Dear Clients and Friends:

Year-end tax planning in 2018 is probably more complicated than it has ever been before. The new tax law enacted late last year—the Tax Cuts and Jobs Act (TCJA)—completely rewrites the federal tax code. This monumental new legislation has a profound effect on both individual taxpayers and businesses of all shapes and sizes.

Among other noteworthy provisions, the TCJA cuts individual tax rates, increases the standard deduction, eliminates personal exemptions and overhauls the rules for itemized deductions. Generally, the changes for individuals take effect in 2018, but are scheduled to "sunset" after 2025. This provides a limited window of opportunity in some instances.

The impact on businesses is just as significant. For starters, the TCJA imposes a flat 21% tax rate on corporations, doubles the maximum Section 179 "expensing" allowance, modifies bonus deprecation rules and repeals deductions for entertainment expenses. Unlike the changes for individuals, most of these provisions are permanent, but could be revised if Congress acts again.

Keeping all that in mind, we have prepared the following 2018 Year-End Tax Letter. For your convenience, the letter is divided into three sections:

- Individual Tax Planning
- Business Tax Planning
- Financial Tax Planning

Be aware that the concepts discussed in this letter are intended to provide only a general overview of year-end tax planning. It is recommended that you review your personal situation with a tax professional.

INDIVIDUAL TAX PLANNING

Standard Deduction/Itemized Deductions

First, the TCJA revamps the graduated tax rate structure for individuals and adjusts the bracket ranges, featuring a top tax rate of 37%, down from 39.6%. Then it effectively doubles the standard deduction to $12,000 for single filers and $24,000 for joint filers, somewhat offsetting the loss of personal exemptions. In conjunction with these changes, the new law reduces the tax benefits of certain itemized deductions, while completely eliminating other tax breaks.

YEAR-END MOVE: With help from your professional tax adviser, figure out if you will be claiming the standard deduction or itemizing deductions in 2018. This analysis will dictate your tax planning approach at the end of the year.

Some of the key TCJA provisions for itemized deductions are as follows:

- The deduction for state and local taxes (SALT) is limited to $10,000 annually. This includes any combination of SALT payments for (1) property taxes and (2) income or sales taxes.
- The deduction for mortgage interest expenses is modified.
- The deduction for casualty and theft losses is eliminated (except for disaster-area losses).
- The deduction for miscellaneous expenses is eliminated.
- The deduction for medical and dental expenses is temporarily enhanced.

Depending on your situation, you may want to accelerate deductible expenses into the current year to offset your 2018 tax liability. However, if you do not expect to itemize in 2018, you might as well postpone these expenses to 2019.

Tip: The TCJA also technically removes the previous reduction of itemized deductions and personal exemptions for high-income taxpayers under the "Pease rule" and Personal Exemption Phaseout (PEP) rule, respectively.

Charitable Donations

Generally, itemizers can deduct amounts donated to qualified charitable organizations if substantiation requirements are met. Note that the TCJA increases the annual deduction limit on monetary contributions to 60% of adjusted gross income (AGI), up from 50% of AGI, among other changes.

YEAR-END MOVE: Absent extenuating circumstances, "bunch" charitable donations in the year they will do you the most tax good. For instance, if you will be itemizing in 2018, you can step up gift giving at the end of the year. Conversely, if you are claiming the standard deduction this year, you may decide to postpone contributions to 2019.

For donations of appreciated property that you have owned longer than one year, you can generally deduct an amount equal to the property's fair market value (FMV). Otherwise, the deduction is limited to your "basis" (i.e., the cost). Also, other special rules may apply to gifts of property. Notably, the annual deduction for property donations generally cannot exceed 30% of AGI.

If you are donating securities to a charity, you might choose those that have appreciated in value. As a result, you can deduct the FMV of the securities while the appreciation remains untaxed forever. More sophisticated arrangements include transfers to charitable remainder trusts (CRTs).

Tip: If you make an online donation in December via credit card, you can write off the donation on your 2018 return—even if you do not actually pay the credit card charge until 2019.

Alternative Minimum Tax

Despite several "patches" in recent years, the alternative minimum tax (AMT) has continued to be a thorn in the side of many moderate-to-high income taxpayers. Briefly stated, the AMT is a complex calculation including certain technical adjustments, inclusion of "tax preference items" and subtraction of an exemption amount (subject to a reduction based on your income). After comparing AMT liability to regular tax liability, you effectively pay the higher of the two.

Now the TCJA provides a major fix by substantially increasing the exemption amounts and the thresholds for the reduction. The chart below shows the exemptions for the last five years.

Filing status	2014	2015	2016	2017	2018
Single filers	$52,800	$53,600	$53,900	$54,300	$70,300
Joint filers	$82,100	$83,400	$83,800	$84,500	$109,400
Married filing separately	$41,050	$41,700	$41,900	$42,250	$54,700

YEAR-END MOVE: Assess your personal situation. If it makes sense, you may then shift certain tax preference items to 2019 to reduce AMT liability for 2018. For instance, you might postpone the exercise of incentive stock options (ISOs) that count as tax preference items.

For 2017, the phaseout reduction equaled 25 cents for each dollar of AMT income above $120,700 for single filers and $160,900 for joint filers. The TCJA hikes the thresholds for 2018 to $500,000 for single filers and $1 million for joint filers.

Tip: The two AMT rates for single and joint filers for 2018 are 26% on AMT income up to $191,500 and 28% on AMT income above this threshold. Note that the top AMT rate is still lower than the new top ordinary income tax rate of 37%.

Medical and Dental Expenses

Prior to the TCJA, taxpayers could deduct unreimbursed medical and dental expenses above 10% of their AGI. But the new law provides some temporary tax relief. Retroactive to 2017, and lasting through 2018, the TCJA lowers the threshold for deducting medical and dental expenses to 7.5% of AGI.

Usually, you have no control over when medical or dental expenses occur. At other times, however, you may be able to schedule elective expenses, such as physical examinations or dental cleanings, to your tax benefit.

YEAR-END MOVE: Move non-emergency expenses into the optimal tax year for your situation. For instance, if you are itemizing and have already surpassed the lower AGI threshold this year, or you expect to clear it soon, accelerate elective expenses into 2018. Otherwise, you might as well delay expenses until 2019, when at least you will have a chance at a deduction.

To qualify for a deduction, the expense must be for the diagnosis, cure, mitigation, treatment or prevention of disease or payments for treatments affecting any structure or function of the body. But any costs for your general health or well-being are nondeductible.

Tip: Count unreimbursed medical and dental expenses paid for your immediate family as well as for other tax dependents, such as an elderly parent or in-law. This might push you above the 7.5%-of-AGI threshold for 2018.

Miscellaneous

- If you pay a child's college tuition bill before 2019, you may qualify for one of two higher education tax credits for 2018, subject to phaseouts based on income. For instance, you might pay tuition in December for the next semester beginning in January. Note that the alternative tuition deduction expired after 2017, although it could be revived again by Congress.

- When appropriate, transfer income-producing property to family members in lower tax brackets. This form of "income-splitting" still makes sense for individuals in the upper tax brackets. But beware of the "kiddie tax" that generally applies to unearned income above $2,100 received in 2018 by a dependent child under age 18 or a full-time student under age 24. Under the TCJA, the kiddie tax is based on the tax rates in effect for estates and trusts, which often will produce a higher tax than it would have under prior law.

- Consider the tax impact of a divorce or separation. The TCJA repeals the deduction for alimony expenses for payors, and the corresponding inclusion in income for recipients, for divorce and separation agreements executed after 2018. Unlike most other changes for individuals, this provision is permanent. Note that deductions may still be available for existing agreements that are modified after 2018.

- With a Section 529 plan, you can set up an account for a child's college education that can grow without any current tax erosion. Payments for qualified expenses are exempt from tax. Beginning in 2018, the TCJA expands the use of 529 plans for tuition payments of up to $10,000 a year for a child's kindergarten, elementary or secondary school education.

- You may be liable for an estimated tax penalty if you fail to pay the required tax during the year. But you can avoid the penalty by paying enough in witholding and/or quarterly installments to satisfy a "safe harbor rule" of 90% of current tax liability or 100% of the previous year's tax liability (110% if your AGI was above $150,000). Usually, it easier to figure out payments based on 100% (or 110%) of last year's tax liability.

BUSINESS TAX PLANNING

Section 179 Deductions

Under Section 179 of the tax code, a business may "expense" (i.e., currently deduct) the cost of qualified property placed in service during the year. The maximum annual deduction is phased out on a dollar-for-dollar basis above a specified threshold.

The maximum Section 179 allowance has been raised over the last decade to $500,000, indexed for inflation. At the same time, the phaseout threshold was increased. Now the TCJA doubles the maximum allowance to $1 million with a $2.5 million phaseout threshold for 2018. The progression is shown below.

Tax year	Deduction limit	Phaseout threshold
2007	$125,000	$500,000
2008–2009	$250,000	$800,000
2010–2015	$500,000	$2 million
2016	$500,000	$2.01 million
2017	$510,000	$2.03 million
2018	$1 million	$2.5 million

YEAR-END MOVE: Make sure qualified property is "placed in service" before the end of the year. In other words, actually start using it. This will help maximize your annual deduction.

However, note that the Section 179 deduction cannot exceed the taxable income from all your business activities this year. This could limit your deduction for 2018.

Tip: Depreciation deductions may still be available for costs that cannot be expensed under Section 179. For instance, you may be able to benefit from "bonus depreciation" for qualified property.

Bonus Depreciation

Generally, a business may claim regular depreciation deductions for qualified property over a specified cost recovery period. In addition, recent tax legislation authorized "bonus" depreciation for qualified property placed in service during the year.

Under the TCJA, the previous 50% bonus depreciation deduction tax break is generally doubled from 50% to 100% for property placed in service after September 27, 2017.

YEAR-END MOVE: Maximize the benefits of 100% bonus depreciation. Factor in all the tax ramifications for your business before purchasing property at the end of the year.

Note that the TCJA gradually phases out bonus depreciation after 2022. This tax break is scheduled to disappear completely after 2026.

Tip: The TCJA expands the definition of qualified property for this purpose to include used, not just new, property.

Travel and Entertainment Expenses

The tax rules for travel and entertainment (T&E) expenses are fraught with numerous twists and turns. On one hand, you can continue to deduct expenses for travel and meal expenses while you are away from home on business, subject to certain limits. On the other hand, the TCJA repeals the deduction for entertainment expenses, beginning in 2018.

YEAR-END MOVE: Schedule business trips for the end of 2018. If you meet the strict substantiation requirements, you may deduct 100% of your travel costs and 50% of meal costs for amounts paid or incurred this year.

Generally, you can deduct reasonable costs of traveling away from home on business, including airfare and lodging. But the primary purpose of the trip must be business-related. It cannot be a disguised vacation.

If you travel by car, you may be able to deduct your actual expenses, including a depreciation allowance, or opt for the standard mileage deduction. The standard mileage rate for 2018 is 54.5 cents per business mile (plus tolls and parking fees). Annual depreciation deductions for "luxury cars" are limited, but the TCJA generally enhances those deductions for vehicles placed in service in 2018 and thereafter.

Prior to the TCJA, you could deduct 50% of your entertainment costs that were "directly-related-to" or "associated-with" your business. The entertainment deduction is no longer available. However, a new ruling issued by the IRS this year clarifies that you can continue to deduct the cost of food and beverages that is invoiced separately from the cost of entertainment activities. This might apply to expenses incurred when you treat a customer or client to tickets to a sporting event.

Tip: Despite the new law changes, you may deduct 100% of a holiday party as long as the entire workforce is invited.

Business Bad Debts
If your business is having difficulty obtaining payments for goods or services it provides, there may be a way to salvage some tax relief on your 2018 return.

YEAR-END MOVE: Step up your collection activities before 2019. For instance, you may issue a series of dunning letters to debtors asking for payment. If you are still unable to collect the unpaid amount, you can generally write off the debt as a business bad debt in 2018.

As a general rule, business bad debts are deducted from taxable income in the year they become worthless. To qualify as a business bad debt, a loan or advance must have been created or acquired in connection with your business operation and result in a loss to the business entity if it cannot be repaid.

Tip: Keep detailed records of all your collection activities—including letters, telephone calls, e-mails and efforts of collection agencies—in your files. This documentation can help support your position claiming worthlessness of the debt if the IRS ever challenges the bad debt deduction.

Business Start-up Expenses
The tax law allows a small-business owner to claim a first-year deduction of up to $5,000 for qualified start-up costs. Any remaining expenses must be amortized over 180 months. However, the $5,000 write-off is phased out for start-up costs exceeding $50,000.

YEAR-END MOVE: Make sure you are officially "open for business" before the end of the year. Otherwise, you cannot claim the current $5,000 deduction on your 2018 return.

Generally, start-up costs are expenses that would be deductible as business expenses. This includes investigatory expenses such as the following:

- An analysis of potential markets, products, labor supply, transportation facilities, etc.
- Advertisements for the opening of the business.
- Salaries and wages for employees who are being trained and those instructing them.
- Travel costs to secure prospective distributors, suppliers, customers or clients.
- Salaries and fees for executives and consultants or similar professional services.

Tip: If it suits your purposes, you can elect to have all business start-up costs amortized over 180 months. This may be preferable for an entrepreneur expecting a low tax liability in 2018.

Miscellaneous

- The TCJA creates a new deduction for up to 20% of the "qualified business income" (QBI) of pass-through entities, including sole proprietorships. But the deduction is phased out for many high-income taxpayers, especially those in personal service businesses. With assistance from your tax adviser, stay below the income thresholds, when possible.

- Stock the shelves with routine business supplies before the end of the year. Usually, your company can deduct the costs in 2018, even if all the supplies are not used until 2019.

- If you buy a heavy-duty SUV or van for business, you may claim a first-year Section 179 allowance of up to $25,000. The "luxury car" limits do not apply to certain heavy-duty vehicles.

- Generally, repairs are currently deductible, while capital improvements must be depreciated over time. Therefore, make minor repairs before 2019 to increase your 2018 deduction.

- If you pay year-end bonuses to employees in 2018, the bonuses are generally deductible by your company and taxable to the employees in 2018. A calendar-year company operating on the accrual basis may be able to deduct bonuses paid as late as March 15, 2019 on its 2018 return.

- Beginning in 2018, the TCJA limits the current deduction for business interest to 30% of adjusted taxable income. But a qualified small business with average annual receipts for the last three years of $25 million or less is exempt. Try to squeeze under this threshold.

- A business may qualify for an up-to-25% credit for paid family and medical leaves of up to 12 weeks. This credit, which only applies for wages paid to employees earning no more than $72,000 annually, expires after 2019.

FINANCIAL TAX PLANNING

Capital Gains and Losses/Dividends

Frequently, investors time sales of securities at year-end to produce optimal tax results. For starters, capital gains and losses offset each other. If you show an excess loss for the year, it then offsets up to $3,000 of ordinary income before being carried over to the next year. Long-term capital gains from sales of securities owned longer than one year are taxed at a maximum rate of 15% or 20% for certain high-income investors. Conversely, short-term capital gains are taxed at ordinary income rates reaching up to 37% in 2018.

YEAR-END MOVE: Review your investment portfolio to target "winners" and "losers." Depending on your situation, you may harvest capital losses to offset gains realized earlier in the year or cherry-pick capital gains that will be partially or wholly absorbed by prior losses.

Be aware of even more favorable tax treatment for certain long-term capital gains. Notably, a 0% rate applies to taxpayers below certain income levels, such as a young child. Furthermore, some taxpayers who ultimately pay ordinary income tax at higher rates due to their investments may qualify for the 0% tax rate on a portion of their long-term capital gains.

The 0%/15%/ 20% rate structure for long-term capital gains also applies to qualified dividends. These are dividends paid by U.S. companies or qualified foreign companies.

Tip: The TCJA retains the breakpoints for capital gains and qualified dividends in effect for 2017. Therefore, investors may be operating under two sets of tax rate structures this year. Seek guidance from your financial and tax advisers.

Net Investment Income Tax

Besides capital gains tax, an extra 3.8% tax applies to the lesser of your "net investment income" (NII) or the amount by which your modified adjusted gross income (MAGI) for the year exceeds $200,000 for single filers and $250,000 for joint filers. (These amounts are not indexed for inflation.) The definition of NII includes interest, dividends, capital gains and income from passive activities, but not Social Security benefits, tax-exempt interest and distributions from qualified retirement plans and IRAs.

YEAR-END MOVE: Where it is feasible, reduce your NII tax liability in 2018, or avoid it altogether. This requires you to assess the amount of both your NII and your MAGI at the end of the year. Then you can act accordingly

For example, you might add municipal bonds ("munis") to your portfolio. Interest income from munis does not count as NII, nor is it included in the calculation of MAGI. Similarly, if you turn a passive activity into an active business, the resulting income may be exempt from the NII tax. These rules are complex, so obtain professional assistance.

Tip: When you add the NII tax to your regular tax plus any applicable state income tax, the overall rate may approach or even exceed 50%. Factor this into your investment decisions.

Estate and Gift Taxes

During this century, Congress has gradually increased the estate tax exemption, while reducing the top estate tax rate. At one point, the estate tax was repealed, but only for 2010, while the unified estate and gift tax exclusion was severed and then reunified. Now the TCJA doubles the exemption from $5 million to $10 million, inflation-indexed to $11.18 million in 2018. The table below shows the progression of the estate tax exemption and top estate tax rate.

Tax year	Maximum estate tax exemption	Top estate tax rate
2002	$1 million	50%
2003	$1 million	49%
2004	$1.5 million	48%
2005	$1.5 million	47%
2006	$2 million	46%
2007–2008	$2 million	45%
2009	$3.5 million	45%
2010	Not applicable	Repealed
2011	$5 million	35%
2012	$5.12 million	35%
2013	$5.25 million	40%
2014	$5.34 million	40%
2015	$5.43 million	40%
2016	$5.45 million	40%
2017	$5.49 million	40%
2018	$11.18 million	40%

YEAR-END MOVE: Update your estate plan to reflect existing law. For instance, wills and trusts may be revised to accommodate the rule allowing portability of the estate tax exemption.

Note that under the "portability" provision for a married couple, the unused portion of the estate tax exemption of the first spouse to die may be carried over to the estate of the surviving spouse. This tax break is now a permanent part of the tax code.

Tip: With the gift tax exclusion, you can give each recipient up $15,000 (up from $14,000 in 2017) without paying any federal gift tax. This exclusion is effectively doubled to $30,000 for joint gifts by a married couple. Such gifts reduce the size of your taxable estate.

Required Minimum Distributions

As a general rule, you must receive required minimum distributions (RMDs) from qualified retirement plans and IRAs after reaching age 70½. The amount of the distribution is based on IRS-approved life expectancy tables and your account balance at the end of last year.

YEAR-END MOVE: Arrange to receive RMDs before the December 31 deadline. Otherwise, you will have to pay a stiff tax penalty equal to 50% of the required amount (less any amount you have received), in addition to the regular tax liability.

However, if you are still working and do not own 5% or more of the business employing you, you can postpone RMDs from the employer's qualified plan until you retire. This "still working exception" does not apply to RMDs from IRAs or plans of employers where you do not work.

Tip: RMDs are not treated as NII for purposes of the 3.8% tax. Nevertheless, an RMD may still increase your MAGI used in the NII tax calculation.

Roth IRA Conversions

Although contributions to traditional IRAs may be tax-deductible, deductions are phased out for active participants in employer-sponsored retirement plans. Future distributions are taxed at ordinary income rates, currently reaching up to 37%. Conversely, Roth IRA contributions are never tax-deductible, but qualified distributions from a Roth IRA in existence at least five years are 100% tax-free. Taxation of other distributions is based on special "ordering rules."

YEAR-END MOVE: Figure out if a Roth conversion makes sense this year. Although the transfer is currently taxable, it can provide future tax-free benefits. A conversion is especially advantageous if you expect to be in a higher tax bracket in your retirement years than you are now.

Nevertheless, a Roth IRA conversion increases your MAGI for purposes of the NII tax. To reduce your overall tax liability, you might arrange a series of Roth IRA conversions over several years instead of converting all the funds this year. Manage your tax brackets accordingly.

Tip: The TCJA removes the ability to "recharacterize" a Roth conversion back into a traditional IRA if the value of the assets declines after the conversion. Essentially, it means that you have "overpaid" the tax. This crackdown is generally effective for 2018 and thereafter.

Miscellaneous

- Sell real estate on an installment basis. For payments over two years or more, you can defer tax on a portion of the sales price. Also, this may effectively reduce your overall tax liability.
- Contribute up to $18,500 to a 401(k) in 2018 ($24,500 if you are age 50 or older). If you clear the 2018 Social Security wage base of $128,400 and promptly allocate the payroll tax savings to a 401(k), you can increase your deferral without any further reduction in your take-home pay.
- Watch out for the "wash sale" rule. If you sell securities at a loss and reacquire substantially identical securities within 30 days of the sale, the tax loss is disallowed. An easy way to avoid this result is to wait at least 31 days to buy back the same or similar securities.
- If you are age 70½ or older, transfer IRA funds directly to a charity. Although the contribution is not deductible, the distribution is not subject to tax and counts as an RMD.

CONCLUSION

This year-end tax-planning letter is based on the prevailing federal tax laws, rules and regulations. Of course, it is subject to change, especially if additional tax legislation is enacted by Congress before the end of the year.

Finally, remember that this letter is intended to serve only as a general guideline. Your personal circumstances will likely require careful examination. We would be glad to schedule a meeting with you to assist with all your tax-planning needs.

Very truly yours,

Harper & Pearson Company, P.C.