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2019 Midyear Tax Planning Letter

Dear Clients and Friends:

With the first tax season under the Tax Cuts and Jobs Act (TCJA) behind us, we have a better understanding of the practical applications on the tax law changes. As expected, the law changes had a profound impact on many taxpayers and created new planning opportunities. There is still time to take advantage of these opportunities for 2019 and future years.

Keeping that in mind, we have prepared the following **2019 Midyear Tax Letter**. This letter is not intended to cover every aspect of the TCJA. The concepts discussed in this letter are intended to provide only a general overview of midyear tax planning. It is recommended that you review your personal situation with your JMF tax professional.

INDIVIDUAL TAX PLANNING

Standard Deduction/Itemized Deductions

A common question this year concerns the decision to take the increased standard deduction for federal purposes or to itemize. As a reminder, the federal standard deduction increased to $12,000 for single filers, $18,000 for heads of households, and $24,000 for joint filers. Between the increased standard deduction, the limited state and local tax deduction, and the elimination of miscellaneous itemized deductions, many taxpayers found themselves taking the standard deduction. However, many of these same taxpayers still itemize on their Alabama income tax return. For that reason, it may be necessary to still track itemized deduction expenses in order to maximize your Alabama deduction.

MIDYEAR MOVE: With help from your JMF tax professional, determine if you will be claiming the standard deduction or itemizing deductions in 2019. Depending on your situation, you may want to accelerate deductible expenses into the current year to offset your 2019 tax liability. However, if you do not expect to itemize in 2019, you might as well postpone these expenses to 2020.

Charitable Donations

Generally, itemizers can deduct amounts donated to qualified charitable organizations if substantiation requirements are met. Note that the TCJA increases the annual deduction limit on monetary contributions to 60% of adjusted gross income (AGI), up from 50% of AGI, among other changes.

MIDYEAR MOVE: Absent extenuating circumstances, “bunch” charitable donations in the year they will do you the most tax good. For instance, if you will be itemizing in 2019, you can step up gift giving for the year. Conversely, if you are claiming the standard deduction this year, you may decide to postpone contributions to 2020. In addition, you may want to consider the strategy explained in the Required Minimum Distribution section below in a year in which you do not qualify to itemize.

For donations of appreciated property that you have owned longer than one year, you can generally deduct an amount equal to the property’s fair market value (FMV). Otherwise, the deduction is limited to your "basis" (i.e., the cost). Also, other special rules may apply to gifts of property. Notably, the annual deduction for property donations generally cannot exceed 30% of AGI.

If you are donating securities to a charity, you might choose those that have appreciated in value. As a result, you can deduct the FMV of the securities while the appreciation remains untaxed forever. More sophisticated arrangements include transfers to charitable remainder trusts (CRTs).

FINANCIAL TAX PLANNING

Capital Gains and Losses/Dividends
Frequently, investors can time the sales of securities to produce optimal tax results. This is especially important if you have capital loss carryovers from prior tax years or if you have already realized a capital gain during 2019. Capital gains and losses offset each other. If you show an excess loss for the year, it then offsets up to $3,000 of ordinary income before being carried over to the next year.

MIDYEAR MOVE: Review your investment portfolio to target "winners" and "losers." Depending on your situation, you may harvest capital losses to offset gains realized earlier in the year or cherry-pick capital gains that will be partially or wholly absorbed by prior losses.

Net Investment Income Tax
Besides capital gains tax, an extra 3.8% tax applies to the lesser of your "net investment income" (NII) or the amount by which your modified adjusted gross income (MAGI) for the year exceeds $200,000 for single filers and $250,000 for joint filers. (These amounts are not indexed for inflation.) The definition of NII includes interest, dividends, capital gains and income from passive activities, but not Social Security benefits, tax-exempt interest and distributions from qualified retirement plans and IRAs.

MIDYEAR MOVE: Where it is feasible, reduce your NII tax liability in 2019, or avoid it altogether. This will require that you estimate what the amount of both your NII and your MAGI will be for the year. Then you can act accordingly.

For example, you might replace taxable interest income generating investments with municipal bonds ("munis"). Interest income from munis does not count as NII, nor is it included in the calculation of MAGI. Similarly, if you turn a passive activity into an active business, the resulting income may be exempt from the NII tax. These rules are complex, so obtain professional assistance.

Tip: When you add the NII tax to your regular tax plus any applicable state income tax, the overall rate may approach or even exceed 50%. Factor this into your investment decisions.

Required Minimum Distributions
As a general rule, you must receive required minimum distributions (RMDs) from qualified retirement plans and IRAs after reaching age 70½. The amount of the distribution is based on IRS-approved life expectancy tables and your account balance at the end of last year.

MIDYEAR MOVE: Arrange to receive RMDs before the December 31 deadline. Otherwise, you will have to pay a stiff tax penalty equal to 50% of the required amount (less any amount you have received), in addition to the regular tax liability.

However, if you are still working and do not own 5% or more of the business employing you, you can postpone RMDs from the employer's qualified plan until you retire. This "still working exception" does not apply to RMDs from IRAs or plans of employers where you do not work.

If you are age 70½ or older, transfer IRA funds directly to a charity. Although the charitable contribution is not deductible, the IRA distribution is not subject to tax and still counts as an RMD. Many taxpayers who no longer can itemize can find significant tax savings using this strategy.

FUTURE TAX PLANNING

Miscellaneous

- Contribute up to $19,000 to a 401(k) in 2019 ($25,000 if you are age 50 or older). If you clear the 2019 Social Security wage base of $132,900 and promptly allocate the payroll tax savings to a 401(k), you can increase your deferral without any further reduction in your take-home pay.

- With a Section 529 plan, you can set up an account for a child's college education that can grow without any current tax erosion. Contributions for an Alabama Section 529 plan are deductible on your Alabama tax return up to $5,000 for single and $10,000 for married filing jointly. Payments for qualified expenses are exempt from tax.

- You may be liable for an estimated tax penalty if you fail to pay the required tax during the year. But you can avoid the penalty by paying enough in withholding and/or quarterly installments to satisfy a "safe harbor rule" of 90% of current tax liability or 100% of the previous year's tax liability (110% if AGI was above $150,000). Usually, it easier to figure out payments based on 100% (or 110%) of last year's tax liability. If you found yourself without enough withheld in 2018, contact your JMF accountant to help you determine the appropriate withholding amount for 2019.

BUSINESS TAX PLANNING

Section 179 Deductions

Under Section 179 of the tax code, a business may "expense" (i.e., currently deduct) the cost of qualified property placed in service during the year. The maximum annual deduction is phased out on a dollar-for-dollar basis above a specified threshold. The TCJA doubled the maximum allowance to $1 million with a $2.5 million phase-out threshold for 2018. For 2019 and beyond these amounts will be indexed for inflation.

MIDYEAR MOVE: Note that the Section 179 deduction cannot exceed the taxable income from all your business activities this year. This could limit your deduction for 2019. Remember that Section 179 now applies to improvements to nonresidential real property including roofs, HVAC, fire protection systems, alarm systems, and security systems.

Bonus Depreciation

Under the TCJA, the bonus depreciation deduction will continue at 100% for property placed in service before January 1, 2023. The TCJA gradually phases out bonus depreciation after 2022. This tax break is scheduled to disappear completely after 2026.

MIDYEAR MOVE: Maximize the benefits of 100% bonus depreciation. Factor in all the tax ramifications for your business before purchasing property at the end of the year. Remember that qualified property includes used property rather than just new property.

Travel and Entertainment Expenses

The tax rules for travel and entertainment (T&E) expenses are fraught with numerous twists and turns. On one hand, you can continue to deduct expenses for travel and meal expenses while you are away from home on business, subject to certain limits. On the other hand, the TCJA repealed the deduction for entertainment expenses beginning in 2018.

MIDYEAR MOVE: Prior to the TCJA, you could deduct 50% of your entertainment costs that were "directly-related-to" or "associated-with" your business. The entertainment deduction is no longer available. However, a new ruling issued by the IRS in 2018 clarifies that you can continue to deduct the cost of food and beverages that is invoiced separately from the cost of entertainment activities. This might apply to expenses incurred when you treat a customer or client to tickets to a sporting event.

Tip: Despite the new law changes, you may deduct 100% of a holiday party as long as the entire workforce is invited. Businesses may also continue to deduct 50% of meals provided for employees furnished on the business premises.

The TCJA has not changed the rules for deducting 50% of the cost of meals. Businesses may still deduct 50% of meals if the following conditions are met:

- The expense is "ordinary and necessary";
- The expense is not lavish or extravagant;
- The business owner or employee is present at the meal;
- And the meal is provided to a current or potential customer, client, consultant, or business contact.

Identity Theft

- Tax fraud through the use of identity theft tops the IRS list of tax scams. Tax returns and tax information should be safeguarded.
- Shredding is the recommended means for disposing of unneeded financial records. Keep in mind, also, that the IRS does not initiate contact with taxpayers by phone or email to request personal or financial information.

- Don't be a victim of a phishing scam. Only respond to IRS communications received by US mail and preferably even then only after you have let us review it for you.

CONCLUSION

This midyear tax planning letter is based on the prevailing federal tax laws, rules and regulations. Please remember that this letter is intended to serve only as a general guideline. Your personal circumstances will likely require careful examination. We would be glad to schedule a meeting with you to assist with all your tax-planning needs.

Sincerely yours,

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