2018
2019

TAX PLANNING GUIDE

YEAR-ROUND STRATEGIES TO MAKE THE TAX LAWS WORK FOR YOU

It's a new day for tax planning

On December 22, 2017, the most sweeping tax legislation since the Tax Reform Act of 1986 was signed into law. The Tax Cuts and Jobs Act (TCJA) makes small reductions to income tax rates for most individual tax brackets, including reducing the top rate from 39.6% to 37%, and substantially reduces the income tax rate for corporations. It also provides a large new tax deduction for owners of pass-through entities and significantly increases exemptions for the individual alternative minimum tax (AMT) and the estate tax.

It's not all good news for taxpayers, however. The TCJA also eliminates or limits many tax breaks, and much of the tax relief provided is only temporary (unless Congress acts to make it permanent). The combined impact of these changes will ultimately determine whether you see reduced taxes. It also will dictate which tax strategies will make sense for you this year, such as the best way to time income and expenses.

This guide provides an overview of the most consequential changes under the TCJA and other key tax provisions you need to be aware of. It offers a variety of strategies to help higher-income taxpayers minimize their taxes in the new tax environment. It will be important to work closely with your tax advisor this year. He or she can help you identify which changes affect you and the best strategies for maximizing the new tax law's benefits and minimizing any negative tax ramifications. Plus, more tax legislation could be signed into law this year, and your tax advisor can keep you apprised of the latest information.

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How does the TCJA affect your tax strategies?

The Tax Cuts and Jobs Act (TCJA) reduces the rates for all individual income tax brackets except 35% and 10%, which remain the same, and adjusts the income ranges each bracket covers. (See Chart 7 on page 24.) These rates apply to "ordinary income," which generally includes salary, income from self-employment or business activities, interest, and distributions from tax-deferred retirement accounts. There are other taxes you need to keep in mind as well, such as the AMT and employment taxes. If possible, try to control to your tax advantage the timing of your ordinary income as well as your deductible expenses — which might be significantly reduced under the TCJA.

AMT triggers

The top alternative minimum tax rate remains at 28%, compared to the new top regular ordinary-income tax rate of 37%. (See Chart 7 on page 24.) But the AMT rate typically applies to a higher taxable income base.

Enhancement! The TCJA substantially increases the AMT exemptions for 2018–2025, which means fewer taxpayers will have to pay the AMT. (See Chart 7 on page 24.) There are now fewer differences between what's deductible for AMT purposes and regular tax purposes, which also will reduce AMT risk. However, AMT will remain a threat for some higher-income taxpayers.

So before timing your income and expenses, determine whether you're already likely to be subject to the AMT — or whether the actions you're considering might trigger it. Deductions used to calculate regular tax that aren't allowed under the AMT (see Chart 1) can trigger AMT liability. Some income items also might trigger or increase AMT liability:

- Long-term capital gains and qualified dividend income, even though they're taxed at the same rate for both regular tax and AMT purposes,
- Accelerated depreciation adjustments and related gain or loss differences when assets are sold, and
- Tax-exempt interest on certain private-activity municipal bonds. (For an exception, see the AMT Alert on page 11.)

Finally, in certain situations exercising incentive stock options (ISOs) can trigger significant AMT liability. (See the AMT Alert on page 7.)

Avoiding or reducing AMT

With proper planning, you may be able to avoid the AMT, reduce its impact or even take advantage of its lower maximum rate. To determine the right timing strategies for your situation, work with your tax advisor to assess whether:

You could be subject to the AMT *this* year. Consider accelerating income into this year, which may allow you to benefit from the lower maximum AMT

CHART 1

What itemized deductions are also deductible for AMT purposes?

Expense	Regular tax	AMT	For more information
State and local income tax[1]	✔		See "What's new!" on page 4.
Property tax[1]	✔		See "Home-related deductions" on page 12.
Mortgage interest	✔	✔	See "Home-related deductions" on page 12.
Interest on home equity debt used to improve your principal residence or second residence	✔	✔	See "Home-related deductions" on page 12.
Investment interest	✔	✔	See "Investment interest expense" on page 11.
Medical expenses[2]	✔	✔	See "Health-care-related breaks" at right.
Charitable contributions	✔	✔	See page 16.

[1] *State and local income tax and property tax deductions in aggregate are limited to $10,000 for regular tax purposes ($5,000 for married couples filing separately).*

[2] *For 2018, a higher threshold applies for AMT purposes.*

rate. And deferring expenses you can't deduct for AMT purposes may allow you to preserve those deductions. If you also defer expenses you *can* deduct for AMT purposes, the deductions may become more valuable because of the higher maximum regular tax rate. Finally, carefully consider the tax consequences of exercising ISOs.

You could be subject to the AMT *next* year. Consider taking the opposite approach. For instance, defer income to next year, because you'll likely pay a relatively lower AMT rate. And prepay expenses that will be deductible this year but that won't help you next year because they're not deductible for AMT purposes. Also, before year end consider selling any private-activity municipal bonds whose interest could be subject to the AMT.

If you pay AMT in one year on deferral items, such as depreciation adjustments, passive activity adjustments or the tax preference on ISO exercises, you may be entitled to a credit in a subsequent year. In effect, this factors in timing differences that reverse in later years.

WHAT'S NEW!

Dramatic changes to personal exemptions, the standard deduction and itemized deductions

For 2017, taxpayers could claim a personal exemption of $4,050 each for themselves, their spouses and any dependents. For 2018–2025, the Tax Cuts and Jobs Act (TCJA) suspends personal exemptions, a change that's expected to have minimal effect on higher-income taxpayers. That's because exemptions generally had been partially or fully phased out in past tax years for higher-income individuals and, when available, were added back for AMT purposes.

The TCJA also nearly doubles the standard deductions for 2018 to $12,000 for singles and separate filers, $18,000 for heads of households, and $24,000 for joint filers. (These amounts will be indexed for inflation through 2025. After that, they're scheduled to drop back to the amounts under pre-TCJA law.)

Taxpayers can choose to either itemize certain deductions or take the standard deduction based on their filing status. With the much higher standard deduction, fewer taxpayers will itemize — but most higher-income taxpayers will still benefit from itemizing, unless they don't donate much to charity or have a mortgage. However, be aware that your itemized deductions will likely be significantly lower than in the past because of other TCJA changes. See "What's new!" on page 4.

Timing income and expenses

Smart timing of income and expenses can reduce your tax liability, and poor timing can unnecessarily increase it. When you don't expect to be subject to the AMT in the current year or the next year, deferring income to the next year and accelerating deductible expenses into the current year may be a good idea. Why? Because it will defer tax, which usually is beneficial.

But when you expect to be in a *higher* tax bracket next year — or you expect tax rates to rise — the opposite approach may be beneficial: Accelerating income will allow more income to be taxed at your current year's lower rate. And deferring expenses will make the deductions more valuable, because deductions save more tax when you're subject to a higher tax rate.

The TCJA makes timing income and deductions more challenging this year, because some strategies that taxpayers have implemented in the past may no longer make sense. For example, property tax used to be a popular expense to time, but with the new limit on the state and local tax deduction (see "What's new!" on page 4), property tax timing will likely provide little, if any, benefit for higher-income taxpayers.

Whatever the reason behind your desire to time income and expenses, you may be able to control the timing of these income items:

- Bonuses,
- Consulting or other self-employment income,
- U.S. Treasury bill income, and
- Retirement plan distributions, to the extent they won't be subject to early-withdrawal penalties and aren't required. (See page 21.)

Some *expenses* with potentially controllable timing are mortgage interest, investment interest expense and charitable contributions.

Health-care-related breaks

Enhancement! Under the TCJA, if 2018 medical expenses not paid via a tax-advantaged account (see page 4) or reimbursable by insurance exceed 7.5% of your adjusted gross income (AGI), you can deduct the excess amount. This "floor" had been 10%, and it's scheduled to return to 10% beginning in 2019. (Note: The floor is still 10% for AMT purposes.)

Eligible expenses may include health insurance premiums, long-term-care insurance premiums (limits apply), medical and dental services, and prescription drugs. Mileage driven for health care purposes also can be deducted — at 18 cents per mile for 2018.

When a deduction is subject to a floor, "bunching" expenses into one year that normally would be spread over two years can save tax, especially when the floor is scheduled to change. So consider bunching elective medical procedures (and any other services and purchases whose timing you can control without negatively affecting your or your family's health) into 2018 to take advantage of the 7.5% floor.

If one spouse has high medical expenses and a relatively lower AGI, filing separately may allow that spouse to exceed the AGI floor and deduct some medical expenses that wouldn't be deductible if the couple filed jointly.

AMT ALERT! Because the AMT exemption for separate returns is considerably lower than the exemption for joint returns, filing separately to exceed the floor could trigger the AMT.

Expenses that are reimbursable by insurance or paid through a tax-advantaged account such as the following aren't deductible:

HSA. If you're covered by a qualified high deductible health plan, you can contribute pretax income to an employer-sponsored Health Savings Account — or make deductible contributions to an HSA you set up yourself — up to $3,450 for self-only coverage and $6,900 for family coverage for 2018. Plus, if you're age 55 or older, you may contribute an additional $1,000. HSAs can bear interest or be invested, growing tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year.

FSA. You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit — not to exceed $2,650 in 2018. The plan pays or reimburses you for qualified medical expenses. What you don't use by the plan year's end, you generally lose — though your plan might allow you to roll over up to $500 to the next year. Or it might give you a 2½-month grace period to incur expenses to use up the previous year's contribution. If you have an HSA, your FSA is limited to funding certain "permitted" expenses.

Employment taxes

In addition to income tax, you must pay Social Security and Medicare taxes on earned income, such as salary and bonuses. The 12.4% Social Security tax applies only up to the Social Security wage base of $128,400 for 2018. All earned income is subject to the 2.9% Medicare tax. Both taxes are split equally between the employee and the employer.

WHAT'S NEW!

Individual deductions affected by the TCJA

In addition to the deduction changes impacting many home-related expenses (see page 12), charitable donations (see page 16) and medical expenses (see page 3), the TCJA limits or eliminates other deductions that are valuable to many individual taxpayers:

State and local tax. For 2018–2025, your entire itemized deduction for state and local taxes — including property tax (see page 12) and either income or sales tax — is limited to $10,000 ($5,000 if you're married filing separately). This will have a significant impact on higher-income taxpayers with large state and local income tax and/or property tax bills.

Miscellaneous itemized deductions subject to the 2% floor. This deduction for expenses such as certain professional fees, investment expenses and unreimbursed employee business expenses is suspended for 2018–2025. If you're an employee and work from home, this includes the home office deduction. (If you're self-employed, you may still be able to deduct home office expenses. See page 12.)

Personal casualty and theft loss deduction. For 2018–2025, this itemized deduction is suspended except if the loss was due to an event officially declared a disaster by the President.

Moving expenses. This above-the-line deduction for work-related moving expenses is suspended for 2018–2025, except for active-duty members of the Armed Forces (and their spouses or dependents) who move because of a military order that calls for a permanent change of station. An above-the-line deduction is one you can take even if you don't itemize; it's subtracted from your income in determining your adjusted gross income (AGI).

But it's not all bad news for tax deductions. Under pre-TCJA law, if your AGI exceeded the applicable threshold, certain itemized deductions were reduced by 3% of the AGI amount over the threshold (not to exceed 80% of otherwise allowable deductions). For 2018–2025, the TCJA suspends this reduction.

Self-employment taxes

If you're self-employed, you pay both the employee and employer portions of employment taxes on your self-employment income. The employer portion (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible above the line.

As a self-employed taxpayer, you may benefit from other above-the-line deductions as well. You can deduct 100% of health insurance costs for yourself, your spouse and your dependents, up to your net self-employment income. You also can deduct contributions to a retirement plan and, if you're eligible, an HSA for yourself. And you might be able to deduct home office expenses. (See page 12.) Above-the-line deductions are particularly valuable because they reduce your AGI and, depending on the specific deduction, your modified AGI (MAGI), which are the triggers for certain additional taxes and the phaseouts of many tax breaks.

Additional 0.9% Medicare tax

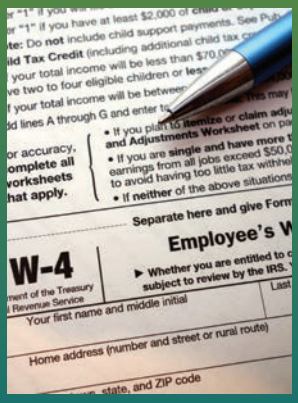
Another employment tax that higher-income taxpayers must be aware of is the additional 0.9% Medicare tax. It applies to FICA wages and net self-employment income exceeding $200,000 per year ($250,000 if married filing jointly and $125,000 if married filing separately).

If your wages or self-employment income varies significantly from year to year or you're nearing the threshold for triggering the additional Medicare tax, income timing strategies may help you avoid or minimize it. For example, if you're an employee, perhaps you can time when you receive a bonus or exercise stock options. If you're self-employed, you may have flexibility on when you purchase new equipment or invoice customers. If you're an S corporation shareholder-employee, you might save tax by adjusting how much you receive as salary vs. distributions. (See "Owner-employees" at right.)

Also consider the withholding rules. Employers must withhold the additional tax beginning in the pay period when wages exceed $200,000 for the calendar year — without regard to an employee's filing status or income from other sources. So your employer might withhold the tax even if you aren't liable for it — or it might *not* withhold the tax even though you *are* liable for it.

WHAT'S NEW!

Updated tables could cause underwithholding



To reflect changes under the TCJA — such as the increase in the standard deduction, suspension of personal exemptions and changes in tax rates and brackets — the IRS updated the tables that indicate how much employers should withhold from their employees' paychecks for federal income taxes, generally reducing the amount withheld. The new tables might cause some taxpayers, such as those who itemize deductions or are in a two-income household, to not have enough withheld to pay their ultimate tax liabilities under the TCJA.

An IRS calculator can help you more accurately estimate how much should be withheld. (Go to IRS.gov and search "withholding.") You may find that you need to increase your withholding by filling out a new Form W-4 and submitting it to your employer. You can modify your withholding at any time during the year, or even multiple times within a year.

If you *don't* owe the tax but your employer *is* withholding it, you can claim a credit on your 2018 income tax return. If you *do* owe the tax but your employer *isn't* withholding it, consider filing a W-4 form to request additional *income* tax withholding, which can be used to cover the shortfall and avoid interest and penalties. Or you can make estimated tax payments.

Owner-employees

There are special considerations if you're a business owner who also works in the business, depending on its structure:

Partnerships and limited liability companies. Generally, all trade or business income that flows through to you for income tax purposes is subject to self-employment taxes — even if the income isn't distributed to you. But such income may not be subject to self-employment taxes if you're a limited partner or the LLC member equivalent. Check with your tax advisor on whether the additional 0.9% Medicare tax on earned income or the 3.8% NIIT (see page 8) will apply.

S corporations. Only income you receive as salary is subject to employment taxes and, if applicable, the 0.9% Medicare tax. To reduce these taxes, you may want to keep your salary relatively — but not unreasonably — low and increase your distributions of company income, because distributions generally aren't taxed at the corporate level or subject to the 0.9% Medicare tax or 3.8% NIIT.

C corporations. Only income you receive as salary is subject to employment taxes and, if applicable, the 0.9% Medicare tax. Nonetheless, you may prefer to take more income as salary (which is deductible at the corporate level) as opposed to dividends (which aren't deductible at the corporate level yet are still taxed at the shareholder level and could be subject to the 3.8% NIIT) if the overall tax paid by both the corporation and you would be less.

Warning: The IRS is cracking down on misclassification of corporate payments to shareholder-employees, so tread carefully.

Estimated payments and withholding

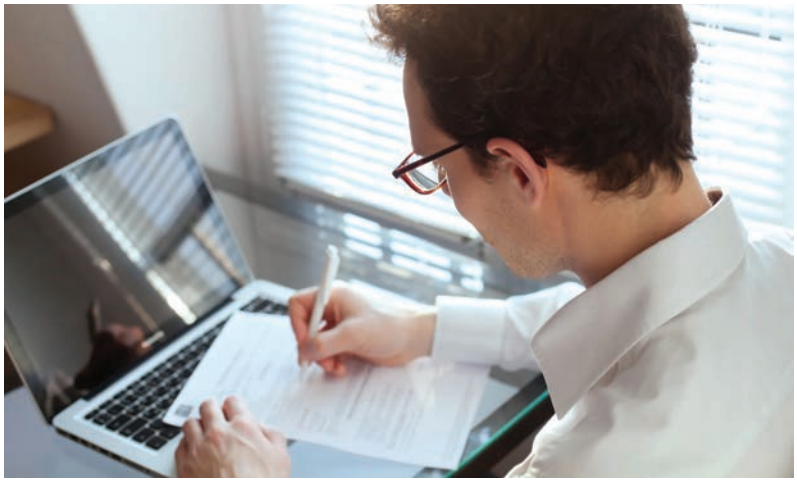
You can be subject to penalties if you don't pay enough tax during the year through estimated tax payments and withholding. Here are some strategies to help avoid underpayment penalties:

Know the minimum payment rules. For you to avoid penalties, your estimated payments and withholding must equal at least 90% of your tax liability for 2018 or 110% of your 2017 tax (100% if your 2017 AGI was $150,000 or less or, if married filing separately, $75,000 or less). ***Warning:*** You may be at a greater risk for underwithholding this year. See "What's new!" at left.

Use the annualized income installment method. This method often benefits taxpayers who have large variability in income from month to month due to bonuses, investment gains and losses, or seasonal income (at least if it's skewed toward the end of the year). Annualizing computes the tax due based on income, gains, losses and deductions through each estimated tax period.

Estimate your tax liability and increase withholding. If you determine you've underpaid, consider having the tax shortfall withheld from your salary or year end bonus by Dec. 31. Because withholding is considered to have been paid ratably throughout the year, this is often a better strategy than making up the difference with an increased quarterly tax payment, which may still leave you exposed to penalties for earlier quarters.

Warning: You can incur interest and penalties if you're subject to the additional 0.9% Medicare tax and it isn't withheld from your pay and you don't make sufficient estimated tax payments. ❖



Smart tax planning for your executive compensation package is crucial

If you're an executive or other key employee, you might receive stock-based compensation, such as restricted stock, restricted stock units (RSUs) or stock options (either incentive or nonqualified), or nonqualified deferred compensation (NQDC). The tax consequences of these types of compensation can be complex — subject to ordinary income, capital gains, employment and other taxes. So smart tax planning is crucial.

Restricted stock

Restricted stock is stock your employer grants to you subject to a substantial risk of forfeiture. Income recognition is normally deferred until the stock is no longer subject to that risk (that is, it's vested) or you sell it. When the restriction lapses, you pay taxes on the stock's fair market value (FMV) at your ordinary-income rate. (The FMV will be considered FICA income, so it could trigger or increase your exposure to the additional 0.9% Medicare tax. See page 4.)

But you can instead make a Section 83(b) election to recognize ordinary income when you *receive* the stock. This election, which you must make within 30 days after receiving the stock, allows you to convert potential future appreciation from ordinary income to long-term capital gains income and defer it until the stock is sold.

The election can be beneficial if the income at the grant date is negligible or the stock is likely to appreciate significantly before income would otherwise be recognized. And with ordinary-income rates now especially low under the Tax Cuts and Jobs Act (TCJA), it might be a good time to recognize income.

There are some potential disadvantages of a Sec. 83(b) election, however. First, prepaying tax in the current year could push you into a higher income tax bracket and trigger or increase your exposure to the additional 0.9% Medicare tax. But if your company is in the earlier stages of development, the income recognized may be relatively small.

Second, any taxes you pay because of the election can't be refunded if you eventually forfeit the stock or sell it at a decreased value. However, you'd have a capital loss in those situations.

Third, when you sell the shares, any gain will be included in net investment income and could trigger or increase your liability for the 3.8% NIIT. (See page 8.)

Work with your tax advisor to map out whether the Sec. 83(b) election is appropriate for you in each situation.

RSUs

RSUs are contractual rights to receive stock, or its cash value, after the award has vested. Unlike restricted stock, RSUs aren't eligible for the Sec. 83(b) election. So there's no opportunity to convert ordinary income into capital gains.

But they do offer a limited ability to defer income taxes: Unlike restricted stock, which becomes taxable immediately upon vesting, RSUs aren't taxable until the employee actually receives the stock. So rather than having the stock delivered immediately upon vesting, you may be able to arrange with your employer to delay delivery.

Such a delay will defer income tax and may allow you to reduce or avoid exposure to the additional 0.9% Medicare tax (because the RSUs are treated as FICA income). However, any income deferral must satisfy the strict requirements of Internal Revenue Code Section 409A. Also keep in mind that it might be better to recognize income now because of the currently low tax rates.

Incentive stock options

ISOs allow you to buy company stock in the future (but before a set expiration date) at a fixed price equal to or greater than the stock's FMV at the date of the grant. Thus, ISOs don't provide a benefit until the stock appreciates in value. If it does, you can buy shares at a price *below* what they're then trading for, provided you're eligible to exercise the options.

ISOs receive tax-favored treatment but must comply with many rules. Here are the key tax consequences:

- You owe no tax when ISOs are granted.
- You owe no regular income tax when you exercise the ISOs.

- If you sell the stock *after* holding the shares at least one year from the exercise date and two years from the grant date, you pay tax on the sale at your long-term capital gains rate. You also may owe the NIIT. (See page 8.)
- If you sell the stock *before* long-term capital gains treatment applies, a "disqualifying disposition" occurs and any gain is taxed as compensation at ordinary-income rates. (Disqualified dispositions aren't, however, subject to FICA and Medicare tax, including the additional 0.9% Medicare tax.)

***AMT ALERT!* If you don't sell the stock in the year of exercise, a tax "preference" item is created for the difference between the stock's FMV and the exercise price (the "bargain element") that can trigger the AMT. A future AMT credit, however, should mitigate this AMT hit. Plus, you may now be at lower AMT risk because of the higher AMT exemption and exemption phaseout range under the TCJA. (See Chart 7 on page 24.) Consult your tax advisor because the rules are complex.**

If you've received ISOs, plan carefully when to exercise them and whether to immediately sell shares received from an exercise or hold them. Waiting to exercise ISOs until just before the expiration date (when the stock value may be the highest, assuming the stock is appreciating) and holding on to the stock long enough to garner long-term capital gains treatment often is beneficial. But there's also market risk to consider. Plus, acting earlier can be advantageous in several situations:

- Exercise early to start the holding period so you can sell and receive long-term capital gains treatment sooner.
- Exercise when the bargain element is small or when the market price is close to bottoming out to reduce or eliminate AMT liability.
- Exercise annually so you can buy only the number of shares that will achieve a breakeven point between the AMT and regular tax and thereby incur no additional tax.
- Sell in a disqualifying disposition and pay the higher ordinary-income rate to avoid the AMT on potentially disappearing appreciation.

WHAT'S NEW!

The TCJA offers new, but limited, tax deferral opportunity

The TCJA has created a new provision that allows for the deferral of tax on stock-based compensation in certain circumstances. Generally, it gives taxpayers the opportunity to match the taxation of restricted stock and stock options with the timing of the sale of the stock. It's intended for situations in which there is no ready market for the sale of the stock.

The availability of the deferral opportunity is limited, however. It generally will apply only if at least 80% of full-time employees are covered by the stock-based compensation plan.

On the negative side, exercising early accelerates the need for funds to buy the stock, exposes you to a loss if the shares' value drops below your exercise cost, and may create a tax cost if the preference item from the exercise generates an AMT liability.

The timing of ISO exercises also could positively or negatively affect your liability for the higher ordinary-income tax rates, the 20% long-term capital gains rate and the NIIT.

With your tax advisor, evaluate the risks and crunch the numbers to determine the best strategy for you.

Nonqualified stock options

The tax treatment of NQSOs is different from the tax treatment of ISOs: NQSOs create compensation income (taxed at ordinary-income rates) on the bargain element when exercised (regardless of whether the stock is held or sold immediately), but they don't create an AMT preference item.

You may need to make estimated tax payments or increase withholding to fully cover the tax on the exercise. Keep in mind that an exercise could trigger or increase exposure to top tax rates, the additional 0.9% Medicare tax and the NIIT.

NQDC plans

These plans pay executives in the future for services to be currently performed. They differ from qualified plans, such as 401(k)s, in several ways. For example, unlike 401(k) plans, NQDC plans can favor highly compensated employees, but plan funding isn't protected from the employer's creditors. (For more on 401(k)s, see page 20.)

Some major changes to the taxation of NQDC that had been included in original versions of the TCJA would have negatively impacted such compensation. Fortunately, those changes didn't make it into the final version that was signed into law.

One important NQDC tax issue is that employment taxes (see page 4) are generally due once services have been performed and there's no longer a substantial risk of forfeiture — even though compensation may not be paid or recognized for income tax purposes until much later. So your employer may withhold your portion of the employment taxes from your salary or ask you to write a check for the liability. Or it may pay your portion, in which case you'll have additional taxable income. ***Warning:*** The additional 0.9% Medicare tax could also apply. ❖

Keep taxes from eroding your investment returns

Tax treatment of your investments varies dramatically based on factors such as type of investment, type of income it produces, how long you've held it and whether any special limitations or breaks apply. And while the Tax Cuts and Jobs Act (TCJA) didn't change the long-term capital gains rates, its changes to ordinary-income tax rates and tax brackets will have an impact on the tax you pay on investments. Consult with your tax advisor about developing strategies aimed at minimizing tax, keeping in mind that taxes, of course, should never be the primary driver of your investment decisions.

3.8% NIIT

Taxpayers with modified adjusted gross income (MAGI) over $200,000 per year ($250,000 if married filing jointly and $125,000 if married filing separately) may owe the NIIT on top of whatever other tax they owe on their investment income. The NIIT equals 3.8% of the lesser of your net investment income or the amount by which your MAGI exceeds the applicable threshold.

Net investment income can include capital gains, dividends, interest and other investment-related income (but not business income or self-rental income from an active trade or business). The rules are somewhat complex, so consult your tax advisor for more information.

Many of the strategies that can help you save or defer income tax on your investments can also help you avoid or defer NIIT liability. And because the threshold for the NIIT is based on MAGI, strategies that reduce your MAGI — such as making retirement plan contributions (see page 20) — could also help you avoid or reduce NIIT liability.

Capital gains tax and timing

Although time, not timing, is generally the key to long-term investment success, timing can have a dramatic impact on the tax consequences of investment activities. Your long-term capital gains rate can be as much as 20 percentage points lower than your ordinary-income tax rate, even with the reductions to most ordinary-income rates under the TCJA. The long-term capital gains rate applies to investments held for more than 12 months. The applicable rate depends on your income level and the type of asset you've sold. (See Chart 2 on page 10.)

New! Because of TCJA-related changes to the brackets, beginning in 2018 the top long-term gains rate of 20% kicks in before the top ordinary-income rate does. (See Chart 2 on page 10 and Chart 7 on page 24.)

Holding on to an investment until you've owned it more than one year may help substantially cut tax on any gain. Keeping it even longer can also make tax sense.

Remember: Appreciation on investments isn't taxed until the investments are sold, deferring tax and perhaps allowing you to time the sale to your tax advantage — such as in a year when you have capital losses to absorb the capital gain. Or, if you've cashed in some big gains during the year and want to reduce your 2018 tax liability, before year end look for unrealized losses in your portfolio and consider selling them to offset your gains. Both long- and short-term gains and losses can offset one another.

AMT ALERT! Substantial net long-term capital gains can trigger the AMT.

Wash sale rule

If you want to achieve a tax loss with minimal change in your portfolio's asset allocation, keep in mind the wash sale rule. It prevents you from taking a loss on a security if you buy a substantially identical security (or an option to buy such a security) within 30 days before or after you sell the security that created the loss. You can then recognize the loss only when you sell the replacement security.

Fortunately, there are ways to avoid triggering the wash sale rule and still achieve your goals. For example, you can:

- Sell the security and immediately buy securities of a different company in the same industry or shares in a mutual fund that holds securities much like the ones you sold,
- Sell the security and wait 31 days to repurchase the same security, or
- Before selling the security, purchase additional shares of that security equal to the number you want to sell at a loss, and then wait 31 days to sell the original portion.

Alternatively, you can do a bond swap, where you sell a bond, take a loss and then immediately buy another bond of similar quality and duration from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical. Thus, you can achieve a tax loss with virtually no change in economic position.

Warning: You can't avoid the wash sale rule by selling stock at a loss in a taxable account and purchasing the same stock within 30 days in a tax-advantaged retirement account.

Loss carryovers

If net losses exceed net gains, you can deduct only $3,000 ($1,500 if married filing separately) of the net losses per year against other income (such as wages, self-employment and business income, dividends and interest).

You can carry forward excess losses until death. Loss carryovers can be a powerful tax-saving tool in future years if you have a large investment portfolio, real estate holdings or a closely held business that might generate substantial future capital gains.

Case Study I

How to qualify for the 0% capital gains rate

Faced with a long-term capital gains tax rate of 23.8% (20% for the top tax bracket, plus the 3.8% NIIT), Miguel and Pilar decide to give some appreciated stock to their adult daughter Gabby. Just out of college and making only enough from her entry-level job to leave her with $25,000 in taxable income, Gabby falls into the 12% ordinary-income tax bracket and the 0% long-term capital gains bracket.

However, the 0% rate applies only to the extent that capital gains "fill up" the gap between Gabby's taxable income and the top end of the 0% bracket. For 2018, the 0% bracket for singles tops out at $38,600 (just $100 less than the top of the 12% ordinary-income bracket). So if Gabby sells the stock her parents transferred to her and her gains are $13,600, the entire amount will qualify for the 0% rate. The sale will be tax-free vs. the $3,237 Miguel and Pilar would have owed had they sold the stock themselves.

Finally, remember that capital gains distributions from mutual funds can also absorb capital losses.

0% rate

The 0% rate generally applies to long-term gain that would be taxed at 10% or 12%, based on the taxpayer's ordinary-income rate. However, a very small portion of income in the top of the 12% brackets won't be eligible for the 0% rate.

If you have adult children in the 10% or 12% tax bracket, consider transferring appreciated assets to them so they can sell the assets and enjoy the 0% rate. (See Case Study I.)

Warning: If the child will be under age 24 on Dec. 31, first make sure he or she won't be subject to the "kiddie tax." (See page 18.) Also consider any gift tax consequences. (See page 22.)

Paying attention to details

If you don't pay attention to the details, the tax consequences of a sale may be different from what you expect. For example, the trade date, not the settlement date, of publicly traded securities determines the year in which you recognize the gain or loss.

And if you bought the same security at different times and prices and want to sell high-tax-basis shares to reduce gain or increase a loss to offset other gains, be sure to specifically identify which block of shares is being sold.

Mutual funds

Investing in mutual funds is an easy way to diversify your portfolio. But beware of the tax pitfalls. First, mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you more tax dollars because of the lower long-term rates.

Second, earnings on mutual funds are typically reinvested, and unless you or your investment advisor increases your basis accordingly, you may report more gain than required when you sell the fund. Brokerage firms are required to track (and report to the IRS) your cost basis in mutual funds acquired during the tax year.

Third, buying equity mutual fund shares late in the year can be costly tax-wise. Such funds often declare a large capital gains distribution at year end, which is a taxable event. If you

own the shares on the distribution's record date, you'll be taxed on the full distribution amount even if it includes significant gains realized by the fund before you owned the shares. And you'll pay tax on those gains in the current year — even if you reinvest the distribution.

Small business stock

By purchasing stock in certain small businesses, you can diversify your portfolio. You also may enjoy preferential tax treatment:

Conversion of capital loss to ordinary loss. If you sell qualifying Section 1244 small business stock at a loss, you can treat up to $50,000 ($100,000, if married filing jointly) as an ordinary, rather than a capital, loss — regardless of your holding period. This means you can use it to offset ordinary income, reducing your tax by as much as 37% of this portion of the loss. Sec. 1244 applies only if total capital invested isn't more than $1 million.

Tax-free gain rollovers. If within 60 days of selling qualified small business (QSB) stock you buy other QSB stock with the proceeds, you can defer the tax on your gain until you dispose of the new stock. The rolled-over gain reduces your basis in the new stock. For determining long-term capital gains treatment, the new stock's holding period includes the holding period of the stock you sold. To be a QSB, a business must be engaged in an active trade or business and must not have assets that exceed $50 million, among other requirements.

Exclusion of gain. Generally, taxpayers selling QSB stock are allowed to exclude up to 50% of their gain if they've held the stock for more than five years. But, depending on the acquisition date, the exclusion may be greater: The exclusion is 75% for stock acquired after Feb. 17, 2009, and before Sept. 28, 2010, and 100% for stock acquired on or after Sept. 28, 2010.

The taxable portion of any QSB gain will be subject to the lesser of your ordinary-income rate or 28%, rather than the normal long-term gains rate. (See Chart 2.) Thus, if the 28% rate and the 50% exclusion apply, the effective rate on the QSB gain will be 14% (28% × 50%).

CHART 2

What's the maximum 2018 capital gains tax rate?

Type of gain	Rate[1]
Short-term (assets held 12 months or less)	Taxpayer's ordinary-income tax rate
Long-term (assets held more than 12 months)	15%
Some key exceptions	
Long-term gain of certain higher-income taxpayers	20%[2]
Most long-term gain that would be taxed at 10% or 12% based on the taxpayer's ordinary-income rate	0%
Long-term gain on collectibles, such as artwork and antiques	28%
Long-term gain attributable to certain recapture of prior depreciation on real property	25%
Gain on qualified small business (QSB) stock held more than 5 years	
■ Acquired on or before Feb. 17, 2009	14%[3]
■ Acquired after Feb. 17, 2009, and before Sept. 28, 2010	7%[4]
■ Acquired on or after Sept. 28, 2010	0%

[1] In addition, the 3.8% NIIT applies to net investment income to the extent that modified adjusted gross income (MAGI) exceeds $200,000 (singles and heads of households), $250,000 (married filing jointly) or $125,000 (married filing separately).

[2] The 20% rate applies to taxpayers with taxable income exceeding $425,800 (singles), $452,400 (heads of households), $479,000 (joint filers) or $239,500 (separate filers).

[3] Effective rate based on a 50% exclusion from a 28% rate.

[4] Effective rate based on a 75% exclusion from a 28% rate.

Keep in mind that all three of these tax benefits are subject to additional requirements and limits. Consult your tax and financial advisors to be sure an investment in small business stock is right for you.

Passive activities

If you've invested in a trade or business in which you don't materially participate and where income or loss flows through to your tax return, remember the passive activity rules. Why? Passive activity *income* may be subject to the 3.8% NIIT, and passive activity *losses* generally are deductible only against income from other passive activities. You can carry forward disallowed losses to the following year, subject to the same limits.

To avoid passive activity treatment, you must "materially participate" in the activity, which typically means you must participate in the trade or business more than 500 hours during the year or demonstrate that your involvement constitutes substantially all of the participation in the activity. (Special rules apply to real estate; see page 13.) To help ensure your hours claim will be able to withstand IRS scrutiny, carefully track and document your time. Contemporaneous record-keeping is better than records that are created after the fact.

If you don't pass the material participation test, consider:

Increasing your involvement. If you can exceed 500 hours, the activity no longer will be subject to passive activity rules.

Grouping activities. You may be able to group certain activities together to be treated as one activity for tax purposes and exceed the 500-hour threshold. But the rules are complex, and there are potential downsides to consider.

Looking at other activities. If you have passive losses, one option is to limit your participation in another activity that's generating income, so that you don't meet the 500-hour test. Another is to invest in another income-producing trade or business that will be passive to you. Under both strategies, you'll have passive income that can absorb some or all of your passive losses.

Disposing of the activity. This generally allows you to deduct all passive losses — including any loss on disposition (subject to basis and capital loss limitations). But, again, the rules are complex.

New! Even if you do pass the material participation test, be aware that your loss deduction might still be limited under the TCJA's new rules for deducting business losses. See page 14.

Income investments

Qualified dividends are taxed at the favorable long-term capital gains tax rate rather than at your higher ordinary-income tax rate.

Interest income, however, generally is taxed at ordinary-income rates. So stocks that pay qualified dividends may be more attractive tax-wise than other income investments, such as CDs and taxable bonds. But there are exceptions.

Some dividends, for example, are subject to ordinary-income rates. These include certain dividends from:

- Real estate investment trusts (REITs),
- Regulated investment companies (RICs),
- Money market mutual funds, and
- Certain foreign investments.

The tax treatment of bond income varies. For example:

- Interest on U.S. government bonds is taxable on federal returns but exempt by law on state and local returns.
- Interest on state and local government bonds is excludable on federal returns. If the bonds were issued in your home state, interest also may be excludable on your state return, depending on the state.
- Corporate bond interest is fully taxable for federal and state purposes.
- Bonds (except U.S. savings bonds) with original issue discount (OID) build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay this interest annually — and you must pay tax on it.

Keep in mind that state and municipal bonds usually pay a lower interest rate. See Case Study II.

Case Study II

Tax-exempt or taxable bonds? It's a question of yield

Working with her financial advisor, Cheryl decides she needs more bonds in her investment portfolio. She's in the 37% bracket, so she's leaning toward municipal bonds. After all, municipal bond interest will be tax-free on Cheryl's federal return.

But the fact that an investment is tax-exempt doesn't necessarily make it a better choice than a comparable taxable investment. Municipal bonds typically offer lower yields than comparable corporate bonds. To make a fair comparison, Cheryl needs to calculate the tax-equivalent yield — which incorporates tax savings into the municipal bond's yield — using this formula:

Tax-equivalent yield = actual yield / (1 – Cheryl's marginal tax rate).

For example, Cheryl considers a municipal bond with a 4.00% yield and a comparable corporate bond that offers a 6.25% yield. Because she's in the 37% tax bracket, the municipal bond's tax-equivalent yield is .04 / (1 – .37) = .0635, or 6.35%. In terms of the amount of income she'll get to keep, the municipal bond is a slightly better choice. If the municipal bond is also exempt from state and local taxes, it's an even better choice. But Cheryl also needs to consider factors such as risk and how well each bond will help achieve her overall investment goals.

AMT ALERT! Tax-exempt interest from private-activity municipal bonds can trigger or increase AMT liability. However, any income from tax-exempt bonds issued in 2009 and 2010 (along with 2009 and 2010 re-fundings of bonds issued after Dec. 31, 2003, and before Jan. 1, 2009) is excluded from the AMT.

Investment interest expense

Investment interest expense — interest on debt used to buy assets held for investment, such as margin debt used to buy securities — generally is deductible for both regular tax and AMT purposes. But special rules apply.

Your investment interest expense deduction is limited to your net investment income, which, for the purposes of this deduction, generally includes taxable interest, nonqualified dividends and net short-term capital gains (but not long-term capital gains), reduced by other investment expenses. Any disallowed interest expense is carried forward, and you can deduct it in a later year against net investment income.

You may elect to treat all or a portion of net long-term capital gains or qualified dividends as investment income in order to deduct more of your investment interest expense. But if you do, that portion of the long-term capital gain or dividend will be taxed at ordinary-income rates.

Payments a short seller makes to the stock lender in lieu of dividends may be deductible as investment interest expense. But interest on debt used to buy securities that pay tax-exempt income, such as municipal bonds, isn't deductible.

Also keep in mind that passive interest expense — interest on debt incurred to fund a passive activity — becomes part of your overall passive activity income or loss, subject to limitations. ❖

The TCJA colors the 2018 real estate tax landscape

There are many ways you can maximize the tax benefits associated with owning a principal residence, vacation home or rental property — or maintaining a home office. Tax planning is also important if you're planning to sell your home or other real estate in 2018. And the Tax Cuts and Jobs Act (TCJA) changes the tax picture with new limits on some home-related deductions, enhancements to depreciation-related breaks and changes to the interest deduction for businesses, including real property businesses.

Home-related deductions

The TCJA includes many changes affecting tax breaks for home ownership. Consider these itemized deductions in your tax planning:

New limits! **Property tax deduction.** For 2018–2025, the property tax deduction is subject to the new $10,000 limit on combined deductions for state and local taxes. (See "What's new!" on page 4.) Higher-income taxpayers owning valuable homes in high-property-tax locations will likely see a huge drop in the federal tax benefit they receive from their property tax payments.

New limits! **Mortgage interest deduction.** You generally can deduct interest on mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your principal residence also may be deductible. For 2018–2025, the TCJA reduces the mortgage debt limit from $1 million to $750,000 for debt incurred after Dec. 15, 2017.

New limits! **Home equity debt interest deduction.** Before the TCJA, interest was deductible on up to $100,000 of home equity debt used for any purpose, such as to pay off credit cards (for which interest isn't deductible). The TCJA effectively limits the home equity interest deduction for 2018–2025 to debt that would qualify for the home mortgage interest deduction.

Home office deduction

Employees can no longer deduct home office expenses, because of the suspension of miscellaneous deductions subject to the 2% of AGI floor. (See "What's new!" on page 4.)

If you're self-employed and your home office is your principal place of business (or used substantially and regularly to conduct business) and that's the only use of the space, you generally can deduct a portion of your mortgage interest, property taxes, insurance, utilities and certain other expenses, and the depreciation allocable to the space. Or you may be able to use the simplified method for calculating the deduction.

Using the simplified option, you can deduct $5 per square foot for up to 300 square feet (maximum of $1,500 per year). Although you can't depreciate the portion of your home that's used as an office — as you could filing Form 8829 — you can claim mortgage interest, property taxes and casualty losses as itemized deductions to the extent otherwise allowable, without needing to apportion them between personal and business use of your home.

Home rental rules

If you rent out all or a portion of your principal residence or second home for less than 15 days, you don't have to report the income. But expenses directly associated with the rental, such as advertising and cleaning, won't be deductible.

If you rent out your principal residence or second home for 15 days or more, you'll have to report the income. But you may be entitled to deduct some or all of your rental expenses — such as utilities, repairs, insurance and depreciation. Exactly what you can deduct depends on whether the home is classified as a rental property for tax purposes (based on the amount of personal vs. rental use):

Rental property. You can deduct rental expenses, including losses, subject to the real estate activity rules discussed at right. Property tax attributable to the rental use of the home *isn't* subject to the new $10,000 limit on the state and local tax deduction. You can't deduct any interest that's attributable to your personal use of the home. However, you can take the personal portion of property tax as an itemized deduction (subject to the new $10,000 limit).

Nonrental property. You can deduct rental expenses only to the extent of your rental or other passive income. Any excess can be carried forward to offset rental income

in future years. You also can take an itemized deduction for the personal portion of both mortgage interest and property taxes, subject to the applicable limits. In some instances, it may be beneficial to reduce personal use of a residence so it will be classified as a rental property.

Home sales

When you sell your principal residence, you can exclude up to $250,000 of gain ($500,000 for married couples filing jointly) if you meet certain tests. Gain that qualifies for exclusion will also be excluded from the 3.8% NIIT. (See page 8.) To support an accurate tax basis, maintain thorough records, including information on your original cost and subsequent improvements, reduced by any casualty losses and depreciation claimed based on business use. ***Warning:*** Gain that's allocable to a period of "nonqualified" use generally isn't excludable.

Losses on the sale of any personal residence aren't deductible. But if part of your home is rented out or used exclusively for your business, the loss attributable to that portion may be deductible.

Because a second home is ineligible for the gain exclusion, consider converting it to rental use before selling. It can be considered a business asset, and you may be able to defer tax on any gains through an installment sale or a Section 1031 exchange. Or you may be able to deduct a loss, but only to the extent attributable to a decline in value *after* the conversion.

Real estate activity rules

Income and losses from investment real estate or rental property are passive by definition — unless you're a real estate professional. Why is this important? Passive activity income and losses have some negative tax consequences. (See "Passive activities" on page 10.)

To qualify as a real estate professional, you must annually perform:

- More than 50% of your personal services in real property trades or businesses in which you materially participate, and
- More than 750 hours of service in these businesses during the year.

Each year stands on its own, and there are other nuances to be aware of. If you're concerned you'll fail either test and be subject to the NIIT or stuck with passive losses, consider increasing your hours so you'll meet the test. Keep in mind that special rules for spouses may help you meet the 750-hour test. ***Warning:*** To help withstand IRS scrutiny, be sure to keep adequate records of time spent.

Depreciation-related breaks

Three valuable depreciation-related breaks are available to real estate investors:

1. *Enhancement!* Bonus depreciation. This additional first-year depreciation is available for qualified assets, which before the TCJA included qualified improvement property. But due to a drafting error in the new law, qualified improvement property will be eligible for bonus depreciation only if a technical correction is issued, which is expected. (Check with your tax advisor for the latest information.) When available, bonus depreciation is increased to 100% (up from 50%) for qualified property placed in service after Sept. 27, 2017, but before Jan. 1, 2023. For 2023 through 2026, bonus depreciation is scheduled to be gradually reduced. ***Warning:*** Under the TCJA, real estate businesses that elect to deduct 100% of their business interest will be ineligible for bonus depreciation starting in 2018.

2. *Enhancement!* Section 179 expensing election. This allows you to deduct (rather than depreciate over a number of years) qualified improvement property — a definition expanded by the TCJA from leasehold-improvement, restaurant and retail-improvement property. The TCJA also allows Sec. 179 expensing for certain depreciable tangible personal property used predominantly to furnish lodging and for the following improvements to nonresidential real property: roofs, HVAC equipment, fire protection and alarm systems, and security systems.

Under the TCJA, for qualifying property placed in service in tax years starting in 2018, the expensing limit increases to $1 million (from $510,000 for 2017), subject to a phaseout if your qualified asset purchases for the year exceed $2.5 million (compared to $2.03 million for 2017). These amounts will be adjusted annually for inflation.

3. *Enhancement!* Accelerated depreciation. This break allows a shortened recovery period of 15 years — rather than 39 years — for "qualified improvement property." This is a much broader property category than the one the break applied to before the TCJA.

Tax-deferral strategies

It's possible to divest yourself of appreciated investment real estate but defer the tax liability. Such strategies may even help you keep your income low enough to avoid triggering the 3.8% NIIT and the 20% long-term capital gains rate. Consider these deferral strategies:

Installment sale. An installment sale allows you to defer gains by spreading them over several years as you receive the proceeds. ***Warning:*** Ordinary gain from certain depreciation recapture is recognized in the year of sale, even if no cash is received.

Sec. 1031 exchange. Also known as a "like-kind" exchange, this technique allows you to exchange one real estate investment property for another and defer paying tax on any gain until you sell the replacement property. Discuss the limits and risks with your tax advisor. ❖

WHAT'S NEW!

The TCJA limits interest deduction

Subject to some restrictions and exceptions, under pre-TCJA law interest paid or accrued by a business generally was fully deductible. Under the TCJA, for tax years that begin in 2018 or later, businesses generally can't deduct interest expenses in excess of 30% of "adjusted taxable income."

Taxpayers (other than tax shelters) with average annual gross receipts of $25 million or less for the three previous tax years are exempt from the interest deduction limitation. Some other taxpayers are also exempt, including real property businesses — but only if they elect to continue to fully deduct their interest. And if they make the election, they're required to use the alternative depreciation system for real property used in the business.

Business owners must look at the TCJA and beyond

Tax planning is a juggling act for business owners. You must keep your eye on your company's income and expenses and applicable tax breaks, which is particularly challenging this year in light of Tax Cuts and Jobs Act (TCJA) changes. But you also need to look out for your own financial future, which requires retirement planning and exit planning. And if you might sell your business or acquire another, it's critical to consider the tax consequences.

Taxes on business income

The TCJA will help reduce the 2018 tax burdens of many businesses and their owners. For C corporations, it replaces graduated rates ranging from 15% to 35% with a flat rate of 21%. (See Chart 8 on page 24.) For pass-through entities, it provides a new deduction. (See "What's new!" at right.)

For all entity types, the TCJA enhances some tax breaks but reduces or eliminates others. For example, it increases depreciation deductions but eliminates the Section 199 "manufacturers'" deduction and more tightly limits breaks available for employee meals and transportation.

For more details on these changes and other ways the TCJA will impact businesses, contact your tax advisor. It's critical to work with him or her to determine exactly how your business — and your individual tax situation — will be affected so you can plan accordingly.

Business loss deduction

New limit! Another significant TCJA change affecting business owners is the new limit on deductions for pass-through business losses. For tax years beginning in 2018–2025, you can't deduct an "excess business loss" in the current year. An excess business loss is the excess of your aggregate business deductions for the tax year over the sum of:

- Your aggregate business income and gains for the tax year, and
- $250,000, or $500,000 for married couples filing jointly.

The excess business loss is carried over to the following tax year and can be deducted under the rules for net operating loss carryforwards.

Retirement saving

If most of your money is tied up in your business, retirement can be a challenge. So if you haven't already set up a tax-advantaged retirement plan, consider doing so this year. If you might be subject to the 3.8% NIIT (see page 8), this may be particularly beneficial because retirement plan contributions can reduce your MAGI and thus help you reduce or avoid the NIIT. Keep in mind that, if you have employees, they generally must be allowed to participate in the plan, provided they work enough hours and meet other qualification requirements. Here are a few options:

Profit-sharing plan. This is a defined contribution plan that allows discretionary employer contributions and flexibility in plan design. You can make deductible 2018 contributions (see Chart 3 for limits) as late as the due date of your 2018 income tax return, including extensions — provided your plan exists on Dec. 31, 2018.

SEP. A Simplified Employee Pension is a defined contribution plan that provides benefits similar to those of a profit-sharing plan. But you can establish a SEP in *2019*

CHART 3

Profit-sharing plan vs. SEP: How much can you contribute?

Profit-sharing plan	SEP
2018 maximum contribution: $55,000 or $61,000	**2018 maximum contribution:** $55,000
Additional limits: You can't contribute more than 25% of your compensation generally. But you can contribute 100% up to the 401(k) limits if the plan includes a 401(k) arrangement. To qualify for the $61,000 limit, your plan must include a 401(k) arrangement. And you must be eligible to make catch-up contributions (that is, be age 50 or older).	**Additional limits:** You can't contribute more than 25% of your eligible compensation (net of the deduction for the contribution if you're self-employed). To make the maximum contribution, your eligible compensation must be at least $220,000 ($275,000 before the deduction if you're self-employed).

Note: *Other factors may further limit your maximum contribution.*

WHAT'S NEW!

New deduction launched for pass-through businesses

For tax years starting in 2018–2025, the TCJA creates a new deduction for owners of pass-through business entities, such as sole proprietorships, partnerships, S corporations and limited liability companies (LLCs) that are treated as sole proprietorships or as partnerships for tax purposes. The deduction generally equals 20% of qualified business income (QBI), subject to limitations that can begin to apply if taxable income exceeds the applicable threshold — $157,500 or, if married filing jointly, $315,000. The limits fully apply when taxable income exceeds $207,500 and $415,000, respectively.

QBI is generally defined as the net amount of qualified items of income, gain, deduction and loss that are effectively connected with the conduct of a U.S. business. QBI doesn't include certain investment items, reasonable compensation paid to an owner for services rendered to the business, or any guaranteed payments to a partner or LLC member treated as a partner for services rendered to the partnership or LLC.

The QBI deduction isn't allowed in calculating the owner's adjusted gross income, but it reduces taxable income. In effect, it's treated the same as an allowable itemized deduction.

When the income-based limit applies to owners of pass-through entities, the QBI deduction generally can't exceed the greater of the owner's share of:

- 50% of the amount of W-2 wages paid to employees by the qualified business during the tax year, or
- The sum of 25% of W-2 wages plus 2.5% of the cost of qualified property.

Qualified property is the depreciable tangible property (including real estate) owned by a qualified business as of year end and used by the business at any point during the tax year to produce qualified business income.

Another limitation for taxpayers subject to the income-based limit is that the QBI deduction generally isn't available for income from specified service businesses. Examples include businesses that involve investment-type services and most professional practices (other than engineering and architecture).

The W-2 wage limitation and the service business limitation don't apply if your taxable income is under the applicable threshold. In that case, you should qualify for the full 20% QBI deduction.

and still make deductible 2018 contributions as late as the due date of your 2018 income tax return, including extensions. (See Chart 3 for contribution limits.)

Defined benefit plan. This plan sets a future pension benefit and then actuarially calculates the contributions needed to attain that benefit. The maximum annual benefit for 2018 is generally $220,000 or 100% of average earned income for the highest three consecutive years, if less. Because it's actuarially driven, the 2018 contribution needed to attain the future benefit may exceed the maximum contributions allowed by other plans, depending on your age and the desired benefit.

You can make deductible 2018 contributions until the due date of your 2018 income tax return, including extensions — provided your plan exists on Dec. 31, 2018. ***Warning:*** Employer contributions generally are required.

Exit planning

An exit strategy is a plan for passing on responsibility for running the company, transferring ownership and extracting your money from the business. This requires planning well in advance of the transition. Here are the most common exit options:

Buy-sell agreement. When a business has more than one owner, a buy-sell agreement can control what happens to the business when a specified event occurs, such as an owner's retirement, disability or death. It's critical to factor in tax and funding issues when drafting a buy-sell agreement.

Succession within the family. You can pass your business on to family members by giving them interests, selling them interests or doing some of each. With the higher gift tax exemption in effect under the TCJA for the next several years, now may be a particularly good time to transfer ownership interests in your business. (See page 22 for more on estate and gift planning.) Valuation discounts may further reduce the taxable value of the gift.

ESOP. An employee stock ownership plan is a qualified retirement plan created primarily to purchase your company's stock. It can provide liquidity and various tax benefits.

Sale to an outsider. If you can find the right buyer, you may be able to sell the business at a premium.

Sale or acquisition

Whether you're selling your business as part of an exit strategy or acquiring another company to help grow your business, the tax consequences can have a major impact on the transaction's success or failure. Consider installment sales, for example. A taxable sale might be structured as an installment sale if the buyer lacks sufficient cash or pays a contingent amount based on the business's performance.

An installment sale also may make sense if the seller wishes to spread the gain over a number of years. This could be especially beneficial if it would allow the seller to stay under the thresholds for triggering the 3.8% NIIT or the 20% long-term capital gains rate. But an installment sale can backfire on the seller. For example:

- Depreciation recapture must be reported as gain in the year of sale, no matter how much cash the seller receives.
- If tax rates increase, the overall tax could wind up being more.

With a corporation, a key consideration is whether the deal should be structured as an asset sale or a stock sale. If a stock sale is chosen, another important question is whether it should be a tax-deferred transfer or a taxable sale.

Of course, tax consequences are only one of many important considerations when planning a sale or acquisition. ❖

Make your charitable giving count in 2018

Giving to charity can provide not only the satisfaction of doing good, but also large tax deductions. On top of that, it's one of the most flexible tax planning tools because you can control the timing to best meet your needs. The Tax Cuts and Jobs Act (TCJA) will generally have minimal impact on charitable giving for higher-income taxpayers: Charitable deductions will save a little less tax if your rate has dropped, the estate planning benefits may be less valuable (see page 22) and a couple of small changes to charitable giving rules might affect you. But as long as you keep in mind the various rules and limits, charitable giving can continue to play a key role in your tax planning.

Cash donations

Outright gifts of cash (which include donations made via check, credit card and payroll deduction) are the easiest to make. The substantiation requirements depend on the gift's value:

- Gifts under $250 can be supported by a canceled check, credit card receipt or written communication from the charity.
- Gifts of $250 or more must be substantiated by the charity.

New! Deductions for cash gifts to public charities can't exceed 60% of your adjusted gross income (AGI). Before the TCJA, the limit was 50%. Proposed legislation, however, could remove AGI-based charitable deduction limits. Check with your tax advisor for the latest information.

For now, the AGI limit remains at 30% for cash donations to nonoperating private foundations. Contributions exceeding the applicable AGI limit can be carried forward for up to five years.

AMT ALERT! Charitable contribution deductions are allowed for AMT purposes, but your tax savings may be less if you're subject to the AMT. For example, if you're in the 37% tax bracket for regular income tax purposes, but the 28% tax bracket for AMT purposes, your deduction may be worth only 28% instead of 37%.

Stock donations

Appreciated publicly traded securities you've held more than one year are long-term capital gains property, which often makes one of the best charitable gifts. Why? Because you can deduct the current fair market value and avoid the capital gains tax you'd pay if you sold the property. This will be especially beneficial to taxpayers facing the 3.8% NIIT (see page 8) or the top 20% long-term capital gains rate this year.

Donations of long-term capital gains property are subject to tighter deduction limits, however — 30% of AGI for gifts

CHART 4

How much can you deduct for your donation?

Cash. This includes not just actual cash but gifts made by check, credit card or payroll deduction. You may deduct 100%.

Ordinary-income property. Examples include stocks and bonds held one year or less, inventory, and property subject to depreciation recapture. You generally may deduct only the lesser of fair market value or your tax basis.

Long-term capital gains property. You may deduct the current fair market value of appreciated stocks, bonds and other securities and real estate held more than one year.

Tangible personal property. Your deduction depends on the situation:

- If the property *isn't* related to the charity's tax-exempt function (such as an antique donated for a charity auction), your deduction is limited to your basis.
- If the property *is* related to the charity's tax-exempt function (such as an antique donated to a museum for its collection), you can deduct the fair market value.

Vehicle. Unless it's being used by the charity, you generally may deduct only the amount the charity receives when it sells the vehicle.

Use of property. Examples include use of a vacation home and a loan of artwork. Generally, you receive no deduction because it isn't considered a completed gift. There may, however, be ways to structure the gift to enable you to get a deduction.

Services. You may deduct only your out-of-pocket expenses, not the fair market value of your services. You can deduct 14 cents per charitable mile driven.

New! **Payments made in exchange for college athletic event seating rights.** Under the TCJA, these are no longer deductible.

Note: *You must itemize to claim charitable deductions on your income tax return, and your annual charitable deductions may be reduced if they exceed certain limits based on your AGI, the type of donation and the type of charity receiving the donation. However, legislation has been proposed that would eliminate the itemizing requirement and the AGI-based limits. If you receive some benefit from the charity relating to your donation, such as services or products, your deduction must be reduced by the value of the benefit you receive. Various substantiation requirements also apply. Consult your tax advisor for additional details.*

to public charities, 20% for gifts to nonoperating private foundations. Again, proposed legislation could remove these limits.

Don't donate stock that's worth *less* than your basis. Instead, sell the stock so you can deduct the loss and then donate the cash proceeds to charity.

IRA donations

Taxpayers age 70½ or older are allowed to make direct contributions from their IRA to qualified charitable organizations, up to $100,000 per tax year. A charitable deduction can't be claimed for the contributions. But the amounts aren't deemed taxable income and can be used to satisfy an IRA owner's required minimum distribution. (See page 21.) A direct contribution might be tax-smart if you won't benefit from the charitable deduction.

To take advantage of the exclusion from income for IRA contributions to charity on your 2018 tax return, you'll need to arrange a direct transfer by the IRA trustee to an eligible charity by Dec. 31, 2018. Donor-advised funds and supporting organizations aren't eligible recipients.

Making gifts over time

If you don't know which charities you want to benefit but you'd like to start making large contributions now, consider a private foundation. It offers you significant control over how your donations ultimately will be used. You must comply with complex rules, however, which can make foundations expensive to run. Also, the AGI limits for deductibility of contributions to nonoperating foundations are lower. (See "Cash donations" and "Stock donations.")

If you'd like to influence how your donations are spent but avoid a foundation's downsides, consider a donor-advised fund (DAF). Many larger public charities and investment firms offer them. ***Warning:*** To deduct your DAF contribution, obtain a written acknowledgment from the sponsoring organization that it has exclusive legal control over the assets contributed.

Charitable remainder trusts

To benefit a charity while helping ensure your own financial future, consider a CRT. Here's how it works:

- For a given term, the CRT pays an amount to you annually (some of which generally is taxable).
- At the term's end, the CRT's remaining assets pass to one or more charities.
- When you fund the CRT, you receive an income tax deduction for the present value of the amount that will go to charity.
- The property is removed from your estate.

A CRT can also help diversify your portfolio if you own non-income-producing assets that would generate a large capital gain if sold. Because a CRT is tax-exempt, it can sell the property without paying tax on the gain and then invest the proceeds in a variety of stocks and bonds.

You may owe capital gains tax when you receive the payments. However, because the payments are spread over time, much of the liability will be deferred. Plus, a portion of each payment might be considered tax-free return of principal. This may help you reduce or avoid exposure to the 3.8% NIIT and the 20% top long-term capital gains rate.

You can name someone other than yourself as income beneficiary or fund the CRT at your death, but the tax consequences will be different.

Charitable lead trusts

To benefit charity while transferring assets to loved ones at a reduced tax cost, consider a CLT. It works as follows:

- For a given term, the CLT pays an amount to one or more charities.
- At the term's end, the CLT's remaining assets pass to one or more loved ones you name as remainder beneficiaries.
- When you fund the CLT, you make a taxable gift equal to the present value of the amount that will go to the remainder beneficiaries.
- The property is removed from your estate.

For gift tax purposes, the amount of the remainder interest is determined using the assumption that the trust assets will grow at the Section 7520 rate. The lower the Sec. 7520 rate, the smaller the remainder interest and the lower the possible gift tax — or the less of your lifetime gift tax exemption you'll have to use up. If the trust's earnings outperform the Sec. 7520 rate, the excess earnings will be transferred to the remainder beneficiaries gift- and estate-tax-free.

Because the Sec. 7520 rate is still fairly low but has been gradually rising with other interest rates, now may be a good time to lock in a relatively low rate while still available and take the chance that your actual return will outperform it. Keep in mind, however, that the increased gift and estate tax exemption may reduce the tax benefits of a CLT, depending on your specific situation. (For more on estate and gift taxes, see page 22.)

You can name yourself as the remainder beneficiary or fund the CLT at your death, but the tax consequences will be different.

Qualified charities

Before you donate, it's critical to make sure the charity you're considering is indeed a qualified charity — that it's eligible to receive tax-deductible contributions.

The IRS's online search tool, Tax Exempt Organization Search, can help you more easily find out whether an organization is eligible to receive tax-deductible charitable contributions. You can access the tool at https://apps.irs.gov/app/eos. According to the IRS, you may rely on this list in determining deductibility of your contributions.

Also, don't forget that political donations aren't deductible. ❖

Plan for your child's financial security

One of the biggest goals of most parents is that their children become financially secure adults. To pave the way, it's important to show young people the value of saving and provide them with the best education possible. By taking advantage of tax breaks for you and your children, you can do both. If you're a grandparent, you also may be able to take advantage of some of these breaks — or help your grandchildren take advantage of them. Also be aware that the Tax Cuts and Jobs Act (TCJA) affects tax planning for children and education.

"Kiddie tax"

The "kiddie tax" generally applies to most unearned income of children under age 19 and of full-time students under age 24 (unless the students provide more than half of their own support from earned income). Before 2018, unearned income subject to the kiddie tax was generally taxed at the parents' tax rate.

New! The TCJA makes the kiddie tax harsher. For 2018–2025, a child's unearned income beyond $2,100 (for 2018) will be taxed according to the tax brackets used for trusts and estates, which for 2018 are taxed at the highest marginal rate of 37% once taxable income exceeds $12,500. In contrast, for a married couple filing jointly, the highest rate doesn't kick in until their 2018 taxable income tops $600,000. In other words, children's unearned income often will be taxed at *higher* rates than their parents' income.

IRAs for teens

One of the best ways to get children on the right financial track is to set up IRAs for them. Their retirement may seem too far off to warrant saving now, but IRAs can be perfect for teenagers precisely because they likely will have many years to let their accounts grow tax-deferred or tax-free.

The 2018 contribution limit is the lesser of $5,500 or 100% of earned income. A teen's *traditional* IRA contributions typically are deductible, but distributions will be taxed. *Roth* IRA contributions aren't deductible, but qualified distributions will be tax-free.

Choosing a Roth IRA is typically a no-brainer if a teen doesn't earn income that exceeds the standard deduction ($12,000 for 2018 for single taxpayers, nearly double the 2017 amount). That's because he or she will likely gain no benefit from the ability to deduct a traditional IRA contribution. Even above that amount, the teen probably is taxed at a very low rate, so the Roth will typically still be the better answer. (For more information on Roth IRAs, see page 20.)

If your children or grandchildren don't want to invest their hard-earned money, consider *giving* them up to the amount they're eligible to contribute. But keep the gift tax in mind. (See page 22.)

If they don't have earned income and you own a business, consider hiring them. As the business owner, you can deduct their pay, and other tax benefits may apply. ***Warning:*** The children must be paid in line with what you'd pay nonfamily employees for the same work.

529 plans

Section 529 plans provide another valuable tax-advantaged savings opportunity. You can choose a prepaid tuition plan to secure current tuition rates or a tax-advantaged savings plan to fund college expenses beyond just tuition. Here are some of the possible benefits of such plans:

- Although contributions aren't deductible for federal purposes, any growth is tax-deferred. (Some states do offer tax breaks for contributing.)
- The plans usually offer high contribution limits, and there are no income limits for contributing.
- There's generally no beneficiary age limit for contributions or distributions.
- You can control the account, even after the child is of legal age.
- You can make tax-free rollovers to another qualifying family member.
- A special break for 529 plans allows you to front-load five years' worth of annual gift tax exclusions and make up to a $75,000 contribution (or $150,000 if you split the gift with your spouse) in 2018.

Prepaid tuition vs. savings plan

With a 529 *prepaid tuition plan*, if your contract is for four years of tuition, tuition is guaranteed regardless of its cost at the time the beneficiary actually attends the school. One downside is that there's uncertainty in how benefits will be applied if the beneficiary attends a different school. Another negative is that the plan doesn't cover costs other than tuition, such as room and board.

A 529 *college savings plan*, on the other hand, can be used to pay a student's expenses at most postsecondary educational institutions. Distributions used to pay qualified postsecondary

school expenses (such as tuition, mandatory fees, books, supplies, computer equipment, software, Internet service and, generally, room and board) are income-tax-free for federal purposes and typically for state purposes as well, thus making the tax deferral a permanent savings.

New! The TCJA has permanently expanded qualified expenses to include elementary and secondary school tuition. But tax-free distributions for such expenses are limited to $10,000 annually per student.

The biggest downside may be that you don't have direct control over investment decisions; you're limited to the options the plan offers. Additionally, for funds already in the plan, you can make changes to your investment options only twice during the year or when you change beneficiaries. For these reasons, some taxpayers prefer Coverdell ESAs.

But each time you make a *new* contribution to a 529 savings plan, you can select a different option for that contribution, regardless of how many times you contribute throughout the year. And every 12 months you can make a tax-free rollover to a different 529 plan for the same child.

ESAs

Coverdell Education Savings Accounts are like 529 savings plans in that contributions aren't deductible for federal purposes, but plan assets can grow tax-deferred and distributions used to pay qualified education expenses are income-tax-free.

One of the biggest ESA advantages used to be that they allowed tax-free distributions for elementary and secondary school costs and 529 plans didn't. With the TCJA enhancements to 529 plans, this is less of an advantage. But ESAs still have a leg up because they can be used for elementary and secondary expenses other than tuition — and there's no dollar limit on such annual distributions. Another advantage is that you have more investment options.

ESAs are worth considering if you want to fund elementary or secondary education expenses in excess of $10,000 per year or beyond just tuition, or would like to have direct control over how and where your contributions are invested. But the $2,000 contribution limit is low, and it's phased out based on income. The limit begins to phase out at a modified adjusted gross income (MAGI) of $190,000 for married couples filing jointly and $95,000 for other filers. No contribution can be made when MAGI hits $220,000 and $110,000, respectively.

Also, amounts left in an ESA when the beneficiary turns age 30 generally must be distributed within 30 days. And any earnings may be subject to tax and a 10% penalty.

ABLE accounts

Achieving a Better Life Experience (ABLE) accounts offer a tax-advantaged way to fund qualified disability expenses for a beneficiary who became blind or disabled before age 26. For federal purposes, tax treatment is similar to that of Section 529 college savings plans.

New! Under the TCJA, for 2018–2025, 529 plan funds can be rolled over to an ABLE account without penalty. That's only if the ABLE account is owned by the beneficiary of the 529 plan or a member of the beneficiary's family. Such rolled-over amounts count toward the overall ABLE account annual contribution limit. Aggregate contributions are generally limited to $15,000 for 2018.

American Opportunity credit

When your child enters college, you may not qualify for the American Opportunity credit because your income is too high (phaseout range of $80,000–$90,000; $160,000–$180,000 for joint filers), but your child might. The maximum credit, *per student*, is $2,500 per year for the first four years of postsecondary education. And both the credit and a tax-free 529 plan or ESA distribution can be taken as long as expenses paid with the distribution aren't used to claim the credit. ❖

WHAT'S NEW!

The TCJA provides new tax-saving opportunity for some higher-income families

Along with the personal exemption, the TCJA eliminates the dependent exemption ($4,050 per dependent for 2017) for 2018–2025. But it expands tax credits for families during that period.

Many higher-income taxpayers won't be hurt significantly (or at all) by the loss of *dependency exemptions* because under pre-TCJA law their exemptions were already partially or fully eliminated due to adjusted gross income (AGI)-based phaseouts. (For 2017, the exemptions began to phase out at AGIs of $287,650 for heads of households and $313,800 for joint filers. They fully phased out when AGI hit $410,150 and $436,300, respectively.)

Some higher-income taxpayers who previously couldn't benefit from the *credits* might now be able to do so. The TCJA significantly raises the modified AGI (MAGI) phaseout ranges for the credits. Beginning in 2018, the total credit amount a taxpayer is allowed to claim is reduced by $50 for every $1,000 (or part of a $1,000) by which modified AGI (MAGI) exceeds $200,000, or $400,000 for married couples filing jointly. The thresholds used to be only $75,000 and $110,000, respectively.

Tax credits reduce your tax bill dollar for dollar (unlike exemptions, which just reduce the amount of income subject to tax), so they're particularly valuable. Under the TCJA:

- For each child under age 17 at the end of 2018, you may be able to claim a $2,000 credit (up from $1,000 for 2017).
- For each qualifying dependent other than a qualifying child (such as a dependent child age 17 or older or a dependent elderly parent), a new $500 family credit may be available.

Another piece of good news for some parents: The adoption credit, which had been proposed for elimination under previous versions of the TCJA, ultimately survived. The credit is $13,810 for 2018, but it's also subject to a MAGI-based phaseout ($207,140–$247,140 for both heads of households and joint filers).

Leveraging the power of tax-advantaged plans

Although you're allowed to contribute only a limited amount to tax-advantaged retirement plans, those tax advantages make the plans especially powerful for taxpayers in the top income tax brackets. So don't ignore these plans just because what you can invest in them annually may be small compared to what you invest elsewhere. Yet to fully leverage their might, be careful when taking retirement plan distributions. Look ahead and watch out for tax traps. Finally, keep in mind that, although the Tax Cuts and Jobs Act (TCJA) didn't make any major changes to retirement plans, some provisions detrimental to them were proposed, which might portend future efforts to restrict their tax benefits.

Retirement plan contributions

Contributing the maximum you're allowed (see Chart 5) to an employer-sponsored defined contribution plan, such as a 401(k), is likely a smart move:

- Contributions are typically pretax, reducing your modified adjusted gross income (MAGI). This in turn can help you reduce or avoid exposure to the 3.8% NIIT. (See page 8.)
- Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions.
- Your employer may match some or all of your contributions.

If you participate in a 401(k), 403(b) or 457 plan, it may allow you to designate some or all of your contributions as Roth contributions. While Roth contributions don't reduce your current MAGI, qualified distributions will be tax-free. Roth contributions may be especially beneficial for higher-income earners, who are ineligible to contribute to a Roth IRA.

Roth IRA conversions

If you have a traditional IRA, consider whether you might benefit from converting some or all of it to a Roth IRA. A conversion can allow you to turn tax-*deferred* future growth into tax-*free* growth. It also can provide estate planning advantages. Unlike other retirement plans, Roth IRAs don't require you to take distributions during your lifetime, so you can let the entire balance grow tax-free over your lifetime for the benefit of your heirs.

There's no income-based limit on who can convert to a Roth IRA. But the converted amount is taxable in the year of the conversion. Whether a conversion makes sense for you depends on factors such as:

- Your age,
- Whether the conversion would push you into a higher income tax bracket or trigger the 3.8% NIIT (see page 8),
- Whether you can afford to pay the tax on the conversion,
- Your tax bracket now and expected tax bracket in retirement, and
- Whether you'll need the IRA funds in retirement.

With tax rates particularly low now under the TCJA (and perhaps a better chance that your rate at retirement will be higher), it may be a good time for a Roth conversion. Your tax advisor can run the numbers and help you decide if a conversion is right for you this year. (See "What's new!" for something else to keep in mind in your conversion decision.)

If you *don't* have a traditional IRA, consider a "back door" Roth IRA: You set up a traditional account and make a nondeductible contribution to it. You then wait until the transaction clears

CHART 5

Retirement plan contribution limits for 2018

	Regular contribution	Catch-up contribution[1]
Traditional and Roth IRAs	$ 5,500	$ 1,000
401(k)s, 403(b)s, 457s and SARSEPs[2]	$ 18,500	$ 6,000
SIMPLEs	$ 12,500	$ 3,000

[1] For taxpayers age 50 or older by the end of the tax year.

[2] Includes Roth versions where applicable.

***Note:** Other factors may further limit your maximum contribution. If you're a business owner or self-employed, you may be able to set up a plan that allows you to make much larger contributions. See Chart 3 on p. 14.*

WHAT'S NEW!

Roth IRA conversions can no longer be undone

Converting a traditional IRA to a Roth IRA can provide valuable benefits. (See "Roth IRA conversions.") But what if you convert your traditional IRA and then discover that you would have been better off if you hadn't converted it? This might happen if, for example:

- The conversion combined with your other income has pushed you into a higher tax bracket, or
- The value of your account has declined since the conversion, which means you would owe taxes partially on money you no longer have.

It used to be possible to undo a Roth IRA conversion by "recharacterizing" the account as a traditional IRA by October 15 of the following year (if you extended your tax return). Unfortunately, the TCJA prohibits such recharacterizations beginning with 2018 Roth IRA conversions. You can, however, still recharacterize *new* Roth IRA contributions as traditional contributions if you do it by the applicable deadline and meet all other rules.

and convert the traditional account to a Roth account. The only tax due will be on any growth in the account between the time you made the contribution and the date of conversion.

Early withdrawals

With a few exceptions, retirement plan distributions before age 59½ are subject to a 10% penalty on top of any income tax that ordinarily would be due on a withdrawal. This means that, if you're in the top tax bracket of 37%, you can lose almost half of your withdrawal to taxes and penalties — and perhaps more than half if you're also subject to state income taxes and/or penalties. Additionally, you'll lose the potential tax-deferred future growth on the withdrawn amount.

If you have a Roth account, you can withdraw up to your contribution amount without incurring taxes or penalties. But you'll be losing the potential tax-*free* growth on the withdrawn amount.

So if you're in need of cash, consider tapping your taxable investment accounts rather than dipping into your retirement plan. (See page 8 for information on the tax treatment of investments.)

Leaving a job

When you change jobs or retire, avoid taking a lump-sum distribution from your employer's retirement plan because it generally will be taxable — and potentially subject to the 10% early-withdrawal penalty. Here are options that will help you avoid current income tax and penalties:

Staying put. You may be able to leave your money in your old plan. But if you'll be participating in a new employer's plan or you already have an IRA, this may not be the best option. Why? Because keeping track of multiple plans can make managing your retirement assets more difficult. Also consider how well the old plan's investment options meet your needs.

A rollover to your new employer's plan. This may be a good solution if you're changing jobs, because it may leave you with only one retirement plan to keep track of. But also evaluate the new plan's investment options.

A rollover to an IRA. If you participate in a new employer's plan, this will require keeping track of two plans. But it may be the best alternative because IRAs offer nearly unlimited investment choices.

If you choose a rollover, request a direct rollover from your old plan to your new plan or IRA. If the funds are sent to you by check, you'll need to make an indirect rollover (that is, deposit the funds into a new IRA) within 60 days to avoid tax and potential penalties.

Warning: If you don't do a direct rollover, the check you receive from your old plan will, unless an exception applies, be net of 20% federal income tax withholding. If you don't roll over the gross amount (making up for the withheld amount with other funds), you'll be subject to income tax — and potentially the 10% penalty — on the difference.

Required minimum distributions

In the year in which you reach age 70½, you must begin to take annual required minimum distributions from your IRAs (except Roth IRAs) and, generally, from your defined contribution plans. If you don't comply, you can owe a penalty equal to 50% of the amount you should have withdrawn but didn't.

An RMD deferral is allowed for the initial year, but you'll have to take two RMDs the next year. And you can avoid the RMD rule for a non-IRA Roth plan by rolling the funds into a Roth IRA.

So, should you take distributions between ages 59½ and 70½, or take more than the RMD after age 70½? Waiting to take distributions until age 70½ generally is advantageous because of tax-deferred compounding. But a distribution (or larger distribution) in a year your tax rate is lower than usual may save tax.

Be sure, however, to consider the lost future tax-deferred growth and, if applicable, whether the distribution could: 1) cause Social Security payments to become taxable, 2) increase income-based Medicare premiums and prescription drug charges, or 3) affect other tax breaks with income-based limits.

Warning: While retirement plan distributions aren't subject to the additional 0.9% Medicare tax (see page 4) or 3.8% NIIT (see page 8), they *are* included in your MAGI. That means they could trigger or increase the NIIT, because the thresholds for that tax are based on MAGI.

If you've inherited a retirement plan, consult your tax advisor about the distribution rules that apply to you. ❖

Estate planning: Assess your strategies in light of recent tax law changes

As difficult as it is, accumulating wealth is only the first step to providing a financially secure future for your family. You also need to develop a comprehensive estate plan. The earlier you begin, the more options you'll have to grow and transfer your wealth in a way that minimizes taxes and leaves the legacy you desire. Then review your plan regularly to account for changes in your finances, family and tax law. The Tax Cuts and Jobs Act (TCJA) doesn't repeal the estate tax, as was originally proposed, but it still impacts estate planning.

Estate tax

Enhancement! While the TCJA keeps the estate tax rate at 40%, it doubles the exemption base amount from $5 million to $10 million. The inflation-adjusted amount for 2018 is $11.18 million. (See Chart 6.) The doubled amount will continue to be adjusted annually for inflation.

Keep in mind that, without further legislation, the estate tax exemption will return to an inflation-adjusted $5 million in 2026. So taxpayers with estates in the roughly $6 million to $11 million range (twice that for married couples), whose estates would escape estate taxes if they were to die while the doubled exemption is in effect, still need to keep potential post-2025 estate tax liability in mind in their estate planning.

Gift tax

Enhancement! The gift tax continues to follow the estate tax, so the gift tax exemption also increases under the TCJA. (See Chart 6.) Any gift tax exemption used during your lifetime reduces the estate tax exemption available at death. Using up some of your exemption during life can be tax-smart, especially if your estate exceeds roughly $6 million (twice that if you're married). Making tax-free wealth transfers to take advantage of the higher exemption amount before it potentially "sunsets" could save substantial tax.

You also can exclude certain gifts of up to $15,000 per recipient in 2018 ($30,000 per recipient if your spouse elects to split the gift with you or you're giving community property) without depleting any of your gift and estate tax exemption.

Warning: You need to use your annual exclusion by Dec. 31. The exclusion doesn't carry over from year to year. For example, if you don't make an annual exclusion gift to your granddaughter this year, you can't add $15,000 to your 2019 exclusion to make a $30,000 tax-free gift to her next year.

GST tax

The generation-skipping (GST) tax generally applies to transfers (both during your lifetime and at death) made to people more than one generation below you, such as your grandchildren. This is in addition to any gift or estate tax due.

Enhancement! The GST tax continues to follow the estate tax, so the GST tax exemption also increases under the TCJA. (See Chart 6.)

The GST tax exemption can be a valuable tax-saving tool for taxpayers with large estates whose children also have — or may eventually have — large estates. With proper planning, they can use the exemption to make transfers to grandchildren and avoid any tax at their children's generation.

State taxes

Even before the TCJA, many states imposed estate tax at a lower threshold than the federal government did. Now the differences in some states will be even more dramatic. To avoid

CHART 6

Transfer tax exemptions and rates

Year	Estate[1] and gift tax exemption	GST tax exemption	Estate, gift and GST tax rate
2017	$ 5.49 million	$ 5.49 million	40%
2018	$ 11.18 million	$ 11.18 million	40%

[1] *Less any gift tax exemption already used during life.*

unexpected tax liability or other unintended consequences, it's critical to consider state law. Consult a tax advisor familiar with the law of your particular state.

Exemption portability

If one spouse dies and part (or all) of his or her estate tax exemption is unused at his or her death, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption. This exemption "portability" provides flexibility at the time of the first spouse's death, but it has some limits. Portability is available only from the most recently deceased spouse, doesn't apply to the GST tax exemption and isn't recognized by many states.

And portability doesn't protect future growth on assets from estate tax like applying the exemption to a credit shelter (or bypass) trust does. Such a trust offers other benefits as well, such as creditor protection, remarriage protection, GST tax planning and state estate tax benefits.

So married couples should still consider these trusts — and transferring assets to each other to the extent necessary to fully fund them at the first death. Transfers to a spouse (during life or at death) are tax-free under the marital deduction, assuming he or she is a U.S. citizen.

Tax-smart giving

Giving away assets now will help reduce the size of your taxable estate. Here are some strategies for tax-smart giving:

Choose gifts wisely. Consider both estate and income tax consequences and the economic aspects of any gifts you'd like to make:

- To minimize *estate tax*, gift property with the greatest future appreciation potential.
- To minimize *your beneficiary's income tax*, gift property that hasn't appreciated significantly while you've owned it.
- To minimize *your own income tax*, don't gift property that's declined in value. Instead, consider selling the property so you can take the tax loss and then gifting the sale proceeds.

Case Study III

Now's the time to create a dynasty

Ryan is a widower who recently sold the business he'd spent 40 years building. His adult children are successful professionals and he has several grandchildren, with more expected. He'd like to leave a financial legacy for this third generation — and beyond.

Ryan hasn't yet used any of his gift and estate tax exemption, so his tax advisor suggests he set up a dynasty trust. He decides to transfer $10 million to it, and there's no gift tax on the transaction because it's within his unused exemption amount. And the funds, together with all future appreciation, are removed from his taxable estate.

Most important, by allocating his GST tax exemption to his trust contributions, he ensures that any future distributions or other transfers of trust assets to his grandchildren or subsequent generations will avoid GST taxes. This is true even if the value of the assets grows well beyond the exemption amount or the exemption is reduced in the future.

Plan gifts to grandchildren carefully. Annual exclusion gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers. For gifts to a grandchild that don't qualify for the exclusion to be tax-free, you generally must apply both your GST tax exemption and your gift tax exemption.

Gift interests in your business or an FLP. If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts. So, for example, if the combined discount is 25%, in 2018 you can gift an ownership interest equal to as much as $20,000 tax-free because the discounted value doesn't exceed the $15,000 annual exclusion.

Another way to potentially benefit from valuation discounts is to set up a family limited partnership. You fund the FLP with assets such as public or private stock and real estate, and then gift limited partnership interests. ***Warning:*** The IRS may challenge valuation discounts; a professional, independent valuation is recommended. The IRS also scrutinizes FLPs, so be sure to properly set up and operate yours.

Pay tuition and medical expenses. You may pay these expenses without the payment being treated as a taxable gift to the student or patient, as long as the payment is made directly to the provider.

Make gifts to charity. Donations to qualified charities aren't subject to gift tax and may provide an income tax deduction. (See page 16.)

Trusts

Trusts can provide significant tax savings while preserving some control over what happens to the transferred assets. For those with large estates, funding them now, while the gift tax exemption is high, may be particularly tax-smart. Here are some trusts to consider:

- A *qualified terminable interest property (QTIP) trust* can benefit first a surviving spouse and then children from a prior marriage.
- A *qualified personal residence trust (QPRT)* allows you to give your home to your children today — removing it from your taxable estate at a reduced gift tax cost (provided you survive the trust's term) — while you retain the right to live in it for a certain period.
- A *grantor-retained annuity trust (GRAT)* works on the same principle as a QPRT, but allows you to transfer other assets; you receive payments back from the trust for a certain period.

Finally, a GST — or "dynasty" — trust can help you leverage both your gift and GST tax exemptions. And it can be an excellent way to potentially lock in the currently high exemptions while removing future appreciation from your estate. (See Case Study III.) ❖

CHART 7

2018 individual income tax rate schedules

Tax rate	Regular tax brackets			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
10%	$ 0 – $ 9,525	$ 0 – $ 13,600	$ 0 – $ 19,050	$ 0 – $ 9,525
12%	$ 9,526 – $ 38,700	$ 13,601 – $ 51,800	$ 19,051 – $ 77,400	$ 9,526 – $ 38,700
22%	$ 38,701 – $ 82,500	$ 51,801 – $ 82,500	$ 77,401 – $ 165,000	$ 38,701 – $ 82,500
24%	$ 82,501 – $ 157,500	$ 82,501 – $ 157,500	$ 165,001 – $ 315,000	$ 82,501 – $ 157,500
32%	$ 157,501 – $ 200,000	$ 157,501 – $ 200,000	$ 315,001 – $ 400,000	$ 157,501 – $ 200,000
35%	$ 200,001 – $ 500,000	$ 200,001 – $ 500,000	$ 400,001 – $ 600,000	$ 200,001 – $ 300,000
37%	Over $ 500,000	Over $ 500,000	Over $ 600,000	Over $ 300,000
Tax rate	**AMT brackets**			
	Single	**Head of household**	**Married filing jointly or surviving spouse**	**Married filing separately**
26%	$ 0 – $ 191,100	$ 0 – $ 191,100	$ 0 – $ 191,100	$ 0 – $ 95,550
28%	Over $ 191,100	Over $ 191,100	Over $ 191,100	Over $ 95,550
	AMT exemptions			
	Single	**Head of household**	**Married filing jointly or surviving spouse**	**Married filing separately**
Amount	$ 70,300	$ 70,300	$ 109,400	$ 54,700
Phaseout[1]	$ 500,000 – $ 781,200	$ 500,000 – $ 781,200	$ 1,000,000 – $ 1,437,600	$ 500,000 – $ 718,800

[1] *The AMT income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.*

Note: *Consult your tax advisor for AMT rates and exemptions for children subject to the "kiddie tax."*

CHART 8

2018 corporate income tax rates

Tax rate	Type of corporation
21%	C corporation
21%	Personal service corporation

CHART 9

2018 estate and trust income tax rate schedule

Tax rate	Tax brackets
10%	$ 0 – $ 2,550
24%	$ 2,551 – $ 9,150
35%	$ 9,151 – $ 12,500
37%	Over $ 12,500

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