Dykema

## Resources

# Tax Planning for the End of 2018 and Beginning of 2019

**December 19, 2018**

Before 2018 comes to a close, it may be worthwhile to review the state of your tax, estate, and charitable giving plans. Along with the typical end-of-year considerations, this year it is crucial also to pay careful attention to the effects of the 2017 tax act (P.L. 115-97, signed into law on December 22, 2017, and informally called the "Tax Cuts and Jobs Act of 2017," herein the "2017 Tax Act") that altered many longstanding rules and assumptions.

Here we highlight a number of important topics for you to consider as you plan for the end of 2018 and the beginning of 2019.

## Planning Considerations

### Charitable Giving

**Consider Bunching Charitable Gifts.** One of the changes made by the 2017 Tax Act was an increase in the standard deduction to $12,000 for individuals and $24,000 for married couples filing jointly. As a result of this change and a cap on the ability to deduct state and local taxes, fewer taxpayers are expected to benefit from itemizing income tax deductions beginning with the 2018 taxable year. Thus, charitable contributions, for which a separate deduction is available only to taxpayers who itemize, now will provide tax benefits to fewer taxpayers.

If you are one of those taxpayers who will not otherwise benefit from itemizing deductions, you should consider bunching your charitable gifts. By bunching charitable gifts—that is, giving a larger amount every two or more years instead of giving even amounts each year—and choosing to itemize deductions only in years in which charitable gifts are made, you may be able to increase the tax impact of your charitable giving.

**IRA Rollovers.** If you have reached the age of 70 ½, you should consider the benefits of a charitable IRA rollover. Under current law, taxpayers who have reached 70 ½ years of age may transfer up to $100,000 annually from their IRA accounts directly to a charity without having to recognize the distribution as income. Charities must be public charities and cannot be donor-advised funds, supporting organizations, or private foundations. Such rollovers are excluded completely from the donor's adjusted gross income and also do not count against the donor's maximum allowable charitable contribution tax deduction limits for the year. These rollovers do count, however, towards the donor's minimum required distributions and can offer tax benefits similar to itemized charitable deductions even for those taxpayers who do not itemize.

### Making Gifts to Friends and Family

**Annual Exclusion Gifts.** Consider making use of your annual exclusion gift amount for the year. In 2018, an individual may exclude from gift tax up to $15,000 per recipient. This amount will remain the same in 2019. Married couples may give up to $30,000, together, to a single recipient. Annual exclusion gifts made directly to individual donees are not subject to gift, estate, or generation-skipping transfer taxes and do not erode lifetime exemption amounts. If the annual exclusion gift amount is not used for the year, it does not carry over to the next year. Annual exclusion gifts may also be leveraged to reduce estate tax exposure through the use of lifetime trusts or other planning vehicles. Please consult an attorney or financial advisor if you are interested in considering the benefits of a comprehensive gifting plan.

**529 Accounts.** Consider opening or adding money to a 529 account for a child or grandchild. Such accounts can be used to pay qualified educational expenses for post-secondary education. Gifts to such accounts can be covered by the annual exclusion (see above). The 2017 Tax Act now allows up to $10,000 per year to be paid from a 529 account for K-12 education. Moreover, some states allow deductions for contributions to 529 accounts. For example, Michigan allows a state income tax deduction for up to $10,000 for married couples filing jointly or $5,000 for individuals for contributions to the

Michigan Education Savings Program (MESP); these deductions are reduced if there have been qualified withdrawals from an MESP account in the same year.

**Increased Estate and Gift Tax Exemption.** Consider taking advantage of the greatly increased exemption amount for gift and generation-skipping transfer taxes, such as through lifetime gifting. The 2017 Tax Act nearly doubled this amount to $11,180,000 in 2018, with inflation adjustments being expected to further increase that number through 2025. Under current law, in 2026, the lifetime exemption amount is scheduled to return to 2017 levels, as adjusted for inflation. Before entering into any gifting plan, careful consideration should be given to all the consequences of such a plan, including the effect of the step-up in tax basis to fair market value that current law provides for appreciated assets held by an individual at death. This basis step-up is not available for assets gifted during life.

**Of Note:** The IRS, in November 2018, issued long-awaited proposed regulations providing that the IRS will honor the higher exemption amounts if used for lifetime gifts and will not claw them back even if the exemption amount will be lower when the taxpayer dies.

## Retirement and Savings

**IRAs and 401(k)s.** Consider maximizing contributions to tax-deferred retirement accounts, such as IRAs and 401(k)s. The contribution limits for 401(k)s are $18,500, set to go up to $19,000 in 2019. Those age 50 or more can contribute up to an additional $6,000 as catch-up contributions. The contribution limit for IRAs is $5,500, or $6,500 for those age 50 or older. This is slated to go up to $6,000 and $7,000, respectively, in 2019.

**Health Savings Account.** If you have a high-deductible health plan (HDHP), consider making contributions to a health savings account, or HSA. The contribution limit to HSAs for 2018 is $6,900 for taxpayers having family HDHP coverage or $3,450 for those having self-only coverage. These limits are set to increase to $7,000 and $3,500, respectively, for 2019. Those age 55 or older can make additional catch-up contributions of $1,000 per year. HSAs are powerful tools for health and retirement saving. HSA contributions are deductible when made, and, if contributed through one's employer, are also exempt from payroll taxes. They are also non-taxable when distributed from the account if used to pay for medical expenses. If HSA funds are withdrawn and used for non-medical expenses, they are subject to income tax and a 20 percent surtax; the 20 percent surtax does not apply to distributions made after the date the taxpayer becomes disabled, reaches age 65, or dies.

## Business Planning

**Pass-Through Deduction.** Consider how to best take advantage of the new section 199A deduction for pass-through businesses. This provision, newly introduced in the 2017 Tax Act, allows taxpayers other than corporations to take a deduction of 20 percent of qualified business income earned in a qualified trade or business, subject to certain earned income and property-based limitations. Contrary to a common misconception, while specified service trades or businesses (such as physicians, lawyers, etc.) generally are not afforded this 20 percent deduction, the deduction is available to those whose income is below $315,000 (if married filing jointly; otherwise, $157,500), and is phased out for those making between that amount and $415,000 (if married filing jointly; otherwise, $207,500).

**Schedule C Deductions.** With the repeal of miscellaneous itemized deductions beginning in 2018 and the $10,000 cap on deductibility of state and local taxes, if you are a sole proprietor, consider making full use of permissible deductions on Schedule C, Profit or Loss from Business, to your individual income tax return. Be aware that such deductions must be ordinary and necessary expenses of carrying on your trade or business and cannot be personal in nature.

**Harvest Tax Losses.** Consider "harvesting" tax losses. If you have capital assets with a built-in loss, consider selling them before the end of the year to offset any capital gains you might have recognized during the year.

**New Partnership Audit Regime.** If you have an interest in any partnerships or LLCs that are taxed as partnerships, make sure that the governing instruments comply with the new partnership audit regime. In particular, instead of a tax matters partner, the Internal Revenue Code now requires the designation of a partnership representative with substantially expanded powers.

## Summary of Important Tax Changes in 2018

The 2017 Tax Act changed tax laws in various ways beginning with the 2018 taxable year. The following is a summary of several of the more significant changes affecting individual taxpayers.

### Changes Affecting Individuals

**Changes to Individual Tax Rates:**

**Single Filers**

| Prior Law | 2017 Tax Act |
|---|---|
| 10% $0-$9,525 | 10% $0-$9,525 |
| 15% $9,525-$38,700 | 12% $9,525-$38,700 |
| 25% $38,700-$93,700 | 22% $38,700-$82,500 |
| 28% $93,700-$195,450 | 24% $82,500-$157,500 |
| 33% $195,450-$424,950 | 32% $157,500-$200,000 |
| 35% $424,950-$426,700 | 35% $200,000-$500,000 |
| 39.6% $426,700+ | 37% $500,000+ |

**Married Filing Jointly**

| Prior Law | 2017 Tax Act |
|---|---|
| 10% $0-$19,050 | 10% $0-$19,050 |
| 15% $19,050-$77,400 | 12% $19,050-$77,400 |
| 25% $77,400-$156,150 | 22% $77,400-$165,000 |
| 28% $156,150-$237,950 | 24% $165,000-$315,000 |
| 33% $237,950-$424,950 | 32% $315,000-$400,000 |
| 35% $424,950-$480,050 | 35% $400,000-$600,000 |
| 39.6% $480,050+ | 37% $600,000+ |

**Standard Deduction Increased.** For single filers, the standard deduction has increased from $6,500 to $12,000. For joint filers, the standard deduction has increased from $13,000 to $24,000.

**Itemized Deductions Reduced:**

- No significant changes to the deductibility of contributions to qualified plans.
- The mortgage interest deduction has been limited to debt of up to $750,000 (reduced from $1,000,000).
- The home equity loan interest deduction has been repealed, unless the loan is used to buy, build, or substantially improve the taxpayer's home securing the loan.
- All miscellaneous itemized deductions subject to the floor of 2 percent of adjusted gross income have been repealed, including those for unreimbursed employee business expenses, home office expenses, and tax preparation fees.
- Casualty loss deductions have been eliminated (except with respect to those for a presidentially declared disaster).
- Personal exemptions have been largely eliminated.
- The deduction for state and local taxes (including income tax and property tax) has been limited to a total of $10,000 per year, per return.

**Charitable Deduction Limit Increased.** Cash gifts to public charities can be deducted to the extent of 60 percent of adjusted gross income (increased from 50 percent).

**Prohibition on Charitable Deduction for Seat Licenses.** The 2017 Tax Act prohibits individuals from deducting payments made in exchange for the right to purchase tickets for seating at an athletic event.

**Child Tax Credit.** The child tax credit has been increased from $1,000 to $2,000. Its phase-out threshold has increased from $110,000 in 2017 to $400,000 for married couples in 2018.

**"Kiddie Tax."** Under prior law, a minor child's unearned income was taxed at the parent's rate. Now, the minor child's unearned income is subject to tax at the same rates as the income of an estate or trust, meaning that the top rate is reached at $12,500.

**Sunset.** These changes are mostly temporary and are set to expire on December 31, 2025.

## Changes Affecting Estates

The estate tax exemption has increased to $10 million per person, indexed for inflation. In 2018, the exemption stands at $11,180,000, and will increase to $11,400,000 in 2019. As with most of the income tax changes, this increase in the estate tax exemption is set to sunset on December 31, 2025.

## Pass-Through Deduction

A new deduction, enacted as section 199A of the Internal Revenue Code, applies to qualified trade or business activity occurring in a partnership, S corporation, disregarded entity (such as a single-member LLC), or sole proprietorship form. The deduction also applies to REITs and publicly traded partnerships.

**Deduction for Qualified Business Income.** The deduction is equal to the lesser of (i) "combined qualified business income" or (ii) 20 percent of taxable income less any net capital gain. There are additional factors relevant to taxpayers with qualified cooperative dividends.

**Combined Qualified Business Income.** This is the sum of (i) 20 percent of qualified REIT dividends and qualified publicly traded partnership income, plus (ii) 20 percent of the taxpayer's qualified business income with respect to each qualified trade or business. There are additional wage and qualified property tests that must be satisfied.

**Limitation for Reasonable Compensation and Guaranteed Payments.** Qualified business income does not include reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business. It also does not include any guaranteed payment described in section 707(c) of the Internal Revenue Code.

**Income Threshold Limitations.** Additional restrictions apply to individuals who have income above certain thresholds. The limitations apply fully to individual taxpayers with taxable income exceeding $207,500 for single filers or $415,000 for joint filers. The limitations proportionately phase out the deduction for single filers with taxable income between $157,500 and $207,500 and for joint filers with income between $315,000 and $415,000.

**Limits for Service Trades or Businesses.** The following "specified service trades or businesses" are not qualified trades or businesses for purposes of the 20 percent section 199A deduction: (i) health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, and brokerage services; (ii) any trade or business where the principal asset is the reputation or skill of one or more employees; (iii) and any trade or business involving the performance of services consisting of investing and investment management, trading, or dealing in securities, partnership interests, or commodities. However, owners of these "specified service trades or businesses" can still take advantage of the 20 percent deduction if their taxable incomes are below the thresholds discussed in the preceding paragraph.

If you would like to learn more about the new tax rules and other possible planning actions, please contact Michael Cumming (mcumming@dykema.com), Tony Frasca (afrasca@dykema.com), Jonathan Michael (jmichael@dykema.com), Marie Deveney (mdeveney@dykema.com), Robert Tiplady (rtiplady@dykema.com), Gene Magidenko (gmagidenko@dykema.com), any of the attorneys in Dykema's tax group, or your relationship attorney.

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