

Tax and A&A

# INDIVIDUAL TAX UPDATE

Presented By:

**G. SCOTT MYERS, CPA, CSEP**

Partner | Tax Services Group



## » Agenda

- Individual Tax Changes
  - Income
  - Itemized Deductions
  - Education
  - Credits
- Estate and Gift Tax Changes
- Foreign Reporting
- Planning Opportunities



## › Individual Tax Reform

- Tax Cuts and Jobs Act
  - Passed December 20, 2017
  - Represents the most significant overhaul of the Internal Revenue Code in more than 30 years
- 2018 Statistics
  - About 65% of households paid less in individual income taxes
    - Average tax cut was \$2,200
  - About 6% of households paid more in individual income taxes
    - Average increase was \$2,800
  - Remaining 29% paid about the same



## › Filing Status

- No change to the 5 filing statuses
- Due diligence requirements for head of household status
  - \$520 preparer penalty



## 2019 Tax Brackets

### 2019 Single Taxable Income Brackets and Rates

Rate	Taxable Income Bracket	Tax Owed
10%	\$0 to \$9,700	10% of Taxable Income
12%	\$9,701 to \$39,475	\$970 plus 12% of the excess over \$9,700
22%	\$39,476 to \$84,200	\$4,543 plus 22% of the excess over \$39,475
24%	\$84,201 to \$160,725	\$14,382.50 plus 24% of the excess over \$84,200
32%	\$160,726 to \$204,100	\$32,748.50 plus 32% of the excess over \$160,725
35%	\$204,101 to \$510,300	\$46,628.50 plus 35% of the excess over \$204,100
37%	\$510,301+	\$153,798.50 plus 37% of the excess over \$510,300



## 2019 Tax Brackets

### 2019 MFJ Taxable Income Brackets and Rates

Rate	Taxable Income Bracket	Tax Owed
10%	\$0 to \$19,400	10% of Taxable Income
12%	\$19,401 to \$78,950	\$1,940 plus 12% of the excess over \$19,400
22%	\$78,951 to \$168,400	\$9,086 plus 22% of the excess over \$78,950
24%	\$168,401 to \$321,450	\$28,765 plus 24% of the excess over \$168,400
32%	\$321,451 to \$408,200	\$65,497 plus 32% of the excess over \$321,450
35%	\$408,200 to \$612,350	\$93,257 plus 35% of the excess over \$408,200
37%	\$612,351+	\$164,709.50 plus 37% of the excess over \$612,350



## › Long-Term Capital Gain Rates

- 2019 rate thresholds
  - Single
    - 15% - \$39,375
    - 20% - \$434,550+
  - Married Filing Jointly
    - 15% - \$78,750
    - 20% - \$488,850+



## › Capital Gains / Dividend Tax Rate

- 15% and 20% rate thresholds are not tied to tax bracket

Income Tax Bracket			Capital Gains Tax		
MFJ	Single	Rate	MFJ	Single	Rate
(taxable income exceeding...)		(is taxed at...)	(taxable income exceeding...)		(is taxed at...)
0	0	10%	0	0	0%
19,400	9,700	12%			
78,950	39,475	22%	78,750	39,375	15%
168,400	84,200	24%			
321,450	160,725	32%			
408,200	204,100	35%	488,850+	434,550+	20%
612,350+	510,300+	37%			



## › Self-Created Property

- Gains or losses from the sale of a patent, invention, model, design or secret formula
  - Held by the taxpayer who created the property
  - Or a taxpayer with a substituted or transferred basis from the taxpayer who created the property
- No capital gain treatment allowed



## › Standard Deduction

Filing Status	2018 Standard Deduction	2019 Standard Deduction
Single/Married Filing Separately	\$12,000	\$12,200
Married Filing Jointly/Surviving Spouse	\$24,000	\$24,400
Head of Household	\$18,000	\$18,350



## › Standard Deduction

- Dependents
  - Calculation of standard deduction is unchanged
  - Greater of:
    - a) \$1,100
    - or
    - b) \$350 plus earned income (but not greater than standard deduction for filing status)
- Aged/Blind
  - Calculation of additional standard deduction is unchanged
  - \$1,300 (\$1,650 if unmarried and not surviving spouse)



## › Standard Deduction – Net Disaster Losses

Addition to the standard deduction for the amount of net personal casualty losses arising in a federal disaster area on or after 1/1/16

- Additional deduction is allowed for AMT



## › Personal Exemptions

- The Tax Cuts and Jobs Act repealed the personal exemption through 2025 (barring any additional action by Congress)



## › Moving Expense Deduction

- Deduction available for members of the Armed Forces (or their spouses or dependents)
- Following requirements must be met:
  - Active duty
  - Move pursuant to a military order
  - Incident to a permanent change of station



## › Alimony

- For divorce or separation instruments executed after December 31, 2018
  - Alimony payments will no longer be included in taxable income
  - Payments are not deductible by the payor
- This treatment also applies to divorce or separation decrees that are modified after December 31, 2018, if the modification specifically states that the new treatment now applies



## › Shared Responsibility Payment

- Originally enacted as part of the ACA
- Taxpayers will no longer have to pay a penalty for not maintaining health insurance



## › Kiddie Tax

- Applies ordinary and capital gain tax rates applicable to trusts and estates to the net unearned income of a child
- Earned income is taxed according to single taxpayer's brackets and rates
- Child's tax is unaffected by the tax situation of the child's parent or the unearned income of any siblings



## › Alternative Minimum Tax

- Exemption Phase-Outs
  - \$510,300 for Single/Married Filing Separately/Head of Household
  - \$1,020,600 for Married Filing Jointly/Surviving Spouse



## Alternative Minimum Tax

Filing Status	Exemption Amount
Single/Head of Household	\$71,700
Married Filing Jointly/Surviving Spouse	\$111,700
Married Filing Separately	\$55,850



## Recharacterization of IRA Contributions

- Tax Reform repealed the special rule that allows the recharacterization of a Roth IRA conversion
- Conversion of a traditional IRA into a Roth IRA is still allowed
  - May be even more appealing now due to lower effective tax rates and higher tax brackets



## ITEMIZED DEDUCTIONS



### › Itemized Deductions

- Pease Limitation no longer applies under the current tax laws
- Tax reform effect
  - 30% of taxpayers itemized in 2017
  - 10% of taxpayers itemized in 2018 (current data)
- Certain miscellaneous expenses remain nondeductible
  - Investment fees and expenses
  - Tax preparation fees
  - Unreimbursed employee business expenses



## › Medical Expenses

AGI threshold has returned to 10% for all taxpayers in 2019

- Medical expense deduction is no longer an AMT preference



## › State, Local and Real Estate Taxes

- Deduction limited to \$10,000 (\$5,000 if MFS) for the aggregate of:
  - State and local real and personal property taxes AND
  - State and local income tax (or state and local sales tax paid, if higher)
- Foreign income tax is included in limited deductible amount; however, deduction is disallowed for foreign property taxes unless the property is used in a trade or business.



## › State and Local Taxes

- Payment of state and local income taxes in 2018 that relate to a tax imposed in 2019 are treated as paid in 2019
- Real property taxes paid in 2019 are only deductible in that year if they are assessed in 2019 under state and local law



## › State and Local Taxes

- Real estate taxes paid on rental property or in connection with trade or business are fully deductible against the rental/business income
- Personal property taxes paid in connection with a trade or business are fully deductible against that business income



## › Charitable Contributions

- 60% AGI limitation for cash contributions to public charities, certain private foundations and certain governmental units
- Charitable deduction for payments made in exchange for athletic seating rights is NOT allowed
- Taxpayers required to obtain contemporaneous written acknowledgement for contributions of \$250 or more
- About 33 million taxpayers claimed charitable deductions of \$160 billion in 2017
  - In 2018 (current data) – 12 million claimed \$102 billion
  - Extended returns due to tax reform impact statistics



## › Mortgage Interest

- Deduction for mortgage interest is limited to debt of up to \$750,000 incurred after December 15, 2017
- Debt limit of \$1,000,000 for grandfathered debt (incurred before December 15, 2017)



## › Exceptions to New Debt Limit

\$1,000,000 (\$500,000 MFS) debt limit continues to apply:

- Binding written contract before 12/15/17 to close prior to 1/1/18 as long as purchased before 4/1/18
- Refinance of existing acquisition indebtedness provided:
  - The extent the amount of the debt resulting from the refinancing does not exceed the amount of the refinanced debt
  - The exception will not apply after:
    - Expiration of the term of the original debt
    - OR
    - Earlier of the expiration of the first refinancing of the debt or 30 years after the date of the first refinancing



## › Exceptions to New Debt Limit

### Home equity loan interest may be deductible

- Funds are used to buy, build or substantially improve the taxpayer's home that secures the loan
- Examples:
  - Interest on a home equity loan used to build an addition to an existing home is generally deductible
  - Interest on a home equity loan used to pay personal expenses such as credit card debt is not deductible
  - Interest on a home equity loan on a taxpayer's main home to purchase a vacation home is not deductible
- Loan will be subject to new dollar limit on qualified residence debt



## › Mortgage Proceeds Used for Business (or Similar) Activity

If a mortgage is secured by the home of the taxpayer, but the proceeds are used to purchase:

- Rental property
- Property used in a trade or business OR
- Investment property

THEN the interest on such loan can be separately deducted elsewhere on a taxpayer's income tax return



## › Home Office Deduction

- Self-employed taxpayer
  - Deduct home office deduction on related form (Schedule C)
  - May deduct portion of mortgage interest and real estate taxes attributable to the portion of the home used for the business
  - The home office deduction is subject to limitation based on the income earned by the taxpayer in the related activity
- Miscellaneous itemized deduction
  - Employees will no longer be able to deduct home office expense as a 2% miscellaneous itemized deduction



## › Personal Casualty & Theft Losses

- No deduction for personal casualty or theft losses **except** for losses incurred within a major disaster area under the *Robert T. Stafford Disaster Relief & Emergency Assistance Act of 2016*
- Gains on personal casualty losses can be offset by other personal casualty losses
  - Does not have to be attributable to a federally declared disaster loss
  - Up to the extent of the gain on the personal casualty loss



EDUCATION



## › 529 Plan Modification

Allow distributions of no more than \$10,000 for designated beneficiaries enrolled at a public, private or religious elementary or secondary school

- The limitation applies on a per-student, not per-account basis
- Any distribution in excess of \$10,000 would be subject to tax under the rules of Section 529



## › ABLE Accounts

- Contribution limit increased in certain circumstances
- General limitation is first
  - Equal to the annual gift tax exclusion
  - Designated beneficiary of the account may make additional contributions up to the lesser of:
    - (1) compensation includible in gross income for the tax year
    - OR
    - (2) the federal poverty line for a one-person household
- Retirement savings contribution credit can be claimed by a designated beneficiary



## › ABLE Accounts

Individuals are allowed to roll over amounts from 529 plans to an ABLE account if the ABLE account is owned by:

- Same designated beneficiary of the 529 plan  
OR
- Member of the designated beneficiary's family before 1/1/26



## › Other Education Items

- Student loan interest deduction – Borrowers can deduct education loan interest up to \$2,500 (subject to limitations)
- Educator deduction – Up to \$250 deduction for teachers who buy supplies at their personal expense



## » Education Credits

- AOTC (Hope Credit) – Qualified taxpayers may be eligible for a maximum credit of \$2,500
- Lifetime Learning Credit – Credit is capped at \$2,000 (subject to limitations)



**CREDITS**



## › Child Tax Credit

- \$2,000 credit for each qualifying child under the age of 17
  - No change to the definition of qualifying child
- Credit is phased out by \$50 for each \$1,000 of MAGI over:
  - \$400,000 for married filing jointly
  - \$200,000 for other filing status
- \$500 credit for other qualifying dependents
  - Other qualifying dependents exclude residents of countries contiguous to the U.S. (i.e., Mexico and Canada)



## › Child Tax Credit

- Refundable amount of credit is available to the extent the child tax credit exceeds the tax liability
  - 15% of earned income in excess of \$2,500
  - Limited to \$1,400 per qualifying child
  - Only applies to credit for qualifying child
    - \$500 credit enhancement is not refundable
- Social Security Number requirements
  - Required for each qualifying child for non-refundable and refundable portion of credit
  - Must be issued prior to the due date of the tax return
  - Not required for \$500 non-refundable credit



## ESTATE & GIFT TAX



### › Estate & Gift Tax

- The exemption for estate and gift taxes in 2019 is \$11.4 million per person, \$22.8 million per married couple
- Estate tax rate maintained at 40%
- Annual gift tax exclusion is \$15,000 per person in 2019, \$30,000 per married couple



## FOREIGN REPORTING



### Foreign Financial Accounts

- Taxpayers who own or have signature authority over foreign accounts with balances that total in excess of \$10,000 must file Form 114 (FBAR)
  - Each account is measured at its maximum balance during the year
  - \$10,000 threshold is an aggregate of all accounts



## PLANNING OPPORTUNITIES



### › Planning Opportunities

- Charitable contributions
- Tax rate arbitrage/rate sunsets
- Roth conversion
- Asset location
- Estate planning

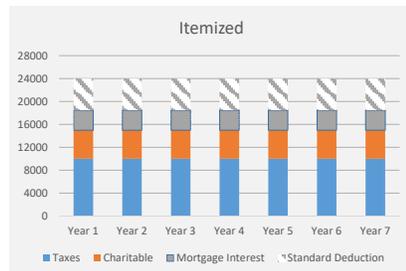


## › Planning Opportunities for Charitable Contributions

- Bunching charitable contribution
- Donor advised funds and private foundations
- IRA qualified charitable distribution
- Donations of appreciated stock
- Donation to a Pennsylvania EITC program
- Complex assets
- Tax rate arbitrage
- Capital gains



## › Charitable – Bunching



### Itemized Deductions

- \$10,000 – Maximum State Income Tax
- \$3,500 – Mortgage Interest
- \$5,000 – Charitable

\$18,500 Itemized < **\$24,000 Standard**



### Bunching Deductions

*Utilizing a charitable vehicle such as a Donor Advised Fund allows larger charitable contributions to be deducted in a single year and distributed at a future point in time.*



## › Charitable – Donor Options

- Donor Advised Fund
  - Set up a fund through an investment advisory firm
  - Bunch years of donations up front
  - Maintain control over the donation annually
- Private Foundations
  - Benefit of charitable contribution deduction up front
  - Control the disbursement of funds over time
  - Legal and administrative costs to set up and run new entity
  - Annual filing requirement (Form 990-PF)
  - Possible state filing requirements



## › Charitable – IRA Distribution

- Direct IRA distribution to charity
- Must be age 70 ½
- Counts toward required minimum distribution
- \$100,000 maximum amount allowed
- Reduces taxable amount of IRA distribution
  - Benefit of reduced adjusted gross income could have favorable impact on Medicare premiums
- Cannot be used for Donor Advised Fund



## › Charitable – Appreciated Stock

- Transfer long-term appreciated stock directly to charity
- Charitable deduction is average fair market value on date of contribution
- 30% AGI limitation applies
- Appraisal not required for noncash contribution of publicly traded securities
- No capital gains tax on appreciated value
- Can be used for Donor Advised Fund



## › Charitable – Complex Assets

### **Examples of complex assets**

- Private company stock
  - S-Corp
  - C-Corp
- Real estate
- Private equity interests: shares, LLC and LP
- Restricted stock
- Insurance interests
- Oil and gas royalty interests
- Certain alternative investments
- Bitcoin (and other cryptocurrencies)



## › Charitable – PA EITC Program

- Tax credit program for eligible businesses contributing to one of three types of entities registered to receive credit funds:
  - Scholarship Organization
  - Educational Improvement Organization
  - Pre-Kindergarten Scholarship Organization
- Contributions to this program can be
  - Cash
  - Personal property
  - Services of value (no part of the contributor's normal course of business)



## › Charitable – PA EITC Program

- Tax credit value OSTC and EITC:
  - 75% of contribution to organization up to \$750,000 for a 1-year commitment
  - OR
  - 90% of the contribution to organization up to \$750,000 for a 2-year commitment
- Tax credit value PKTC:
  - 100% of contribution to organization up to \$10,000 and 90% of any additional contributions capped at \$200,000
  - No difference between a 1 and 2-year commitment
- Selling Point
  - Deductible as a charitable contribution for federal purposes
    - Difference between contribution and state tax credit
  - Reduces Pennsylvania state tax

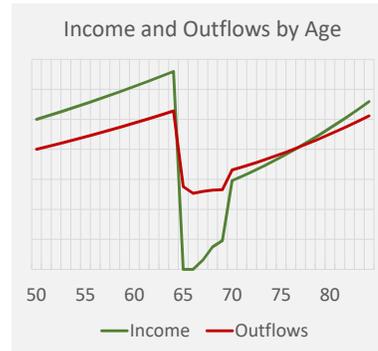


## › Tax Rate Arbitrage & Sunsets

Tax rate arbitrage is a strategy of realizing income at lower tax rates vs. higher rates in the future.

“Filling out the bracket” is a common method for accomplishing this goal.

Normally, the tax rate arbitrage opportunity occurs because of a decrease in AGI, typically between retirement and onset of Social Security and/or Required Minimum Distributions.



## › Tax Rate Arbitrage & Sunsets

However, because the TCJA was passed through reconciliation, a unique opportunity presents itself.

Lower marginal tax rates and the doubled standard deduction are scheduled to sunset after 2025.

This sets the stage to realize more income **now**, prior to tax rates reverting back to their previous levels.

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



## › Capital Gains

- May be able to reap greater benefits from capital gains and other income without being subject to AMT
- Work with 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



## › Roth Conversion

- Convert traditional IRA to a Roth IRA
- Must pay tax now
- Pros
  - No RMD for the account owner
  - Tax-free withdraw of converted balances
  - Earnings grow tax-free and withdrawals are tax-free after 59 ½ years old
- Cons
  - Pay tax on the converted savings
  - Converted funds may trigger higher tax bracket
  - Must wait five years to withdraw investment



## › Asset Location

- Different financial 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.
- Maximize your after-tax returns.
- All forms of taxation are evaluated (income and estate).



## › Estate Planning

- Utilize the annual exclusion – \$15,000
- Utilize the lifetime exclusion – \$11.4 million
- Portability – must file Form 706 to claim
- Review estate plan documents/will
  - Is the title of the assets correct?
  - Change in life status- married, divorce, children, new job, health, move, inheritance, etc.
  - Do you have a plan in place if there is a change in tax law after 2020?



**FOCUSED.  
ON YOU.**

**G. SCOTT MYERS, CPA, CSEP**  
[smyers@rklcpa.com](mailto:smyers@rklcpa.com) | [RKLcpa.com](http://RKLcpa.com)

**rki**  
FOCUSED. ON YOU.