FAIRMAN GROUP
FAMILY OFFICE

899 Cassatt Road, Suite 115, Berwyn, PA 19312
Phone: 610-889-7300 Fax: 610-889-7326
www.fairmangroup.com

Year-End Tax Income Planning under the Tax Cuts and Jobs Act

As the leaves continue to fall and your thoughts turn to family and the holidays, consider what you can do—this year—to lower your tax bill. To help you get ready for tax season, our team has prepared some important information regarding:

1. Standard vs. Itemized Deduction Changes
2. Qualified Business Income (QBI) Deduction
3. Section 179 Tax Deduction for Businesses
4. Elimination of Entertainment Expense Deductions
5. Tried and True Ways to Manage Taxable Income

Standard vs. Itemized Deduction Changes

One of the most notable changes with the Tax Cuts and Jobs Act 2018 (TCJA) is that the standard deduction has increased to $24,000 for joint filers (and $12,000 for single filers), meaning that the total amount of your itemized deductions must be greater than $24,000 to get a tax benefit.

However, you may still be able to benefit from your itemized deductions by applying a bunching strategy to charitable contributions and medical expenses, even though certain itemized deductions have been limited or eliminated for 2018.

The tax code allows most taxpayers to either utilize the standard deduction or itemize their deductions, whichever provides the greater benefit. While some taxpayers wait until tax time to add everything up, we prefer a more proactive approach. By applying a 'bunching strategy', you can time the payments of tax-deductible items to maximize your itemized deductions in one year and take the standard deduction in another year.

- **Charitable Contributions.** The charitable contribution base has increased from 50% of Adjusted Gross Income (AGI) to 60%. If you want to take advantage of itemized deductions, but do not want all the money to go to a charity in a single year, a Donor Advised Fund (DAF) is a great vehicle to consider.

- **Medical Expense.** The threshold to claim itemized deductions for medical expenses is temporarily reduced to 7.5% of AGI for 2018. For tax years after 2018, the threshold returns to 10% of AGI.

- **Miscellaneous Deductions.** Miscellaneous itemized deductions are eliminated for 2018. This includes expenses such as investment advisory fees, tax preparation fees, certain legal fees, and unreimbursed business expenses.

- **State and Local Income & Property Taxes (SALT)**. The deduction for State and Local Income and Property Taxes is limited to $10,000. You may be aware that certain states created "charitable funds" whereby a taxpayer would donate to the charitable fund set up by the municipality, take a charitable deduction on the federal tax return, and receive a credit against their property or income tax bill. Be aware that the IRS has issued proposed regulations blocking states from creating a workaround. While certain states—such as California, Connecticut, New Jersey, and New York—are continuing to fight this, expect that the $10,000 SALT limitation applies for 2018 planning purposes.

Qualified Business Income (QBI) Deduction

The top tax rate for C Corporations has been reduced from 35% to 21%. In order to place individual business owners and passthrough business owners in a similar tax rate situation, the TCJA added a 20% qualified business income deduction.

For service businesses, such as consulting, accounting, financial services, health, and law, the deduction is limited for taxable income over $315,000 for joint filers (or $157,500 for single filers and trusts) and completely phased out for taxable income over $415,000 for joint filers (or $207,500 for single filers and trusts). For other trades or businesses, the deduction is limited for taxable income over $315,000 for joint filers (or $157,500 for single filers and trusts).

While the TCJA was meant to simplify the tax code, the QBI deduction is anything but simple. The calculation is complex and involves many moving parts. The deduction is subject to multiple limits 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/or the unadjusted basis of qualified property held by the trade or business.

One strategy to qualify for the QBI deduction is to try and keep taxable income under the thresholds. This can be accomplished using the traditional methods of loss harvesting, deferring income, and accelerating

deductions. There are additional steps which can be taken to lower income, such as setting up a defined benefit plan in the business and/or gifting part of the business to a trust.

Please contact us to discuss planning ideas for qualifying for the QBI deduction.

Section 179 Tax Deduction for Businesses

For qualified property placed in service during 2018, $1,000,000 can be expensed under Section 179 (up from $510,000 in 2017). This deduction begins to be phased out if more than $2,500,000 of property is placed in service during 2018.

Elimination of Entertainment Expense Deductions

Entertainment expenses are no longer deductible; however, meals remain deductible and are still subject to the 50% limitation. For example, if you take a client to a baseball game—and purchase tickets, hot dogs, and drinks—the cost of the ticket is not deductible, but the hotdogs and drinks are allowed as a deduction subject to the 50% limitation.

Tried and True Ways to Manage Taxable Income

While the TCJA drastically changed several tax provisions, many year-end planning tactics remain. Managing taxable income is important not only for the new QBI deduction, but also for the additional Medicare tax and Net Investment income tax. Lowering your taxable income may also enable you to claim credits and other tax breaks that are phased out over varying levels of AGI.

Some ways to manage taxable income include:

- Harvesting capital losses to offset capital gains in your portfolio
- Deferring a bonus or other compensation until 2019
- If you are at least 70 ½ years, contributing to charities directly from your IRAs without having the amount of the contribution included in gross income
- Disposing of a passive activity in 2018, if doing so will allow you to deduct suspended passive activity losses
- Shifting income-producing assets to a child or other taxpayer to take advantage of lower brackets. For trusts, consider making distribution to beneficiaries in lower tax brackets.

Additional considerations for year-end:

- Contributing to 529 plans
- Making annual exclusion gifts—up to $15,000 per individual—before the end of the year
- Revisiting your estate plan in light of the new increased exemptions available

For 2018, year-end planning is important to ensure that deductions are properly being utilized and taxable income is being managed. Through a combination of bunching and traditional techniques, we can help you keep the tax bill as low as possible.

Please contact us to set up your one-on-one review.

Are You Ready to Make Your Best Financial Decision, Ever?

Marianne Inforzato, CFP®

Partner

minforzato@fairmangroup.com

Walter Reed, JD, CFP®, CDFA™

Principal

Lee Profy, JD, LLM

Principal

Julia Ziechmann, JD, LLM

Manager