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Year-End Tax Planning Strategies for Individuals

Most taxpayers have now filed their first tax returns under 2017's TCJA. Several clear strategies and tactics emerged during the first tax filing season, which can be used to make key decisions between now and the end of the year.

Here are 2019 and 2020 tax planning opportunities worth consideration.

1: Decide Whether or Not to Defer Income

Deferring income into the next tax year and accelerating expenses into the current tax year is a time-tested technique for taxpayers who don't expect to be in a higher tax bracket the following year. Business owners who use the cash method of accounting can, for example, hold off on sending invoices until late December to push the associated income into 2020.

However, in some cases, it may be more beneficial to claim the income this year. For example, future tax rates could go up depending on 2020 election results, particularly for those with higher income. Additionally, higher tax rates that were in place for 2017 are scheduled to return in 2026, signaling that the era of income deferment may soon be over.

Moreover, taxpayers eligible for the qualified business income (QBI) deduction for pass-through entities could end up reducing the size of that deduction if they reduce their income. It might make more sense to maximize the QBI deduction (scheduled to end after 2025) while it's still available.

Unearned Income Surtax

Higher-income taxpayers are wary of the 3.8% surtax on certain unearned income. The surtax is 3.8% of the lesser of:

- Net investment income (NII), or
- The excess of modified adjusted gross income (MAGI) over a threshold amount

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

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2: Harvest Losses against Capital Gains

All taxpayers, regardless of employment status, may opt to defer income by taking capital gains after January 1. The risk with this strategy is that waiting to sell opens the door to the possibility of the investment becoming less valuable.

Additionally, taxpayers may wish to review their investment portfolios for tax loss harvesting opportunities. Selling underperforming investments before year-end may allow an investor to realize losses that can be used to offset taxable gains realized this year, on a dollar-for-dollar basis.

If losses exceed the gains, the investor generally can apply up to $3,000 of the excess to offset ordinary income. Any unused losses, however, may be carried forward indefinitely throughout the investor's lifetime to be used in a subsequent year.

No deduction is allowed for a loss if you acquire substantially identical securities within a 61-day period beginning 30 days before the sale and ending 30 days after the sale. Instead, the disallowed loss is added to the cost basis of the new stock, unless you avoid this rule by acquiring similar, but not substantially identical investments.

3: Make Charitable Contributions

When making charitable contributions, consider making gifts with appreciated (must be held long-term – more than 1 year) publicly traded securities instead of cash. That way, a deduction is obtained for the full value of the stock, while the regular income tax on the appreciation in value is avoided.

Out-of-pocket costs paid on behalf of charitable organizations (i.e., costs to sponsor a benefit dinner or a fundraising gathering) are generally deductible as a charitable contribution. Charitable contributions paid by credit card are deductible in the year charged, not when the payment is made on the card. A charitable deduction is also allowed for non-cash contributions (i.e., contributions of clothing and household items to Goodwill, Salvation Army etc.).

4: Maximize Retirement Contributions

Individual taxpayers should consider making their maximum allowable contributions for the year to their IRAs, 401(k) plans, deferred annuities, and other tax-advantaged retirement accounts.

For 2019, you can contribute up to $19,000 to 401(k)s and $6,000 for IRAs. Those age 50 or older are eligible to make an additional catch-up contribution of $1,000 to an IRA and, if allowed, $6,000 for 401(k)s and other employer-sponsored plans.

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Limitation on Deduction for Active Participants in Certain Pension Plans

If you (or your spouse) is an active participant in an employer plan and your modified adjusted gross income (AGI) exceeds certain limits, you can't deduct the full amount of the IRA contribution and may not be able to deduct any of it.

For tax years beginning in 2020, the applicable dollar amounts used to determine the limitation on the deduction for active participants in certain pension plans are as follows:

Filing Status	Applicable Amount
Married Individual Filing a Joint Return	$104,000
All Other Taxpayers (other than a Married Individual Filing a Separate Return)	$65,000
Married Individual Filing a Separate Return	$ 0
Spouses Who Are Not Active Participants	$196,000

5: Invest in a Qualified Small Business Corporation

The greatest advantage of owning qualified small business stock (QSBS) is that noncorporate taxpayers can exclude 100% of any gain realized on the sale or exchange of QSBS held for more than five years.

With limited exceptions, an investor can elect to "rollover" gain from the sale of QSBS sold by the individual investor, or by a partnership, mutual fund or "S corporation" in which the investor holds an interest. In a rollover in which the investor is the seller of the QSBS, the investor can sell the QSBS without currently paying tax if replacement QSBS stock is acquired within 60 days of the original sale. The investor must have held the stock for more than six months to take advantage of this break.

For eligibility purposes, a qualified small business corporation is generally a domestic C corporation whose assets don't exceed $50 million. In addition, 80% or more of the corporation's assets must be used in the active conduct of a qualified business. There are also other requirements that must be met.

6: Invest in a Qualified Opportunity Fund

Qualified opportunity funds (QOFs) are entities that invest in certain low-income communities known as qualified opportunity zones. QOFs provide tax incentives for investors who have gains to defer and can satisfy a detailed and complex set of rules.

There are two major benefits of investing in a QOF.

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Defer and partially exclude gain from the sale of property by reinvesting in a QOF.

Gains may be deferred until the taxpayer sells their interest in the QOF, or December 31, 2026, whichever occurs first.

Additionally, 10% of the gain may be excluded if the taxpayer holds the QOF investment for at least five years, with an additional 5% exclusion if the investment is held for at least seven years, for a total of 15%.

Permanently exclude gain from the sale or exchange of the investment in the QOF.

A taxpayer can exclude any post-acquisition capital gains on an investment in a QOF if the investment is the QOF is held for 10 years.

7: Take Advantage of Special Benefits for Fire Victims

Taxpayers who are in a federally declared disaster area and suffered uninsured or unreimbursed disaster-related losses, may choose to claim casualty losses either on the return for the year the loss occurred (for example, the 2019 tax year) or on the return for the prior year (2018). Also, taxpayers may want to settle an insurance or damage claim in 2019 in order to maximize the casualty loss deduction this year. This is especially important for those affected by recent California fires.

8: Make Gifts to Family Members

Make gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may save gift and estate taxes.

The exclusion applies to gifts of up to $15,000 made in 2019 to each of an unlimited number of individuals. Individuals cannot carry over unused exclusions from one year to the next.
Such transfers are a standard estate planning technique, and may also save a family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

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Several exemption and exclusion limits are set to change for the 2020 tax year. Here is a brief overview to assist with your estate and gift tax planning in the year ahead.

Exclusion / Exemption Amount	**2019 Limit**	**2020 Limit**
Unified Estate and Gift Tax Exclusion Amount	$11,400,000	$11,580,000
Generation-Skipping Transfer (GST) Tax Exemption Amount[1]	$11,400,000	$11,580,000
Gift Tax Annual Exclusion	$15,000	$15,000
Annual Exclusion for Gifts to Non-Citizen Spouses	$155,000	$157,000

[1] *If a taxpayer uses the entire exemption and the exemption amount increases, the taxpayer may claim the additional amount in the future year.*

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Tax Planning Opportunities for Business Owners

1: Maximize the Qualified Business Income Deduction.

Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income from sole proprietorships and pass-through entities such as partnerships, LLCs, and S corporations.

Taxpayers may be able to achieve significant savings with respect to this deduction by deferring income or accelerating deductions so as to come under the dollar thresholds (or be subject to a smaller phaseout of the deduction) for 2019.

Depending on their business model, taxpayers also may be able increase the new deduction by increasing W-2 wages before year-end. The deduction is complex and subject to various rules and limitations based on the taxable income, the type of business and the business' W2 wages and property. Planning strategies should be considered to maximize the deduction.

2: Accelerate Write-Off of Business Assets

Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2019, the expensing limit is $1,020,000 and the investment ceiling limit is $2,550,000.

Expensing is generally available for the following:

- Most depreciable property (other than buildings)
- Off-the-shelf computer software
- Qualified improvement property
- Roofs
- HVAC
- Fire protection, alarm, and security systems

The generous dollar ceilings that apply this year mean that many small and medium sized businesses that make timely purchases can deduct most (if not all) of their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year.

The fact that the expensing deduction may be claimed in full, regardless of how long the property is held during the year can be a potent tool for year-end tax planning.

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Property acquired and placed in service in the last days of 2019, rather than at the beginning of 2020, can result in a full expensing deduction for 2019.

3: Maximize First-Year Depreciation Deduction

Businesses can also claim a 100% bonus first-year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if purchased and placed in service this year.

The 100% write-off is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the first-year bonus is available even if qualifying assets are in service for only a few days in 2019.

Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules.

Where the UNICAP rules aren't an issue and other eligibility requirements are met, consider purchasing such qualifying items before the end of 2019.

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Tax Briefing from the Hill

There is much focus on what the tax writers in the House and Senate will be able to accomplish before the end of 2019. Here are tax priorities up for consideration.

1: Extenders

There is interest in extending the expired and expiring tax preferences. There may not be sufficient time to pass tax extenders legislation before the end of the year-end session. Lawmakers appear distracted by efforts to negotiate several nontax issues, including trade agreements with Mexico and Canada, the pending shutdown of the federal government on December 20[2], and House Democrats' impeachment inquiry into President Trump. All of that has some insiders lowering their expectation for success on an extenders deal.

2: Expiring Tax Provisions

2019	2020	2021
• Credit for health insurance costs • Electricity production or investment credit • New markets tax credit • Paid family and medical leave employer credit • Work opportunity credit • Related foreign corporations look-through treatment • Health insurance policy fee • Self-insured health plan fee • Tax break for alcoholic beverage producers	• Part of the advanced nuclear power production credit	• Interest payment deduction limit • Tax perk for Puerto Rico, Virgin Islands • Residential energy property credit • Increased business solar energy property credit • Geothermal heat, small wind property credit • Hybrid solar lighting system credit • Fuel cell, microturbine credit • Five-year recovery period for energy property

Source data from Joint Committee on Taxation

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[2] A short-term spending bill was passed late on Thursday, November 21, 2019, extending federal funding through December 20, 2019.

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3: Technical Corrections

Tax writers would like to fix errors in the 2017 Tax Act, including the "retail glitch" that keeps restaurants and retailers from immediately writing off the costs of interior improvements and the accelerated depreciation of qualified improvement property.

A correction is also needed to repeal the 21% tax rate imposed on fringe benefits of nonprofit employees, such as free parking and passes for mass transit.

4: Retirement Provisions

The House passed a retirement package earlier in the year (Secure Act). The Senate is considering introducing bipartisan retirement security legislation, which includes revenue raisers relating to stretch IRAs, increasing penalties for failure to file returns (including retirement plan returns), and increasing excise tax information sharing.

5: Other Potential Tax Legislation

- Expand the Earned Income Tax Credit and the Child Tax Credit
- A clean energy tax package
- Undo the repeal of the federal deduction for state and local taxes
- Address expiring health related tax breaks
- Tax treatment of investment income of certain private foundations

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