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CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

Year-end Planning Moves for Individuals

Game the Increased Standard Deduction Allowances: The TCJA almost doubled the standard deduction amounts. For 2018, the amounts are $12,000 for singles and those who use married filing separate status (up from $6,350 for 2017), $24,000 for married joint filing couples (up from $12,700), and $18,000 for heads of household (up from $9,350). If your total annual itemizable deductions for 2018 will be close to your standard deduction amount, consider making additional expenditures before year-end to exceed your standard deduction. That will lower this year's tax bill. Next year, you can claim the standard deduction, which will be increased a bit to account for inflation.

The easiest deductible expense to accelerate is included in your house payment due on January 1. Accelerating that payment into this year will give you 13 months' worth of interest in 2018. Although the TCJA put new limits on itemized deductions for home mortgage interest, you are probably unaffected. Check with us if you are uncertain.

Also, consider state and local income and property taxes that are due early next year. Prepaying those bills before year-end can decrease your 2018 federal income tax bill because your itemized deductions will be that much higher. However, the TCJA decreased the maximum amount you can deduct for state and local taxes to $10,000 ($5,000 if you use married filing separate status). **So, beware of this new limitation.**

Accelerating other expenditures could cause your itemized deductions to exceed your standard deduction in 2018. For example, consider making bigger charitable donations this year and smaller contributions next year to compensate. Also, consider accelerating elective medical procedures, dental work, and vision care. For 2018, medical expenses are deductible to the extent they exceed 7.5% of Adjusted Gross Income (AGI), assuming you itemize.

Warning: The state and local tax prepayment drill can be a bad idea if you owe Alternative Minimum Tax (AMT) for this year. That's because write-offs for state and local income and property taxes are completely disallowed under the AMT rules. Therefore, prepaying those expenses may do little or no good if you are an AMT victim. Contact us if you are unsure about your exposure to the AMT.

Carefully Manage Investment Gains and Losses in Taxable Accounts: If you hold investments in taxable brokerage firm accounts, consider the tax advantage of selling appreciated securities that have been held for over 12 months. The maximum federal income tax rate on long-term capital gains recognized in 2018 is only 15% for most folks, although it can reach a maximum of 20% at higher income levels. The 3.8% Net Investment Income Tax (NIIT) also can apply at higher income levels.

To the extent you have capital losses that were recognized earlier this year or capital loss carryovers from pre-2018 years, selling winners this year will not result in any tax hit. In particular, sheltering net short-term capital gains with capital losses is a sweet deal because net short-term gains would otherwise be taxed at higher ordinary income rates.

What if you have some loser investments that you would like to unload? Biting the bullet and taking the resulting capital losses this year would shelter capital gains, including high-taxed short-term gains, from other sales this year.

If selling a bunch of losers would cause your capital losses to exceed your capital gains, the result would be a net capital loss for the year. No problem! That net capital loss can be used to shelter up to $3,000 of 2018 ordinary income from salaries, bonuses, self-employment income, interest income, royalties, and whatever else ($1,500 if you use married filing separate status). Any excess net capital loss from this year is carried forward to next year and beyond.

In fact, having a capital loss carryover into next year could turn out to be a pretty good deal. The carryover can be used to shelter both short-term and long-term gains recognized next year and beyond. This can give you extra investing flexibility in those years because you won't have to hold appreciated securities for over a year to get a preferential tax rate. Since the top two federal rates on net short-term capital gains recognized in 2019 and beyond are 35% and 37% (plus the 3.8% NIIT, if applicable), having a capital loss carryover into next year to shelter short-term gains recognized next year and beyond could be a very good thing.

Take Advantage of 0% Tax Rate on Investment Income: The TCJA retained the 0%, 15%, and 20% rates on Long-term Capital Gains (LTCGs) and qualified dividends recognized by individual taxpayers. However, for 2018–2025, these rates have their own brackets that are not tied to the ordinary income brackets. Here are the brackets for 2018:

	Single	Joint	Head of Household
0% bracket	\$0–38,600	\$0–77,200	\$0–51,700
Beginning of 15% bracket	38,601	77,201	51,701
Beginning of 20% bracket	425,801	479,001	452,401

Note: The 3.8% NIIT can hit LTCGs and dividends recognized by higher-income individuals. This means that many folks will actually pay 18.8% (15% + 3.8% for the NIIT) and 23.8% (20% + 3.8%) on their 2018 LTCGs and dividends.

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who will be in the 0% bracket. If so, consider giving them appreciated stock or mutual fund shares that they can sell and pay 0% tax on the resulting long-term gains. Gains will be long-term as long as your ownership period plus the gift recipient's ownership period (before the sale) equals at least a year and a day.

Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 0% rate bracket, they will be federal-income-tax-free.

Warning: If you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting capital gains and dividends to be taxed at the higher rates that apply to trusts and estates. That would defeat the purpose. Please contact us if you have questions about the Kiddie Tax.

Give Away Winner Shares or Sell Loser Shares and Give Away the Resulting Cash: If you want to make gifts to some favorite relatives and/or charities, they can be made in conjunction with an overall revamping of your taxable account stock and equity mutual fund portfolios. Gifts should be made according to the following tax-smart principles.

<u>Gifts to Relatives.</u> Don't give away loser shares (currently worth less than what you paid for them). Instead, you should sell the shares and book the resulting tax-saving capital loss. Then, you can give the sales proceeds to your relative.

On the other hand, you should give away winner shares to relatives. Most likely, they will pay lower tax rates than you would pay if you sold the same shares. As explained earlier, relatives in the 0% federal income tax bracket for LTCGs and qualified dividends will pay a 0% federal tax rate on gains from shares that were held for over a year before being sold. (For purposes of meeting the more-than-one-year rule for gifted shares, you can count your ownership period plus the gift recipient's ownership period.) Even if the winner shares have been held for a year or less before being sold, your relative will probably pay a much lower tax rate on the gain than you would.

Gifts to Charities. The principles for tax-smart gifts to relatives also apply to donations to IRS-approved charities. You should sell loser shares and collect the resulting tax-saving capital losses. Then, you can give the sales proceeds to favored charities and claim the resulting tax-saving charitable deductions (assuming you itemize). Following this strategy delivers a double tax benefit: tax-saving capital losses plus tax-saving charitable donation deductions.

On the other hand, you should donate winner shares instead of giving away cash. Why? Because donations of publicly traded shares that you have owned over a year result in charitable deductions equal to the full current market value of the shares at the time of the gift (assuming you itemize). Plus, when you donate winner shares, you escape any capital gains taxes on those shares. This makes this idea another double tax-saver: you avoid capital gains taxes while getting a tax-saving donation deduction (assuming you itemize). Meanwhile, the tax-exempt charitable organization can sell the donated shares without owing anything to the IRS.

Convert Traditional IRAs into Roth Accounts: The best profile for the Roth conversion strategy is when you expect to be in the same or higher tax bracket during your retirement years. The current tax hit from a conversion done this year may turn out to be a relatively small price to pay for completely avoiding potentially higher future tax rates on the account's earnings.

Watch out for the AMT: The TCJA significantly reduced the odds that you will owe AMT for 2018 by significantly increasing the AMT exemption amounts and the income levels at which those exemptions are phased out. Even if you still owe AMT, you will probably owe considerably less than under prior law. Nevertheless, it's still critical to evaluate year-end tax planning strategies in light of the AMT rules. Because the AMT rules are complicated, you may want some assistance. We stand ready to help.