December 15, 2018

Dear Clients and Friends,

We look forward to assisting you with your 2018 tax returns. Now is an excellent time to consider tax planning and wealth preservation strategies in advance of the close of 2018.

Below are some year-end tax planning strategies to consider, along with an update on tax law changes, tax rates and regulations that may impact you.

**Year-End Tax Planning Strategies**

Tax planning for 2018 presents a number of challenges, primarily due to tax law changes brought about by the passage of the Tax Cuts and Jobs Act (TCJA) in December 2017. These changes include nearly doubling of the standard deduction, elimination of personal exemptions, and reducing or eliminating numerous itemized deductions. Many taxpayers who previously itemized deductions will now be filing with the standard deduction.

Below are some general tax planning strategies to consider:

* Capital gains planning, including capital loss harvesting, and contributions to tax-deferred accounts (retirement savings or flexible spending accounts) can play an important role in your year-end tax planning strategy.
* Testing your current tax position to determine if you should make estimated payments or are subject to the Alternative Minimum Tax should be a part of your year-end review.
* Review your current withholding to determine if estimated tax payments should be made, especially if you have income not covered by withholding taxes
* Consider funding a Health Savings Account if you meet the eligibility requirements.
* Establish a Roth IRA. Taxpayers whose income exceeds the Roth IRA AGI limitation ($135,000 single or head of household and $199,000 married filing jointly for 2018) can benefit from the “Backdoor Roth IRA” contribution to a traditional IRA.
* If you anticipate an increase in taxable income in 2019, and are expecting a bonus at year-end, try to get it before December 31, 2018. Keep in mind, however, that contractual bonuses are different, in that they are typically not paid out until the first quarter of the following year. Therefore, any taxes owed on a contractual bonus would not be due until you file your 2019 tax return in 2020
* If your company grants stock options, you may want to exercise the option or sell stock acquired by exercise of an option this year if you think your tax bracket will be higher in 2019. Exercise of the option is often but not always a taxable event; sale of stock is almost always a taxable event.
* If you’re self-employed, send invoices or bills to clients or customers this year to be paid in full by the end of December.

Please note that taxpayers who paid Alternative Minimum Tax may need to modify certain strategies mentioned above.

**Noteworthy 2018 Tax Regulations and Guidelines**

**Accelerating Income and Deductions**

Accelerating income and deductions are two strategies that are commonly used to help taxpayers minimize their tax liability, depending on the tax bracket expectations for this year vs next.

**Accelerating Income**

If you anticipate being in a higher tax bracket next year, accelerating income into 2018 is a good idea, especially for taxpayers whose earnings are close to threshold amounts ($200,000 for single filers and $250,000 for married filing jointly) that make them liable for additional Medicare Tax or Net Investment Income Tax (see below). Taxpayers near threshold amounts should still be mindful of one-time (Roth conversion, large asset sales, etc.) income spikes.

In cases where tax benefits are phased out over a certain adjusted gross income (AGI) amount, a strategy of accelerating income and deductions might allow you to claim larger deductions, credits, and other tax breaks for 2018, depending on your situation. Roth IRA contributions, conversions of regular IRAs to Roth IRAs, child tax credits, higher education tax credits, and deductions for student loan interest are examples of these types of tax benefits.

**Accelerating Deductions**

If a taxpayer is itemizing deductions, a taxpayer might accelerate and increase deductions by:

Paying a state estimated tax installment in December instead of at the January due date. However, make sure the payment is based on a reasonable estimate of your state tax. *Note: The state and local property, income and sales tax deduction is limited to a total of $10,000.*

Paying their entire property tax bill, including installments due in year 2019, by year-end. Property taxes need to be assessed before they are prepaid. This does not apply to mortgage escrow accounts. *Note: The state and local property, income and sales tax deduction is limited to a total of $10,000.*

Bunching "threshold" expenses (medical and dental expenses) and charitable contributions in whichever year they would do you the most tax good.

* Note: Medical and dental expenses are only deductible to the extent they exceed 7.5% of adjusted gross income (AGI). By bunching these expenses into one year, rather than spreading them out over two years, you have a better chance of exceeding the thresholds and maximizing your deduction. You may consider prepaying deductible expenses or accelerating charitable donations by credit card to claim deductions without using immediate cash. Note in 2019, the deduction threshold goes to 10%.

Note: TCJA limited the mortgage interest deduction (different limitations depending on whether it is an old or new mortgage).

**Standard Deductions**   
The standard deduction for married couples filing a joint return or qualifying widow/widower in 2018 is $24,000. For singles and married individuals filing separately, the standard deduction is $12,000.  For heads of household, the standard deduction is $18,000.

The additional standard deduction for blind people and senior citizens in 2018 is $1,300 for married individuals and $1,600 for singles and heads of household.

**Income Tax Rates**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Tax Rate** | **Single** | **Married Filing Jointly or Qualifying Widow / Widower** | **Married Filing Separately** | **Head of**  **Household** |
| 10% | $0 to $9,525 | $0 to $19,050 | $0 to $9,525 | $0 to $13,600 |
| 12% | $9,526 - $38,700 | $19,051 - $77,400 | $9,526 - $38,700 | $13,601 - $51,800 |
| 22% | $38,701 - $82,500 | $77,401 - $165,000 | $38,701 - $82,500 | $51,801 - $82,500 |
| 24% | $82,501 - $157,500 | $165,001 - $315,000 | $82,501 - $157,500 | $82,501 - $157,500 |
| 32% | $157,501 - $200,000 | $315,001 - $400,000 | $157,501 - $200,000 | $157,501 - $200,000 |
| 35% | $200,001 - $500,000 | $400,001 - $600,000 | $200,001 - $300,000 | $200,001 - $500,000 |
| 37% | Over $500,001 | Over $600,001 | Over $300,001 | Over $500,001 |

**Alternate Minimum Tax**

Although the AMT remained under the TCJA, exemption amounts increased significantly. As such, the AMT is not expected to affect as many taxpayers. Furthermore, the phaseout threshold increases to $500,000 ($1 million for married filing jointly). Both the exemption and threshold amounts are indexed for inflation. Please call or email if you're not sure whether AMT applies to you.

**Note:** AMT exemption amounts for 2018 are as follows:

* $70,300 for single and head of household filers,
* $109,400 for married people filing jointly and for qualifying widows or widowers,
* $54,700 for married people filing separately

**Long Term Capital Gains**  
In 2018 taxpayers pay 0%, 15% or 20% on long-term capital gains:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Tax Rate** | **Single** | **Married Filing Jointly or Qualifying Widow / Widower** | **Married Filing Separately** | **Head of**  **Household** |
| 0% | $0 to $38,600 | $0 to $77,200 | $0 to $38,600 | $0 to $51,700 |
| 15% | $38,601 - $425,800 | $77,201 - $479,000 | $38,601 - $239,500 | $51,701 - $452,400 |
| 20% | Over $425,801 | Over $479,001 | Over $239,501 | Over $452,401 |

**Adoption Credit**  
In 2018, a nonrefundable credit of up to $13,840 is available for qualified adoption expenses for each eligible child.

**Child and Dependent Care Credit**  
If you pay someone to take care of your dependent (defined as being under the age of 13 at the end of the tax year or incapable of self-care) in order to work or look for work, you may qualify for a credit of up to $1,050 or 35 percent of $3,000 of eligible expenses.

For two or more qualifying dependents, you can claim up to 35 percent of $6,000 (or $2,100) of eligible expenses. For higher income earners the credit percentage is reduced, but not below 20 percent, regardless of the amount of adjusted gross income.

**Child Tax Credit**  
For tax year 2018, the child tax credit is $2,000. The credit is phased out for those with higher incomes.

**Earned Income Tax Credit (EITC)**   
For tax year 2018, the maximum earned income tax credit (EITC) for low and moderate income workers and working families increased to $6,431. The maximum income limit for the EITC increased to $54,884 for married filing jointly. The credit varies by family size, filing status and other factors, with the maximum credit going to joint filers with three or more qualifying children.

**Education Expenses**

In 2018, there are several different tax credits or deductions that may apply depending on the type of expense.

**American Opportunity Tax Credit**   
In 2018, the maximum American Opportunity Tax Credit that can be used to offset certain higher education expenses is $2,500 per student, although it is phased out beginning at $160,000 adjusted gross income for joint filers and $80,000 for other filers.

**Lifetime Learning Credit**  
A credit of up to $2,000 is available for an unlimited number of years for certain costs of post-secondary or graduate courses or courses to acquire or improve your job skills. For 2018, the modified adjusted gross income threshold at which the lifetime learning credit begins to phase out is $112,000 for joint filers and $56,000 for singles and heads of household.

**Coverdell Education Savings Account**  
You can contribute up to $2,000 a year to Coverdell savings accounts in 2018. These accounts can be used to offset the cost of elementary and secondary education, as well as post-secondary education.

**Employer Provided Educational Assistance**  
In 2018, as an employee, you can exclude up to $5,250 of qualifying post-secondary and graduate education expenses that are reimbursed by your employer.

**Student Loan Interest**  
In 2018, you can deduct up to $2,500 in student-loan interest. The deduction begins to phase out if your modified adjusted gross income is larger than $130,000 for joint filers and $65,000 for singles and heads of household.

**Charitable Contributions**

Cash and property can be donated to a charity. You can generally take a deduction for the fair market value of the property; however, for certain property, the deduction is limited to your cost basis. While you can also donate your services to charity, you may not deduct the value of these services. However, you may also be able to deduct charity-related travel expenses and some out-of-pocket expenses.

Keep in mind that a written record of your charitable contributions--including travel expenses such as mileage--is required in order to qualify for a deduction. A donor may not claim a deduction for any contribution of cash, a check or other monetary gift unless the donor maintains a record of the contribution in the form of either a bank record (such as a cancelled check) or written communication from the charity (such as a receipt or a letter) showing the name of the charity, the date of the contribution, and the amount of the contribution.

Contributions of appreciated property (i.e. stock) provide an additional benefit because you avoid paying capital gains on any profit. Taxpayers age 70 ½ or older can reduce income tax owed on required minimum distributions (RMDs) from IRA accounts by donating them to a charitable organization(s) instead.

**Investment Gains and Losses**

This year, and in the coming years, investment decisions are often more about managing capital gains than about minimizing taxes. For example, taxpayers below threshold amounts in 2018 might want to take gains; whereas taxpayers above threshold amounts might want to take losses. As a general rule, if you have a large capital gain this year, you may consider selling an investment on which you have an accumulated loss. Capital losses up to the amount of your capital gains plus $3,000 per year ($1,500 if married filing separately) can be claimed as a deduction against income.

Wash Sale Rule. After selling a securities investment to generate a capital loss, you can repurchase it after 30 days. This is known as the "Wash Rule Sale." If you buy it back within 30 days, the loss will be disallowed. Or you can immediately repurchase a similar (but not the same) investment, e.g., an ETF or another mutual fund with the same objectives as the one you sold.

**Mutual Fund Investments**

Before investing in a mutual fund, ask whether a dividend is paid at the end of the year or whether a dividend will be paid early in the next year but be deemed paid this year. The year-end dividend could make a substantial difference in the tax you pay for taxable accounts.

**Roth Conversion Recharacterization Repeal**

Effective January 1, 2018, recharacterization of Roth conversions has been eliminated. However, Roth contributions can continue to be recharacterized.

**Additional Medicare Tax**

Taxpayers whose income exceeds certain threshold amounts ($200,000 single filers and $250,000 married filing jointly) are liable for an additional Medicare tax of 0.9 percent on their tax returns, but may request that their employers withhold additional income tax from their pay to be applied against their tax liability when filing their 2018 tax return next April.

High net worth individuals should consider contributing to Roth IRAs and 401(k) because distributions are not subject to the Medicare Tax.

If you're a taxpayer close to the threshold for the Medicare Tax, it might make sense to switch Roth retirement contributions to a traditional IRA plan, thereby avoiding the 3.8 percent Net Investment Income Tax as well (more about the NIIT below).

**Net Investment Income Tax (NIIT)**

The Net Investment Income Tax, which went into effect in 2013, is a 3.8 percent tax that is applied to investment income such as long-term capital gains for earners above certain threshold amounts ($200,000 for single filers and $250,000 for married taxpayers filing jointly).

Short-term capital gains are subject to ordinary income tax rates as well as the 3.8 percent NIIT. This information is something to think about as you plan your long-term investments. Business income is not considered subject to the NIIT provided the individual business owner materially participates in the business.

**Gift Tax**

The federal gift and estate tax exemption, which is currently set at $11.18million in 2018 and $11.4 million in 2019. The American Taxpayer Relief Act of 2012 set the maximum estate tax rate at 40 percent.

For many, sound estate planning begins with lifetime gifts to family members. In other words, gifts that reduce the donor's assets subject to future estate tax. Such gifts are often made at year-end, during the holiday season, in ways that qualify for exemption from federal gift tax. Gifts of "future interests," assets that the donee can only enjoy at some future time, such as certain gifts in trust, generally don't qualify for exemption; however, gifts for the benefit of a minor child can be made to qualify.

Gifts to a donee are exempt from the gift tax for amounts up to $15,000 (for 2018 and 2019) a year per donee. For example, a husband and wife could each gift their child $15,000 for a total of $30,000.

**New Tax Rate Structure for the Kiddie Tax**

Income earned on investments you give to children or other family members are generally taxed to them, not to you. In prior years, amounts exceeding $1,050 were taxed at the parent's marginal tax rate if that rate was higher than the child's rate.

Under the TCJA, however, the kiddie tax rules have changed. For tax years 2018 through 2025, unearned income exceeding $1,050 is taxed at the rates paid by trusts and estates. For ordinary income (amounts over $12,501), the maximum rate is 37 percent. For long-term capital gains and qualified dividends (amounts over $12,501), the maximum rate is 20 percent.

**Retirement Plan Contributions**

Consider maximizing your retirement plan contributions. If you own an incorporated or unincorporated business, consider setting up a retirement plan if you don't already have one. It doesn't actually need to be funded until you pay your taxes, but allowable contributions will be deductible on this year's return.

If you are an employee and your employer has a 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan, taxpayers can contribute a maximum amount ($18,500 for 2018), plus an additional catch-up contribution of $6,000 if age 50 or over, assuming the plan allows this and income restrictions don't apply.

If you are employed or self-employed with no retirement plan, you can make a deductible or non-deductible (dependent on income levels) contribution of up to $5,500 a year to a traditional IRA (deduction is sometimes allowed even if you have a plan). Further, there is also an additional catch-up contribution of $1,000 if age 50 or over. Please follow up with us to discuss your specific situation.

**Retirement Savings Contribution Credit**  
In 2018, the AGI limit for the saver's credit (also known as the retirement savings contributions credit) for low-and moderate-income workers is $63,000 for married couples filing jointly, $47,250 for heads of household, and $31,500 for married individuals filing separately and for singles. The maximum credit is $2,000 ($4,000 for married couples filing jointly).

**Affordable Care Act Tax Provisions**

An individual shared responsibility payment may be required if you and all of your dependents do not have minimum essential coverage and don’t have an exemption.  The individual shared responsibility payment amount is the greater of a percentage of your household income or a flat dollar amount.

An individual will owe 1/12th of the annual payment for each month the individual or their dependent(s) don’t have either coverage or an exemption.

For 2018, the annual payment amount is:

* The greater of:
  + 2.5 percent of the individual’s household income that is above the tax return filing threshold for the filing status, limited to the total yearly premium for the national average price of a Bronze plan sold through the Marketplace, or
  + The individual’s (or family's) flat dollar amount, which is $695 per adult and $347.50 per child, limited to a family maximum of $2,085.

**Health Savings Accounts**

Consider setting up a health savings account (HSA). You can deduct contributions to the account, investment earnings are tax-deferred until withdrawn, and amounts you withdraw are tax-free when used to pay medical bills. The contribution limit in 2018 is $6,900 for family coverage (more than one individual) and $3,450 for single, with a $1,000 age 55 or older catch-up contribution.

In effect, medical expenses paid from the account are deductible from the first dollar (unlike the usual rule limiting such deductions to the excess over 7.5 percent of AGI). For amounts withdrawn at age 65 or later, and not used for medical bills, the HSA functions much like an IRA.

To be eligible, you must have a high-deductible health plan (HDHP), and only such insurance, subject to numerous exceptions, and must not be enrolled in Medicare. For 2018, to qualify for the HSA, your minimum deductible in your HDHP must be at least $1,350 for single coverage or $2,700 for a family.

**Flexible Spending Accounts (FSA)**  
FSAs are limited to $2,650 per year in 2018 and apply only to salary reduction contributions under a health FSA. The term "taxable year" refers to the plan year of the cafeteria plan, which is typically the period during which salary reduction elections are made.

Specifically, in the case of a plan providing a grace period (which may be up to two months and 15 days), unused salary reduction contributions to the health FSA for plan years beginning in 2012 or later that are carried over into the grace period for that plan year will not count against the $2,650 limit for the subsequent plan year.

Employers may allow employees to carry over into the next calendar year up to $500 in their accounts, but aren't required to do so.

**529 Education Plans**

Maximize contributions to 529 plans, which starting in 2018, can be used for elementary and secondary school tuition (up to $10,000 of tuition per beneficiary) as well as college or vocational school.

**Social Security Benefits**

All Social Security benefit recipients should receive Form SSA-1099 from the Social Security Administration, which shows the total amount of benefits.  Please let us know if you have questions regarding the taxability of your Social Security Benefits.

**Tips for Recently Married or Divorced Taxpayers**

Newlyweds and the recently divorced should ensure the name on their tax return matches the name registered with the Social Security Administration (SSA).

**Local Taxes**

Please note that the TAXPAYER is responsible for determining if there are any local taxes owed.  The TAXPAYER is responsible for letting Papajcik Brothers Tax LLC know that a municipality or county will be assessing taxes. We are happy to work with you to make this determination, but the facts are very case specific. Please let us know if your residence or your workplace might cause you to be subject to local taxes.

**Businesses**

Whether you file as a corporation or sole proprietor, below is what business owners need to know about tax changes for 2018.

**Business Expense Deductions for Meals, Entertainment**

Prior to 2018, a business could deduct up to 50 percent of entertainment expenses directly related to the active conduct of a trade or business or, if incurred immediately before or after a bona fide business discussion, associated with the active conduct of a trade or business. However, the TCJA eliminated the deduction for any expenses related to activities generally considered entertainment, amusement or recreation.

Taxpayers may continue to deduct 50 percent of the cost of business meals if the taxpayer (or an employee of the taxpayer) is present and the food or beverages are not considered lavish or extravagant. The meals may be provided to a current or potential business customer, client, consultant or similar business contact. Please note that food and beverages that are provided during entertainment events will not be considered entertainment if purchased separately from the event.

**Qualified Business Income Deduction (Section 199A Deduction)**

Under the TCJA, non-corporations may be entitled to a deduction of up to 20 percent of their qualified business income (QBI) from a qualified trade or business for tax years 2018 through 2025, as well as certain dividends. To take advantage of the deduction, taxable income must be under $157,500 ($315,000 for joint returns).

Below are 7 key facts about the qualified business income deduction:

1. The deduction applies to qualified business income from a qualified business (i.e. pass-through entities) such as: sole proprietorship, S-corporation, Partnership, LLC treated as a sole proprietorship or partnership for tax purposes, Non-corporate taxpayers such as trusts and estates, REITs and Publicly traded partnerships.
2. Qualified business income is the net amount of qualified items of income, gain, deduction, and loss connected to a qualified U.S. trade or business. Only items included in taxable income are counted. Qualified business income does not include income from performing services as an employee. Capital gains and losses, shareholders wages, certain dividends, and interest income are excluded as well.
3. The deduction is available to eligible taxpayers, whether they itemize their deductions on Schedule A or take the standard deduction. The deduction can be taken in addition to the standard or itemized deductions and is subject to limitations based on the type of trade or business, the taxpayer's taxable income, the amount of W-2 wages paid with respect to the qualified trade or business, and the unadjusted basis of qualified property held by the trade or business.
4. The deduction is generally equal to the lesser of these two amounts:
   1. 20 percent of qualified business income plus 20 percent of qualified real estate investment trust dividends and qualified publicly traded partnership income.
   2. 20 percent of taxable income computed before the qualified business income deduction minus net capital gains.
5. For taxpayers with taxable income computed before the qualified business income deduction that exceeds $315,000 for a married couple filing a joint return, or $157,500 for all other taxpayers, the deduction may be subject to additional limitations or exceptions. These are based on the type of trade or business (see #7 below), the taxpayer's taxable income, the amount of W-2 wages paid by the qualified trade or business, and the unadjusted basis immediately after acquisition of qualified property held by the trade or business.
6. Income earned through a C corporation is not eligible for the deduction.
7. A qualified trade or business is any trade or business except one 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 exclusion only applies, however, 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 QBI deduction is complex, and tax planning strategies can directly affect (increase or decrease) the amount of deduction. Please contact our office to discuss the QBI deduction further.

**Section 179 Expensing**  
In 2018, businesses can elect to expense (deduct immediately) the entire cost of most new equipment up to a maximum of $1 million for the first $2.5 million of property placed in service by December 31, 2018. Keep in mind that the Section 179 deduction cannot exceed net taxable business income. The deduction is phased out dollar for dollar on amounts exceeding the $2.5 million threshold and eliminated above amounts exceeding $3.5 million. Please contact our office to discuss which property is either included or excluded.

Bonus Depreciation. Businesses are allowed to immediately deduct 100% of the cost of eligible property placed in service after September 27, 2017, and before January 1, 2023, after which it will be phased downward over a four-year period: 80% in 2023, 60% in 2024, 40% in 2025, and 20% in 2026.

**Standard Mileage Rates**  
The standard mileage rates in 2018 are as follows: 54.5 cents per business mile driven, 18 cents per mile driven for medical or moving purposes, and 14 cents per mile driven in service of charitable organizations.

**SIMPLE IRA Plan Contributions**  
Contribution limits for SIMPLE IRA plans remain at $12,500 for persons under age 50 and $15,500 for persons age 50 or older in 2018. The maximum compensation used to determine contributions increases to $275,000.

**Health Care Tax Credit for Small Businesses**  
Small business employers with 25 or fewer full-time-equivalent employees (average annual wages of less than $53,200 in 2018) may qualify for a tax credit to help pay for employees' health insurance. The credit is up to 50 percent (35 percent for non-profits).

**Work Opportunity Tax Credit (WOTC)**

The Work Opportunity Tax Credit has been modified and enhanced for employers who hire long-term unemployed individuals (unemployed for 27 weeks or more) and can be up to 40 percent of first year wages paid to a new hire (up to a certain ceiling determined by the target group).