ordinary-income tax rates and tax brackets will have an impact on the tax you pay on investments. But don't let tax considerations control your investment decisions. Also consider your investment goals, time horizon, risk tolerance, factors related to the investment itself, and fees and charges that apply to buying and selling securities.

### Capital gains tax and timing

Although time, not timing, is generally the key to long-term investment success, timing can have a dramatic impact on the tax consequences of investment activities. Your long-term capital gains rate can be as much as 20 percentage points lower than your ordinary-income tax rate, even with the reductions to most ordinary-income rates under the TCJA. The long-term gains rate applies

to investments held for more than 12 months and remains at 15% for middle-bracket taxpayers. A 20% long-term capital gains rate still applies to higher-income taxpayers.

**New!** Because of TCJA-related changes to the brackets, beginning in 2018 the 20% rate kicks in before the top ordinary-income rate does. (See Chart 2 and Chart 5 on page 16.)

Higher rates also still apply to certain types of assets. (See Chart 2.) But taxpayers in the bottom two brackets generally continue to enjoy a 0% long-term capital gains rate. (See Case Study I on page 7.)

Holding on to an investment until you've owned it more than a year may help substantially cut tax on any gain. Here are some other tax-saving strategies related to timing:

### Use unrealized losses to absorb gains.

To determine capital gains tax liability, realized capital gains are netted against realized capital losses. Both long- and short-term gains and losses can offset one another. If you've cashed in some big gains during the year and want to reduce your 2018 tax liability, look for unrealized losses in your portfolio before year end and consider selling them to offset your gains.

**Avoid wash sales.** If you want to achieve a tax loss with minimal change in your portfolio's asset allocation, consider the wash sale rule. It prevents you from taking a loss on a security if you buy a substantially identical security (or an option to buy such a security) within 30 days before or after you sell the security that created the loss. You can recognize the loss only when you sell the replacement security.

Fortunately, there are ways to avoid triggering the wash sale rule and still achieve your goals. For example, you can immediately buy securities of a different company in the same industry or shares in a mutual fund

CHART 2

### What's the 2018 capital gains tax rate?

Type of gain	Rate <sup>1</sup>
Short-term (assets held 12 months or less)	Taxpayer's ordinary-income tax rate
Long-term (assets held more than 12 months)	15%
<b>Some key exceptions</b>	
Long-term gain of certain higher-income taxpayers	20% <sup>2</sup>
Most long-term gain that would be taxed at 10% or 12% based on the taxpayer's ordinary-income rate	0%
Long-term gain on collectibles, such as artwork and antiques	28%
Long-term gain attributable to certain recapture of prior depreciation on real property	25%

<sup>1</sup> In addition, the 3.8% NIIT applies to net investment income to the extent that modified adjusted gross income (MAGI) exceeds \$200,000 (singles and heads of households), \$250,000 (married filing jointly) or \$125,000 (married filing separately).

<sup>2</sup> The 20% rate applies to taxpayers with taxable income exceeding \$425,800 (singles), \$452,400 (heads of households), \$479,000 (joint filers) or \$239,500 (separate filers).

that holds securities much like the ones you sold. Or, you can wait 31 days to repurchase the same security. Alternatively, before selling the security, you can purchase additional shares equal to the number you want to sell at a loss, and then wait 31 days to sell the original portion.

**Swap your bonds.** With a bond swap, you sell a bond, take a loss and then immediately buy another bond of similar quality and duration from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical. Thus, you achieve a tax loss with virtually no change in economic position.

**Mind your mutual funds.** Mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you more tax dollars because of the lower long-term rates.

Also pay attention to earnings reinvestments. Unless you or your investment advisor increases your basis accordingly, you may report more gain than required when you sell the fund. Brokerage firms are required to track (and report to the IRS) your cost basis in mutual funds acquired during the tax year.

Finally, beware of buying equity mutual fund shares late in the year. Such funds often declare a large capital gains distribution at year end. If you own the shares on the distribution's record date, you'll be taxed on the full distribution amount even if it includes significant gains realized by the fund before you owned the shares.

### Loss carryovers

If net losses exceed net gains, you can deduct only \$3,000 (\$1,500 for married taxpayers filing separately) of the net losses per year against other income (such as wages, self-employment and business income, dividends and interest).

You can carry forward excess losses until death. Loss carryovers can be a powerful tax-saving tool in future years if you have a large investment portfolio, real estate holdings or a closely held business that might generate substantial future capital gains.

### Case Study I

## How to qualify for the 0% capital gains rate

Faced with a long-term capital gains tax rate of 23.8% (20% for the top tax bracket, plus the 3.8% NIIT), Miguel and Pilar decide to give some appreciated stock to their adult daughter Gabby. Just out of college and making only enough from her entry-level job to leave her with \$25,000 in taxable income, Gabby falls into the 12% ordinary-income tax bracket and the 0% long-term capital gains bracket.

However, the 0% rate applies only to the extent that capital gains "fill up" the gap between Gabby's taxable income and the top end of the 0% bracket. For 2018, the 0% bracket for singles tops out at \$38,600 (just \$100 less than the top of the 12% ordinary-income bracket). So if Gabby sells the stock her parents transferred to her and her gains are \$13,600, the entire amount will qualify for the 0% rate. The sale will be tax-free vs. the \$3,237 Miguel and Pilar would have owed had they sold the stock themselves.

### Income investments

Some types of investments produce income in the form of dividends or interest. Here are some tax consequences to consider:

#### Dividend-producing investments.

Qualified dividends are taxed at the favorable long-term capital gains tax rate rather than at your higher ordinary-income tax rate.

#### Interest-producing investments.

Interest income generally is taxed at ordinary-income rates. So stocks that pay qualified dividends may be more attractive tax-wise than other income investments, such as CDs and taxable bonds. But also consider nontax issues, such as investment risk, rate of return and diversification.

**Bonds.** These also produce interest income, but the tax treatment varies:

- Interest on U.S. government bonds is taxable on federal returns but exempt by law on state and local returns.
- Interest on state and local government bonds is excludable on federal returns. If the bonds were issued in your home state, interest also may be excludable on your state return.
- Tax-exempt interest from certain private-activity municipal bonds can trigger or increase the AMT (see page 3) in some situations.

- Corporate bond interest is fully taxable for federal and state purposes.
- Bonds (except U.S. savings bonds) with original issue discount build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay this interest annually — and you must pay tax on it.

### 3.8% NIIT

Taxpayers with modified adjusted gross income (MAGI) over \$200,000 per year (\$250,000 if married filing jointly and \$125,000 if married filing separately) may owe the net investment income tax, in addition to other taxes already discussed here. The NIIT equals 3.8% of the lesser of your net investment income or the amount by which your MAGI exceeds the applicable threshold. Net investment income can include capital gains, dividends, interest and other investment-related income (but not business income or self-rental income from an active trade or business).

Many of the strategies that can help you save or defer income tax on your investments can also help you avoid or defer NIIT liability. And because the threshold for the NIIT is based on MAGI, strategies that reduce your MAGI could also help you avoid or reduce NIIT liability. ❖





## Businesses carry a lighter tax load in 2018

The Tax Cuts and Jobs Act (TCJA) will help reduce the 2018 tax burdens of many businesses and their owners. For C corporations, it replaces graduated rates ranging from 15% to 35% with a flat rate of 21%. For sole proprietors and owners of pass-through entities, it provides a new deduction. And for all entity types, it enhances many depreciation-related breaks. But the TCJA also reduces or eliminates some tax breaks for businesses. It's critical to work with your tax advisor to determine exactly how your business will be affected so you can plan accordingly.

### Depreciation

For assets with a useful life of more than one year, you generally must depreciate the cost over a period of years. In most cases, the Modified Accelerated Cost Recovery System (MACRS) will be preferable to other methods because you'll get larger deductions in the early years of an asset's life.

But if you make more than 40% of the year's asset purchases in the last quarter, you could be subject to the typically less favorable midquarter convention. Careful planning can help you maximize depreciation deductions in the year of purchase.

Other depreciation-related breaks and strategies may be available and, in many cases, have been enhanced by the TCJA:

**Enhancement! Section 179 expensing election.** This allows you to deduct (rather than depreciate over a number of years) the cost of purchasing eligible new or used assets, such as equipment, furniture, off-the-shelf computer software, and qualified improvement property — a definition expanded by the TCJA from leasehold-improvement, restaurant and retail-improvement property. The TCJA also allows Sec. 179 expensing for certain depreciable tangible personal property used predominantly to furnish lodging and for the following improvements

to nonresidential real property: roofs, HVAC equipment, fire protection and alarm systems, and security systems.

Under the TCJA, for qualifying property placed in service in tax years starting in 2018, the expensing limit increases to \$1 million (from \$510,000 for 2017). The break begins to phase out dollar for dollar when asset acquisitions for the year exceed \$2.5 million (compared to \$2.03 million for 2017). These amounts will be annually indexed for inflation going forward.

#### WHAT'S NEW!

### New law ushers in hefty tax cuts for corporations



The TCJA will substantially impact C corporations, mostly to their benefit:

**New 21% corporate tax rate.** Under pre-TCJA law, C corporations paid federal income tax at graduated rates of 15% on taxable income of \$0 to \$50,000; 25% on taxable income of

\$50,001 to \$75,000; 34% on taxable income of \$75,001 to \$10 million; and 35% on taxable income over \$10 million. Personal service corporations (PSCs) paid a flat 35% rate. For tax years starting in 2018 or later, the TCJA sets a flat 21% corporate rate, and that rate also applies to PSCs.

**Corporate AMT repealed.** Prior to the TCJA, the corporate alternative minimum tax was imposed at a 20% rate. However, corporations with average annual gross receipts of less than \$7.5 million for the preceding three tax years were exempt. For tax years starting in 2018 or later, the new law repeals the corporate AMT. For corporations that paid the corporate AMT in earlier years, an AMT credit was allowed under prior law. The new law allows corporations to fully use their AMT credit carryovers in their 2018–2021 tax years.

But it's not all good news for C corporations: Under pre-TCJA law, C corporations that received dividends from other corporations were entitled to partially deduct those dividends. If the corporation owned at least 20% of the stock of another corporation, an 80% deduction applied. Otherwise, the deduction was 70% of dividends received. For tax years starting in 2018 or later, the TCJA reduces the 80% deduction to 65% and the 70% deduction to 50%.

### **Enhancement!** Bonus depreciation.

This additional first-year depreciation is available for qualified assets, which include new tangible property with a recovery period of 20 years or less (such as office furniture and equipment), off-the-shelf computer software, and water utility property. But due to a drafting error in the TCJA, qualified improvement property will be eligible for bonus depreciation only if a technical correction is issued, which is expected. (Check with your tax advisor for the latest information.)

Under the TCJA, for assets placed in service after Sept. 27, 2017, through Dec. 31, 2026, the definition has been expanded to include *used* property and qualified film, television and live theatrical productions. For qualified assets placed in service after Sept. 27, 2017, but before Jan. 1, 2023, bonus depreciation is 100% (up from 50%). For 2023 through 2026, bonus depreciation is scheduled to be gradually reduced. For certain property with longer production periods, these reductions are delayed by one year.

**Warning:** Under the TCJA, in some cases a business may not be eligible for bonus depreciation starting in 2018. Examples include real estate businesses that elect to deduct 100% of their business interest and dealerships with floor-plan financing, if they have average annual gross receipts of more than \$25 million for the three previous tax years.

### **Vehicle-related deductions**


Business-related vehicle expenses can be deducted using the mileage-rate method (54.5 cents per mile driven in 2018) or the actual-cost method (total out-of-pocket expenses for fuel, insurance, repairs and other vehicle expenses, plus depreciation).

Purchases of *new* or *used* vehicles may be eligible for Sec. 179 expensing. However, many rules and limits apply. For example, the normal Sec. 179 expensing limit generally applies to vehicles with a gross vehicle weight rating of more than 14,000 pounds. A \$25,000 limit applies to vehicles (typically SUVs) rated at more than 6,000 pounds, but no more than 14,000 pounds.

Vehicles rated at 6,000 pounds or less are subject to the passenger vehicle limits. For passenger vehicles placed in service in 2018, the first-year depreciation limit is \$18,000 (\$10,000 plus \$8,000

WHAT'S NEW!

### New deduction launched for pass-through businesses



For tax years starting in 2018–2025, the TCJA creates a new deduction for owners of pass-through business entities, such as sole proprietorships, partnerships, S corporations and limited liability companies (LLCs) that are treated as sole proprietorships, partnerships or S corporations for tax purposes. The deduction generally equals 20% of qualified business income (QBI), subject to limitations that can begin to apply if taxable income exceeds the applicable threshold — \$157,500 or, if married filing jointly, \$315,000. The limits fully apply when taxable income exceeds \$207,500 and \$415,000, respectively.

QBI is generally defined as the net amount of qualified items of income, gain, deduction and loss that are effectively connected with the conduct of a U.S. business. QBI doesn't include certain investment items, reasonable compensation paid to an owner for services rendered to the business, or any guaranteed payments to a partner or LLC member treated as a partner for services rendered to the partnership or LLC.

The QBI deduction isn't allowed in calculating the owner's adjusted gross income, but it reduces taxable income. In effect, it's treated the same as an allowable itemized deduction.

When the income-based limit applies to owners of pass-through entities, the QBI deduction generally can't exceed the greater of the owner's share of:

- 50% of the amount of W-2 wages paid to employees by the qualified business during the tax year, or
- The sum of 25% of W-2 wages plus 2.5% of the cost of qualified property.

Qualified property is the depreciable tangible property (including real estate) owned by a qualified business as of year end and used by the business at any point during the tax year to produce qualified business income. Additional rules apply.

Another limitation for taxpayers subject to the income-based limit is that the QBI deduction generally isn't available for income from specified service businesses. Examples include businesses that involve investment-type services and most professional practices (other than engineering and architecture).

The W-2 wage limitation and the service business limitation don't apply if your taxable income is under the applicable threshold. In that case, you should qualify for the full 20% QBI deduction.

bonus depreciation). **Warning:** If bonus depreciation is elected, no additional depreciation can be taken until Year 7.

Also keep in mind that, if a vehicle is used for business and personal purposes, the associated expenses, including depreciation, must be allocated between deductible business use and nondeductible personal use. The depreciation limit is reduced if the business use is less than 100%. If business use is 50% or less, you can't use Sec. 179 expensing or the accelerated regular MACRS; you must use the straight-line method.

### **Employee benefits**

Offering a variety of benefits not only can help you attract and retain the best employees, but also may save tax:

**Qualified deferred compensation plans.** These include pension, profit-sharing, SEP and 401(k) plans, as well as SIMPLEs. You take a tax deduction for your contributions to employees' accounts. (For information on the benefits to employees, see page 12.) Certain small employers may also be eligible for a credit when setting up a plan. (See page 11.)

WHAT'S NEW!

## Big changes to meals and entertainment deductions



For amounts paid or incurred after Dec. 31, 2017, business-related entertainment expenses are no longer deductible. Meal expenses incurred while traveling on business are still 50% deductible. However, the 50% disallowance rule now also applies to meals provided via an on-premises cafeteria or otherwise on the employer's premises for the convenience of the employer.

**HSAs and FSAs.** If you provide employees with a qualified high-deductible health plan (HDHP), you can also offer them Health Savings Accounts. Regardless of the type of health insurance you provide, you can offer Flexible Spending Accounts for health care. If you have employees who incur day care expenses, consider offering FSAs for child and dependent care. (See page 4.)

**HRAs.** A Health Reimbursement Account reimburses an employee for medical expenses up to a maximum dollar amount. Unlike an HSA, no HDHP is required. Unlike an FSA, any unused portion can be carried forward to the next year. But only the employer can contribute to an HRA.

**Fringe benefits.** Certain fringe benefits aren't included in employee income, yet the employer can still deduct the portion, if any, that it pays and typically also avoid payroll taxes. Examples are employee discounts, group term-life insurance (up to \$50,000 per person) and health insurance.

You might even be penalized for not offering health insurance. The play-or-pay provision of the Affordable Care Act (ACA) can in some cases impose a penalty on "large" employers if they don't offer full-time employees "minimum essential coverage" or if the coverage offered is "unaffordable" or doesn't provide "minimum value."

**Deductions eliminated! Commuting costs and transportation fringe benefits.** Employer deductions for the cost of

providing commuting transportation to an employee (such as hiring a car service) are no longer allowed, unless the transportation is necessary for the employee's safety. Also eliminated are employer deductions for the cost of providing qualified employee transportation fringe benefits (for example, parking allowances, mass transit passes and van pooling). However, those benefits are still tax-free to recipient employees.

### Tax credits

Tax credits reduce tax liability dollar for dollar, making them particularly beneficial:

**Research credit.** The research credit (often called the "research and development" credit) gives businesses an incentive to step up their investments in research. Certain start-ups (in general, those with less than \$5 million

in gross receipts) can use the credit against their payroll tax. While the credit is complicated to compute, the tax savings can prove significant.

**Work Opportunity credit.** This credit is designed to encourage hiring from certain disadvantaged groups, such as certain veterans, ex-felons, individuals who've been unemployed for 27 weeks or more and food stamp recipients. Despite its proposed elimination, the credit survived and is available for 2018.

The size of the credit depends on the hired person's target group, the wages paid to that person and the number of hours he or she worked during the first year of employment. The maximum credit is generally \$2,400 per new employee but can be higher for members of certain target groups — up to \$9,600 for certain veterans.

**Warning:** Certification from the appropriate State Workforce Agency generally must be requested within 28 days after the employee begins work.

**New Markets credit.** This gives investors who make "qualified equity investments" in certain low-income communities a 39% credit over a seven-year period. The credit is scheduled to expire on Dec. 31, 2019.

**Retirement plan credit.** Small employers (generally those with 100 or fewer employees) that create a retirement plan may be eligible for a \$500 credit per year for three years. The credit is limited to 50% of qualified start-up costs.

WHAT'S NEW!

## The TCJA limits interest expense deduction



Subject to some restrictions and exceptions, under pre-TCJA law interest paid or accrued by a business generally was fully deductible. Under the TCJA, for tax years that begin in 2018 or later, businesses generally can't deduct interest expenses in excess of 30% of "adjusted taxable income."

Taxpayers (other than tax shelters) with average annual gross receipts of \$25 million or less for the three previous tax years are exempt from the interest deduction limitation. Some other taxpayers are also exempt. For example, real property businesses can elect to continue to fully deduct their interest, but then would be required to use the alternative depreciation system for real property used in the business.



### Small-business health care credit.

The maximum credit is 50% of group health coverage premiums paid by the employer, provided it contributes at least 50% of the total premium or of a benchmark premium. For 2018, the full credit is potentially available for employers with 10 or fewer full-time equivalent employees (FTEs) and average annual wages of less than \$26,600 per employee. Partial credits may be available on a sliding scale to businesses with fewer than 25 FTEs and average annual wages of less than \$53,200.

**New! Family medical leave credit.** For 2018 and 2019, the TCJA creates a tax credit for qualifying employers that begin providing paid family and medical leave to their employees. The credit is equal to a minimum of 12.5% of the employee's wages paid during that leave (up to 12 weeks per year) and can be as much as 25% of wages paid. Ordinary paid leave that employees are already entitled to doesn't qualify. Additional rules and limits apply.

### Sale or acquisition

Whether you're selling your business or acquiring another company, the tax consequences can have a major impact on the transaction's success or failure.

Consider installment sales, for example. A taxable sale might be structured as an installment sale if the buyer lacks sufficient cash or pays a contingent amount based on the business's performance. An installment sale also may make sense if the seller wishes to spread the gain over a number of years. This could be especially beneficial if it would allow the seller to stay under the thresholds for triggering the 3.8% NIIT or the 20% long-term capital gains rate. But an installment sale can backfire on the seller. For example:

- Depreciation recapture must be reported as gain in the year of sale, no matter how much cash the seller receives.
- If tax rates increase, the overall tax could wind up being more.

With a corporation, a key consideration is whether the deal should be structured as an asset sale or a stock sale. If a stock sale is chosen, another important question is whether it should be a tax-deferred transfer or a taxable sale.

### WHAT'S NEW!

## The TCJA reduces and eliminates some business tax breaks



Here are some changes in the TCJA that businesses won't welcome:

**Section 199 deduction.** Commonly referred to as the "domestic production activities deduction" or "manufacturers' deduction," this break is eliminated for tax years beginning after Dec. 31, 2017.

**Business net operating losses (NOLs).** For NOLs that arise in tax years *starting* after Dec. 31, 2017, the maximum amount of taxable

income that can be offset with NOL deductions is generally reduced from 100% to 80%. In addition, NOLs incurred in tax years *ending* after Dec. 31, 2017, generally can't be carried back to an earlier tax year but can be carried forward indefinitely (as opposed to the 20-year limit under pre-TCJA law). (The differences between the effective dates for these changes may have been a mistake, and a technical correction might be made by Congress. Check with your tax advisor for the latest information.)

**"Excess" business losses.** For tax years beginning in 2018–2025, a new limit applies to deductions for current-year business losses incurred by noncorporate taxpayers: Such losses generally can't offset more than \$250,000 of income from other sources, such as salary, self-employment income, interest, dividends and capital gains. The limit is \$500,000 for a married couple filing jointly. Disallowed losses are carried forward to later tax years and can then be deducted under the NOL rules.

**Sec. 1031 "like-kind" exchanges.** Starting in 2018, generally there are no more tax-deferred like-kind exchanges for personal property assets; only real estate qualifies.

**Compensation deductions.** Deductions for amounts paid to principal executive officers generally can't exceed \$1 million per year, subject to a transition rule for amounts paid under binding contracts in effect as of Nov. 2, 2017.

On a positive note, the eligibility rules to use the more-flexible cash method of accounting are liberalized to make them available to many more medium-size businesses. Also, eligible businesses are excused from the chore of doing inventory accounting for tax purposes.

### The self-employed

If you're self-employed, you can deduct 100% of health insurance costs for yourself, your spouse and your dependents. This above-the-line deduction is limited to your net self-employment income. You also can take an above-the-line deduction for contributions to a retirement plan (see page 12) and, if you're eligible, an HSA (see page 3) for yourself.

You pay both the employee and employer portions of employment

taxes on your self-employment income. The employer portion (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible above the line.

And if your home office is your principal place of business (or used substantially and regularly to conduct business) and that's the only use of the space, you may be able to deduct home office expenses from your self-employment income. ❖



## Step by step, make solid retirement plans

Planning for your retirement means making a series of financial decisions that will impact your golden years: What type of plans should you invest in? When should you start taking withdrawals? In what amounts? Whether you're just starting to think about retirement planning, are retired already or are somewhere in between, addressing the questions relevant to your current situation will help ensure your golden years are truly golden.

### 401(k)s and other employer plans

Contributing to a traditional employer-sponsored defined contribution plan is usually a good first step:

- Contributions are typically pretax, reducing your taxable income.
- Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions.
- Your employer may match some or all of your contributions.

Chart 3 shows the 2018 employee contribution limits. Because of tax-deferred compounding, increasing your contributions sooner rather than later can have a significant impact on the size of your nest egg at retirement. Employees age 50 or older can also make “catch-up” contributions, however. So if you didn't contribute

much when you were younger, this may allow you to partially make up for lost time.

If your employer offers a match, at *minimum* contribute the amount necessary to get the maximum match so you don't miss out on that “free” money.

### More tax-deferred options

In certain situations, other tax-deferred saving options may be available:

**You're a business owner or self-employed.** You may be able to set up a plan that allows you to make much larger contributions than you could make to an employer-sponsored plan as an employee. You might not have to make 2018 contributions, or even set up the plan, before year end. SEP plans, for example, generally may be set up as late as the due date (including

extensions) of your business's income tax return for that year.

**Your employer doesn't offer a retirement plan.** Consider a traditional IRA. You can likely deduct your contributions, though your deduction may be limited if your spouse participates in an employer-sponsored plan. You can make 2018 contributions until the April 2019 income-tax-return-filing deadline for individuals. Your annual contribution limit (see Chart 3) is reduced by any Roth IRA contributions you make for the year.

### Roth alternatives

A potential downside of tax-deferred saving is that you'll have to pay taxes when you make withdrawals at retirement. Roth plans, however, allow tax-free distributions; the tradeoff is that contributions to these plans don't reduce your current-year taxable income:

**Roth IRAs.** An income-based phaseout may reduce or eliminate your ability to contribute. But estate planning advantages are an added benefit: Unlike other retirement plans, Roth IRAs don't require you to take distributions during your lifetime, so you can let the entire balance grow tax-free over your lifetime for the benefit of your heirs.

**Roth conversions.** If you have a traditional IRA, consider whether you might benefit from converting some or all of it to a Roth IRA. A conversion can allow you to turn *tax-deferred* future growth into *tax-free* growth and take advantage of a Roth IRA's estate planning benefits. There's no income-based limit on who can convert to a Roth IRA. But the converted amount is taxable in the year of the conversion.

CHART 3

### Retirement plan contribution limits for 2018

	Regular contribution	Catch-up contribution <sup>1</sup>
Traditional and Roth IRAs	\$ 5,500	\$ 1,000
401(k)s, 403(b)s, 457s and SARSEPs <sup>2</sup>	\$ 18,500	\$ 6,000
SIMPLEs	\$ 12,500	\$ 3,000

<sup>1</sup> For taxpayers age 50 or older by the end of the tax year.

<sup>2</sup> Includes Roth versions where applicable.

**Note:** Other factors may further limit your maximum contribution.



Whether a conversion makes sense depends on factors such as:

- Your age,
- Whether the conversion would push you into a higher income tax bracket or trigger the 3.8% NIIT (see page 7),
- Whether you can afford to pay the tax on the conversion,
- Your tax bracket now and expected tax bracket in retirement, and
- Whether you'll need the IRA funds in retirement.

**New!** Unlike in prior years, you no longer can change your mind and recharacterize a Roth conversion back to a traditional IRA.

**“Back door” Roth IRAs.** If the income-based phaseout prevents you from making Roth IRA contributions and you *don't* have a traditional IRA, consider setting up a traditional account and making a nondeductible contribution to it. You can then immediately convert the traditional account to a Roth account with minimal tax impact.

**Roth 401(k), Roth 403(b), and Roth 457 plans.** Employers may offer one of these in addition to the traditional, tax-deferred version. You may make some or all of your contributions to the Roth plan, but any employer match will be made to the traditional plan. No income-based phaseout applies, so even high-income taxpayers can contribute.

### Early withdrawals

Early withdrawals from retirement plans should be a last resort. With a few exceptions, distributions before age 59½ are subject to a 10% penalty on top of any income tax that ordinarily would be due on a withdrawal. Additionally, you'll lose the potential tax-deferred future growth on the withdrawn amount.

If you must make an early withdrawal and you have a Roth account, consider withdrawing from that. You can withdraw up to your contribution amount without incurring taxes or penalties. Another option: If your employer-sponsored plan allows it, take a plan loan. You'll have to pay it back with interest and make regular principal payments, but you won't be subject to current taxes or penalties.

### Case Study II

## Avoiding retirement plan pitfalls when leaving a job



Lauren and Megan both change jobs in 2018 and decide to roll over funds from their traditional 401(k) plans with their former employers to traditional IRAs so that they'll have more investment choices. Each has a balance of \$100,000. Lauren requests a direct rollover from her old plan to her IRA. Because she never personally receives the funds, she owes no income tax or penalties.

Megan, however, doesn't request a direct rollover. Instead, she receives a lump-sum check. Much to her surprise, the check is for only \$80,000, because her employer withheld 20% for federal income taxes. After consulting with her tax advisor, she learns that she needs to make an indirect rollover to her IRA within 60 days to avoid tax and

potential penalties. (She may be able to receive a refund of the \$20,000 withheld when she files her 2018 tax return, depending on her overall tax liability for the year.)

She also learns that if she doesn't roll over the gross amount of \$100,000 — which will require her to make up for the withheld amount with other funds — she'll be subject to income tax on the \$20,000 difference. And, because she's under age 59½, she'll also owe the 10% early withdrawal penalty.

Early distribution rules also become important if you change jobs or retire. See Case Study II.

### Required minimum distributions

In the year in which you reach age 70½, you must begin to take annual required minimum distributions (RMDs) from your IRAs (except Roth IRAs) and, generally, from your defined contribution plans. If you don't comply, you can owe a penalty equal to 50% of the amount you should have withdrawn but didn't. (An RMD deferral is allowed for the initial year, but you'll have to take two RMDs the next year.) You can avoid the RMD rule for a non-IRA Roth plan by rolling the funds into a Roth IRA.

Waiting to take distributions until age 70½ generally is advantageous because of tax-deferred compounding. But a distribution (or larger distribution) in a year your tax bracket is low may save tax. Be sure, however, to consider

the lost future tax-deferred growth and, if applicable, whether the distribution could: 1) cause Social Security payments to become taxable, 2) increase income-based Medicare premiums and prescription drug charges, or 3) affect tax breaks with income-based limits.

If you've inherited a retirement plan, consult your tax advisor about the distribution rules that apply to you.

### IRA donations to charity

Taxpayers age 70½ or older are allowed to make direct contributions from their IRA to qualified charitable organizations up to \$100,000 per tax year. A charitable deduction can't be claimed for the contributions. But the amounts aren't included in taxable income and can be used to satisfy an IRA owner's RMD. A direct contribution might be tax-smart if you won't benefit from the charitable deduction. (See page 3.) ❖



## Estate planning: Assess your strategies in light of recent tax law changes

**A**s difficult as it is, accumulating wealth is only the first step to providing a financially secure future for your family. You also need to develop a comprehensive estate plan. The earlier you begin, the more options you'll have to grow and transfer your wealth in a way that minimizes taxes and leaves the legacy you desire. Then review your plan regularly to account for changes in your finances, family and tax law. The Tax Cuts and Jobs Act (TCJA) doesn't repeal the estate tax, as was originally proposed, but it still impacts estate planning.

**Warning:** You need to use your annual exclusion by Dec. 31. The exclusion doesn't carry over from year to year. For example, if you don't make an annual exclusion gift to your granddaughter this year, you can't add \$15,000 to your 2019 exclusion to make a \$30,000 tax-free gift to her next year.

### Estate tax

**Enhancement!** While the TCJA keeps the estate tax rate at 40%, it doubles the exemption base amount from \$5 million to \$10 million. The inflation-adjusted amount for 2018 is \$11.18 million. (See Chart 4.) The doubled amount will continue to be adjusted annually for inflation.

Keep in mind that, without further legislation, the estate tax exemption will return to an inflation-adjusted \$5 million in 2026. So taxpayers with estates in the roughly \$6 million to \$11 million range (twice that for married couples), whose estates would escape estate taxes if they were to die while the doubled exemption is in effect, still need to keep potential post-2025 estate tax liability in mind in their estate planning.

### Gift tax

**Enhancement!** The gift tax continues to follow the estate tax, so the gift tax exemption also increases under the TCJA. (See Chart 4.) Any gift tax exemption used during your lifetime reduces the estate tax exemption available at death. Using up some of your exemption during your lifetime can be tax-smart, especially if your estate exceeds roughly \$6 million (twice that if you're married). Making tax-free wealth transfers to take advantage of the higher exemption amount before it potentially "sunset" could save substantial tax.

You also can exclude certain gifts of up to \$15,000 per recipient in 2018 (\$30,000 per recipient if your spouse elects to split the gift with you or you're giving community property) without depleting any of your gift and estate tax exemption.

### GST tax

The generation-skipping (GST) tax generally applies to transfers (both during your lifetime and at death) made to people more than one generation below you, such as your grandchildren. This is in addition to any gift or estate tax due.

**Enhancement!** The GST tax continues to follow the estate tax, so the GST tax exemption also increases under the TCJA. (See Chart 4.)

The GST tax exemption can be a valuable tax-saving tool for taxpayers with large estates whose children also have — or may eventually have — large estates. With proper planning, they can use the exemption to make transfers to grandchildren and avoid any tax at their children's generation.

CHART 4

### Transfer tax exemptions and rates

Year	Estate tax exemption <sup>1</sup>	Gift tax exemption	GST tax exemption	Estate, gift and GST tax rate
2017	\$ 5.49 million	\$ 5.49 million	\$ 5.49 million	40%
2018	\$ 11.18 million	\$ 11.18 million	\$ 11.18 million	40%

<sup>1</sup> Less any gift tax exemption already used during life.

### State taxes

Even before the TCJA, many states imposed estate tax at a lower threshold than the federal government did. Now the differences in some states will be even more dramatic. To avoid unexpected tax liability or other unintended consequences, it's critical to consider state law. Consult a tax advisor familiar with the law of your particular state.

## Exemption portability

If one spouse dies and part (or all) of his or her estate tax exemption is unused at his or her death, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption. This exemption "portability" provides flexibility at the time of the first spouse's death, but it has some limits. Portability is available only from the most recently deceased spouse, doesn't apply to the GST tax exemption and isn't recognized by many states.

And portability doesn't protect future growth on assets from estate tax like applying the exemption to a credit shelter (or bypass) trust does. Such a trust offers other benefits as well, such as creditor protection, remarriage protection, GST tax planning and state estate tax benefits.

So married couples should still consider these trusts — and transferring assets to each other to the extent necessary to fully fund them at the first death. Transfers to a spouse (during life or at death) are tax-free under the marital deduction, assuming he or she is a U.S. citizen.

## Tax-smart giving

Giving away assets now will help reduce the size of your taxable estate. Here are some strategies for tax-smart giving:

**Choose gifts wisely.** Consider both estate and income tax consequences and the economic aspects of any gifts you'd like to make:

- To minimize *estate tax*, gift property with the greatest future appreciation potential.
- To minimize *your beneficiary's income tax*, gift property that hasn't appreciated significantly while you've owned it.
- To minimize *your own income tax*, don't gift property that's declined in value. Instead, consider selling the property so you can take the tax loss and then gifting the sale proceeds.

### Plan gifts to grandchildren carefully.

Annual exclusion gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers. For gifts to a grandchild that don't qualify for the exclusion to be tax-free, you generally must apply both your GST tax exemption and your gift tax exemption.

## Case Study III

### Now's the time to create a dynasty



Ryan is a widower who recently sold the business he'd spent 40 years building. His adult children are successful professionals and he has several grandchildren, with more expected. He'd like to leave a financial legacy for this third generation — and beyond.

Ryan hasn't yet used any of his gift and estate tax exemption, so his tax advisor suggests he set up a dynasty trust. He decides to transfer \$10 million to it, and there's no gift tax on the transaction because it's within his unused exemption amount. And the funds, together with all future appreciation, are removed from his taxable estate.

Most important, by allocating his GST tax exemption to his trust contributions, he ensures that any future distributions or other transfers of trust assets to his grandchildren or subsequent generations will avoid GST taxes. This is true even if the value of the assets grows well beyond the exemption amount or the exemption is reduced in the future.

### Gift interests in your business or an FLP.

If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts. So, for example, if the combined discount is 25%, in 2018 you can gift an ownership interest equal to as much as \$20,000 tax-free because the discounted value doesn't exceed the \$15,000 annual exclusion.

Another way to potentially benefit from valuation discounts is to set up a family limited partnership. You fund the FLP with assets such as public or private stock and real estate, and then gift limited partnership interests. **Warning:** The IRS may challenge valuation discounts; a professional, independent valuation is recommended. The IRS also scrutinizes FLPs, so be sure to properly set up and operate yours.

**Pay tuition and medical expenses.** You may pay these expenses without the payment being treated as a taxable gift to the student or patient, as long as the payment is made directly to the provider.

**Make gifts to charity.** Donations to qualified charities aren't subject to gift tax. They may also be eligible for an income tax deduction, but this deduction may benefit fewer taxpayers than in the past. (See page 3.)

### Trusts

Trusts can provide significant tax savings while preserving some control over what happens to the transferred assets. For those with large estates, funding them now, while the gift tax exemption is high, may be particularly tax-smart. Here are some trusts to consider:

- A *qualified terminable interest property (QTIP) trust* can benefit first a surviving spouse and then children from a prior marriage.
- A *qualified personal residence trust (QPRT)* allows you to give your home to your children today — removing it from your taxable estate at a reduced gift tax cost (provided you survive the trust's term) — while you retain the right to live in it for a certain period.
- A *grantor-retained annuity trust (GRAT)* works on the same principle as a QPRT, but allows you to transfer other assets; you receive payments back from the trust for a certain period.

Finally, a GST — or "dynasty" — trust can help you leverage both your gift and GST tax exemptions. And it can be an excellent way to potentially lock in the currently high exemptions while removing future appreciation from your estate. See Case Study III. ❖



CHART 5

### 2018 individual income tax rate schedules

Tax rate	Regular tax brackets			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
10%	\$ 0 – \$ 9,525	\$ 0 – \$ 13,600	\$ 0 – \$ 19,050	\$ 0 – \$ 9,525
12%	\$ 9,526 – \$ 38,700	\$ 13,601 – \$ 51,800	\$ 19,051 – \$ 77,400	\$ 9,526 – \$ 38,700
22%	\$ 38,701 – \$ 82,500	\$ 51,801 – \$ 82,500	\$ 77,401 – \$ 165,000	\$ 38,701 – \$ 82,500
24%	\$ 82,501 – \$ 157,500	\$ 82,501 – \$ 157,500	\$ 165,001 – \$ 315,000	\$ 82,501 – \$ 157,500
32%	\$ 157,501 – \$ 200,000	\$ 157,501 – \$ 200,000	\$ 315,001 – \$ 400,000	\$ 157,501 – \$ 200,000
35%	\$ 200,001 – \$ 500,000	\$ 200,001 – \$ 500,000	\$ 400,001 – \$ 600,000	\$ 200,001 – \$ 300,000
37%	Over \$ 500,000	Over \$ 500,000	Over \$ 600,000	Over \$ 300,000

Tax rate	AMT brackets			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
26%	\$ 0 – \$ 191,100	\$ 0 – \$ 191,100	\$ 0 – \$ 191,100	\$ 0 – \$ 95,550
28%	Over \$ 191,100	Over \$ 191,100	Over \$ 191,100	Over \$ 95,550

Tax rate	AMT exemptions			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
Amount	\$ 70,300	\$ 70,300	\$ 109,400	\$ 54,700
Phaseout <sup>1</sup>	\$ 500,000 – \$ 781,200	\$ 500,000 – \$ 781,200	\$ 1,000,000 – \$ 1,437,600	\$ 500,000 – \$ 718,800

<sup>1</sup> The AMT income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.

**Note:** Consult your tax advisor for AMT rates and exemptions for children subject to the “kiddie tax.”

CHART 6

### 2018 corporate income tax rates

Tax rate	Type of corporation
21%	C corporation
21%	Personal service corporation

CHART 7

### 2018 estate and trust income tax rate schedule

Tax rate	Tax brackets
10%	\$ 0 – \$ 2,550
24%	\$ 2,551 – \$ 9,150
35%	\$ 9,151 – \$ 12,500
37%	Over \$ 12,500

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