2018 Year-End TAX PLANNING GUIDE

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2018 YEAR-END
TAX PLANNING GUIDE ›

The Tax Cuts and Jobs Act significantly altered the U.S. tax landscape and upended decades of conventional wisdom and planning strategies when it was signed into law in December 2017. RKL's team of tax advisors took a deep dive into tax reform so our clients didn't have to, sorting through the glut of information and delivering the answers and strategies to help you come out on top.

The 2018 installment of RKL's Year-End Tax Planning Guide is packed with real opportunities for maximum business and personal tax savings under the new law. It also highlights perennially important information and considerations for individuals and business owners.

As federal regulators continue to untangle tax reform's complexities and derive technical regulations from the legislative language, you can be sure the RKL team is monitoring this activity and will continue to update our clients and connections. We've noted throughout the guide instances where additional regulatory guidance is forthcoming or further federal clarification is needed. Stay tuned to RKL's dedicated Tax Reform Resource Center, Real Insights e-news and LinkedIn feed for more information and updates.

As always, please contact your RKL advisor before implementing any of the strategies outlined in this guide. Our team stands ready to assess and evaluate each opportunity within the context of your unique financial situation.

QUICK LOOK:
KEY 2018 TAX FIGURES & FILING DEADLINES

STANDARD DEDUCTION

Married Filing Jointly	$24,000
Single	$12,000
Head of Household	$18,000
Married Filing Separately	$12,000

IRA CONTRIBUTION
(Traditional & Roth)

$5,500, with additional $1,000 catchup over age 50

FEDERAL ESTATE TAX

40 percent

GIFT TAX EXCLUSION

Single	$15,000
Married Filing Jointly	$30,000

HSA CONTRIBUTION
(Employer & Employee)

Self only	$3,450
Family	$6,900

DEADLINES FOR 2018 INDIVIDUAL & BUSINESS TAX FILINGS

TAX TYPE	DUE DATE (for calendar year entities)
Partnerships (Form 1065) & S Corporations (Form 1120S)	March 15, 2019
Individuals (Form 1040), C Corporations (Form 1120), Foreign Bank and Financial Reporting Form (FBAR) FinCEN Report 114 and Trusts and Estates (Form 1041)	April 15, 2019
Tax-exempt Nonprofit Organizations (Form 990)	May 15, 2019
Filing extensions for Partnerships & S Corporations	September 16, 2019
Filing extension for Trust and Estates	October 1, 2019
Filing extensions for Individuals, Foreign Financial Reporting & C Corporations	October 15, 2019
Filing extension for Tax-exempt Nonprofit Organizations	November 15, 2019

INDIVIDUAL **TAX PLANNING** ›

Tax reform impacts individuals in a number of ways, like lower personal income tax rates and simplification in certain areas. In this section, we'll explain how your federal personal income tax return will look different in 2018 than it did in 2017. At the state level, conformity with provisions like changes to deductions may be an issue in certain jurisdictions. RKL's tax team includes the state and local tax expertise to help clients navigate such conformity issues and interpret other relevant state legislative actions.

Beyond the life events that can affect tax status, year-end planning and review is even more vital in the new tax reform era. Your RKL advisor can guide you through important conversations around withholding status, eligibility for itemized deductions and the impact of changes to tax rates and taxable income.

TAX REFORM IMPACT: Individuals

- Overall tax rates decreased
- Personal exemption eliminated
- Standard deduction doubled & popular deductions changed
- AMT remains but exemptions & phase-outs raised

These provisions sunset on Jan. 1, 2026 without additional legislative action.

INDIVIDUAL
TAX RATES & BRACKETS ›

The Tax Cuts and Jobs Act retains seven tax brackets. The upper tiers of most of the tax brackets increased. Overall tax rates for individuals have temporarily decreased, but some more than others. The previous rates of 10, 15, 25, 28, 33, 35 and 39.6 percent were replaced starting on January 1, 2018, with rates of 10, 12, 22, 24, 32, 35 and 37 percent. These rates will return to previous 2017 levels after 2025.

The combination of these factors equals a generally lower effective tax rate. However, due to changes in the way taxable income is calculated, not everyone's taxes will decrease.

RATE	SINGLE	HEAD OF HOUSEHOLD	MARRIED FILING JOINTLY	MARRIED FILING SEPARATELY
10%	$0 to $9,525 **TAX OWED** 10% of taxable income	$0 to $13,600 **TAX OWED** 10% of taxable income	$0 to $19,050 **TAX OWED** 10% of taxable income	$0 to $9,525 **TAX OWED** 10% of taxable income
12%	$9,525 to $38,700 **TAX OWED** $952.50 plus 12% of the excess over $9,525	$13,600 to $51,800 **TAX OWED** $1,360 plus 12% of the excess over $13,600	$19,050 to $77,400 **TAX OWED** $1,905 plus 12% of the excess over $19,050	$9,525 to $38,700 **TAX OWED** $952.50 plus 12% of the excess over $9,525
22%	$38,700 to $82,500 **TAX OWED** $4,453.50 plus 22% of the excess over $38,700	$51,800 to $82,500 **TAX OWED** $5,944 plus 22% of the excess over $51,800	$77,400 to $165,000 **TAX OWED** $8,907 plus 22% of the excess over $77,400	$38,700 to $82,500 **TAX OWED** $4,453.50 plus 22% of the excess over $38,700
24%	$82,500 to $157,500 **TAX OWED** $14,089.50 plus 24% of the excess over $82,500	$82,500 to $157,500 **TAX OWED** $12,698 plus 24% of the excess over $82,500	$165,000 to $315,000 **TAX OWED** $28,179 plus 24% of the excess over $165,000	$82,500 to $157,500 **TAX OWED** $14,089.50 plus 24% of the excess over $82,500
32%	$157,500 to $200,000 **TAX OWED** $32,089.50 plus 32% of the excess over $157,500	$157,500 to $200,000 **TAX OWED** $30,698 plus 32% of the excess over $157,500	$315,000 to $400,000 **TAX OWED** $64,179 plus 32% of the excess over $315,000	$157,500 to $200,000 **TAX OWED** $32,089.50 plus 32% of the excess over $157,500
35%	$200,000 to $500,000 **TAX OWED** $45,689.50 plus 35% of the excess over $200,000	$200,000 to $500,000 **TAX OWED** $44,298 plus 35% of the excess over $200,000	$400,000 to $600,000 **TAX OWED** $91,379 plus 35% of the excess over $400,000	$200,000 to $300,000 **TAX OWED** $45,689.50 plus 35% of the excess over $200,000
37%	$500,000+ **TAX OWED** $150,689.50 plus 37% of the excess over $500,000	$500,000+ **TAX OWED** $149,298 plus 37% of the excess over $500,000	$600,000+ **TAX OWED** $161,379 plus 37% of the excess over $600,000	$300,000+ **TAX OWED** $80,689.50 plus 37% of the excess over $300,000

WATCH Withholdings

Since the passage of tax reform, the IRS issued several pieces of withholding guidance, including an updated Form W-4 and withholding calculator. Annual evaluation of withholding positions is a personal finance best practice, but it is even more vital in light of tax reform changes. The IRS recommends performing a "payroll checkup" and adjusting existing W-4s and withholding positions as needed based upon the recent tax law changes.

STANDARD DEDUCTION **& PERSONAL EXEMPTION**

Under tax reform, the standard deduction nearly doubles and the personal exemption disappears. The standard deduction increase is intended to simplify tax filing and offset another component of the law – the elimination or reduction of many tax credits and deductions, which will be covered later in this guide. Many taxpayers who previously itemized deductions may now fall under the standard deduction threshold. Although there is less to track, it is still a best practice to document itemized deductions.

Standard deduction amounts will be adjusted for inflation annually using the Chained Consumer Price Index for All Urban Consumers (C-CPI-U), as explained on page 16 of this guide.

The change in the standard deduction also impacts dependent filers. The standard deduction amount for an individual who may be claimed as a dependent by another taxpayer cannot exceed the greater of $1,050 ***or*** the sum of $350 and the individual's earned income up to $12,000.

If a taxpayer is age 65 or older and/or blind on the last day of the tax year, he or she remains entitled to take an additional standard deduction. This additional deduction amount equals $1,300 and increases to $1,600 for unmarried taxpayers.

2018 STANDARD **DEDUCTION**

FILING STATUS	STANDARD DEDUCTION
Single/Married Filing Separately	$12,000
Married Filing Jointly/Surviving Spouse	$24,000
Head of Household	$18,000

TAX **DEDUCTIONS** ›

Tax reform changed several popular tax deductions, which are recapped below. The legislation also suspended through December 31, 2025 the so-called Pease Rule which reduced itemized deductions of certain taxpayers by three percent of their adjusted gross income (AGI). As with the new tax rates, all changes made to individual tax credits and deductions are temporary and generally expire after 2025.

Above-the-line deductions:

- **Moving expenses:** This deduction is repealed through the end of tax year 2025, but remains available to members of the Armed Forces (or their spouses or dependents) who are active duty, required to move by military order related to a permanent change of station.
- **Alimony:** Tax reform eliminates deductions for alimony payments required under divorce or separation instruments executed after December 31, 2018. Recipients of affected alimony payments will no longer have to include them in taxable income. Tax reform's 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 expensive. Child support payments remain non-deductible by the payor.

Itemized deductions:

- **Medical expenses:** Taxpayers may continue to deduct medical expenses in excess of 7.5 percent of adjusted gross income. For tax year 2018, the AGI threshold was lowered from the previous 10 percent.
- **State, local and real estate taxes:** These deductions are cumulatively capped at $10,000 for married filing jointly and $5,000 for single filers. 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 cutoff for mortgage interest deductibility drops from $1 million or less to $750,000 or less for mortgage debt incurred after December 15, 2017.
- **Home equity loan interest:** Despite the initial impression that tax reform fully suspended this deduction starting in 2018, the IRS clarified in February that home equity loan interest remains deductible, subject to usage criteria. Interest from home equity loans, home equity lines of credit (HELOC) and lines of credit may be deductible up to $100,000 as long as the loan proceeds are used to "buy, build or substantially improve" the home that secures the loan. Any other use is not permitted for the deduction.
- **Charitable contributions:** This popular deduction remains an option for taxpayers, subject to income limitations. The income limitation for cash donations to public charities did change from 50 to 60 percent of AGI, but capital gain property donations, like appreciated stock, remains capped at 30 percent AGI.
- **Miscellaneous itemized deductions:** This broad category, which includes investment fees and expenses, professional service fees and unreimbursed business expenses, is repealed through tax year 2025.

AMT & ADDITIONAL TAXES

Tax Reform Impact on AMT

While the individual alternative minimum tax (AMT) remained in the Tax Cuts and Jobs Act, there are some alterations, including a temporary increase through 2025 of the exemption amount to $109,400 for joint filers, $125,000 (married filing separately) and $70,300 for all others (excluding estates and trusts). The exemption phase-out level is also raised to subject income of $1 million and above (joint filers) and $500,000 (all other filers) to AMT. The exemption amounts outlined below will be adjusted annually for inflation.

TAX EXEMPTIONS

FILING STATUS	2018 EXEMPTION AMOUNT
Single/Head of Household	$70,300
Married Filing Jointly/Surviving Spouse	$109,400
Married Filing Separately	$54,700

Net Investment Income Tax

Certain individuals may be subject to a 3.8 percent tax on net investment income (NII). Examples of NII include interest, annuities, dividends, net capital gain, rents and passive business or trade activities. NII is calculated as the lesser of (1) net investment income, or (2) excess of modified adjusted gross income (AGI) over the applicable threshold amount. Modified AGI thresholds are $250,000 (married filing jointly), $125,000 (married filing separately) and $200,000 (all other filers). There are several strategies to lessen NII exposure, so consider discussing these options with your tax advisor:

- 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 filing of Form 8959.

TAX **CREDITS**

Unlike deductions, many of the popular tax credits enjoyed by individuals and families were retained by tax reform or even enhanced. Most notably, the child tax credit was significantly expanded – read on for more details. Keep in mind the 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 Expanded

Tax reform temporarily doubles the Child Tax Credit to $2,000 for each qualifying child under the age of 17. There is no change to the definition of qualifying child. The Child Tax Credit starts to phase out by $50 for each $1,000 of modified adjusted gross income (AGI) over $400,000 for married filing jointly taxpayers and $200,000 for other filing statuses. The majority of the Child Tax Credit is refundable and will be indexed for inflation. For 2018, the refundable amount is $1,400 per eligible child.

New Other Dependent Credit Available

A new $500 credit was introduced for 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 $500 credit is nonrefundable and begins to phase out at modified AGI of $200,000 ($400,000 if married filing jointly). Like the Child Tax Credit, this credit will be indexed annually for inflation.

TAKING CHILD TAX CREDIT? Don’t Forget SSN

Tax reform eliminated personal exemptions so dependent Social Security Numbers are no longer necessary unless claiming the nonrefundable and refundable portion of the Child Tax Credit. The SSN must be issued prior to the due date of the tax return including extensions. For the new Other Dependent Credit, an SSN is not required, but an Individual Taxpayer Identification Number (ITIN) is.

Popular Education Tax Provisions Remain

Tax reform retained several tax credits and deductions popular with parents, student borrowers and educators, including:

- **American Opportunity Tax (formerly Hope) Credit – no change:** For the American Opportunity Tax Credit, taxpayers with incomes of under $90,000 (single) or $180,000 (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 – no change:** The Lifetime Learning Credit is capped at $2,000 per tax return and phases out for taxpayers with adjusted gross income above $66,000 (single filers) and $132,000 (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 – no change:** The Tax Cuts and Jobs Act preserved this provision, which allows borrowers to deduct education loan interest up to $2,500 per tax year, subject to annual income limitations of $80,000 (single) and $165,000 (married filing jointly).
- **Student loan indebtedness discharge – expanded:** Loans discharged after December 31, 2017, will no longer be included in taxable income. Tax reform expanded the definition of discharge to include death and permanent disability. These changes take effect in 2018 and expire in 2026.
- **Educator expense deduction – no change:** Teachers dipping into their own wallets to buy supplies for their classrooms can still deduct up to $250 of purchases.
- **529 plans – expanded:** Distributions from 529 plans can now cover up to $10,000 of educational expenses for designated beneficiaries enrolled at a public, private or religious elementary or secondary school.

TUITION & FEES DEDUCTION Off the Table

The Bipartisan Budget Act of 2018, not the Tax Cuts and Jobs Act, retroactively extended the tuition and fees deduction for the 2017 tax year. Without further legislation action to renew or extend, however, taxpayers will not be able to take advantage of this deduction on their 2018 returns.

ABLE ACCOUNTS for Individuals with Disabilities

Achieving a Better Life Experience (ABLE) programs allow individuals and families to save for qualified disability related expense, like housing, transportation and education. Annual contributions are capped at the gift tax exclusion in place at the time, savings grow tax-free, withdrawals are exempt from federal and state income tax when used for qualified expenses and accounts are exempt from inheritance tax and excluded from determination of eligibility for other government benefits.

HEALTH CARE & YOUR TAXES

The repeal of the shared responsibility requirement of the Affordable Care Act, commonly referred to as the individual mandate, was a key headline of tax reform coverage. The tax law reduced the penalty for not maintaining health insurance to $0, effective starting after December 31, 2018. The IRS cautioned that returns submitted for tax year 2018 that do not report full-year coverage, report a shared responsibility payment or claim a coverage exemption will be rejected as incomplete and inaccurate.

Ways to Save for Health Costs: HSAs and FSAs

Individuals and families have two tax-advantaged options to save for and pay current or future medical expenses for themselves, spouses and qualified dependents. The first, a **Health Savings Account or HSA,** provides three levels of benefit:

- Contributions are tax-deductible (or pre-tax if made through payroll deduction)
- Interest earned on the account is tax-free
- Withdrawals from the account are tax-free for qualified medical expenses not previously reimbursed by insurance

2018 CONTRIBUTION AND OUT-OF-POCKET LIMITS FOR **HEALTH SAVINGS ACCOUNTS AND HIGH-DEDUCTIBLE HEALTH PLANS**	
HSA contribution limit (employer + employee)	**Self-only:** $3,450 **Family:** $6,900
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:** $6,650 **Family:** $13,300

A Flexible Spending Account (FSA) retains the pre-tax contribution and tax-free growth and withdrawal advantages of HSAs but differ in several key ways. FSAs can be used in tandem with any health plan (not required to be high-deductible). 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.

FOREIGN FINANCIAL ACCOUNTS: **REPORTING OBLIGATIONS**

Taxpayers with foreign bank accounts or assets are required to report these holdings annually to the IRS. Failure to do so carries significant penalties. There are cases where taxpayers may still have a reporting obligation even if they do not directly own a share in a foreign business or a foreign bank account. For example, an executive or employee with signature authority over a foreign bank account owned by her company would be responsible for reporting the account to the IRS.

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 file an FBAR electronically with the IRS. 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. For the purposes of FBAR reporting, the IRS defines “authority” as the ability to initiate a withdraw from the account and its definition of “financial account” includes, but is not limited to, traditional bank accounts and other accounts held with a financial institution, as well as brokerage or commodities accounts, insurance and annuity policies with a cash value and mutual funds.

> ***FBAR Due Dates & Penalties:*** *The FBAR filing deadline was recently altered to align with the annual federal income tax deadline. Six-month extensions are available. Failure to file can result in fines ranging from $10,000 (non-willful) to the greater of $100,000 or 50 percent of account balances, plus possible criminal charges (willful).*

Form 8938, Statement of Specified Foreign Financial Assets:

Taxpayers holding foreign assets of $50,000 or more on the last day of the tax year or $75,000 or more at any time during the year must report these holdings on Form 8938. For married filing jointly taxpayers, these thresholds rise to $100,000 (last day) or $150,000 (any point during year). Different thresholds apply to Americans living abroad. The Form 8938 definition of specified foreign financial assets includes the foreign accounts reported via FBAR (see previous page) as well as stock or securities (including debt) issued by a non-U.S. person, any ownership interest in a foreign entity or any financial instrument or financial contract issued by a non-U.S. person.

> ***Form 8938 Due Dates & Penalties:*** *The annual federal income tax deadline also applies to Form 8938, with a six-month extension available. Penalties include up to $10,000 for failure to disclose and an additional $10,000 for each 30-day period of nonfiling after receipt of IRS notice up to $50,000 plus possible criminal penalties.*

WEALTH **MANAGEMENT**

From tax rate reduction to changes to certain deductions, many aspects of tax reform play into wealth management and retirement planning, as seen in the chart below. Your tax or wealth advisor can help you take a comprehensive view of how these reforms will cumulatively impact your personal planning, but this section offers an overview of the impacts and available strategies to help individuals maximize tax benefits.

TAX REFORM IMPACT: **WEALTH MANAGEMENT**

WHAT STAYED THE SAME:	WHAT CHANGED:
• Estate and gift tax retained • Roth IRA conversions remain • Recharacterization of Roth and traditional IRA contributions remain • Charitable contributions still deductible, subject to income limitation (capital gain property donations still capped at 30% of adjusted gross income) • Capital gains and qualified dividends tax rates • Current 401(k) and retirement plan rules retained	• Estate and gift tax exemption amount increased • Recharacterization of Roth conversions now disallowed • Income limitation for cash donations to public charities changed from 50% to 60% of adjusted gross income • Increased in standard deduction makes alternate giving methods (like bunching) more beneficial • Marginal tax rates and inflation of brackets

CAPITAL GAINS
& QUALIFIED DIVIDENDS

Post-tax reform, the tax rates for long-term capital gains and qualified dividends remain 20, 15 and 0 percent depending on an individual's tax bracket. The below chart aligns the new tax brackets with its corresponding capital gains rate. Short-term gains and nonqualified dividends are still taxed at ordinary income rates

INCOME TAX **BRACKET**			CAPITAL GAINS **TAX**		
MARRIED FILING JOINTLY	**SINGLE**	**RATE**	**MARRIED FILING JOINTLY**	**SINGLE**	**RATE**
(taxable income exceeding...)		(is taxed at...)	(taxable income exceeding...)		(is taxed at...)
$0	$0	10%	$0	$0	0%
$19,050	$9,525	12%	--		
$77,400	$38,700	22%	$77,200	$38,600	15%
$165,000	$82,500	24%	--		
$315,000	$157,500	32%	--		
$400,000	$200,000	35%	$479,000+	$425,800+	20%
$600,000+	$500,000	37%	--		

While tax reform did not change the rates for capital gains, it did raise the thresholds at which the alternative minimum tax (AMT) kicks in for individuals, as discussed on page 8 of this guide. Starting in 2018, $109,400 of income for married filing jointly (up from $84,500) and $70,300 of income for single filers (up from $54,300) is exempt from AMT. The exemption begins to phase out at $1 million for married filing jointly and $500,000 for single filers.

PLANNING Opportunity

Taxpayers may be able to reap greater benefits from capital gains and other income without being subject to AMT. Since a zero percent rate for capital gains is still an option depending on taxable income, individuals should work with their advisors to develop a strategy for maximizing the tax benefits of long-term holdings. Retired individuals may benefit the most from this approach, due to the higher standard deduction and zero percent capital gains rate for certain income thresholds.

TAX ARBITRAGE
& SCHEDULED RATE SUNSET

Tax rate arbitrage is a maneuver that allows individuals to realize income now at lower tax rates instead of doing so in the future when rates may be higher. Also referred to as "filling out the bracket," tax rate arbitrage opportunities often occur due to a decrease in adjusted gross income (AGI) thanks to retirement, the onset of Social Security payments and/or Required Minimum Distributions from IRAs. Tax reform presents a unique opportunity for tax rate arbitrage because the legislation was passed through the budget reconciliation process. To comply with reconciliation's various requirements related to timing and budgetary impact, Congress scheduled tax reform's individual provisions to sunset after 2025.

This means the lower marginal tax rates and doubled standard deduction will revert to 2017 levels without further legislative action to extend or make permanent. This window of opportunity sets the stage for individuals to realize more income now at the new lower tax rates before they expire, as outlined below.

2017	2018 - 2025	2026 AND BEYOND
10%	**10%**	10%
15%	**12%**	15%
25%	**22%**	25%
28%	**24%**	28%
33%	**32%**	33%
35%	**35%**	35%
39.6%	**37%**	39.6%

INFLATION OF BRACKETS (CPI-U vs. C-CPI-U)

Previously, the Consumer Price Index for all Urban Consumers (CPI-U) was used to inflate tax brackets. Tax reform shifted this to C-CPI-U, also known as Chained CPI. C-CPI-U supplements existing indexes by incorporating "substitution bias" (for example, when steak gets expensive people eat more chicken). C-CPI-U is actually considered a more accurate estimate of inflation because it is a truer reflection of consumer behavior. C-CPI-U is historically approximately 0.2 percent lower than CPI-U on an annualized basis. The impact of this shift will be more pronounced at higher income levels with higher marginal rates and will compound over time.

RETIREMENT **PLANNING**

Tax-advantaged retirement savings plans

Traditional IRAs are funded with pre-tax dollars and withdrawals are taxable as ordinary income after age 59½. Roth IRAs are funded with post-tax dollars, which means withdrawals are tax-free after age 59½. Both types are subject to income phase-outs and contribution limits.

Given that the choice between a traditional IRA or Roth IRA is essentially a choice to pay taxes now or pay taxes later, it makes sense that this historically low rate environment plays a large role in the decision around which type of IRA to fund. Previously, individuals in higher marginal tax brackets were encouraged to defer as much income as possible through contributions to a traditional IRA, take a tax deduction for the contributions and then strategically draw down assets in retirement when they are in a lower tax bracket.

Planning opportunities under tax reform

- Contribute to a Roth IRA: Barring any legislative action to extend or make these tax rate reductions and doubled standard deduction permanent, contributions to a Roth IRA should be prioritized during this brief window to capitalize on the lower rate environment, particularly for taxpayers who expect to be taxed at a higher rate in retirement.

- Convert a 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 rate reduction and expanded tax brackets, combined with the increased standard deduction, may lower tax payments and allow taxpayers to contribute to the converted Roth IRA at the current lower rates. Keep in mind that tax reform disallows the practice of recharacterizing Roth IRAs after conversion.

Social Security taxability

Social Security recipients must beware the "provisional income" thresholds that could tip their benefits into taxable territory. Defined as modified adjusted gross income (AGI) plus half of Social Security benefits, provisional income that surpasses the base amount for an individual's filing status below may result in 50 to 85 percent of your benefits being taxed.

- $25,000 – single, head of household, qualifying widow or widower with a dependent child or married filing separately and lived apart from spouse for the entire year
- $32,000 – married filing jointly
- $0 – married filing separately and lived with their spouse at any time during the year

Income and transactions throughout the year can bump an individual over a provisional income threshold, so monitor finances carefully, particularly as the end of the year approaches. In some cases, it may make sense to defer income until the start of a new year.

CHARITABLE GIVING
IN THE TAX REFORM ERA

The charitable deduction has always been a flexible and beneficial option for philanthropically minded people to support the causes they care about and reap tax benefits for doing so. In light of tax reform's increase to the standard deduction and changes to allowable itemized deductions, taxpayers must identify the optimal timing and methods of donation to ensure maximum tax savings for their charitable giving, which the strategies outlined below.

Keep in mind that the income limitation for cash donations to public charities changed from 50 percent to 60 percent of adjusted gross income (AGI) under tax reform. Capital gain property donations (like appreciated stock) are still capped at 30 percent of AGI.

- **Bunching method:** Prepaying charitable contributions on an alternating or every few years basis (also known as bunching) allows taxpayers to itemize deductions in the year contributions are made and use the standard deduction in years featuring little or no donations. Future donations are repeated according to the established timetable.
- **Donor Advised Fund (DAF):** DAFs may be used in tandem with the bunching method. Here's how it works: a taxpayer funds a DAF in year one with a large donation and claims the itemized deduction. In the subsequent years, the taxpayer directs the amounts and timing of distributions from the DAF to favorite charities and takes the standard deduction. Timing plays a major role with this method, so be sure to develop a plan with your advisor to execute DAF donations in years with larger projected tax liabilities. This provides tax savings at times when marginal tax rates may be higher.
- **Donation of appreciated assets:** Once appreciated, assets like common stocks, mutual funds or ETFs can be donated. This may further enhance the tax savings by shifting the unrealized capital gain to a charity or DAF with no tax liability on the sale of those securities.
- **Qualified Charitable Distribution (QCD) from IRA:** Taxpayers over age 70½ can make a QCD from their IRAs and reap dual benefits: supporting a cause important to them and getting closer toward their IRA annual Required Minimum Distribution. Keep in mind that the maximum annual QCD limit is $100,000 and this method is not permitted to fund DAFs, private foundations or split-interest charitable trusts.

SAVING FOR EDUCATION EXPENSES *just got easier*

Tax reform modified rules around 529 plans, now allowing proceeds up to $10,000 per account to be used for qualified expenses related to not only higher education but also public, private or religious elementary or secondary education. Any distribution in excess of $10,000 for elementary or secondary education would be subject to tax under the rules of Section 529 of the IRS Code.

529 plan savers can still avoid taxes on gains and withdrawals from these accounts so long as proceeds are used for qualified higher education expenses. Savers can also obtain Pennsylvania tax deductions for contributions, subject to income and gifting limitations.

ESTATE & GIFT PLANNING ❯

A critical component of any wealth management strategy, estate planning lets individuals maintain financial security now and codify their wishes related to the transfer of property and assets after their death. Several provisions of the Tax Cuts and Jobs Act unlock new opportunities for gifting and estate planning. While tax reform retained the maximum federal estate tax of 40 percent, it doubled to $22.4 million the amount married couples can exempt (adjusted annually for inflation). Like the rest of tax reform's individual provisions, this joint exemption amount will sunset to half the exemption in place in 2025 without additional legislative action. Individuals should consult with their advisors and consider the following efforts to maximize potential benefits.

- **Review estate plan documents:** Standard financial best practices suggest periodic review of estate planning documents like trust documents and wills, but reviews become even more critical in the post-tax reform landscape. Between the scheduled federal sunset and the potential for changes on the state level, estate planning documents should be flexible and allow tax-planning adjustments and decisions to be made after a spouse's death.

- **Increase gifting:** Assuming that the federal estate tax exemption will revert back to the 2017 level of $5.49 million (per individual) after 2025, tax reform affords individuals a limited window between 2018 to 2025 in which to make significant, estate tax-free gifts directly to family members or into trusts. The doubling of the exemption ($11.2 million per individual and $22.4 million per marred couple) is an unprecedented opportunity for high net worth individuals to remove more assets from their taxable estate, particularly when coupled with other discounting techniques. Keep in mind the annual exclusion increased for 2018 to $15,000 per recipient or $30,000 if married. The exclusion must be used by December 31 with no carry over.

- **Maximize lifetime gifts and generation-skipping transfers:** The generation-skipping transfer (GST) exemption is linked to the lifetime estate tax exemption, which means taxpayers have several opportunities to maximize GSTs by revisiting irrevocable trusts that previously faced GST-related issues and consider making a late allocation of GST-exempt funds, where appropriate. Making additional $5 million irrevocable GST gifts, which shifts future appreciation and locks in use of the increased exclusion, is another option to consider.

CRYPTOCURRENCY tax impact

As virtual currencies like bitcoin and ethereum draw the attention of investors, the IRS maintains its 2014 guidance on their taxability. According to the IRS, virtual currency transactions are legally taxable and these cryptocurrencies 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. Investors that simply buy and hold the currency are under no reporting requirement. 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.

Tax reform did not alter the portability of a deceased spouse's unused exemption or the step-up in basis on inherited property. Although the increased exemption will greatly reduce the number of estates subject to transfer tax, there are still many considerations that make estate planning important, like asset preservation, family business succession, guardianship of minor children and providing for family members with special needs. Be sure to discuss these and other priorities with your RKL advisor, who can take a holistic approach to developing an estate and gifting approach that meets your unique situation.

BUSINESS **TAX PLANNING**

The wide-ranging commercial provisions of the Tax Cuts and Jobs Act are intended to stimulate economic growth and encourage hiring and business expansion. Some of these provisions are straightforward, like the significant and permanent reduction in the corporate tax rate, while others, like the new deduction for pass-through entities, are more complex. It's important to place all of these changes in the context of your particular enterprise and understand the full range of implications. In this section, we'll break down some of the major changes in the business tax arena, but be sure to consult your RKL advisor for a full assessment of the opportunities presented by tax reform.

TAX REFORM IMPACT: Businesses

- Corporate rate cut
- Rules for net operating losses
- New pass-through deduction
- Bonus depreciation doubled
- Partnership technical termination rules repealed

These provisions are permanent under the Tax Cuts and Jobs Act

STATE & LOCAL Tax Issues with Federal Tax Reform

Watch for state level conformity issues related to bonus depreciation, Section 179 expensing, business expense limitation, repatriation and dividend received deductions. RKL's state and local tax advisors continue to monitor action at the state level to adapt to the new federal tax law.

KEY FILINGS & DEADLINES
FOR BUSINESS TAXPAYERS

Beyond the various dates for key individual and business tax returns, included at the start of this guide and included in the below chart, there are a number of other important tax-related dates business owners must adhere to. Keep in mind the due date for C Corporations with fiscal year ending on June 30 remains the 15th day of the third month after the end of the fiscal year. Any change to that due date has been deferred until December 31, 2025.

Some of the tax forms listed below, like Forms 1094-C/1095-C, W-2 and 1099, are informational returns required by the IRS. While there is no tax payment associated with these filings, there are financial penalties and consequences for late submission or failure to file.

Forms 1094 and1095 are both required under the Affordable Care Act (ACA). 1094-C proves to the IRS that applicable large employers fulfilled their requirements under the ACA's Employer Shared Responsibility Mandate. Employers must provide 1095-C to their employees to help them demonstrate that they met the minimum essential coverage mandate under the ACA. As previously noted, tax reform's repeal of the ACA's individual mandate does not take effect until December 31, 2018. As such, returns submitted for tax year 2018 that do not report full-year coverage, report a shared responsibility payment or claim a coverage exemption will be rejected by the IRS as incomplete and inaccurate.

BUSINESS TAX TYPE	DUE DATE(S) (for calendar year entities)
Forms 1094-C and 1095-C	**January 31, 2019** to employees **February 28, 2019** to IRS if filing hard copy **April 1, 2019** to IRS if e-filing
Form 1099	**January 31, 2019** to recipients **February 28, 2019** to IRS if filing hard copy **April 1, 2019** to IRS if e-filing
Forms W-2, W-3 and 1099-MISC (Box 7 – Nonemployee compensation)	**January 31, 2019** to employees/recipients, Social Security Administration and IRS if filing hard copy or e-filing
Partnerships (Form 1065) & S Corporations (Form 1120S)	March 15, 2019
Individuals (Form 1040), C Corporations (Form 1120) and Trusts and Estates (Form 1041)	April 15, 2019
Tax-exempt nonprofit organizations (Form 990)	May 15, 2019
Employee Benefit Plans (Form 5500)	July 31, 2019
Filing extensions for partnerships & S Corporations	September 16, 2019
Filing extension for trust and estates	October 1, 2019
Filing extensions for individuals, C Corporations and Employee Benefit Plans	October 15, 2019
Filing extension for tax-exempt nonprofit organizations	November 15, 2019

PERMANENT CORPORATE **TAX REFORM**

Corporations profits are subject to tax twice at the federal level: once on corporate business income and again on profits paid out to shareholders as dividends. Tax reform keeps these two levels of taxation, but it changed the previous top graduated rate from 35 percent to a flat 21 percent. This means that many C Corporations may pay significantly less tax under the new law. In addition, this will have a significant impact on the value of many company's deferred tax assets and liabilities.

The corporate tax rules have changed significantly for net operating losses, depreciation, interest deductibility, and for companies doing business outside the U.S. These provisions will be explored in the coming pages. Another big development is the elimination of corporate AMT. These and other business components of tax reform are permanent.

SHOULD I CHANGE my business entity type?

Does the reduction of the corporate tax rate mean every pass-through should elect to be taxed as a C Corporation? In short, probably not. While the corporate tax rates were reduced, tax reform created a brand-new section of law designed to create a fairer playing field for pass-through business owners, too. Read more about the Section 199A on page 28 of this guide.

There are a few other factors business owners should consider before changing their choice of entity. These include the Section 1202 stock rules which permit certain corporate taxpayers to sell stock held for more than five years and pay zero percent tax on the gain. State tax implications, especially for Pennsylvania businesses, must also be evaluated. The PA tax rate for C Corporations is 9.99 percent while the individual tax rate applicable for pass-through entity owners is only 3.07 percent.

Changes to Net Operating Losses

Tax reform created some unfriendly changes to net operating loss (NOL) rules. Under one of the new rules, NOLs arising in tax years that begin after December 31, 2017, will be limited to offsetting no more than 80 percent of taxable income in each subsequent year. Businesses with NOLs arising in years that begin before December 31, 2017, can use them to offset 100 percent of future taxable income. These rules will require additional diligence in tracking NOL generation and usage by year.

Another rule eliminates the ability to carryback NOLs to the two years prior to the year the NOL was generated. The date for this rule is tied to when the tax year ends. In this case, the two-year carryback rule is applicable to NOLs generated in tax years that end on or before December 31, 2017, meaning that taxpayers with NOLs generated in tax years that end after 2017 are not able to carry those losses back and claim refunds. Losses arising in years that end after 2017 have an indefinite carryforward period. Losses that end on or before December 31, 2017, have a 20-year carryforward period limitation.

Special attention is required by fiscal year taxpayers. The rule eliminating the two-year carryback and 20-year carryforward limitations are applicable to NOLs generated for fiscal years ending in 2018. NOLs generated from a fiscal year ending in 2018 can be carried forward indefinitely.

A special carve-out was made for farming business taxpayers. The post-2017 NOLs generated in a farming business are able to utilize the two-year carryback provisions. Post-2017 NOLs generated in a farming business can be carried forward indefinitely.

Expanded Access to Accounting Methods

The new tax rules will now allow businesses up to $25 million in gross receipts to take advantage of accounting methods that used to only apply to much smaller businesses. Your business may now be eligible to report on cash basis or avoid accounting for inventories.

Previously, the cash receipts/cash disbursement method of accounting could only be used by C Corporations or Partnerships with a C Corporation partner with average annual gross receipts of less than $5 million over the prior three-year period. For all types of businesses in which inventory is a material income producing factor (not just C Corporations or Partnerships with C Corporation partners), the cash method was only an option if average annual gross receipts (based on the prior three tax years) were **less than $1 million or $10 million in certain cases.**

Taxpayers were also required to account for long-term contracts using the percentage-of-completion method of accounting, with exceptions for small contractors, home construction contracts and residential construction contracts.

Under tax reform, C Corporations, Partnerships with a C Corporation partner and businesses in which inventory is a material income producing factor can now use the cash method if their annual gross receipts are **less than $25 million.**

FOREIGN INCOME
TAX REFORM CHANGES ❯

In addition to rate cuts and deduction changes, tax reform ushered in a significant shift in the treatment of companies doing business overseas. Previously, the U.S. operated with a worldwide system of taxation, foreign corporation earnings were generally taxed when distributed and anti-deferral rules taxed certain earnings currently, while foreign tax credits helped mitigate double taxation.

Tax reform moves the U.S. closer to a territorial system of taxation by implementing a new dividends received deduction for foreign-source income distributed to U.S. shareholders of foreign corporations, charges a one-time "transition tax" on earnings and profits held abroad, limits the applicability of foreign tax credits and expands anti-deferral provisions. Below, you'll find an overview of four key reforms to international tax law.

Mandatory Repatriation

The new tax law mandates that accumulated earnings held offshore are deemed to be repatriated and subject to a transition tax at a reduced tax rate. This one-time tax is applicable to shareholders who own 10 percent, directly or indirectly, of a specified foreign corporation (SFC). The base for the tax is the accumulated foreign earnings of the SFC since 1986 that have not previously been taxed in the U.S.

Two preferential tax rates will be applied to a U.S. shareholder's allocable share of post-1986 deferred foreign income. A 15.5 percent rate will be applied to the portion of earnings representing liquid assets such as cash, accounts receivable, certificates of deposit, government securities, etc. An 8 percent tax rate will be applied to the remainder of the allocated amount.

An election is available to pay the tax on an installment basis over eight years or until a triggering event occurs (sale, liquidation, or cessation of the business, failure to pay an installment). The first installment of transition tax is due by the original due date of the shareholder's return for the last tax year beginning before January 1, 2018. S Corporations are allowed a special election to defer the tax completely until a triggering event occurs or the entity ceases to be an S Corporation.

Territorial Tax System

Tax reform moves from the previous system of worldwide taxation, in which income of U.S. citizens and residents is taxed in the U.S. regardless where it is earned, and closer to a territorial system, in which tax applies to income sourced to a particular jurisdiction. The new "participation exemption", in the form of a 100 percent dividends received deduction, helps transition the U.S. toward a territorial system. This deduction is allowed against the foreign-source portion of distributions from specified 10 percent foreign corporations (those owned at least 10 percent by a domestic corporation). It is only available to U.S. C Corporations.

Expansion of Anti-Deferral Provisions

While the participation exemption effectively excludes foreign-source income from U.S. taxation for U.S. C Corporations, provisions of existing law meant to prevent certain types of earnings from being held offshore long-term, such as Subpart F income and Section 956 Inclusions, have been retained under the law for all taxpayers and have been expanded to encompass new categories of income. Specifically, the law 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.

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. 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.

BUSINESS TAX **DEDUCTION CHANGES**

Many business tax deductions have changed or been repealed under tax reform and the law also created a new, significant deduction opportunity for pass-through business owners. For specific discussions around deductions used in the past, contact your RKL tax advisor.

Limits on Interest Expense Deduction

For businesses with more than $25 million in revenue, tax reform caps the amount of deductible interest expense at the sum of 30 percent of adjusted taxable income, business interest income and floor plan financing interest expense for years 2018 and forward. Interest expense is defined as taxable interest paid or accrued on indebtedness allocable to a trade or business. As a result, investments in tax-free municipal bonds do not increase a taxpayer's interest expense deduction capacity.

The deduction limitation is applied after other interest disallowance, deferral, capitalization or other limitation provisions. Any business interest not allowed as a deduction for any taxable year as a result of the limitation is treated as business interest paid or accrued in the succeeding taxable year. Any disallowed interest generally may be carried forward for an indefinite period.

The Partnership or S Corporation deduction limitation applies at the entity level. Disallowed interest of the entity is allocated to each partner or shareholder as excess business interest.

For leveraged businesses of this size, this could increase the amount of taxable income and effectively increases the cost of debt capital. It creates additional complexity for reporting in tiered pass-through entity structures. The provision does not include a grandfather rule for existing debt obligations or disallowances and the limitation reduces the advantages of debt financing or debt assumption in mergers and acquisitions.

There are a number of complexities with the new deduction limitation and additional guidance still forthcoming from regulators. Contact your RKL advisor to discuss within the confines of your individual business circumstances.

DPAD Repealed

For tax years beginning after December 31, 2017, the Domestic Production Activity Deduction (DPAD) no longer applies. Congress originally intended to help U.S. companies compete against international tax systems with this targeted corporate rate reduction. Since an overall lower corporate tax rate was enacted with the passage of tax reform, DPAD is no longer needed to achieve the desired result.

Patents & Self-Created Property

The Tax Cuts and Jobs Act amended the definition of capital asset to exclude patents, inventions, models or designs (whether or not patented) and secret formulas or processes. Gain or loss arising from the sale, exchange or other disposition of these assets will no longer be treated as the sale of capital assets and will be taxed at ordinary rates. This treatment is effective for dispositions after December 31, 2017.

Gain or loss on the disposition of other self-created intangibles such as personal goodwill, client lists and customer contracts are still eligible for capital gain treatment.

Like-Kind Exchanges

Like-kind exchanges rules under Code §1031 now only apply to exchanges of real property. Real property must still be held for productive use in a trade or business or for investment to be eligible for like-kind exchange treatment. This applies to exchanges completed after December 31, 2017. Keep in mind that real property located in the U.S. is not considered like-kind to real property located outside the U.S.

Partnerships that made a valid election to be excluded from subchapter K continue to be treated as an interest in the assets of the partnership and not an interest in the partnership for Code §1031 purposes.

Entertainment & Meals

Effective for amounts paid or incurred after December 31, 2017, tax reform disallows deductions for:

- An activity considered entertainment, amusement, and recreation, even when directly related to the conduct of a taxpayer's trade or business;
- Membership dues for any club organized for business, pleasure, recreation, or other social purposes; or
- A facility or portion of a facility used in connection with any of the above.

Tax reform still allows a 50 percent deduction for food and beverage expenses associated with a trade or business. For tax years after 2017 and before 2026, this 50 percent deduction limitation will also apply to certain meals provided by an employer that were previously 100 percent deductible, including de minimis meals, on-premises meals and meals provided for the convenience of the employer. For tax years after 2025, these meals will all be 100 percent nondeductible.

Fringe Benefit Limitations

Deductions are no longer allowed for expenses associated with providing qualified transportation fringe benefits and transportation for commuting between the employee's residence and place of business (unless for the purpose of ensuring the safety of an employee). This includes van pools, subway or transit cards, qualified parking expenses and qualified bicycle commuting reimbursements.

Employers now have to choose to either include these amounts in employee taxable income and take a 100 percent tax deduction or exclude the amounts from income and take a lesser deduction.

SECTION 199A
NEW PASS-THROUGH DEDUCTION ❯

The Tax Cuts and Jobs Act created a new section of the tax code, Section 199A, which allows certain business owners to avoid tax on 20 percent of their business profits, referred to in the law as "qualified business income." This may result in lower taxes for the owners of eligible pass-through entities.

There are many factors that impact the business owner's eligibility for and amount of the deduction including type of business activity, employee wages, acquisition of qualified property and level of taxable income. Below, we highlight some key considerations to explore with your tax advisor when determining eligibility.

Specified Service Provider Definition

Language in Section 199A explicitly prohibits service professionals from taking the 20 percent qualified business income deduction. This includes professionals in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, as narrowly defined in proposed regulations.

Action items for pass-through owners:

- Closely review the NAICS codes on tax returns to make sure services provided by the business are not misrepresented.
- Consider whether gross receipts fall under the threshold of new de minimis exception for businesses that both sell products and perform services – this may allow companies to escape the specified service provider designation.

There is still hope for professionals within excluded fields. Section 199A makes an exception to the specified service trade or business based on taxable income. If a taxpayer's taxable income from all sources (not adjusted gross income) for a given year is less than $157,000 for individuals or $315,000 for married filing jointly, plus $50,000 for single filers and $100,000 for joint returns, the taxpayer is eligible to take the Section 199A deduction. This benefit phases out at $207,500 for individuals and $415,000 for married filing jointly.

Optimal Wage Levels

Another factor determining eligibility for the Section 199A deduction is wages. In the most basic terms, a business owner's deduction under Section 199A is limited to the greater of 50 percent of W-2 wages or 25 percent of W-2 wages plus 2.5 percent of the unadjusted basis of all qualified property used or held by the business.

In order to fully take advantage of this deduction opportunity, business owners should make sure their wages are set at an appropriate level. The tax code defines W-2 wages as the sum of wages subject to withholding, elective deferrals and deferred compensation paid by the partnership, S Corporation or sole proprietorship during a given tax year. Keep in mind this does not include independent contractor or management fees.

Action items for pass-through owners:

- To satisfy the taxable income and wage optimization requirements of Section 199A, business owners may consider hiring independent contractors as employees.
- Consider the appropriate grouping/aggregation elections to make on 2018 tax returns.

The same taxable income threshold ($157,000 for individuals, $315,000 for married filing jointly) and phase-outs ($207,500 for individuals, $415,000 for married taxpayers) applied to specified services also apply here, so companies with taxable income under the amounts below may ignore the limitations on W-2 wages.

WANT TO ASSESS ELIGIBILITY FOR SECTION 199A?
RKL can help.

There's a lot to unpack around this new deduction, so be sure to enlist the professional expertise of your RKL tax advisor for help assessing the impact of income thresholds and phase-outs, setting compensation and wages at optimal levels and evaluate other methods to maximize Section 199A eligibility within the context of your unique financial circumstances.

FIXED ASSET **PLANNING**

Tax reform allows owners to garner more immediate savings from larger business deductions and expenditures in two key areas: bonus depreciation and IRC Section 179 expensing. Using bonus depreciation or Section 179 requires strategic advance planning, so make sure to discuss all tax implications of asset purchases with your RKL advisor.

Bonus Depreciation Doubled

Previously, businesses could deduct only 50 percent of their capital expenditures through bonus depreciation for things like new equipment, vehicles and furniture. Starting September 27, 2017 through December 31, 2022, tax reform doubles bonus depreciation to 100 percent for qualifying property and based on acquisition and in-service dates. In addition to the doubled rate (which reduces by 20 percent annually after 2022), tax reform also expanded the types of property eligible for bonus depreciation. For the first time, these benefits are extended to include used property, in addition to assets like films, television shows and theatrical productions.

As a result of qualifying used property now being eligible for bonus depreciation, cost segregation has become even more of a beneficial tax strategy. Personal property and land improvements identified through cost segregation of a building purchased and placed into service after September 27, 2017, are now eligible for 100 percent bonus depreciation (rate reduces by 20 percent annually after 2022). Previously, these assets would not have qualified since they were considered used property.

Bottom line: The retroactive application back to September 27, 2017, plus the widened eligibility, allows facility owners to get twice the immediate deduction from writing off qualified purchases.

Section 179 Limits Increased

Another popular asset-related tax strategy is the IRC Section 179 Small Business Asset Expensing Election. This election allows owners to immediately expense the full purchase price of eligible property such as software, equipment, furniture and fixtures, rather than capitalizing them as long as they have taxable income in the year of acquisition.

Starting January 1, 2018, tax reform makes small business asset expensing an even more attractive option for business owners in two key ways.

First, the Section 179 limit increased from $510,000 to $1 million. This limitation will be adjusted annually for inflation and applies only to property placed in service in tax years beginning after 2017. The phase-out threshold also increased from $2.03 million to $2.5 million. Businesses that exceed this phase-out will see their expensing amount reduced dollar-for-dollar.

Second, the new tax law also broadens eligibility to the following items that were previously excluded:

- Tangible personal property used in connection with lodging
- Certain structural components in ***non-residential*** real property: roofs, HVAC, fire protection and alarm systems and security systems

TAX REFORM'S **IMPACT ON NONPROFITS**

Since most of the tax reform headlines focus on the individual and for-profit business provisions, nonprofit leaders may wonder how the new law will affect their finances and operations. In fact, there are a number of impacts for which tax-exempt organizations must prepare. Below, we outline key areas and offer action items to help nonprofit leaders adjust to the new tax landscape. Your RKL tax advisor can demonstrate the pros and cons of each planning idea within the context of your nonprofit's unique circumstances.

Unrelated Business Taxable Income

Under tax reform, unrelated business taxable income (UBTI) will now be taxed at the new corporate rate of 21 percent, instead of the previous multi-level rate schedule. The financial impact of this rate change depends on the level of unrelated taxable income. Organizations with less than $90,000 of taxable income will now pay more tax due to the switch, while organizations with taxable income over $90,000 may see a smaller tax burden.

Tax reform also changes how UBTI is calculated and taxed. Starting in 2018, nonprofits must calculate UBTI on each trade or business individually, rather than the previous aggregated method. Therefore, it is expected that incomes/losses from individual business activities will need to be reported separately, and losses from one may not be used to offset income from other business activities.

In late August 2018, the IRS issued interim guidance that reliance on the use of NAICS six-digit codes will be considered a reasonable interpretation until proposed regulations are published. Interim guidance was also issued regarding income from partnership interests. A nonprofit is permitted to aggregate its UBTI from its interest in a single partnership with multiple trades or businesses as long as it passes either the de minimis or control test.

A nonprofit meets the de minimis test if it directly holds no more than two percent of the capital interest and no more than two percent of the profits interest in a partnership. A nonprofit meets the control test if its partnership interest does not exceed 20 percent of the capital interest and it has control or influence over the partnership.

Information on Schedule K-1 may be used to determine if the nonprofit meets one or both of these tests. This interim guidance also provides a transition rule to allow the aggregation of income within each direct partnership interest acquired before August 21, 2018.

Ways to prepare:

- Review estimated taxes and safe harbor status in light of the rate changes.
- Evaluate control issues and interests for all partnership holdings.
- Allocate the appropriate general or shared expenses to each trade or business to maximize benefit and minimize tax burden.
- Move multiple taxable trade or business activities into a wholly owned corporation to offset profitable activities with loss activities (consider with the consultation of a tax advisor).

Net Operating Losses

Tax reform sets new rules for net operating losses (NOL) carryforwards at 80 percent of taxable income. It eliminates carryback of NOLs and allows carryforwards indefinitely. Keep in mind, all new NOLs must be calculated by trade or business and can no longer “cross pollinate.” The IRS late August 2018 guidance sets ordering rules for how pre-2018 and post-2018 NOLs can be used. Congress does allow for a transition period that allows carryover of any NOL occurring in a taxable year before 2018.

Ways to prepare:

- Review ongoing loss activities to determine whether or not they should be continued by your organization.
- Track NOLs by activity/business for carryforward purposes.

Fringe Benefits

Tax reform also expands the definition of UBTI to include certain fringe benefits offered to employees, like on-premise athletic facilities and qualified transportation or parking, which can be on-premise or off. Before December 2017, an employee could exclude up to $255 per month of employer-provided parking as a qualified transportation benefit and the employer could deduct 100 percent of that expense. Starting in 2018, an employee may still exclude up to $260 per month of employer-provided parking as a qualified transportation benefit, but employers may no longer deduct any of the expense. Instead, nonprofits must report that fringe benefit expense as UBTI.

Ways to prepare:

- Renegotiate parking lease (if rented from same landlord as office space) to increase office rent and include free parking, which permits 100 percent deduction of office rent and avoids UBTI classification.
- Increase wages and leave it to employees to cover their own parking expenses.

Excise Tax on Excessive Executive Compensation

The Tax Cuts and Jobs Act created a brand-new section of tax code, Section 4960, to impose an excise tax on excessive compensation for nonprofit executives, with the intent of bringing nonprofit pay in line with public company compensation rules. This tax is paid by the nonprofit, not the individual employee, and is here to stay: Section 4960 will not sunset after December 31, 2025, unlike other provisions of the Tax Cuts and Jobs Act.

The new 21 percent excise tax is applied to annual compensation of $1 million or higher to an organization's top five highest compensated employees. Section 4960 defines as covered employees both current and former employees who are among the top five highest compensated employees for the year since 2016.

The $1 million limit only applies to federal withholding wages, not separation or parachute payments, which are calculated differently as explained later in this section. Wages from a related party or organization paid to a covered employee, however, do count toward the $1 million limit. Other notable exclusions from the $1 million limit are Roth contributions to a 401(k) plan and compensation paid to licensed medical professionals, like doctors, nurses and veterinarians, for medical services. Compensation for non-medical services must still be figured into the excise tax calculation.

The 21 percent excise tax is also levied on certain separation pay packages, commonly referred to as "golden parachutes," that are greater than or equal to three times the departing executive's base salary. Three times base salary is the point at which the payment becomes taxable, but the excise tax is not levied on the excess of the base salary times three. Instead, it is levied on the difference between the base salary and the separation payment.

Example: *A nonprofit provides a departing executive with a lump-sum payment of $700,000 on the date of separation. The executive's base salary was $225,000, so the separation payment is more than three times the base. So only the difference between the separation payment and the base salary, which equals $475,000, is considered excess. Thus, the 21 percent excise tax owed is $99,750, or 21 percent of $475,000.*

To continually assess the annual impact of the compensation excise tax, nonprofit leaders should keep close track of covered employees and remuneration from related entities to determine liability and discuss the exposure mitigation tactics outlined below with their RKL advisor.

Ways to prepare

- Shift income from bonus/salary to involuntary separation pay, or vice versa (must be conducted in compliance with Sections 457(f) and 409A regulations).
- Replace parachute payments with a phased retirement program eliminates the separation pay and benefits that trigger the excise tax. This could impact on provision of service or medical benefit eligibility so vet thoroughly before implementing.
- Extend vesting schedules for employee compensation. Spreading payments over several years can prevent any single year from exceeding the $1 million threshold.

LET'S GET
REAL ANSWERS ›

The RKL team cuts through the noise to provide you the knowledge and perspectives you need to uncover real opportunities for tax savings. To discuss how tax reform affects your year-end tax planning, reach out to your RKL advisor, contact one of our local offices or visit our online Tax Reform Resource Center at **RKLcpa.com/tax-reform.**

Lancaster: 717.394.5666 | **Reading:** 610.376.1595 | **York:** 717.843.3804
Harrisburg: 717.525.7447 | **Mechanicsburg:** 717.790.9333 | **Exton:** 484.874.2200

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