Shifting Income and Deductions into the Most Advantageous Year

You can shift taxable income between 2018 and 2019 by controlling the receipt of income and the payment of deductions. Generally, income should be received in the year with the lower marginal tax rate, while deductible expenses should be paid in the year with the higher marginal rate. If your top tax rate is the same in 2018 and 2019, deferring income into 2019 and accelerating deductions into 2018 will generally produce a tax deferral of up to one year. On the other hand, if you expect your tax rate to be higher in 2019, you may want to accelerate income into 2018 and defer deductions to 2019. Keep in mind, however, that the aforementioned tax reform repeals most itemized deductions.

Planning Suggestion: The time value of money should be considered when making a decision to defer income or accelerate deductions. Comparative computations should be made to determine and evaluate the net after-tax result of these financial actions.

Moreover, you should consider whether you expect to be subject to the AMT for either or both years (see AMT).

CONTROLLING INCOME

Income can be accelerated into 2018, or deferred to 2019, by controlling the receipt of various types of income depending on your situation, such as:

For Business Owners

- Year-end interest or dividend payments from closely-held corporations
- Rents and fees for services (delay December billings to defer income)
- Commissions (close sales in January to defer income)

Caution: Income cannot be deferred to 2019 if you constructively receive it in 2018. Constructive receipt occurs when you have the right to receive payment or have received a check for payment, even though it has not been deposited. Income also cannot be deferred if you effectively receive the benefit of the income; for example, if you are allowed to pledge a deferred compensation account balance to obtain a loan.

Bonuses that are determined based on work performed in 2018 can be paid during 2018 or in 2019. Payment in 2018 secures the 2018 deduction for the business using either the cash or accrual basis of accounting. Payment in 2019 will delay the deduction for a cash basis business, therefore allowing some flexibility in the year of deduction.

For Investors

- Interest on short-term investments, such as Treasury bills (T-bills) and certain certificates of deposit that do not permit early withdrawal of the interest without a substantial penalty, is not taxable until maturity.

Example: In November 2018, an investor buys a six-month T-bill. The interest is not taxable until 2019, assuming the T-bill is held to maturity.

Interest on U.S. Series EE savings bonds

Other than not being taxable until the proceeds are received, interest on issued Series EE bonds may be exempt from tax if the proceeds of the bond are used to pay certain educational expenses for yourself or your dependents, and the requirements of “qualified United States savings bonds” are met.

Planning Suggestion: Consider investments that generate interest exempt from the regular income tax. You must, however, compare the tax-exempt yield with the after-tax yield on taxable securities to determine the most advantageous investment. In addition, some tax-exempt interest may be subject to AMT (see AMT) which could lower the after-tax yield.

Other ways to defer income include installment sales and tax-free exchanges of "like-kind" investment or business property. Following tax reform, such like-kind exchanges apply only to real property and do not apply to exchanges of personal or intangible property.

Planning Suggestion: If you made a 2018 sale that is eligible for installment reporting, you have until the due date of your 2018 return, including extensions, to decide if you do not want to use the installment method and, instead, report the entire gain in 2018.

Net Investment Income Tax

The Health Care and Education Reconciliation Act imposes an additional 3.8 percent tax (net investment income tax) on net investment income in excess of certain thresholds for taxable years beginning after December 31, 2012. Examples of net investment income include non-business interest, dividends, and capital gains. Net investment income also includes business income from an activity in which the taxpayer does not materially participate, including from partnerships and S corporations. Income excluded from net investment income includes wages, unemployment compensation, self-employment income, Social Security benefits, tax-exempt interest, distributions from certain qualified retirement plans, and non-investment income from businesses in which the taxpayer is a material participant. The 3.8 percent tax is applicable to taxpayers with modified adjusted gross income for 2018 exceeding $250,000 for married couples and surviving spouses, $125,000 for married individuals filing separate returns, and $200,000 for single individuals and head of household filers. You should be aware that these statutory threshold amounts are not indexed for inflation. The tax is 3.8 percent of the lesser of your net investment income or the excess of your modified adjusted gross income over the applicable threshold amount stated above. This tax is also likely to apply to a significant portion of the net investment income of an estate or trust that is otherwise subject to income tax on such income. The suspension of most itemized deductions under tax reform eliminates the use of such itemized deductions against net investment income for tax years beginning in 2018 and ending before 2026.

Planning Suggestion: We strongly encourage you to consult your investment and tax advisors to maximize the after-tax returns if you believe your portfolio may not be currently aligned to account for increased tax exposure.

For Employees

Year-end bonuses and deferred compensation

Caution: The Service will scrutinize deferrals of income between owner-employees and their closely-held corporations. Additionally, if you own more than 50 percent of a taxable (C) corporation or any stock of an S corporation that reports its income on an accrual method of accounting, the corporation can deduct a year-end bonus to you only when it is paid. Also, any deferred compensation arrangements must comply with the Section 409A rules discussed later in this letter. These rules may prevent a reduction of 2018 taxable income by deferral but elections can be made before December 31, 2018, that affect your 2019 taxable income.

Planning Suggestion: Determine if you would like to avoid 2019 taxation of your 2019 compensation and make the appropriate deferral election before the end of 2018.

Additional Planning: Evaluate existing deferred compensation arrangements and the stated distribution schedule. If distributions are not scheduled to begin within the next 12 months, consider a second deferral of five additional years.

The impact of the tax reform changes on your effective tax rate should be carefully evaluated before deferring income.

The tax rates for the Medicare (hospital insurance) portion of the social security tax are:

- 1.45 percent for employees for 2019
- 1.45 percent for employers for 2019
- 2.9 percent for self-employed individuals for 2019

There is an additional 0.9 percent tax on all wages and self-employment income in excess of $200,000 for single, head of household and surviving spouse taxpayers, $250,000 for married taxpayers filing jointly, and $125,000 for married taxpayers filing a separate return.

This tax is imposed on all employee compensation and self-employment income, including vested deferred compensation, without any limitation or cap. The income thresholds for the additional 0.9 percent tax apply first to total wages, and then to self-employment income.

Planning Suggestion: If you are a shareholder in an S corporation, you might be able to reduce the tax by reducing your salary. However, reasonable compensation must be paid to S corporation shareholders for services rendered to the S corporation.

The tax rate for the old age, survivors, and disability insurance portion of the social security tax is:

- 6.2 percent for employees for 2019
- 6.2 percent for employers for 2019
- 12.4 percent for self-employed individuals for 2019

Similar to the Medicare withholding tax, this tax is imposed on employee compensation and self-employment income, except that this tax is imposed only to the extent of the maximum wage base set by the Social Security Administration ($128,400 for 2018).

Distributions from retirement plans

Distributions from qualified retirement plans can be delayed (see Retirement Plan Distributions)

Caution: Penalties may be imposed on early, late, or insufficient distributions.

IRA distributions

All distributions from a regular individual retirement account (IRA) are subject to ordinary income taxes. This tax liability can be delayed until age 70½ at which time you are required to begin taking annual distributions from your IRA. The 10 percent early withdrawal penalty prevents distributions before age 59½ in most cases. However, if you are over 59½ you can take a penalty-free voluntary distribution if accelerating ordinary taxable income into 2019 is desirable. Penalty-free access to the funds is available prior to age 59½ to the extent the distribution is used (1) to pay unreimbursed medical expenses in excess of 10 percent of your adjusted gross income (AGI), (2) to pay any health insurance premiums (provided you have received unemployment compensation for at least 12 weeks), or (3) for a limited number of other exceptions.

If you are planning to purchase a new home, you may withdraw up to $10,000 from your IRA to pay certain qualified acquisition expenses without having to pay the 10 percent early withdrawal penalty. The distribution is still subject to regular income tax. The $10,000 withdrawal is a lifetime cap. If a taxpayer or spouse has owned a principal residence in the previous two years, this penalty-free provision is not available. An eligible homebuyer for this purpose can be the owner of the IRA, his or her spouse, child, grandchild, or any ancestor. Also, penalty-free distributions can be made from IRAs for higher education expenses of a taxpayer, spouse, child, or grandchild.

If you are planning to make a charitable gift, individuals aged 70 ½ or older can donate money from their IRA account directly to a charitable organization without the gift counting as income. Qualified charitable distributions can also satisfy all or part of your required minimum distribution from your IRA.

Accelerated insurance benefits

Subject to certain requirements, payments received under a life insurance policy of an individual who is terminally or chronically ill are excluded from gross income. If you sell a life insurance policy to a viatical settlement provider (regularly engaged in the business of purchasing or taking assignments of life insurance policies), these payments also are excluded from gross income.

Educational expense exclusion

An exclusion for employer-provided education benefits for non-graduate and graduate courses up to $5,250 per year is available.

Damages received for non-physical injuries and punitive damages

All amounts received as punitive damages and damages attributable to non-physical injuries are gross income in the year received. Legal fees attributable to employment related unlawful discrimination lawsuits are a deduction in arriving at adjusted gross income, instead of a miscellaneous itemized deduction. Damages received by a spouse, which are attributable to loss of consortium due to physical injuries of the other spouse, are excluded from income.

CONTROLLING DEDUCTIONS

The phase-out of itemized deductions for high income individual taxpayers, called the "Pease" limitation, was suspended for tax years 2018 through 2025. Under the Pease limitation, itemized deductions that would otherwise be allowable were reduced by the lesser of:

- 3 percent of the amount of the taxpayer's AGI in excess of a threshold amount, or
- 80 percent of the itemized deductions otherwise allowable for the taxable year.

High-earning taxpayers will once again be able to take itemized deductions that were limited under Pease, however with the increased standard deduction, a taxpayer's amount of total deductions must generally be greater than $12,000 for single individuals and $24,000 for married couples filing jointly before they incur the benefit of itemizing deductions.

Deductions that may be accelerated into 2018 or deferred to 2019 include:

Charitable contributions (cash or property)

You must obtain written substantiation from the charitable organization, in addition to a canceled check, for all charitable donations in excess of $250.

Charities are required to inform you of the amount of your net contribution where you receive goods or services in excess of $75 in exchange for your contribution.

If the value of contributed property exceeds $5,000, you must obtain a qualified written appraisal (prior to the due date of your tax return, including extensions), except for publicly-traded securities and non-publicly-traded stock of $10,000 or less.

Planning Suggestion: If you are considering contributing marketable securities to a charity and the securities have declined in value, sell the securities first and then donate the sales proceeds. You will obtain both a capital loss and a charitable contribution deduction.

Caution: If you are contemplating the repurchase of the security in the future, you need to consider the wash sale rules discussed (See below under Capital Gains and Losses, Page 9).

On the other hand, if the marketable securities or other long-term capital gain property have appreciated in value, you should contribute the property in kind to the charity. By contributing the property in kind, you will avoid taxes on the appreciation and receive a charitable contribution deduction for the property's full fair market value.

If you wish to make a significant gift of property to a charitable organization yet retain current income for yourself, a charitable remainder trust may fulfill your needs. A charitable remainder trust is a trust that generates a current charitable deduction for a future contribution to a charity. The trust pays you (or another person) income annually on the principal in the trust for a specified term or for life. When the term of the trust ends, the trust's assets are distributed to the designated charity. You obtain a current income tax deduction when the trust is funded based on the present value of the assets that will pass to the charity when the trust terminates (at least 10 percent of the initial FMV). This accelerates your deduction into the year the trust is funded, while you retain the income from the assets. This method of making a charitable contribution can work very well with appreciated property.

If you volunteer time to a charity, you cannot deduct the value of your time, but you can deduct your out-of-pocket expenses. If you use your automobile in connection with performing charitable work, including driving to and from the organization, you can deduct 14 cents per mile for 2018. You must keep a record of the miles.

The allowable deduction for donating an automobile (also, a boat and airplane) is significantly reduced. The deduction for a contribution made to a charity, in which the claimed value exceeds $500, will be dependent on the charity's use of the vehicle. If the charity sells the donated property without having significantly used the vehicle in regularly conducted activities, the taxpayer's deduction will be limited to the amount of the proceeds from the charity's sale. In addition, greater substantiation requirements are also imposed on property contributions. For example, a deduction will be disallowed unless the taxpayer receives written acknowledgement from the charity containing detailed information regarding the vehicle donated, as well as specific information regarding a subsequent sale of the property.

Tax reform increased the adjusted gross income limitation for cash contributions to a public charity beginning in 2018 from 50 percent of adjusted gross income to 60 percent of adjusted gross income.

Medical expenses

In addition to medical expenses for doctors, hospitals, prescription medications, and medical insurance premiums, you may be entitled to deduct certain related out-of-pocket expenses such as transportation, lodging (but not meals), and home healthcare expenses. If you use your car for trips to the doctor during 2018, you can deduct 18 cents per mile for travel during 2018. Payments for programs to help you stop smoking and prescription medications to alleviate nicotine withdrawal problems are deductible medical expenses. Uncompensated costs of weight-loss programs to treat diseases diagnosed by a physician, including obesity, are also deductible medical expenses.

In 2018, the deduction is limited to the extent your medical expenses exceed 7.5 percent of your adjusted gross income. In 2019, the limit will be increased to 10 percent.

Planning Suggestion: If you pay your medical expenses by credit card, the expense is deductible in the year the expense is charged, not when you pay the credit card company. It is important to remember that prepayments for medical services generally are not deductible until the year when the services are actually rendered. Because medical expenses are deductible in 2018 only to the extent they exceed 7.5 percent of AGI as discussed above, they should, where possible, be bunched in a year in which they would exceed this AGI limit.

Under certain conditions, if you provide more than half of an individual's support, such as a dependent parent, you can deduct the unreimbursed medical expenses you pay for that individual to the extent all medical expenses exceed the applicable AGI limit. Even if you cannot claim that individual as your dependent because his or her 2018 gross income is $4,150 or more, you are still entitled to the medical deduction. Please consult your advisor for details.

Long-term care insurance and services

Premiums you pay on a qualified long-term care insurance policy are deductible as a medical expense. The maximum amount of your deduction is determined by your age. The following table sets forth the deductible limits for 2018:

Age	Deduction Limitation
40 or less	$420
41 – 50	$780
51 – 60	$1,560
61 – 70	$4,160
Over 70	$5,200

These limitations are per person, not per return. Thus, a married couple over 70 years old has a combined maximum deduction of $10,400, subject to the applicable AGI limit.

Generally, if your employer pays these premiums, they are not taxable income to you. However, if this benefit is provided as part of a flexible spending account or cafeteria plan arrangement, the premiums are taxable to you. The deduction for health and long-term care insurance premiums paid by a self-employed individual is covered in the chart at the end of this letter titled "Tax Tips for the Self-Employed".

Medical payments for qualified long-term care services prescribed by a licensed healthcare professional for a chronically ill individual are also deductible as medical expenses.

Coverage for adult children

The Patient Protection and Affordable Care Act (ACA) provides that any health insurance plan that covers dependents must be extended to provide coverage of adult children until the day the child reaches age 26. The general exclusion from gross income also includes premiums from employer-provided health benefits to any employee's child who has not attained age 27 as of the end of the taxable year is also extended under the ACA. Republican congressional leaders and President Trump attempted to repeal the ACA several times during 2017, and though so far unsuccessful, they continue to express that repeal remains a future possibility.

Mortgage interest and points

Interest as well as points paid on a loan to purchase or improve a principal residence is generally deductible in the year paid. The mortgage loan must be secured by your principal residence. Points paid in connection with refinancing an existing mortgage are not deductible currently, but rather must be amortized over the life of the new mortgage unless the loan proceeds are used to substantially improve the residence. However, if the mortgage is refinanced again, the unamortized points on the old mortgage can be deducted in full. See Home Mortgage Interest for additional information regarding mortgage and other interest payments.

Interest paid on qualified education loans

An "above-the-line" deduction (a deduction to arrive at AGI) is allowed for interest paid on qualified education loans. All student loan interest up to the $2,500 annual limit is deductible. However, in 2018 this deduction begins to phase out for single individuals with modified AGI of $65,000 and is completely phased out if AGI is $80,000 or more ($135,000 to $165,000 for joint returns).

Caution: Interest paid to a relative or to an entity (such as a corporation or trust) controlled by you or a relative does not qualify for the deduction.

Non-business bad debts

Non-business bad debts are treated as short-term capital losses when they become totally worthless. To establish worthlessness, you must demonstrate there is no reasonable prospect of recovering the debt. This might include documenting the efforts you made to collect the debt, including correspondence to the debtor to demand payment.

Retirement plan contributions

If your employer (including a tax-exempt organization) has a 401(k) plan or 403(b) plan, as applicable, consider making elective contributions up to the maximum amount of $18,500 ($24,500 if over age 50) in 2018, especially if you are unable to make contributions to an IRA. You should also consider making after-tax, nondeductible contributions to a 401(k) plan if the plan allows, as future earnings on those contributions will grow tax-deferred. A nondeductible contribution to a Roth IRA can also be considered (see Roth IRAs and Education IRAs).

Planning Suggestion: If you are a participant in an employer's qualified plan that allows employee contributions such as a 401(k) plan and are at least 50 years old, you can elect to make a deductible "catch-up" contribution of $6,000 to the plan (for a $24,500 maximum contribution). To make a "catch-up" contribution, your employer's plan must allow such contributions.

IRA deductions

The total allowable annual deduction for IRAs in 2018 is $5,500, subject to certain AGI limitations if you are an "active participant" in a qualified retirement plan. A non-working spouse may also make an IRA contribution based upon the earned income of his or her spouse. A catch-up provision for individuals age 50 or older applies to increase the deductible limit by $1,000 for IRAs to a total deductible amount of $6,500.

Planning Suggestion: Consider making your full IRA contribution early in the year so that income earned on the contribution can accumulate tax-free for the entire year.

Planning Suggestion: If cash flow is a concern, consider the use of credit cards to make tax deductible year-end payments. Note however, interest paid to a credit card company is not deductible because it is personal interest (see Personal Interest).

Caution: If you choose to accelerate income into 2018 or defer deductions to 2019, make sure your estimated tax payments and withheld taxes are sufficient to avoid 2018 estimated tax penalties (see Estimated Taxes).

DEFERRED COMPENSATION

Since the enactment of Section 409A by the American Jobs Creation Act of 2004, the deferral or change to a deferral of compensation has become more challenging. Section 409A restricts the timing of distributions from and contributions to deferred compensation plans requiring most individuals to:

1. Make an election to defer compensation in the calendar year prior to the year in which the services related to the compensation are performed and
2. Limit the timing of distributions based on one (or more) of six prescribed times or events as follows:
   a. separation from service
   b. disability

c. death

d. a specified time (or pursuant to a fixed schedule)

e. change in ownership of the company

f. an unforeseeable emergency

Plans that may be affected by these rules include salary deferral plans, incentive bonus plans, severance plans, discounted stock options, stock appreciation rights, phantom stock plans, restricted stock unit plans, and salary continuation agreements included in employment contracts.

A violation of these rules requires not only a payment of normal income taxes on all amounts deferred up to the time of the violation (or vesting if later), but an additional 20 percent tax as well. This punitive tax makes it challenging to accelerate properly deferred compensation into a current taxable year. However, if you wish to delay income taxes on compensation that you will earn in 2019 to a later taxable year, the agreement to defer generally must be executed before December 31, 2018.

Additionally, under Section 457A, taxpayers who have previously deferred compensation may be required to include deferred amounts in their income by December 31, 2018, if not previously included.

CAPITAL GAINS AND LOSSES

The brackets for long-term capital gains for 2018 are shown below. Long-term capital gains have a lower tax rate, so investors may consider holding on to assets for over a year to qualify for those taxable rates.

Long-Term Capital Gains Tax Rate	Single	Joint	Head of Household
0%	$0-$38,600	$0-$77,200	$0-$51,700
15% minimum income	$38,601	$77,201	$51,701
20% minimum income	$425,801	$429,001	$452,401

Note: Capital gains may also be subject to the 3.8 percent net investment income tax discussed on page 3.

Caution: The tax law contains rules to prevent converting ordinary income into long-term capital gains. For instance, net long-term capital gains on investment property are excluded in computing the amount of investment interest expense that can be deducted (see Investment Interest Expense) unless the taxpayer elects to subject those gains to ordinary income tax rates. Additionally, if long-term real property is sold at a gain, the portion of the gain represented by prior depreciation is taxed at a maximum 25 percent rate.

Capital losses are offset against capital gains. For joint filers, net capital losses of up to $3,000 ($1,500 for married individuals filing separately) can be deducted against ordinary income. Unused capital losses may be carried forward indefinitely and offset against capital gains and up to $3,000 ($1,500 for single filers) of ordinary income annually, in future years.

Planning Suggestion: Add up all capital gains and losses you have realized so far this year, plus anticipated year-end capital gain distributions from mutual funds (this amount should be presently available by calling your mutual fund's customer service number). Then review the unrealized gains and losses in your portfolio. Consider selling additional securities to generate gains or losses to maximize tax benefits.

Caution: Do not sell a security simply to generate a gain or loss to offset other realized gains or losses. The investment merits of selling any security must also be considered.

Note: Capital gains and losses on publicly-traded securities are recognized on the trade date, not the settlement date. For instance, gains and losses on trades executed on December 31, 2018, are taken into account in computing your 2018 taxable income.

If a security is sold at a loss and substantially the same security is acquired within 30 days before or after the sale, the loss is considered a "wash sale" and is not currently deductible. However, this nondeductible loss is added to the cost of the purchased security that caused the "wash sale." This basis adjustment will reduce gain, or increase loss, later when that security is sold.

Although present tax law significantly limits a taxpayer's ability to lock in capital gains without realizing the gains for tax purposes, there are still methods by which this can be accomplished. Please consult your advisor for further guidance.

QUALIFIED SMALL BUSINESS STOCK

A non-corporate taxpayer can exclude specified percentages (50 percent, 75 percent or 100 percent depending on date of issuance) of any gain realized from the sale of "qualified small business stock" (QSBS). To be eligible, the stock must be issued after August 10, 1993, and must have been held for more than five years. The gain eligible for this exclusion cannot exceed the greater of (i) ten times the taxpayer's basis in the stock disposed of during the year or (ii) $10 million less the taxpayer's aggregate prior-year gains from the sale of the same corporation's stock. The includible portion of the gain is subject to a maximum tax rate of 28 percent, and a portion of the excluded gain is included as a tax preference in determining the taxpayer's liability (if any) for the AMT.

However, the 100-percent exclusion is available only for qualified stock issued after September 27, 2010. If a 100-percent exclusion is available, no portion of the gain is subject to the AMT.

A non-corporate taxpayer may also elect to rollover the entire gain from the sale of "qualified small business stock" held for more than six months if, within the 60-day period beginning on the date of sale, the taxpayer purchases QSBS having a cost at least equal to the amount realized from the sale.

Your advisor can be consulted for more information.

DIVIDEND INCOME

Qualified dividend income from domestic corporations and qualified foreign corporations is taxed at the same reduced rates as long-term capital gains for regular tax and AMT purposes.