2019

Year-End Tax Planning Guide

TABLE OF **CONTENTS**

Welcome to RKL's
2019 Year-End Tax Planning Guide ›

RKL's tax team always keeps one eye on the horizon, tracking regulatory developments and uncovering new opportunities for savings. This proactive approach is more essential than ever since the passage of the Tax Cuts and Jobs Act (TCJA) in December 2017.

Together with our valued clients, we navigated the uncharted territory as tax reform took effect in 2018. This experience carried over into 2019, as the IRS worked to translate 119 tax-related TCJA legislative provisions into concrete guidance. At the time this guide went to print, we are still waiting on IRS guidance for some of tax reform's most significant changes and clearer definitions for many words and concepts used in the legislation.

Inside this 2019 Year-End Tax Planning Guide, you'll find important facts, figures and deadlines, along with various strategies to consider with your RKL advisor in the context of your unique financial or business circumstances. We made sure to highlight any outstanding regulatory areas.

> **At RKL, we view all reforms and regulatory impacts through the lens of your best interests and financial goals. You can trust us to develop a comprehensive tax strategy to protect and achieve them. As such, make sure to contact us before implementing any of the tactics or strategies outlined in this guide so we can discuss within your unique circumstances.**

Thank you for relying on RKL as your trusted tax advisor.
We'll never stop driving real results for you.

ROBERT M. GRATALO, CPA, MST
Partner & Leader | Tax Services Group

Quick Guide:
2019 Tax Year Figures & Filings ›

Standard Deduction

Married Filing Jointly	$24,400
Single	$12,200
Head of Household	$18,350
Married Filing Separately	$12,200

IRA Contribution (Traditional & Roth)

$6,000, with additional $1,000 catchup age 50 or over

Federal Estate Tax

40% (maximum rate)

Annual Gift Tax Exclusions

$15,000 or $30,000 if gift-splitting with spouse (must be used by December 31 with no carry-over)

HSA Contribution (Employer & Employee)

Self only	$3,500
Family	$7,000

Deadlines for Key 2019 Tax Filings

Tax Type	Due Date (for calendar year entities)
Partnerships (Form 1065) & S Corporations (Form 1120S)	March 16, 2020
Individuals (Form 1040), C Corporations (Form 1120), Report of Foreign Bank and Financial Accounts (FBAR) and Trusts and Estates (Form 1041)	April 15, 2020
Tax-exempt Nonprofit Organizations (Form 990)	May 15, 2020
Extended return filing for Partnerships (Form 1065) & S Corporations (Form 1120S)	September 15, 2020
Extended return filing for Trusts and Estates (Form 1041)	September 30, 2020
Extended return filing for Individuals (Form 1040), C Corporations (Form 1120), Report of Foreign Bank and Financial Accounts (FBAR)	October 15, 2020
Extended return filing for Tax-exempt Nonprofit Organizations (Form 990)	November 16, 2020


FINANCIAL
ACTUAL SUMMARY
BUDGET VS ACTUAL
SUMMARY BY CATEGORY

Individual **Tax Planning**

Each year, we encourage clients to take stock of any personal or professional changes that may affect tax exposure, such as:

- Marriage, divorce or death that changes filing status
- Birth of a child
- Child outgrows tax credit eligibility
- Health changes
- Relocation/new home purchase
- Higher education expenses
- Starting or closing a business
- Inheritance
- Gifting
- New job or employment status
- Retirement

Make sure to discuss these and other significant events with your RKL advisor as you kick off year-end tax planning.

Tax Tip: Perform a Payroll Checkup

Annual evaluation of withholding is a personal finance best practice that has become even more essential after tax reform's changes to individual tax rates and brackets. During the 2018 tax year, many individuals realized the need to adjust their withholding to realign with their new income tax liability. The IRS recommends performing a "payroll checkup" and adjusting W-4s as needed to ensure adequate tax is withheld. When updating withholding, make sure to use the most recent version of the W-4.

Visit irs.gov/withholding for a free calculator and more information on withholding.

Individual **Tax Rates & Brackets**

The seven tax rates have not changed for the 2019 tax year; however, the tax brackets have been increased for inflation.

Rate	Single	Head of Household	Married Filing Jointly	Married Filing Separately
10%	$0 to $9,700	$0 to $13,850	$0 to $19,400	$0 to $9,700
	Tax Owed 10% of taxable income	**Tax Owed** 10% of taxable income	**Tax Owed** 10% of taxable income	**Tax Owed** 10% of taxable income
12%	$9,701 to $39,475	$13,851 to $52,850	$19,401 to $78,950	$9,701 to $39,475
	Tax Owed $970 plus 12% of the excess over $9,700	**Tax Owed** $1,385 plus 12% of the excess over $13,850	**Tax Owed** $1,940 plus 12% of the excess over $19,400	**Tax Owed** $970 plus 12% of the excess over $9,700
22%	$39,476 to $84,200	$52,851 to $84,200	$78,951 to $168,400	$39,476 to $84,200
	Tax Owed $4,543 plus 22% of the excess over $39,475	**Tax Owed** $6,065 plus 22% of the excess over $52,850	**Tax Owed** $9,086 plus 22% of the excess over $78,950	**Tax Owed** $4,543 plus 22% of the excess over $39,475
24%	$84,201 to $160,725	$84,201 to $160,700	$168,401 to $321,450	$84,201 to $160,725
	Tax Owed $14,382.50 plus 24% of the excess over $84,200	**Tax Owed** $12,962 plus 24% of the excess over $84,200	**Tax Owed** $28,765 plus 24% of the excess over $168,400	**Tax Owed** $14,382.50 plus 24% of the excess over $84,200
32%	$160,726 to $204,100	$160,701 to $204,100	$321,451 to $408,200	$160,726 to $204,100
	Tax Owed $32,748.50 plus 32% of the excess over $160,725	**Tax Owed** $31,322 plus 32% of the excess over $160,700	**Tax Owed** $65,497 plus 32% of the excess over $321,450	**Tax Owed** $32,748.50 plus 32% of the excess over $160,725
35%	$204,101 to $510,300	$204,101 to $510,300	$408,201 to $612,350	$204,101 to $306,175
	Tax Owed $46,628.50 plus 35% of the excess over $204,100	**Tax Owed** $45,210 plus 35% of the excess over $204,100	**Tax Owed** $93,257 plus 35% of the excess over $408,200	**Tax Owed** $46,628.50 plus 35% of the excess over $204,100
37%	$510,301+	$510,301+	$612,351+	$306,176+
	Tax Owed $153,798.50 plus 37% of the excess over $510,300	**Tax Owed** $152,380 plus 37% of the excess over $510,300	**Tax Owed** $164,709.50 plus 37% of the excess over $612,350	**Tax Owed** $82,354.75 plus 37% of the excess over $306,175

Standard **Deduction**

After tax reform, many taxpayers who previously itemized deductions will now find the standard deduction more beneficial. Although there is less to track, taxpayers should continue to document itemized deductions. ***Keep in mind, the Tax Cuts and Jobs Act repealed the personal exemption through 2025 (barring any additional action by Congress).***

2019 Filing Status	2019 Standard Deduction
Single/Married Filing Separately	$12,200
Married Filing Jointly/Surviving Spouse	$24,400
Head of Household	$18,350

Adjusted for inflation using the Chained Consumer Price Index for All Urban Consumers (C-CPI-U)

Dependent filers: The standard deduction amount for an individual who may be claimed as a dependent by another taxpayer cannot exceed the greater of $1,100 or the sum of $350 and the individual's earned income up to $12,200.

Additional standard deduction: If a taxpayer is age 65 or older and/or blind on the last day of the tax year, he or she is entitled to take an additional standard deduction. This additional deduction amount equals $1,300 and increases to $1,650 for unmarried taxpayers.

Tax **Deductions**

Below is a recap of several popular tax deductions and a few changes that took effect in 2019. All changes made to individual tax deductions are temporary and generally expire after 2025.

Above-the-Line Deductions

- **Moving expenses:** Available only to members of the Armed Forces (or their spouses or dependents) who are active duty and required to move by military order related to a permanent change of station.
- **Alimony and child support:** For divorce or separation instruments executed after December 31, 2018, alimony payments will no longer be included in taxable income. Additionally, the payments are not deductible by the payor. This treatment of alimony payments also applies to divorce or separation decrees that are modified after December 31, 2018, if the modification specifically states that the new treatment of alimony payments now applies. For individuals who must pay alimony, this change may be costly. Child support payments remain non-deductible by the payor.

Note: Be sure to contact your attorney if this situation applies to you so alimony and child support can be properly addressed in your divorce agreements.

Itemized Deductions

- **Medical expenses:** For 2019, taxpayers may deduct medical expenses in excess of 10 percent of adjusted gross income (AGI). The AGI threshold was lowered to 7.5 percent in 2018, but returned to 10 percent this year.
- **State, local and real estate taxes:** These deductions are cumulatively capped at $10,000 ($5,000 for married filing separately). Keep in mind an individual cannot deduct foreign real estate property taxes unless the property is used in a trade or business.
- **Mortgage interest:** The deduction for mortgage interest is limited to debt of up to $750,000 incurred after December 15, 2017. For grandfathered debt (incurred before December 15, 2017), the debt limit is $1,000,000.
- **Home equity loan interest:** Beginning in 2018, interest paid on home equity debt generally is not deductible. However, if the loan is used to make substantial improvements to the main home or the second home, the interest paid is typically deductible under the $750,000 total mortgage acquisition indebtedness cap. If a home equity loan is used to pay personal living expenses such as credit card debt, the loan interest will not be allowed as an itemized deduction. Understanding how to structure your debt is more important now under the new law, so be sure to reach out to your tax professional.
- **Charitable contributions:** This popular deduction remains available for taxpayers, subject to income limitations. The income limitation for cash donations to public charities remains at 60 percent of adjusted gross income (AGI), but capital gain property donations, like appreciated stock, remains capped at 30 percent AGI.

Reminder: Miscellaneous itemized deductions, which includes investment fees and expenses, professional service fees and unreimbursed business expenses, is repealed through tax year 2025.

Qualified Business Income Deduction

Many individuals who earn income from pass-through entities, real estate properties or other business ventures may be eligible for the Qualified Business Income (QBI) deduction, also known as Section 199A. This deduction allows eligible taxpayers to reduce taxable income from their business by up to 20 percent. Please refer to page 29 of this guide for more information on this potential deduction.

Additional **Taxes**

Alternative Minimum Tax

Alternative Minimum Tax (AMT) is calculated using a different set of tax rules than those used for regular tax. Under AMT rules, some deductions taken for regular tax are not allowed. Certain income and expenses are also recognized under different rules for AMT. If the AMT calculation of tax is higher than regular tax, the taxpayer must pay the additional AMT tax. In the past more taxpayers were subject to AMT due to itemized deduction addbacks. Due to tax reform and the repeal of various itemized deductions, fewer taxpayers are subject to AMT.

Filing Status	2019 AMT Exemption Amount	Exemption Reduced by 25% of AMT Income Over:	Exemption Eliminated at AMT Income of:
Married Filing Jointly/ Surviving Spouse	$111,700	$1,020,600	$1,467,400
Single/Head of Household	$71,700	$510,300	$797,100
Married Filing Separately	$55,850	$510,300	$733,700

Net Investment Income Tax

Certain individuals may be subject to a 3.8 percent tax on net investment income (NII), which includes interest, annuities, dividends, net capital gain, rents and passive business or trade income. NII is calculated as the lesser of (1) net investment income, or (2) excess of modified adjusted gross income (MAGI) over the applicable threshold amount outlined in the chart below.

Filing Status	Tax Imposed When MAGI Exceeds:
Married Filing Jointly/Surviving Spouse	$250,000
Single/Head of Household	$200,000
Married Filing Separately	$125,000

According to your unique financial situation, your RKL advisor can suggest ways to lessen NII exposure, including:

- Shift taxable investments to tax-free vehicles
- Offset the income with deductions
- Group similar categories of investment income activities

Additional Medicare Surtax

Higher-income salaried or self-employed individuals must also pay a 0.9 percent additional Medicare tax on any wages, compensation or self-employment income exceeding the threshold amount of $250,000 (married filing jointly), $125,000 (married filing separately) or $200,000 (single). For wage earners, this tax may be withheld by employers. Both self-employed individuals and wage earners must report this tax via Form 8959.

Tax **Credits**

There are two types of tax credits: refundable and nonrefundable. Refundable tax credits are treated as payments of tax made during the year, so credits in excess of tax owed will result in a refund from the IRS. Any excess nonrefundable tax credits will not be returned to the taxpayer.

Child Tax Credit

The Child Tax Credit remains $2,000 for each qualifying child under the age of 17. The definition of qualifying child has also remained the same. The Child Tax Credit starts to phase out by $50 for each $1,000 of modified adjusted gross income (MAGI) over $400,000 for married filing jointly taxpayers and $200,000 for other filing statuses. There is also an additional Child Tax Credit, which is a portion of the Child Tax Credit and is refundable for certain taxpayers with more than $2,500 of earned income. Eligible taxpayers should complete Schedule 8812 to compute the refundable portion of the credit. This credit cannot exceed $1,400 for any qualifying child.

Note: Releasing exemption to noncustodial parent does not entitle parent to exemption deduction; however, it does make the noncustodial parent eligible for the Child Tax Credit.

Other Dependent Credit

This $500 credit applies to any dependents who are not qualifying children under age 17. There is no age limit for the $500 credit but the tests for dependency must be met. **This credit is nonrefundable and begins to phase out at MAGI of $200,000 ($400,000 if married filing jointly).**

Taking Child Tax or Other Dependent Credits? Don't Forget SSN.

If you are claiming the nonrefundable and refundable portion of the Child Tax Credit, dependent Social Security Numbers (SSN) are required. The SSN must be issued prior to the due date of the tax return including extensions. For the Other Dependent Credit, a SSN is not required but an Individual Taxpayer Identification Number (ITIN) is.

Education Tax Provisions

- **American Opportunity Tax Credit:** Taxpayers with incomes of under $80,000 (single) or $160,000 (married filing jointly) may be eligible for a maximum credit of $2,500 for qualified tuition, fees and course material expenses paid during the tax year for themselves or their dependents who have not completed the first four years of post-secondary education. The credit is per eligible student.
- **Lifetime Learning Credit:** This credit is capped at $2,000 per tax return and phases out for taxpayers with adjusted gross income above $68,000 (single filers) and $136,000 (married filing jointly). This credit is available to offset expenses related to tuition, fees and course-related books, supplies and equipment for all years of higher education, including additional courses to acquire or improve job skills.
- **Student loan interest deduction:** Borrowers can deduct education loan interest up to $2,500 per tax year, subject to annual income limitations of $85,000 (single) and $170,000 (married filing jointly).
- **Student loan indebtedness discharge:** Certain loans discharged after December 31, 2017, will no longer be included in taxable income.
- **Educator expense deduction:** Teachers who buy supplies for their classrooms at their personal expense can deduct up to $250 of purchases.

529 plans: Keep in mind that, starting in 2018, distributions from 529 plans may be used to cover up to $10,000 of educational expenses for designated beneficiaries enrolled at a public, private, or religious elementary or secondary school. Talk to your advisor on how to maximize this tax-advantaged tool for elementary or secondary school expenses. Refer to page 22 for more information on 529 plans.

Health Care **Tax Considerations**

The Affordable Care Act (ACA) is still the law of the land, but the Tax Cuts and Jobs Act repealed the ACA's shared responsibility requirement effective January 1, 2019. As a result, taxpayers will no longer have to pay a penalty for not maintaining health insurance.

Health Cost Savings Options

Individuals and families may use a **Health Savings Account (HSA) or Flexible Spending Account (FSA)** to save for and pay current or future medical expenses for themselves, spouses and qualified dependents. Both allow for pre-tax contribution and offer tax-free growth and withdrawal advantages. See the below chart for 2019 HSA limits. Money saved in an FSA must be used by the end of a calendar year or it is forfeited. Taxpayers should familiarize themselves with their plan's terms and conditions to ensure they are not leaving money behind.

2019 Contribution and Out-of-Pocket Limits for Health Savings Accounts and High-Deductible Health Plans

HSA contribution limit (employer + employee)	**Self-only:** $3,500 **Family:** $7,000
HSA catch-up contributions (age 55 or older)	$1,000
HDHP minimum deductibles	**Self-only:** $1,350 **Family:** $2,700
HDHP maximum out-of-pocket amounts (deductibles, co-payments and other amounts excluding premiums)	**Self-only:** $6,750 **Family:** $13,500

Reporting Requirements for **Foreign Financial Accounts & Assets**

Do you have a foreign bank account or assets? Do you have signature authority over your company's foreign bank account? These are two of the most common triggers for annual reporting of foreign financial accounts and assets to the IRS and the U.S. Department of Treasury, which is completed through Forms 114 and 8938.

Form 114, Reports of Foreign Bank and Financial Accounts (FBAR)

Taxpayers who own or have signature authority over foreign accounts with balances that total in excess of $10,000 must electronically file an FBAR. The IRS defines "authority" as the ability to initiate account withdrawals, and its definition of "financial account" includes, but is not limited to:

- Traditional bank accounts and other accounts held with a financial institution
- Brokerage or commodities accounts
- Insurance and annuity policies with a cash value
- Mutual funds

Keep in mind that each account is measured at its maximum balance during the year and the $10,000 figure is the aggregate of all accounts. Whether or not a foreign account produces taxable income holds no bearing on the requirement to file an FBAR.

When to file: FBARs are due April 15 following the calendar year reported. Taxpayers are automatically granted a six-month extension until October 15 (no request needed).

Non-filing penalties: Non-willful failure to file an FBAR can trigger penalties of up to $10,000 per foreign account. Willful non-filers can be penalized up to $100,000 or 50 percent of the account value, and may also face criminal charges (depending on facts and circumstances).

Form 8938, Statement of Specified Foreign Financial Assets

Taxpayers who hold certain levels of foreign assets during or at the end of a tax year must report these holdings on Form 8938, in accordance with the Foreign Account Tax Compliance Act (FATCA). See the chart below detailing the reporting thresholds for various tax filing statuses. Generally speaking, only individuals and specified domestic entities (closely held entities which derive at least 50 percent of its income from passive activities) must file Form 8938, but your RKL advisor can help determine whether you have a filing requirement.

FATCA Reporting Thresholds

Taxpayer Type	Amount on last day of year exceeding:		Amount at any time during year exceeding:
Unmarried and living in U.S.	$50,000	OR	$75,000
Joint filers living in U.S.	$100,000	OR	$150,000
Single filers living abroad	$200,000	OR	$300,000
Joint filers living abroad	$400,000	OR	$600,000

FATCA's definition of specified foreign financial assets includes foreign financial accounts (reported via FBAR – see page 14) and foreign non-account assets (i.e. foreign stock, securities or debt).

NOTE: Filing Form 8938 does not relieve taxpayers of filing responsibility for FBAR (Form 114).

When to file: Form 8938 is attached to a taxpayer's annual return and must be filed by the due date, including extensions, for that return. For individuals and calendar-year C Corporations, this would be April 15 with a six-month extension available upon request.

Non-filing penalties: Failure to file Form 8938 can result in a $10,000 penalty. Continued failure after IRS notification can result in additional penalties of up to $50,000 and a 40 percent penalty on an understatement of tax attributable to non-disclosed assets.

Other reportable foreign financial accounts:

- Investment or retirement assets held in foreign jurisdictions
- Foreign trusts
- Foreign partnerships
- Investment in a passive foreign investment company (PFIC)

Your RKL advisor can assess and navigate the complex calculations and reporting requirements for foreign asset holdings.

Planning Opportunities

Tax Arbitrage & Scheduled Rate Sunset

Tax rate arbitrage (also known as "filling out the bracket") lets individuals realize income now at lower tax rates instead of doing so in the future when rates may be higher. These opportunities often occur due to a decrease in adjusted gross income thanks to retirement, and may be most optimal before the onset of Social Security payments and/or Required Minimum Distributions from IRAs. Since lower marginal tax rates and higher standard deduction will revert to 2017 levels after 2025 (barring further legislative action), taxpayers have a window of opportunity to realize more income now at current lower rates. Your RKL advisor can help you evaluate and execute this opportunity.

Asset Location

Different financial asset accounts have different tax treatments. Understanding how tax rules apply to the various aspects of your investment portfolio is critical to an integrated and proactive wealth management approach. Asset location examines how assets (like stocks, bonds and mutual funds) are distributed and managed among investment accounts (like an IRA, taxable account, tax-exempt account, tax-deferred account, trust account, insurance policy, foundations, etc.) to maximize your after-tax returns. This encompasses all forms of taxation, including estate taxes. Asset location is one of the many factors your RKL advisor takes into account when developing a comprehensive plan to meet your unique goals.

Cryptocurrency Tax Impact

According to the IRS, virtual currency transactions are legally taxable and cryptocurrencies like bitcoin and ethereum should be treated as property, akin to stocks, bonds or real estate property, not cash currency. As a result, the sale of any cryptocurrency triggers the requirement to report gains and losses. Keep in mind, the exchange of one cryptocurrency for another is also treated the same as a sale (unlike currencies). Investors that simply buy and hold the currency are under no reporting requirement. In fact, the IRS recently began issuing letters to virtual currency owners reminding them of their reporting obligations.

Unlike stock or bond sales, which are documented with a 1099 from a bank or brokerage, virtual currency exchanges may not provide investors with documentation to substantiate sales, gains and losses. As a result, investors should consider keeping their own detailed records of transactions for greater ease in calculating tax obligations.

Strategic Deployment:
Capital Gains & Qualified Dividends

Tax rates for long-term capital gains and qualified dividends depend on an individual's tax bracket. Below, we align these brackets with the resulting capital gains rate. Short-term gains and nonqualified dividends are still taxed at ordinary income rates. To use the chart, first determine the tax bracket for the ordinary portion of taxable income. Then assess the rate that applies to the capital gains above that income level.

Income Tax Bracket

Married Filing Jointly (taxable income exceeding...)	Single (taxable income exceeding...)	Rate (is taxed at...)
$0	$0	10%
$19,400	$9,700	12%
$78,950	$39,475	22%
$168,400	$84,200	24%
$321,450	$160,725	32%
$408,200	$204,100	35%
$612,305+	$510,300+	37%

Capital Gains Tax

Married Filing Jointly (taxable income exceeding...)	Single (taxable income exceeding...)	Rate (is taxed at...)
$0	$0	0%
$78,750	$39,375	15%
$488,850+	$434,550+	20%

Year-end action item: Before December 31, compute year-to-date realized gains and losses from all taxable investment accounts. Consider factors like trade date, mutual fund distributions and income from pass-through entities (including partnerships, S corporations and LLCs). Harvest additional gains or losses before the end of the year to meet investment, tax and financial planning goals. Your RKL advisor can help you determine the most appropriate method and timing to maximize capital gains and minimize the impact of losses. Here is a quick overview of common situations and action items.

Do you hold...	Consider...
Short and long-term losses?	Recognizing unrealized gains by selling securities (ideally short-term holdings) up to $3,000 less than the amount of losses.
More long-term gains than short-term losses?	Taking losses up to $3,000 more than the net gain (starting with long-term positions), then follow suit for short-term losses.
More short-term gains than long-term losses? Or equal amounts of short and long-term gains?	Taking losses up to $3,000 more than the net gain (starting with long-term positions). This helps offset short-term gains.
Bad debts or worthless securities?	Ensuring losses are deductible in the current year with the proper substantiation.

Should I convert my traditional IRA to a Roth IRA?

Changing from a traditional IRA (pre-tax dollars) to a Roth IRA (post-tax dollars) means that the taxes must be paid all at once during the conversion. The current lower rate environment may make it an appealing time for individuals to consider this change. Below is a snapshot of the major pros and cons of IRA conversion. Other factors like age and income tax brackets (current vs. expected future) may impact the benefits, so be sure to discuss with your advisor.

Pros for a Roth Conversion	Cons for a Roth Conversion
• No Required Minimum Distributions (RMDs) for the account owner • Tax-free withdraw of converted balances • Earnings grow tax-free and withdrawals are tax-free after 59 ½	• Pay tax on the converted savings • Converted funds may trigger higher tax bracket • Must wait five years to withdraw investment earnings

How Saving for Retirement May Impact 199A Deduction Eligibility

Tax reform created the 199A deduction for pass-through business owners and self-employed taxpayers. Essentially, eligible taxpayers must meet income limitations to qualify for 199A. If taxable income exceeds the 199A threshold (or phase-outs for specified service providers) taxpayers may benefit from reducing taxable income. One way to reduce taxable income is with contributions to a retirement account (like 401(k)s, IRAs or defined benefit plans).

If taxable income falls within the qualifying income limitation, reducing taxable income may decrease the 199A deduction. This may reduce the current tax benefit of the retirement contribution. Your RKL advisor can help determine the level of contributions needed to qualify for 199A. For more detailed information on 199A, turn to page 29 of this guide.

Managing Assets **in Retirement**

Watch Social Security Taxability Thresholds

For individual recipients with income over $25,000 or married couples with joint income of $32,000 or more, Social Security benefits are taxable. Over these thresholds, the exact portion of taxable benefits varies based on income level and is capped at 85 percent for all taxpayers.

- Up to 50 percent of benefits will be taxed for individuals with incomes between $25,000 and $34,000 and married couples filing jointly with incomes between $32,000 and $44,000.
- Up to 85 percent of benefits will be taxed for individuals with income over $34,000 and married couples with income over $44,000.

For the purposes of calculating this tax treatment, the IRS defines income as:

Adjusted Gross Income + Nontaxable Interest + Half of Social Security Benefits

Based on the calculation and income thresholds, Social Security recipients must monitor finances carefully throughout the year. In some cases, it may make sense to defer income until the start of a new year.

Change to Medicare Premium Cost: New Additional Tier

The Social Security Administration uses a modified adjusted gross income (MAGI), which for its purposes means adjusted gross income plus tax-exempt income, to determine how much beneficiaries pay in Medicare premiums for the year. 2019 premiums are based on 2017 MAGI (the most recent tax return info available). In addition to routine premiums, higher-earning beneficiaries ($85,000+ MAGI for individuals and $170,000+ MAGI married couples) are required to pay an income-related monthly adjustment amount (IRMAA) surcharge.

Starting in 2019, there is a new top tier for the IRMAA surcharge for beneficiaries with MAGI of $500,000+ (individuals) and $750,000+ (married couples).

> ***Here is a demonstration of the new top tier for married taxpayers filing jointly:*** *Previously, the highest premium was $433.50 a month for beneficiaries with MAGI above $320,000. Now, the highest premium level is $460.50 a month for MAGI of $750,000 and above.*

Unlike a life-changing event (retirement, marriage, divorce, death of a spouse), one-time spikes in income, like a large portfolio distribution, Roth IRA conversion or real estate transaction, may increase Medicare premiums. Your RKL advisor can help you assess the impact of financial transactions on Social Security taxability and Medicare costs and readjust premiums after a triggering financial event.

Remember RMDs

Individuals age 70 ½ or above are required to take a Required Minimum Distribution (RMD) from taxable retirement accounts by December 31 of each year, and pay income tax on a portion of the withdrawal. Certain Roth IRAs do not have an RMD – discuss your specific account requirements with your advisor.

The calculation of RMD amount depends on individual factors like age, account balances and beneficiary. Taxpayers that skip RMDs or withdraw too little are subject to a 50 percent federal penalty, in addition to making catch-up RMDs and paying the necessary tax.

Taxpayers may want to consider taking IRA distributions before their RMDs to fill out their tax brackets, especially if the RMDs will be sizable enough to keep or bump them into a high tax bracket. This strategy could also support IRA withdrawals needed for cash flow purposes. For taxpayers 59 ½ or older, these withdrawals would not trigger an early penalty. Read more about filling out the bracket on page 17.

Your RKL advisor can help you determine RMD taxability, manage RMDs across various accounts and develop the most tax-effective strategy for deploying these withdrawals, including consolidating accounts where possible.

RMD Deferral Option:
Qualifying Longevity Annuity Contract (QLAC)

Approved by the U.S. Treasury in 2014, a QLAC is a deferred income annuity within a retirement plan. In addition to the dependable income stream provided by annuities, QLACs offer a secondary benefit. There are no RMDs for money invested in a QLAC until the annuity income begins, which is generally required at age 85. Once payments start, however, they are treated as ordinary income just like traditional IRA distributions. There are limitations around funding that should be considered and potential state implications. Talk with your RKL advisor to determine whether QLAC is an appropriate addition to your retirement income toolkit.

Charitable **Giving**

The charitable deduction is a flexible and beneficial way for individuals to support causes they care about and reap tax benefits. To maximize these tax benefits, it is critical that taxpayers optimize the timing and methods of their donation.

Tax-Advantaged Donation Strategies

Donation of appreciated assets: Assets like common stocks, mutual funds or exchange traded funds can be donated once they appreciate. Want to enhance the tax savings of this strategy? Consider shifting the unrealized capital gain to a charity or DAF with no tax liability on the sale of those securities. The deduction is equal to the average fair market value on date of contribution and is capped at 30 percent of adjusted gross income.

Bunching method: Developing a timetable to prepay charitable contributions on an alternating basis is known as bunching. In years where contributions are made, the taxpayer uses itemized deductions. In years with little or no donations, the taxpayer takes the standard deduction.

Donor Advised Fund (DAF): This vehicle streamlines charitable giving and can be used in tandem with bunching. In the first year, a taxpayer funds the DAF with a larger donation in the first year in order to capture the itemized deduction for charitable contributions. Moving forward, the taxpayer controls when donations are made from the DAF and can spread charitable giving across a number of years. Ideally, contributions to a DAF should be made in years when tax liabilities are projected to be higher in order to gain maximum tax benefits. Be sure to deploy this strategy under guidance from your RKL advisor.

Qualified Charitable Distribution (QCD) from IRA: Taxpayers age 70½ or older can make tax-free "qualified charitable distributions" (QCDs) from their IRAs. Not only does this advance charitable giving, a QCD also counts toward the taxpayer's IRA required minimum distribution (RMD). Unlike other RMDs, however, QCDs are excluded from gross income. Eligible taxpayers can direct up to $100,000 per year ($200,000 if filing jointly) to a qualified charity and avoid income tax on that amount. QCDs are prohibited from funding DAFs, private foundations or split-interest charitable trusts.

Save for Education & Save on Taxes

The cost of higher education continues to rise and levels of student debt have reached new heights. Saving in advance for this considerable expense is one surefire way to minimize student debt. 529 plans help individuals and families save in a tax-advantaged and flexible way.

Funds saved in a 529 account can be used at most colleges and trade schools; can be rolled into another plan or earmarked for another beneficiary; and remain indefinitely in the control of the account owner (not the student beneficiary). The tax benefits of 529 plans include:

- State and federal tax-free growth and distributions when used for qualified higher education expenses, such as tuition, room and board, books, etc., or elementary and secondary school expenses (up to $10,000 per year)
- State tax deduction for contributions (limited to federal gift exclusion and cannot exceed taxpayer/spouse PA taxable income; rules vary by state/jurisdiction)
- Gift and estate tax benefits up to $75,000 ($150,000 for married couples)

For the purposes of financial aid, a 529 account owned by the parent or student is treated as the owner's asset. If the account owner is a grandparent or other individual, 529 plan distributions are reportable as student income on their FAFSA. Keep in mind, 529 plans have special rules to be used in tandem with the education credit.

Estate & Gift **Tax Planning** ›

Estate planning is critical to any wealth management strategy, allowing individuals to maintain financial security now and formalize plans for the transfer of property and assets after their death, including issues like family business succession, guardianship of minor children and providing for family members with special needs. Be sure to discuss your financial and personal priorities with your RKL advisor, who can help you develop, maintain and execute a tax-advantaged estate and gifting approach that meets your goals.

Estate and Gift Tax Rates, Rules & Limits

- Federal estate tax (maximum rate): 40 percent (each state has its own set of estate/inheritance tax laws)
- 2019 exemption amount: $11.4 million per individual, $22.8 million per married couple
- Annual gift tax exclusion: $15,000 or $30,000 if gift-splitting with spouse (must be used by December 31 with no carry-over)
- Portability: Surviving spouse may use the deceased spouse's remaining estate tax exemption
- Stepped-up basis: Inherited asset receives a step-up in basis to market value as of date of death

Planning Strategies and Best Practices

Routinely review estate plan documents:

Standard financial best practices suggest periodic review of estate planning documents like trust documents and wills. Estate planning documents should be flexible and allow tax-planning adjustments and decisions to be made after a spouse's death.

Fully utilize lifetime exemption:

Under the Tax Cuts and Jobs Act of 2017, the lifetime exemption was increased to $11.4 million (adjusted for inflation) through December 31, 2025. On January 1, 2026, the lifetime exemption is set to revert back to $5 million if Congress does nothing. A change in the lifetime exemption amount could come even sooner depending on the outcome of the 2020 elections, with many Democratic candidates calling for significant reductions in the lifetime exemption (as well as increased estate tax rates). Individuals with substantial wealth should seize this limited opportunity to make large, estate tax-free gifts to family members, either directly or into trusts. The increased (and annually inflation-adjusted) exemption provides a unique chance for high net worth individuals to remove more of their assets from their taxable estate, particularly when coupled with other discounting techniques. The decision to make a large lifetime gift must be balanced with the impact of losing a step-up in basis at death.

Maximize generation-skipping transfers:

The generation-skipping transfer (GST) exemption is linked to the lifetime estate tax exemption, which means taxpayers also have opportunities to maximize transfers that benefit grandchildren and future generations. One opportunity is to revisit previously funded non-GST exempt irrevocable trusts and consider making a late allocation of GST-exemption, if appropriate. Another opportunity is to make a gift to an irrevocable multi-generational trust which fully utilizes both the taxpayer's remaining lifetime exemption and GST exemption. Such a gift shifts all future appreciation and locks in use of the increased exclusion. A third and more complex option is to couple a lifetime gift with a sale of additional assets (typically closely held business interests) to the same irrevocable multi-generational trust. Known as a "freeze transaction," this type of transaction, if structured properly, can be a very powerful way to transfer business interests to future generations in the right circumstances.

Business Taxpayers: **Deadlines for Key Filings**

Tax Form	Due Date (for calendar year entities)
Forms 1094-C and 1095-C (Health insurance offer and coverage info)	**January 31, 2020** to employees **February 28, 2020** to IRS if filing hard copy **March 31, 2020** to IRS if e-filing
Form 1099 (Non-employer income)	**January 31, 2020** to recipients **February 28, 2020** to IRS if filing hard copy **March 31, 2020** to IRS if e-filing
Forms W-2, W-3 and 1099-MISC (Box 7 – Nonemployee compensation)	**January 31, 2020** to employees/recipients, Social Security Administration and IRS if filing hard copy or e-filing
Partnerships (Form 1065) & S Corporations (Form 1120S)	March 16, 2020
Individuals (Form 1040), C Corporations (Form 1120) and Trusts and Estates (Form 1041)	April 15, 2020
Tax-exempt nonprofit organizations (Form 990)	May 15, 2020
Employee Benefit Plans (Form 5500)	July 31, 2020
Extended return filings for partnerships & S Corporations	September 15, 2020
Extended return filing for trust and estates	September 30, 2020
Extended return filing for individuals, C Corporations and Employee Benefit Plans	October 15, 2020
Extended return filing for tax-exempt nonprofit organizations (Form 990 series)	November 16, 2020

Compliance Tip: Watch State and Local Tax Issues

At the state and local level, conformity with various federal tax provisions may vary by jurisdiction. RKL's state and local tax team helps clients navigate compliance requirements and interpret legislative actions.

Is Your Business Using the Most **Beneficial Accounting Method?**

For businesses with up to $26 million in gross receipts, a change in accounting method could provide significant tax benefits. If your business has average gross receipts (last three years) that are less than $26 million, you may be eligible to report on the cash basis or avoid the additional burdens of accounting for inventories and Section 263a costs associated with uniform capitalization rules. Contractors may also be eligible to use the completed contract method to report their contracts income.

Businesses that may see the greatest tax benefits from an accounting method switch include:

- High receivable and low payable/accrued expense businesses
- Producers and resellers with high capitalized overhead ratios
- Producers and resellers calculating and capitalizing 263a costs into their tax inventory
- Contractors using the percentage of completion for tax purposes

Benefits of changing accounting methods:

- Deferral of income until cash is received
- Easier administration and simplified calculations related to tax inventory costs
- Better matching of cash flows relating to income taxes paid
- Delaying recognition of contracts income until contract is completed

Want to make sure your business is using the most advantageous accounting method? The RKL tax team can help you evaluate your current state and weigh the pros and cons of making a change.

Should Your Business Review Its Entity Selection?

Tax reform upended the playing field for all entity types, thanks to changes like the reduction of the corporate tax rate to a flat 21 percent, the removal of corporate AMT and the introduction of the Section 199A deduction for pass-through business owners.

While it is clear that not every pass-through entity should elect to be taxed as a C Corporation, the end of another tax year is an appropriate time to make sure your entity selection supports your business strategy. An entity type review may allow owners to seize opportunities such as improving after-tax cash flows to owners, increasing cash available for business reinvestment, ensuring optimum organizational efficiency and optimizing tax distribution policies in light of lower tax rates.

Entity Type Review: Beyond the Numbers

- Ensure optimum organizational efficiency
- Evaluate long-term exit strategies
- Optimize tax distribution policies

An entity type review helps owners go beyond the numbers and develop or enhance their long-term goals. There are a few factors that can help this development process. First, what are your plans for business earnings? Will they be distributed out to owners or reinvested back into the business? Another factor is the eligibility for the pass-through deduction and applicable individual tax rates for each owner along with the effective state tax rates for corporations and individuals. Taxpayers should also consider the exit strategy for the business. Will the business be passed onto future generations or sold? The tax implications in choosing whether to perform a stock sale or asset sale of the company can be a material factor in entity selection.

Entity Selection: Favoring Factors At a Glance

Factors	Pass-through Entities	C Corporations
Eligibility for the Section 199A deduction	Have the ability to claim the 20% Section 199A deduction.	Do not have the ability to claim the 20% Section 199A deduction.
Planning for business earnings	Favorable to high or moderate level of discretionary distributions to owners.	Favorable to low levels of discretionary distributions and the reinvestment of earnings into the business.
Business exit strategy	Taxable exit in sale of the entity is likely. Sale of a pass-through entity involves one level of taxation at the individual level.	Taxable exit in sale of the entity is unlikely. C Corporation sales can potentially liquidate tax liabilities at the corporate entity and individual levels.

Deductions for **Businesses**

Your company may be eligible for a tax deduction on common expenditures. Below, we highlight three key deduction opportunities for businesses. Read on to page 29 for a full update on the new Section 199A pass-through deduction created by tax reform. Consult your RKL advisor to assess eligibility for these and other deductions.

Meals Still Deductible (But Not Entertainment Expenses)

Tax reform **eliminated the deduction for entertainment expenses** incurred after December 31, 2017, which were previously 50 percent deductible. Entertainment expenses are amusement or recreation activities directly related to the conduct of a taxpayer's trade or business – for example, the cost of tickets and associated expenses incurred while hosting current or prospective clients at country clubs, theaters and sporting events.

Reminder:
Employer costs for strictly employee recreational activities, such as company holiday parties or annual gatherings, are still fully deductible.

The business meal deduction remains at two levels, as outlined below.

Nondeductible Meal & Entertainment Items

- Lunch with customer, client or employee without a business purpose/discussion.
- Club dues – for example, country clubs, golf and athletic clubs.
- Lavish or extravagant entertainment expenses.

100 Percent Deductible Meal Expenses

- Meal expenses for a company picnic or holiday party.
- Food made available to the public for free – usually as part of a promotional campaign.
- Meal expenses included as taxable compensation to the employee or independent contractor and included on the W-2 or Form 1099.
- Meals expenses that are sold to a client or customer.

50 Percent Deductible Meal Expenses

- Any de minimis meals provided to employees for the convenience of the employer. Note: these meal expenses will be 100 percent nondeductible after 2025.
- Meal expenses for business meetings of employees, stockholders, agents and directors. Office meetings and partner meetings fall into this category. If there is no business function to the meal, it is completely nondeductible for tax purposes.
- Generally, any meals during business travel. If a portion of a business trip can be considered personal and not related to the business function of the trip, then a portion of the meals expense should also be considered personal and not deductible.
- Meals at a convention, seminar or any type of meeting, even if the meals cost is not separately stated from the cost of the event. If not separately stated, it must be calculated by the taxpayer based on reasonableness or per diem rates for that location.
- Meals with people related to the business such as clients, customers and vendors, provided that there is a business purpose or some benefit to the business will result, the taxpayer is present and the amount is not lavish or extravagant.
- Meal expenses purchased separately from the entertainment or the cost of the meal is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts.

Best Practices for Meals & Entertainment Recordkeeping

Maintain certain details about events and expenses to support deductions taken. This can be as simple as a copy of the receipt, with attendees and a short phrase regarding purpose of the meal jotted down on the back. If using a standardized expense reimbursement form, update it to include prompts for pertinent info, such as attendee details and purpose or primary discussion topic of the meal. Consider setting up separate general ledger accounts for each class of meals and entertainment instead of merging into one account – this may keep the deduction and documentation process clearer and simpler.

Deductions for **Businesses** (continued)

Interest Expense Deduction Still Available, but Capped

Effective for tax years beginning after December 31, 2017, as amended by the Tax Cuts and Jobs Act, the deduction for interest expense for any entity with average gross receipts greater than $26 million is limited to the sum of:

- 30 percent of adjusted taxable income
- Business interest income
- Floor plan financing

Disallowed interest carries forward indefinitely, with annual retesting. Internal Revenue Code Section 163(j) defines "business interest" as interest paid or accrued on indebtedness allocable to a trade or business (not interest earned on investments). Keep in mind, all interest is business interest for C Corporations.

While many details of this deduction were finalized by the IRS, a few areas remain unclear at the time this guide went to print, including:

- Eligibility of large real estate partnerships
- How to handle inter-company transactions
- Clarity around the broad definition of interest expense
- Depreciation add-back for adjusted taxable income

State tax impact: *For consolidated entities, Pennsylvania will determine the limitation at a consolidated basis, not on a separate company basis.*

The RKL tax team continues to monitor all regulatory actions. Contact your advisor with any questions regarding eligibility for the interest expense deduction.

New Treatment for Parking Fringe Benefits

Previously, an employee could exclude up to $255 per month of employer-provided parking as a qualified transportation fringe benefit and the employer could deduct 100 percent of the expense. Now, the employee exclusion remains, but this amount must be included by the employer as a nondeductible business expense. This calculation will vary depending on the manner in which an employer covers the cost of employee parking.

For small employers with only a few spots and low maintenance costs, the parking expenses may not result in a significant increase to taxable income. Larger employers with numerous locations may face a larger tax bill. The new treatment also impacts nonprofit organizations – get more details on page 43.

Methods to Preserve Deductible Parking Benefit

- Consider a compensation reduction agreement for employees to offer a choice between cash compensation or the parking benefit.
- Give employees a taxable bonus that must be used to cover parking costs on an after-tax basis.
- Make your parking spots available to the general public as well as employees. The IRS permits deduction of parking expenses if the spots are used more than 50 percent of the time by members of the public, visitors, clients, patients, deliveries, etc.

We expect this guidance to evolve, as the IRS continues to solicit and consider feedback. Contact your RKL advisor to discuss your parking circumstances within the most current regulations.

FYI: Beyond cost of parking itself, the IRS also considers utility costs, maintenance, insurance, property taxes, removal of leaves, trash, snow and ice, landscape costs, repairs, security and rent or lease payments as "parking expenses."

Update on **Section 199A Deduction**

After much speculation and a steady drip of guidance from the IRS around the mechanics of Section 199A, the 2018 filing season was our first chance to see how this new deduction would benefit business owners. Overall, the 20 percent qualified business income (QBI) deduction provided significant tax relief for eligible business owners. Through 2018 and 2019, the IRS defined certain aspects of 199A eligibility but other areas await further clarification.

Clarity around Rental Real Estate Safe Harbor

In 2018, the IRS released a safe harbor test for rental real estate. If a rental real estate enterprise – defined as a collection of real property with the same character (commercial or residential) owned by a taxpayer – fulfills the three requirements listed below, the income qualifies for the QBI deduction.

Rental Real Estate Safe Harbor Requirements		
Separate books and records are maintained for each rental enterprise.	250 hours or more of "rental services" are performed per year for the enterprise.	The taxpayer must maintain current records (who, what, when, and how long) of all services performed.

This IRS guidance also provided additional rules for rental real estate:

- Triple net leases cannot qualify for the rental real estate safe harbor.
- Self-rental automatically qualifies for QBI (Note: If the self-rent is to a specified service trade or business, the rental income will also be specified service income for QBI purposes).

Keep in mind that new IRS guidance and additional court decisions may alter future treatment of QBI qualifications for rental real estate. Stay connected with RKL's e-newsletter and LinkedIn feed for ongoing updates.

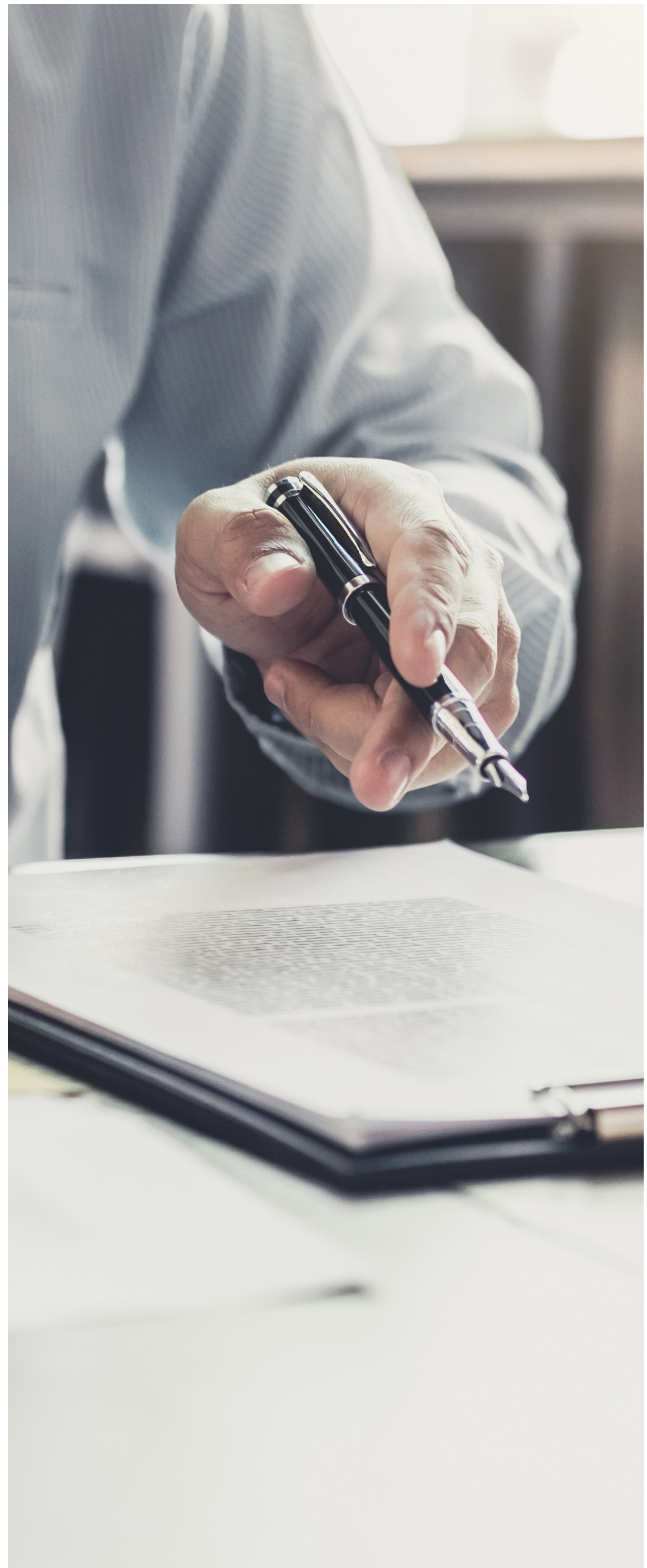
Specified Service Businesses: Some Clarity, Some Remaining Grey Areas

Section 199A defines "specified service trade or business" as professional service companies in fields including law, health, performing arts, actuarial science, financial services or any trade or business that relies heavily on the reputation or skill of employees or owners. Generally, these businesses will not be eligible for the 199A deduction. However, don't forget that owners of specified service businesses will get the 199A QBI deduction if they have income less than $160,700 for individuals and $321,400 for married filing jointly, plus the phase out range of $50,000 for single filers and $100,000 for joint returns.

Update on **Section 199A Deduction**

(continued)

Over the past year, the IRS has provided some clarity and examples around what is considered specified service and what is not. One key area that was clarified recently is healthcare services. It can be tricky to know where the practice of medicine starts and stops, but the final IRS regulations provided some examples that help the RKL tax team determine how QBI should be applied to the healthcare industry and how to maximize the deduction for our clients.



199A Deduction Planning Opportunities

After one full year of applying the QBI deduction, there are a few areas of opportunity for businesses to gauge eligibility and plan ahead for the upcoming tax season. First, take stock of how close your business is to the limitations so that you can efficiently plan to maximize the QBI deduction. If your business is close to being limited or is currently limited, discuss the applicability of the following planning ideas with your RKL advisor.

Adjust wages to optimal levels

Wages can be a big deal when it comes to the bottom line, but they can also have a big effect on the QBI deduction. Section 199A is limited to the greater of 50 percent of W-2 wages or 25 percent of W-2 wages and 2.5 percent of unadjusted basis of all qualified property used or held by the business. If your business is over this wage limitation or getting close, consider the below strategies to optimize wages:

- Consider hiring independent contractors as employees.
- Consider a compensation analysis, which may allow you to optimize QBI (by lowering wages and increasing income) and still maintain reasonable compensation.

Increase capital assets

This strategy can be cash flow-intensive, but for businesses already considering the purchase of capital assets, an increased QBI deduction can be an added incentive. Note that the purchase of capital assets may not increase QBI if the limitation is based solely on wages (50 percent of wages) instead of wages and qualified property (25 percent of W-2 wages and 2.5 percent of unadjusted basis of all qualified property).

Manage income

The QBI limitations (wages and property basis) do not apply if you are below the same thresholds that apply to specified services ($321,400 for MFJ and $160,700 for Single). If your taxable income is near these limits, individuals may want to consider reducing taxable income in order to avoid limitation. Options include charitable deductions, qualified retirement plan contributions and gifts of business interest.

Aggregate businesses

If you have multiple businesses that qualify for aggregation (see requirements below), it may be beneficial to aggregate if some of the businesses are QBI limited. Aggregating will allow the group to bunch the limiting factors (wages and/or qualified property) before applying the limitation to 20 percent of the aggregated group's QBI.

Requirements to aggregate businesses

Common control of businesses

+

No specified service businesses

+

Satisfy two out of three of these factors:

Provide products and services normally offered together

Share facilities or significant centralized business elements

Operate in coordination or reliance on one another

Tax Strategy Spotlight:
Are You Eligible for the R&D Credit?

If you answer yes to any of the questions below, your company may be eligible for the Research and Development (R&D) tax credit, a dollar-for-dollar reduction against taxes currently owed or previously paid in the prior three years.

Are you in the manufacturing, engineering, software/information technology, system integration, architecture, agriculture, construction or scientific/technical service industry?

Does your company:

- Develop new, improved, or more reliable concepts, products, processes, techniques or formulas?
- Develop and/or implement new materials, technology or processes to improve project or internal efficiencies?
- Develop new or improved software or hardware?
- Develop prototypes and/or test prototypes?
- Design for LEED/green initiatives?
- Apply for patents?
- Conduct environment testing?
- Test new technologies or products?
- Design new or one-off tools, jigs, molds or dies?
- Design and/or implement mechanical equipment or processes?
- Incorporate equipment that adds a new functionality or improves a process?

Do you pay contractors or consultants that perform any of these activities?

Did you know? The PATH Act of 2015 permanently established the R&D credit as a tax planning option for eligible businesses and removed limitations that previously excluded small or midsized companies from using this credit.

Dispelling Common R&D Myths:

Myth: Companies can only claim the R&D credit for successful bids or projects.

Reality: The success of a project or a bid is not required for eligibility – time and effort on unsuccessful projects or unawarded bids can lead to a credit opportunity.

Myth: The R&D credit won't help because my company is not profitable.

Reality: In this scenario, taxpayers have two options:

- Carry the R&D credit back one year and forward 20 years, banking credits for use in future years.
- Carry forward unclaimed credits if the business is or was in a net operating loss or alternative minimum tax position.

Myth: The R&D credit is only for big companies.

Reality: Companies of all sizes are eligible to claim the R&D tax credit.

Myth: The R&D tax credit is for increasing research; since my spending is flat, my company is not eligible.

Reality: The credit is available to companies with continued investment in R&D and does not require an exponential increase on a year-to-year basis.

Fixed Asset **Planning**

Purchase new equipment this year? Place new or used assets into service? Expand your company's vehicle fleet? If these scenarios apply to your business during 2019, you may be eligible for tax benefits. Two fixed asset planning strategies – Section 179 expensing and bonus depreciation – became even more valuable for business owners after tax reform, but some grey areas remain. Read on for a quick refresher on tax reform changes and for an eligibility guide for common property categories.

Section 179 Small Business Asset Expensing Election

Key tax reform changes: Allowable expense limit increased to $1 million, with phase-out threshold raised to $2.5 million. Definition of qualified property for commercial property expanded to include roofs, HVAC, alarm systems and property connected with furnishing lodging. Tangible personal property used in conjunction with leasing is now eligible for Section 179.

Taxpayer considerations: Section 179 has potentially increased application to rental real estate and certain improvement property; however, use of this elective expense could negatively impact the Qualified Business Income (QBI) deduction for certain entities.

Bonus Depreciation

Key tax reform changes: Bonus depreciation doubled to 100 percent and expanded to used assets, beginning with assets acquired and placed in service after September 27, 2017 (phase-out begins in 2023).

Taxpayer considerations: Weigh aggressive action against the potential negative reversal in future years. Additionally, greater deductions could negatively impact QBI deduction in future years (post-2019). Election out of bonus depreciation (entirely or by asset class) must still be completed at the entity level.

Property Type	Eligible for Bonus Depreciation	Eligible for Section 179
Qualified improvement property (certain interior improvements – excludes enlargement of building, elevator/escalators or internal building structure or frame)	NO (read more below)	YES
Non-residential real property (i.e. roofs, HVAC, fire protection and alarm systems, security systems)	NO	YES
Tangible personal property (i.e. furniture, appliances) used in connection with lodging facilities (i.e. hotels, rental homes, dormitories)	YES	YES
Luxury automobiles (used in trade or business)	YES (limited to $18,000 in first year)	YES (limited to $10,000 in first year)

Unresolved Tax Reform Issue:

Why isn't my qualified improvement property bonus-eligible?

The Tax Cuts and Jobs Act omitted language to revise the recovery period for this property type from 39-year to 15-year, which would have made it eligible for bonus depreciation. This appears to have been a legislative drafting error, and the RKL tax team awaits further clarification from the IRS.

Tax Tip: Supercharge Depreciation with a Cost Segregation Study

Cost segregation is not a new strategy, but tax reform makes it more valuable. Essentially, cost segregation identifies parts of a building that can be depreciated more quickly and turns those components into bigger tax deductions that can generate more cash flow in the earlier years of a building's lifespan. Tax reform's changes to bonus depreciation provide even more incentive for business owners to consider a cost segregation study in the near future.

Now through 2022, any qualifying personal property or land improvement identified and broken out from the building cost through cost segregation are eligible for 100 percent bonus depreciation in the current year. Since used property is now eligible, owners can take advantage of bonus depreciation on personal property and land improvements identified at the time of a building's purchase. Before tax reform, these assets were depreciated with shorter depreciable lives and accelerated methods, but not eligible for bonus depreciation.

Real Results from Cost Segregation

Client A constructed a new hotel facility in 2018. RKL identified $5 million of the total project cost of $13.5 million as personal property and land improvements. Combined with 100 percent bonus depreciation, this cost segregation produced a **present value of the tax savings of $958,000,** with projected additional depreciation deductions of $4 million for a tax savings of $1.5 million.

Client B purchased a manufacturing facility. Since the tenant paid for their own interior fit-out, RKL considered only exterior assets in the cost segregation study. RKL identified $894,600 of the nearly $3.1 million building cost as personal property and land improvements. Combined with 100 percent bonus depreciation, this cost segregation produced a **present value of the tax savings of $220,550,** with projected additional depreciation deductions of $881,500 for a tax savings of $376,100.

Contact your RKL advisor to find out how a cost segregation study may benefit you.

U.S. International **Tax Compliance**

Tax reform introduced big changes to the landscape of international taxation, including one-time mandatory repatriation in 2017 that transitioned the U.S. to a quasi-territorial system. Since enactment of these once-in-a-generation changes, clarifying regulations (many of them retroactive) have slowly been released by the Treasury Department and IRS. We have gained additional insights into key areas outlined below.

Increased Reporting Requirements

Information reporting for U.S. taxpayers with ownership in foreign corporations increased dramatically in order to keep up with complexities of U.S. international tax law after tax reform. This additional data is required to be included with the tax return of a "U.S. Shareholder," that is, a domestic individual or entity with a 10 percent ownership interest in a foreign corporation that is a controlled foreign corporation (CFC). A CFC is a foreign corporation with more than a 50 percent share (by vote or value) owned by 10 percent U.S. Shareholders. Allow sufficient time to gather the new documentation and potentially coordinate with other shareholders to get a complete picture of the earnings subject to tax.

Key Additions to CFC Reporting for 2018 Tax Year and Beyond:

- Reporting of all direct owners of the foreign corporation
- Detailed questionnaire regarding payments to foreign persons, foreign-derived sales, inversions, intercompany arrangements and other transactions to provide a roadmap for the IRS to identify relevant international tax concerns
- Foreign tax payment support information including the amount of income taxable on the foreign tax return, foreign currency and breakdown of taxes applied to various U.S. anti-deferral categories and buckets of earnings
- Supporting data relating to the calculation of Global Intangible Low-Taxed Income (GILTI, see below)
- Breakdown of the foreign corporation's earnings and profits (E&P) into various categories and E&P buckets, along with additional detail by shareholder for amounts previously taxed under one of the anti-deferral regimes

Compliance Tip:

The 10 percent ownership interest threshold for determining status as a U.S. Shareholder is not applicable for ownership in captive insurance companies. In that case, any ownership share automatically causes a U.S. person to be a U.S. Shareholder.

Expansion of Anti-Deferral Provisions

Although the Tax Cuts and Jobs Act (TCJA) was touted as enacting a more territorial tax system through the new 100 percent dividends-received deduction (participation exemption) allowed to U.S. C Corporations, the reach of U.S. taxation was in fact broadened to new types of income. Provisions of existing law meant to prevent certain types of earnings from being held offshore, such as Subpart F income and Section 956 inclusions, have been retained under the law. In addition, the TCJA provides for a minimum tax on Global Intangible Low-Taxed Income (GILTI). GILTI includes not only intangible income, but all income earned by a controlled foreign corporation (CFC) above a 10 percent return on its depreciable tangible property used to generate the income. A deduction meant to reduce the tax rate on GILTI income by 50 percent is only available to C Corporations.

Recent development: Final GILTI regulations allow a limited exception to partners with small ownership interests in a domestic partnership that is a 10 percent U.S. Shareholder of a controlled foreign corporation. Rather than calculating GILTI at the partnership level and allocating the income, the regulations look to the indirect ownership share of the U.S. partner to allocate the related income and expense items. If the partner is not him or herself a U.S. Shareholder, no GILTI-tested items should be assigned to the partner.

Reduced Rate on High-Margin Exports

As a counterbalance to GILTI, Congress created an export incentive in the form of a deduction for foreign-derived intangible income (FDII). Income from the export of goods and services for use in a foreign country will generally be eligible for the FDII deduction if profit is above a 10 percent return on depreciable tangible property used to generate the income. Corporations with profits from the use of intangibles can also benefit. The net effect of the deduction is intended to reduce the tax rate on such income to 13.125 percent. This deduction is also only available to C Corporations.

During 2019, the U.S. Treasury Department released proposed regulations prescribing the rules for calculating FDII, as well as the documentation required to be maintained in support of the deduction. In order to qualify, a taxpayer must be able to establish that the property or services are sold to a foreign person (individual or entity) for foreign use.

Note: *The FDII deduction and the 50 percent deduction against GILTI income (collectively the Section 250 deduction) are limited by taxable income, meaning that the deduction cannot cause a corporation to incur a taxable loss.*

FDII Deduction Documentation

To establish:	Documentation types:
Foreign person	Written statement from recipient, documentation entity is organized in a foreign jurisdiction, government issued identification for individuals
Foreign use	Written statement from recipient, contract specifying that sale is for foreign use, documentation of shipment to location outside the U.S.

Foreign Dividend Planning

In line with Congress' stated aim to incentivize the flow of cash to the United States, there is a silver lining to the additional foreign income inclusions enacted as part of tax reform: tax-free repatriation of cash. To the extent that foreign earnings are subject to tax under a provision of the Code (for example, GILTI), the equivalent amount may generally be distributed to U.S. shareholders without being taxed a second time. For U.S. C Corporations, an even more generous 100 percent dividends received deduction is allowed against dividends from 10 percent-owned foreign corporations.

The Transition Tax Lives On

The Section 965 transition tax represents a mandatory deemed repatriation of the accumulated earnings of foreign corporations with U.S. ownership. For calendar year foreign corporations, the tax generally applied to the 2017 tax year, while owners of a fiscal year corporation may have seen the impact in 2018. Since the transition tax amounts to a significant liability for many taxpayers, an election was allowed to pay the tax in installments over eight years. In that case, each payment is due by the taxpayer's annual tax return due date (without considering extensions). Specifically, the installment payments are due as follows:

- 8 percent of the tax liability for each of the first five installments
- 15 percent of the tax liability for the sixth installment
- 20 percent of the tax liability for the seventh installment
- 25 percent of the tax liability for the eighth installment

In addition to penalties, failure to make a timely installment payment can cause the entire tax liability to be accelerated and come due immediately.

More Important Changes Beginning in 2018

- Penalty for failure of foreign-owned U.S. corporations to report required information on Form 5472 increased from $10,000 to $25,000
- Form 5472 reporting expanded to apply to foreign-owned disregarded entities, such as single-member LLCs
- Base-Erosion and Anti-Abuse Tax (BEAT) applies a minimum tax to corporations with average gross receipts of $500 million or more
- Denial of U.S. deduction for payments of interest or royalties by a U.S. corporation to a foreign hybrid entity treated as a corporation for U.S. tax purposes and a pass-through under foreign tax law

Tax Withholding in Focus: **Reporting for Payments to Foreign Persons**

Similar to Form 1099 reporting for domestic vendors, taxpayers who conduct business with foreign vendors and foreign related parties must report payments and withhold tax from certain types of income. The rules for withholding tax on payments of U.S. income earned by foreign persons can be quite complex and missing a tax deposit during the year can be costly. Remember:

- Forms 1042, 1042-S and 1042-T (which summarize yearly withholdings) are due each year on March 15.
- Tax withholding generally applies to income that is passive in nature, such as interest, dividends, rents, royalties (including items deemed to be royalties, such as software subscriptions), premiums and annuities. Services performed in the U.S. can also be subject to withholding.
- Interest charges apply to late deposits and late payment penalties can reach as high as 25 percent of the unpaid tax in some cases. If annual Form 1042 filings are missed, late filing penalties up to another 25 percent of the tax can result.
- Even if the default withholding rate is reduced to zero, there is still a requirement to file Form 1042.

Developing a system to identify these payments with the assistance of your RKL tax advisor is essential to staying in compliance. Here's a quick guide to help business owners get started.

Step 1: Review Vendor List

Start by sorting your vendor list by address to find non-U.S. payees. Then review this list for passive payments and those for services performed in the U.S. by a foreign person or company. Inventory and equipment purchases can be excluded.

Step 2: Document properly

The default withholding tax rate is set at 30 percent, but tax treaties between the U.S. and many of its trading partners may reduce the rate significantly or even provide an exemption from tax entirely, depending on the type of income. A Form W-8 asserting a lower rate of tax generally must be obtained from a foreign payee before payments are made in order for the transaction to qualify for the lower rate. Establishing a policy of requiring completed Forms W-9 (for domestic payees) and Forms W-8 (for foreign payees) as part of the vendor acceptance process is an important step to reduce potential tax or penalty exposure for your company.

Step 3: Withhold tax at time of payment

Being proactive is important when it comes to cross-border transaction withholding and falling behind can be expensive. Electronically deposit withholding taxes to the U.S. Treasury within three business days after the end of the quarter-monthly period (i.e. after the 7th, 15th, 22nd and last day of the month) in which the payment is made to the foreign party.

Step 4: Ensure compliance with your RKL advisor

Withholding on foreign payments is complex – but you don't have to go it alone. Your RKL tax advisor can help you document and file properly. Stay in contact as payments are made in real time to prevent issues down the line.

Tax Planning for **Exempt Organizations**

Today's nonprofits face big fundraising challenges, thanks to factors like tax reform changes such as allowable itemized deductions as well as generational shifts in donors. To combat these forces, many organizations seek to diversify their revenue streams in a variety of ways, such as alternative funding sources or partnerships with for-profit entities.

Any revenue that falls outside of an organization's official charitable mission is considered unrelated business taxable income (UBTI), which, if excessive in nature, may threaten its tax-exempt status. While the IRS does not have a formally stated amount of allowable UBTI, private letter rulings have taken away exempt status for organizations with unrelated business receipts totaling 40 percent or more of gross receipts.

Nonprofit Options for **Investing in Unrelated Business Income**

How do organizations manage UBTI in accordance with exempt purpose? Nonprofits have several options to manage the tax implications of current and future activities:

Option #1: Stay the course

If a nonprofit is close to the 40 percent threshold, it can chose to maintain the current approach to UBTI and wait for the IRS to examine their exempt status and decide whether or not to revoke it. This "wait and see" gamble has no current out-of-pocket costs; however, nonprofits are prohibited from offsetting unrelated net losses against unrelated net income, which comes at a price. Additionally, there may be fees and assessments on previously untaxed activity if the IRS audits and ultimately revokes exempt status, as well as state tax repercussions.

Option #2: Create a corporation

Organizations could create a wholly owned taxable corporate subsidiary to house all unrelated activities. This approach provides a level of protection for the nonprofit by separating the assets and activities of the unrelated activity from the exempt purpose assets and activities. This new entity can hold more than one business type, but would be subject to the state corporate tax rate (9.99 percent in Pennsylvania) and additional federal tax exposure at 21 percent. Under this structure, net income and net losses from different business activities can be aggregated in a corporate tax Form 1120 versus the silo treatment on the nonprofit Form 990-T. The organization can then receive dividends from the C Corporation as a nontaxable event because of the specific exclusion of dividend income from unrelated business income tax. Other expenses include one-time set-up, application and professional fees and ongoing corporate tax exposure to the for-profit entity.

Option #3: Enter into a partnership

Organizations can enter into partnerships to carry out the unrelated business activity. This is another separate entity type that offers protection for other assets and activities in the nonprofit. Under this approach, nonprofits can partner with for-profit entities and use their combined resources to carry out a new business. Any unrelated income generated from this partnership investment will be reported using Schedule K-1 and be taxed on the Form 990-T at the 21 percent federal tax rate.

Option #4: Become a partner in an investment partnership

Investment income from non-debt financed investments is specifically excluded from unrelated business income. If a nonprofit has the funds to invest in an investment partnership that only generates investment income (no trade/business income or rental income), these proceeds would flow through to Schedule K-1 and would not be taxable. Even if the nonprofit invested in an investment partnership that generates a small amount of trade or business income, keep in mind that only the non-investment income would be subject to the 21 percent federal tax rate.

Keep these factors in mind when creating a new entity to interact with your nonprofit:

1. Any investment made using debt financing will make the portion of income relative to the debt financing subject to federal income tax, regardless of the type of income.
2. Any intercompany transactions must be thoroughly examined to avoid "piercing the corporate veil," of the newly formed entities.

2019 Deadlines: Form 990 Series (990, 990-EZ, 990-PF, 990-N, 990-T)	
Filing for December 31 year-ends	May 15, 2020
Extensions for December 31 year-ends	November 16, 2020
Filing for June 30 year-ends	November 16, 2020
Extensions for June 30 year-ends	May 17, 2021
All other year-ends	15th day of the 5th month following the end of the organization's taxable year (extensions due six months after that date)

Additional Nonprofit **Tax Considerations**

2018 marked the first year nonprofits had to include fringe benefits (like employee parking) in their UBTI, calculate net operating losses differently and remit an excise tax on excessive compensation for its five highest compensated executives. Based on the most recent available regulatory guidance and interpretations, here are tips for nonprofits to lessen the impact of these new provisions.

Employee Parking

Does your nonprofit offer free parking or cover transportation costs for employees? If so, organizations must count qualified parking expenses as UBTI. Qualified parking is defined as parking provided to employees on or near the business work premises, or parking on or near a location from which employees commute to work by commuted highway vehicle, mass transit or van pool. Parking is considered qualified (and thus a taxable fringe benefit) even if the nonprofit owns a facility or lot.

This UBTI calculation will vary depending on the manner in which a nonprofit offers employee parking. Final IRS regulations are still pending at the time this guide went to print and many grey areas require clarification. In the meantime, here is how UBTI would be calculated under two common parking scenarios:

- If the organization pays a third party for employee parking spots only, UBTI is limited to the lesser of the total cost or the monthly exclusion limit of $260 per employee per month.
- If the organization owns or leases an entire parking lot, or portion of a parking lot, reserved employee parking as a percentage of total parking expense is included in UBTI (spots open to the public and reserved non-employee spots are not counted as UBTI).

RKL's nonprofit tax advisors can conduct the necessary UBTI calculations and advise on applicable mitigation strategies within your organization's unique circumstances.

Net Operating Losses

Do your nonprofit's deductions exceed unrelated business income in a given year? If so, you are eligible to take a net operating loss (NOL) in the exceeding amount. While this concept is not new, the way NOLs are tracked and applied has changed, thanks to tax reform. Starting in 2018, NOL carrybacks are no longer permitted and carryforwards are capped at 80 percent of taxable income. Most significantly, "cross-pollination" or aggregation of NOLs (just like unrelated business income or UBI) is no longer permitted. Nonprofits must calculate NOLs separately for each trade or business.

In late 2018, the IRS issued ordering rules on how NOLs must be used during the transition to new tax reform treatment. Post-2017 NOLs should first be used against the associated income from which they are derived. Then, use the pre-2018 NOLs against the total UBI until the pre-2018 NOLs are completely exhausted.

Here are two best practices for NOL tracking and application:

- Review ongoing loss activities to determine whether or not they should be continued by your organization.
- Take advantage of permissible aggregation for individual partnership activities.
- Track NOLs by activity/business for carryforward purposes.

Excessive Executive Compensation Excise Tax

Are executives at your nonprofit compensated over $1 million annually or eligible for sizable separation payouts? If so, these expenses are now taxable, thanks to a new section of Internal Revenue Code created by tax reform. Section 4960 taxes at 21 percent any annual compensation over $1 million paid to a nonprofit's five highest paid current or former employees in a given year. The new excise tax also applies to separation pay or "golden parachute" packages greater than or equal to three times the departing executive's base salary.

There are a few ways nonprofits may be able to reduce their excise tax bill, including:

- Extending employee vesting schedules
- Shifting income to keep annual wages and/or separation pay under threshold
- Taking a step-down approach to phase executives into retirement

Be sure to discuss these strategies in greater detail with your RKL advisor.

Let's Continue **the Conversation**

This publication is intended to guide our clients and friends through year-end planning and facilitate discussion around new tactics or opportunities. Questions about any of the topics discussed here? Ready to implement any of these strategies?

Contact your RKL advisor, reach us at one of our offices listed below or visit us online at RKLcpa.com.

Lancaster: 717.394.5666
Reading: 610.376.1595
York: 717.843.3804
Harrisburg: 717.525.7447
Mechanicsburg: 717.790.9333
Exton: 484.874.220

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