Just as the daylight hours are getting shorter, so is the time for fine tuning any last-minute strategies to lower your 2018 tax bill.

Unlike recent years, in which the tax rules have been fairly stable, 2018 brings extensive changes as a result of a large tax overhaul that passed Congress last December. These changes will affect how your 2018 taxes will be calculated. Here's a quick recap of the new rules, followed by some thoughts on steps we can take to reduce your bill.

I. New Tax Rules for 2018

A centerpiece of last year's legislation is the reduction in income tax rates. While the new law keeps the same number of tax brackets for individuals as there were in 2017, many tax rates are two to three percentage points lower than prior years. The top rate is reduced from 39.6 percent to 37 percent and kicks in at higher taxable income levels - $600,000 of taxable income for joint filers, $300,000 for married taxpayers filing separately, and $500,000 for all other individual taxpayers.

The 2018 tax rates are 10%, 12%, 22%, 24%, 32%, 35%, and 37%, compared with the 2017 tax rates of 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. However, while applicable tax rates at any given level of income have generally gone down by two to three points, some individuals will see an increase in taxes due to the tax brackets at which the rates apply. For example, the tax rate for single taxpayers with taxable income between $200,000 and $400,000 goes from 33 percent to 35 percent (head of household filers face a similar jump, but at a slightly different breakpoint). However, high-income taxpayers are also subject to a 3.8 percent net investment income tax and/or the .9 percent Medicare surtax. There were no changes made to these taxes in last year's tax overhaul. In addition, the maximum tax rates on net capital gain and qualified dividends are the same in 2018 as they were in 2017.

For 2018 individual tax returns, two of the most significant changes are the repeal of the personal exemption deductions and the increase in the standard deduction amounts. The standard deduction amounts are almost twice what they were in 2017: $24,000 for joint filers and surviving spouses, $18,000 for heads of household, and $12,000 for single individuals and those who are married but filing separately. Additional amounts for the elderly and blind are also available. Because the standard deduction is generally claimed only when it exceeds available itemized deductions, the increase in the standard deduction will not benefit you if you itemize deductions. The repeal of the personal exemption deductions, by contrast, will affect you whether you itemize or not.

To compensate for the repealed exemptions for dependents, the new law increased the child tax credit from the 2017 amount of $1,000 (which was fully refundable) to $2,000 ($1,400 is refundable). The modified adjusted gross income threshold where the credit phases out has been increased to $400,000 for joint filers and $200,000 for all others (up from $230,000 and

$115,000, respectively). The maximum age for a child eligible for the credit remains 16 (at the end of the tax year). In addition, a $500 nonrefundable tax credit for dependent children over age 16 and all other dependents is also available beginning in 2018. Most families with non-child dependents will lose some ground here, as the $500 credit will generally be less valuable than the $4,150 exemption deduction it replaces.

Other significant changes as a result of the new tax law, as discussed below, include the elimination of many expenses that were previously deductible and new limitations on other expenses, particularly the $10,000 limitation on the deduction of state and local income and property taxes. While you may have itemized your deductions in prior years, we need to review whether that still makes sense in light of the increased standard deduction and the changes in the deductibility of other expenses.

The following are some items we should review in our year-end tax planning session so we can evaluate whether they will impact your 2018 tax return.

State and Local Income and Property Taxes. New for 2018, there is a $10,000 limit on the deduction for state and local income and property taxes. No deduction is allowed for foreign property taxes.

Mortgage Interest. The mortgage interest deduction on acquisition indebtedness (e.g., mortgages) of more than $750,000 obtained after December 14, 2017, is limited to the portion of the interest allocable to $750,000 ($375,000 in the case of married taxpayers filing separately). In the case of acquisition indebtedness incurred before December 15, 2017, the limitation is the same as it was under prior law: $1,000,000 ($500,000 in the case of married taxpayers filing separately). Additionally, no deduction is allowed for interest paid on home equity indebtedness. However, to the extent the debt is used for certain purposes, the interest on the debt may still be deductible.

Child and Dependent Care Expenses. If you paid someone to take care of your child or a dependent so you can work or look for work, you may be entitled to a tax credit for up to 35 percent of the expenses paid. Various qualifications must be met in order to be eligible for the credit, but if you incurred such expenses, you may qualify.

Adoption Expenses. If you incurred expenses to adopt a child, you may be eligible for a tax credit of up to $13,810 for some or all of those expenses. The determination of the tax year in which qualified adoption expenses are allowable as a credit depends on whether they were paid before the year in which the adoption became final or whether they were paid during or after the year in which the adoption became final.

Medical, Dental, and Vision Expenses. For 2018, you can deduct medical, dental, and vision expenses to the extent they exceed 7.5 percent of your adjusted gross income (AGI). In order to take this deduction in following years, such expenses must exceed 10 percent of your AGI. Thus, to the extent you are planning any elective medical, dental, or vision procedures, the expenses of which you can accelerate into 2018, the bunching up of those expenses in 2018 may help reduce your taxable income if you will be itemizing deductions. Such expenses must be primarily to alleviate or prevent a physical or mental defect or illness. They do not include expenses that are merely beneficial to general health, such as vitamins, or the costs of cosmetic surgery, unless the surgery is necessary to ameliorate a deformity resulting from a congenital abnormality, a personal injury, or a disfiguring disease

Casualty and Theft Losses. If you incurred a casualty loss in a presidentially declared disaster area, it may be deductible. Any other casualty loss, along with all theft losses, are not deductible.

Charitable Contributions. Whether it makes sense to take an itemized deduction for your charitable contributions depends on whether your total itemized deductions exceed your standard deduction. It's also worth noting that a new change in the law increases the maximum contribution percentage limit from 50 percent of your contribution base to 60 percent for cash contributions to public charities.

Taxpayers 70 1/2 years old and older who own an IRA are required to take minimum distributions from that account each year and include those amounts in taxable income. If you are in this category, a special rule allows you to make a charitable contribution directly from your IRA to a charity. This has several benefits. First, since charitable contributions deductions are usually only available to individuals who itemize, individuals who take the standard deduction instead can benefit from this rule. Second, making the contribution directly to a charity counts towards your required minimum distribution but that amount is not included in income and thus reduces your taxable income and adjusted gross income. A lower AGI is advantageous because it increases your ability to take medical expense deductions that you might not otherwise be able to take. For example, medical expenses are only deductible to the extent those expenses exceed 7.5 percent of your AGI and a lower AGI means you can deduct more medical expenses. In addition, as AGI increases, more of your social security income is subject to tax. Finally, the 3.8 percent net investment income tax applies to the extent your AGI exceeds a certain level.

Miscellaneous Itemized Expenses. If you deducted miscellaneous itemized expenses in prior years, such deductions are no longer available for 2018. The miscellaneous itemized expense deduction has been eliminated for tax years 2018 through 2025.

Education-Related Expenses. If you have any student loans outstanding, the interest you paid on those loans may be deductible. A deduction of up to $2,500 of interest paid on a qualified student loan is deductible in computing adjusted gross income. The deduction is phased out if your modified adjusted gross income is between $65,000 and $80,000 ($130,000 and $160,000 if filing a joint return).

If you are an educator and spend your own money on school supplies, up to $250 may be deductible from gross income.

Moving Expense Reimbursement. If you received a reimbursement from your employer for moving expenses incurred in 2018, the reimbursement is taxable income. However, if you receive a reimbursement in 2018 for 2017 moving expenses, that is not taxable income. While taxpayers could previously deduct employment-relating moving expenses, this deduction is no longer available for moves taking place in years 2018-2025, unless the taxpayer is a member of the U.S. Armed Forces on active duty who moves pursuant to a military order to a permanent change of station.

Alternative Minimum Tax. If you were subject to the alternative minimum tax in prior years, you may get a break this year as the result of increases in the alternative minimum tax (AMT) exemption amounts as well as the increases in the income level at which the exemption is phased out.

Distributions from a 529 Plan. New for 2018, if you have a 529 Plan, you can use up to $10,000 in aggregate 529 distributions per year for elementary and secondary school tuition. Previously, 529 distributions could only be used for higher education expenses.

Individual Healthcare Penalty. While the tax penalty on individuals who fail to carry health insurance, which was enacted as part of the Affordable Care Act, has been eliminated for tax years after 2018, the penalty still applies for 2018 unless a taxpayer is exempt from the penalty because the taxpayer's income falls beneath a certain level.

Passthrough Tax Break. Another change in the law, effective for 2018, allows a 20 percent deduction for qualified business income from sole proprietorships, S corporations, partnerships, and LLCs taxed as partnerships. If you qualify for the deduction, which is available to both itemizers and nonitemizers, it is taken on your individual tax returns as a reduction to taxable income. The new tax break is subject to some complicated restrictions and limitations, but the rules that apply to individuals with taxable income at or below $157,500 ($315,000 for joint filers) are simpler and more permissive than the ones that apply above those thresholds.

It's worth noting that the effective marginal tax rate on qualified business income for individuals in the top 37-percent tax bracket who are able to fully apply the new deduction will be 29.6 percent - a full 10 points lower than the top rate under prior law.

II. Year-End Tax Planning

Life Events. Life events can significantly impact your taxes. For example, if you are using head of household or surviving spouse filing status for 2018, but will change to a filing tax status of single for 2019, your tax rate will go up. Thus, accelerating income into 2018 and pushing deductions into 2019 may also yield tax savings.

Retirement Plans Considerations. Fully funding your company 401(k) with pre-tax dollars will reduce your current year taxes, as well as increase your retirement nest egg. For 2018, the maximum 401(k) contribution you can make with pre-tax earnings is $18,500. For taxpayers 50 or older, that amount increases to $24,500.

If you have a SIMPLE 401(k), the maximum pre-tax contribution for 2018 is $12,500. That amount increases to $15,500 for taxpayers age 50 or older.

If certain requirements are met, contributions to an individual retirement account (IRA) may be deductible. For taxpayers under 50, the maximum contribution amount for 2018 is $5,500. For taxpayers 50 or older but less than age 70 1/2, the maximum contribution amount is $6,500. Contributions exceeding the maximum amount are subject to a 6 percent excise tax. Even if you are not eligible to deduct contributions, contributing after-tax money to an IRA may be advantageous because it will allow you to later convert that traditional IRA to a Roth IRA. Qualified withdrawals from a Roth IRA, including earnings, are free of tax, while earnings on a traditional IRA are taxable when withdrawn.

If you already have a traditional IRA, we should evaluate whether it is appropriate to convert it to a Roth IRA this year. You'll have to pay tax on the amount converted as ordinary income, but subsequent earnings will be free of tax and the decrease in tax rates that are effective this year makes such a conversion less costly than it would have been in previous years. Of course, this option only makes sense if the tax rates when the money is withdrawn from the Roth IRA are anticipated to be higher than the tax rates when the traditional IRA is converted. And if you have a traditional 401(k), 403(b), or 457 plan that includes after-tax contributions, you can generally rollover these after-tax amounts to a Roth IRA with no tax consequences. A rollover of a SIMPLE 401(k) into a Roth IRA may also be available. As with all tax rules, there are qualifications that apply to these rollovers that we should discuss before any actions are taken.

Capital Gains and Losses. If your stock portfolio includes stocks that have lost value since you originally invested and you've decided you want to divest yourself of them, we should evaluate whether you might benefit from selling off appreciated stocks, particularly those that would generate a short-term capital gain, and using the resulting gain to limit your exposure to a long-term capital loss, the deduction of which is limited. And any net capital gain you may reap, will be taxed at the substantially reduced capital gain tax rate.

The tax rate for net capital gain is generally no higher than 15 percent for most taxpayers. Some or all of your net capital gain may be taxed at 0 percent if your income is not above $38,600 (single), $77,200 (joint), or $51,700 (head of household). However, a 20 percent tax rate on net capital gain does apply to the extent that your ordinary taxable income is over $425,800 (single), over $479,000 (joint), $239,500 (married filing separately), or over $452,400 (head of household). There are a few other exceptions where capital gains may be taxed at rates greater than 15 percent: (1) the taxable part of a gain from selling certain qualified small business stock is taxed at a maximum 28 percent rate; (2) net capital gains from selling collectibles (such as coins or art) are taxed at a maximum 28 percent rate; and (3) the portion of certain unrecaptured gain from selling real property is taxed at a maximum 25 percent rate. If you have been involved in any such transactions during the year, we should review your options for reducing the tax on those transactions.

Alternative Minimum Tax. Beginning in 2018, fewer taxpayers will be subject to the alternative minimum tax (AMT) as a result of sharp increases in exemption amounts and higher exemption phaseout levels. Nonetheless, if it looks like you may be subject to the AMT this year, there are certain strategies we should review to see if they may reduce or eliminate the impact of the AMT in your situation. While all taxpayers are eligible for an exemption from the AMT, the amount of the exemption depends on your filing status. For 2018, the exemption amounts for individuals, other than those subject to the kiddie tax, are (1) $109,400 in the case of a joint return or a surviving spouse; (2) $70,300 in the case of an individual who is unmarried and not a surviving spouse; and (3) $54,7000 in the case of a married individual filing a separate return. However, these exemptions are phased out by an amount equal to 25 percent of the amount by which your alternative minimum taxable income (AMTI) exceeds: (1) $1,000,000 in the case of married individuals filing a joint return and surviving spouses and (2) $500,000 in the case of all other individuals.

Certain adjustments to your taxable income for regular tax purposes are not allowed for AMT purposes and will increase your AMTI, thus potentially subjecting you to the AMT. Typical items which may reduce regular income but are not allowed for AMTI purposes include the standard deduction, state and local income taxes, property taxes, interest on a second mortgage where the proceeds from that second mortgage were not used for a qualified purpose (i.e., such as home improvements), and various tax credits. Thus, if you have a substantial increase in any of these items for 2018, but have not previously been subject to the AMT, there is the possibility that you could be subject to the AMT for 2018. If you work from home, one strategy for avoiding the AMT is to allocate part of your mortgage interest or property taxes to your

Schedule C business. To the extent you can claim items on your Schedule C, they will not be added back in calculating AMTI.

Gifting Appreciated Stock. You can reap a large tax benefit by donating appreciated assets, such as stock, to a charity. Generally, the higher the appreciated value of an asset, the bigger the potential value of the tax benefit. Donating appreciated assets not only entitles you to a charitable contribution deduction but you also avoid the capital gains tax that would otherwise be due if you sold the stock. For example, if you own stock with a fair market value of $1,000 that was purchased for $250 and your capital gains tax rate is 15%, the capital gains tax would be $113 ($750 gain x 15%). If you donate that stock instead of selling it, and are in the 24% tax bracket, you get an ordinary income deduction worth $240 ($1,000 FMV x 24%). You also save $150 in capital gains tax that you would otherwise pay if you sold the stock. Thus, the after-tax cost of the gift of appreciated stock is $647 ($1,000 - $240 - $113) compared to the after tax cost of a donation of $1,000 cash which would be $760 ($1,000 - $240). However, it should be noted that a tax deduction for appreciated property is limited to 50 percent of your adjusted gross income.

Additionally, if you have children, particularly college age kids, we should consider if there is any income that can be shifted to them so that the tax on the income is paid at the child's tax rate. One strategy is gifting appreciated stock to the child. Where a child has earned income and the child's income is substantially less than the parent's income, capital gains generated on the stock sale could be taxed at 0 percent rather than a higher capital gains rate applicable to the parent's higher tax bracket.

Reducing Exposure to the 3.8 Percent Net Investment Income Tax. A 3.8 percent tax applies to certain net investment income of individuals with income above a threshold amount. The threshold amounts are $250,000 (married filing jointly and qualifying widow(er) with dependent child), $200,000 (single and head of household), and $125,000 (married filing separately). In general, investment income includes, but is not limited to: interest, dividends, capital gains, rental and royalty income, non-qualified annuities, and income from businesses involved in trading of financial instruments or commodities. Thus, while the top tax rate for qualified dividend income is generally 20 percent, the top rate on such income increases to 23.8 percent for a taxpayer subject to the net investment income tax (NIIT).

If it appears you may be subject to the NIIT, the following actions may help avoid the tax and we should discuss whether any of these options make sense in light of your financial situation.

(1) Donate or gift appreciated property. As discussed above, by donating appreciated property to a charity, you can avoid recognizing the appreciation for income tax purposes and for net investment income tax purposes. Or you may gift the property so that the donee can sell it and report the income. In this case, you'll want to gift the property to individuals that have income below the $200,000 (single) or $250,000 (couples) thresholds.

(2) Replace stocks with state and local bonds. Interest on tax-exempt state and local bonds are exempt from the NIIT. In addition, because such interest income is not included in adjusted gross income, it can help keep you below the threshold for which the NIIT applies.

(3) If you are in the real estate business, we should review the criteria for being classified as a real estate professional. If you meet these requirements, your rental income is considered nonpassive and thus escapes the NIIT.

(4) If you intend to sell any appreciated assets, consider whether the sale can be structured as an installment sale so the gain recognition is spread over several years.

(5) Since capital losses can offset capital gains for NIIT purposes, consider whether it makes sense to sell any losing stocks, but keeping in mind the transaction costs associated with selling stocks.

(6) If you have appreciated real property to dispose of and are not considered a real estate professional, a like-kind exchange may be more advantageous. By deferring the gain recognition, you can avoid recognizing income subject to the NIIT.

Because the NIIT does not apply to a trade or business unless (1) the trade or business is a passive activity with respect to the taxpayer, or (2) the trade or business consists of trading financial instruments or commodities, we may want to look at ways in which a venture you are involved with could qualify as a trade or business. However, such classification could have Form 1099 reporting implications whereas personal payments are not reportable if your activity is not considered a trade or business.

Liability for the .9 Percent Medicare Tax. An additional Medicare tax of 0.9 percent is imposed on wages, compensation, and self-employment income in excess of a threshold amount. The threshold amounts are $250,000 (joint return or surviving spouse), $125,000 (married individual filing a separate return), and $200,000 (all others). However, the threshold amount is reduced (but not below zero) by the amount of the taxpayer's wages. Thus, a single individual who has $145,000 in self-employment income and $130,000 of wages is subject to the .9 percent additional tax on $75,000 of self-employment income ($145,000 - $70,000 (the $200,000 threshold - $130,000 in wages)). No tax deduction is allowed for the additional Medicare tax.

For married couples, employers do not take a spouse's self-employment income or wages into account when calculating Medicare tax withholding for an employee. If you and your spouse will exceed the $250,000 threshold in 2018 and have not made enough tax payments to cover the additional .9 percent tax, you can file Form W-4 with the IRS before year end to have an additional amount deducted from your paycheck to cover the additional .9 percent tax. Otherwise, underpayment of tax penalties may apply.

Foreign Bank Account Reporting. If you have an interest in a foreign bank account, it must be disclosed; failure to do so carries stiff penalties. You must file a Report of Foreign Bank and Financial Accounts (FBAR) if: (1) you are a U.S. resident or a person doing business in the United States; (2) you had one or more financial accounts that exceeded $10,000 during the calendar year; (3) the financial account was in a foreign country; and (4) you had a financial interest in the account or signatory or other authority over the foreign financial account. If you are unclear about the requirements or think they could possibly apply to you, please let me know.

Flex Spending Accounts. Generally, you will lose any amounts remaining in a health flexible spending account at the end of the year unless your employer allows you to use the account until March 15, 2019, in which case you'll have until then. You should check with your employer to see if they give employees the optional grace period to March 15.

Vacation Home Rentals. If you rent out a vacation home that you also use for personal purposes, we should review the number of days it was used for business versus pleasure to see if there are ways to maximize tax savings with respect to that property.

Accelerating Income into 2018. Depending on your projected income for 2018, it may make sense to accelerate income into 2018 if you expect 2019 income to be significantly higher because of increased income or substantially decreased deductions. Options for accelerating income include: (1) harvesting gains from your investment portfolio, keeping in mind the 3.8 percent NIIT; (2) converting a retirement account into a Roth IRA and recognizing the conversion income this year; (3) taking IRA distributions this year rather than next year; (4) if you are self-employed and have clients with receivables on hand, try to get them to pay before year end; and (5) settling any outstanding lawsuits or insurance claims that will generate income this year.

Deferring Income into 2019. If it looks like you may have a significant decrease in income next year, either from a reduction in income or an increase in deductions, it may make sense to defer income into 2019 or later years. Some options for deferring income include: (1) if you are due a year-end bonus, having your employer pay the bonus in January 2019; (2) if you are considering selling assets that will generate a gain, postponing the sale until 2019; (3) if you are considering exercising stock options, delaying the exercise of those options; (4) if you are planning on selling appreciated property, consider an installment sale with larger payments being received in 2019; and (5) consider parking investments in deferred annuities.

Accelerating Deductions into 2018. If you expect a decrease in income next year, accelerating deductions into the current year can offset the higher income this year. Some options include: (1) prepaying property taxes in December, keeping in mind the $10,000 limitation on deducting state income and property taxes; (2) if you owe state income taxes, making up any shortfall in December rather than waiting until your state income tax return is due (and similarly keeping in mind the $10,000 limitation); (3) making January mortgage payment in December; (4) since medical expenses are deductible in 2019 only to the extent they exceed 10 percent of adjusted gross income and because a lower threshold of 7.5 percent applies in 2018, bunching large medical bills not covered by insurance into 2018 to help overcome this threshold; (5) making any large charitable contributions in 2018, rather than 2019; (6) selling some or all loss stocks; and (7) if you qualify for a health savings account, setting one up and making the maximum contribution allowable.

Deferring Deductions into 2019. If you anticipate a substantial increase in taxable income next year, it may be advantageous to push deductions into 2019 by: (1) postponing year-end charitable contributions, property tax payments, and medical and dental expense payments, to the extent deductions are available for such payments, until next year; and (2) postponing the sale of any loss-generating property.

Please call us at your convenience so we can set up an appointment.

Sincerely,

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