

Individual Tax Planning for 2019 and the Future

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Major Changes of 2017 Tax Act on Individuals

- Lower tax rates until end of 2025
- Highest tax rate reduced from 39.6% to 37%
- Increased standard deduction
 - \$12,200 for single and \$24,400 for married couples in 2019
 - For 2020, increase of \$200 for singles and \$400 for married couples
- Reduced itemized deductions
 - \$10,000 cap on deduction for state income tax/property tax
 - Remaining common deductions are mortgage interest and charity
 - A few take deductions for medical expenses
- Personal exemptions eliminated in favor of child tax credits

Projected Impact of 2017 Tax Act

- Economic Impact
 - Total cost of tax bill over 10 years \$1.457 trillion
 - Positive impact on GDP (0.451) trillion
 - Net cost of 2017 Tax Act \$1.066 trillion
- Tax Policy Center projected that average individual would receive federal tax cut of \$1,260

Tax Surprises When Filing 2018 Tax Returns

- Surprise when individuals filed 2018 tax returns
 - Refunds shrunk
 - Withholding tables not adjusted promptly
- Don't get surprised two years in a row – check withholding and need for estimated tax payments before year-end

Impact of 2017 Tax Act on WB Clients

- Average federal tax rate of WB individual clients
 - Decrease from 28% average rate on 2017 returns to 26% on 2018 returns
 - Note that many WB clients are investors earning dividends and capital gains for which the tax rate did not change
- Alternative minimum tax
 - On 2017 individual tax returns, 31% of WB clients paid AMT
 - On 2018 individual tax returns, only 3% of WB clients paid AMT
 - AMT tax paid declined 86%

Harvesting Capital Gains

- Advisable if expect to be in higher tax bracket in future
- Trade-off between lower tax rate but accelerate payment of tax
- Capital gains are taxed at 0% federal tax rates for taxpayers with taxable income not greater than two lowest brackets, 10% and 12%

Harvesting Capital Losses

- Offsets capital gains and \$3,000 per year of other income
- Difficulty in finding loss assets due to strong economy?
- Wash sale rules prevent deduction of loss if there is a repurchase of substantially similar security within 30 days before or after the sale
- Produces timing benefit

Opportunity Zones: Investor Tax Incentives

Temporary
deferral of
current
capital gains
(until
12/31/2026)

Step up in
basis of
capital gain
(up to 15%)

Permanent
exclusion on
opportunity
zone
investment
gains

Opportunity Zones: Comparison of Returns

TRADITIONAL PORTFOLIO INVESTMENT		QOF INVESTMENT	
Original Gain: \$200,000 LTCG Tax Rate of 20% 10% Annual Appreciation		Original Gain \$200,000 LTCG Tax Rate of 20% 10% Annual Appreciation	
Original gain	\$200,000	Original gain	\$200,000
Tax on gain in year of sale	20%	Tax on gain in year of sale	0%
Tax paid on original gain	(40,000)	Amount Reinvested	\$200,000
Amount Reinvested	\$160,000		
Value after 10 years	\$415,000	Value after 10 years	\$518,750
Less tax on appreciation	(51,000)	Less tax on deferred gain*	(34,000)
Net Return	\$364,000	Less tax on appreciation	0
		Net Return	\$484,750
		<small>*After 15% Step-Up in Basis not adjusted for TMV of \$.</small>	
ROI – 82%		ROI – 142%	

Section 1202 Stock – Saving Tax on Sale

- 100% gain exclusion on sale of qualified small business stock and no AMT preference if stock acquired after 9/27/2010; holding period must be more than 5 years
- Stock must be acquired at original issue in exchange for services rendered or for money
- Company must be a C corporation
- Company must be qualified small business in which gross assets are \$50 million or less at any time from 8/10/1993 to immediately after issuance of stock

Sec. 1202 Stock – Qualifying Companies

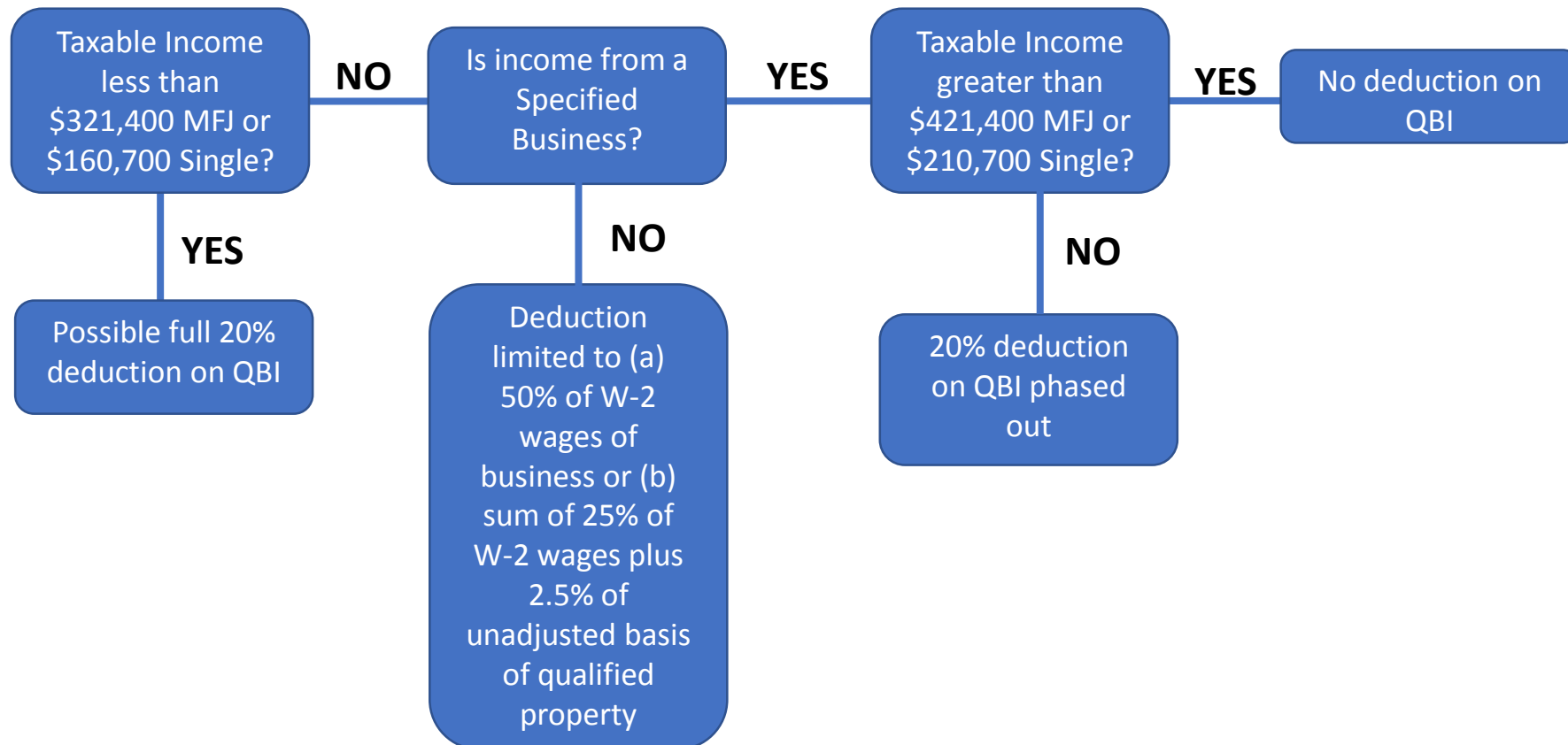
- Corporation must meet an active business requirement test during substantially all of shareholder's holding period
- 80% or more of corporate assets must be used in a business other than ineligible businesses such as health, law, engineering, accounting, bank, farming, mineral extraction, hotels, and restaurants

Deferring Capital Gains Tax – Sale of a Business

- An installment sale is a sale in which the seller pays an asset to another person in exchange for a promissory note
- Not available for sale of publicly held stock
- Frequently used in sale of privately held businesses
- Taxable gain recognized by the seller is deferred until payments are made on principal of the note
- Consider an installment sale of a family business to children, followed by a sale 2 years and 1 day later by the children

Section 199A Planning

Pass-Through Deduction



Section 199A – Managing Income

- Connor is a married physician and is the sole owner of an S corporation that operates his medical practice
- For 2019, Connor earns wages of \$150K and has pass-through income of \$400K
- Connor has no income from other sources
- Since he is a physician, Connor works in a specified service trade or business and cannot take a Section 199A deduction unless his taxable income is less than \$321,400

Section 199A – Managing Income

W-2 Income	\$ 150,000
Pass through income	\$ 400,000
Defined benefit or cash balance plan contribution	\$(150,000)
Oil & gas partnership	\$ (50,000)
Contribution to donor advised fund	<u>\$ (30,000)</u>
Taxable income	<u><u>\$ 320,000</u></u>

SECURE Act

- In May 2019, bill passed House by vote of 417 - 3
- Still pending in Senate
- Raises required age at which must begin taking IRA minimum distributions to age 72 from current age 70 ½
- Limits on “stretch IRA” strategy
 - Applies to inherited IRAs
 - Currently, beneficiary can stretch distributions over his/her life expectancy
 - Change is that funds must be withdrawn within 10 years after the death of the original IRA owner

Maximizing Retirement Plan Contributions

	<u>2019 Limit</u>	<u>2020 Increase</u>
401(k) contribution	\$19,000	\$ 500
Catch-up 401(k) contribution (over age 50)	\$ 6,000	\$ 500
IRA	\$ 6,000	\$ 0
Catch-up IRA contribution (over age 50)	\$ 1,000	\$ 0
SIMPLE IRA contribution	\$13,000	\$ 500
Catch-up SIMPLE IRA contribution (over age 50)	\$ 3,000	\$ 0
Overall limit on defined contribution plans	\$56,000	\$1,000
Health savings account (single)	\$ 3,500	\$ 50
Health savings account (married)	\$ 7,000	\$ 100
Catch-up HSA contribution (over age 55)	\$ 1,000	\$ 0

Back Door Roth IRA Contributions

- Income limits to make Roth IRA contribution
 - Singles – modified AGI of \$122K - \$137K for 2019
 - Married couples – modified AGI of \$193K - \$203K for 2019
- Steps to achieve back door Roth contribution
 - Make non-deductible IRA contribution
 - Immediately roll over non-deductible IRA contribution into Roth IRA
- If no traditional pre-tax IRA, roll over has no tax consequences as long as non-deductible IRA contribution had no earnings before roll over

Back Door Roth IRA – Beware!

- If individual owns pre-tax IRAs, the conversion of the non-deductible contribution to a Roth IRA is not completely tax-free.
- Example: Sam makes a \$6,000 non-deductible IRA contribution in 2019 and immediately rolls this contribution into Roth IRA. Sam owns pre-tax IRAs valued at \$60,000. Only 9% (\$6,000 divided by \$66,000) of his conversion is tax-free; the other 91% is taxable.
- Planning idea – What if Sam participates in a 401(k) plan that allows him to roll his pre-tax IRAs into the 401(k) plan?

Charitable Giving – Maximizing Tax Benefits

- If taxpayer takes standard deduction, no tax benefit from charitable giving
- Bunch several years of contributions into a single year
- Donation of long-term publicly held appreciated assets
 - Limited to 30% of adjusted gross income for gifts to public charities
 - 20% limit for gifts of publicly held stock to private foundation
 - Beware cost basis limits for donations of non-publicly held assets

Charitable IRA Rollover

- Also called qualified charitable distribution (QCD)
- Taxpayers who are at least 70 ½ can give up to \$100,000 from their IRA to public charity
- Private foundations and donor advised funds are ineligible to receive gift
- No income or deduction
- Cannot receive anything in exchange for contribution (no chicken dinners!)
- Can use to satisfy outstanding charitable pledge
- Useful for those who do not itemize deductions, those keeping their AGI down to save on Medicare premiums, and those whose charitable giving exceeds limits

Charitable Giving – Donor Advised Funds

- National Philanthropic Trust's *2019 Donor-Advised Fund Report*
- In past 5 years, number of DAFs in United States has tripled
- Assets in DAFs exceed \$120 billion
- Annual Grants from DAFs to charities doubled in 5 years and now exceed \$23 billion
- Helpful to those who want to “bunch” itemized deductions
- Useful in sale of business, where donor has charitable intent but has not yet decided on where to give
- Avoids costs and administration of private foundation

Current Estate and Gift Tax Structure

- Estate/Gift Tax Exemption
 - \$11.4 million per person (\$22.8 million for married couple) in 2019
 - In 2020, exemption increases to \$11.58 million per person, allowing each person to protect an additional \$180,000 (\$360,000 for a couple)
- In 2026, exemption decreases to projected amount of \$6.75 million per person (exact # depends on inflation)
- Continue with 40% tax rate
- Basis set up remains

Current Unlimited Estate and Gift Transfers

- Gift Tax Annual Exclusion
 - Limit is \$15,000 per donee per year
 - Amount is unchanged for 2020
- Unlimited gifts for medical care and tuition, **paid directly**

Maximizing Basis Step-Up

- Assets That Benefit the Most from a Step-Up in Basis
 - Zero or low cost basis property
 - Collectibles
 - Negative basis assets (e.g. real estate LLC interests)
 - Assets likely to be sold soon after step-up
 - Assets that can be depreciated
 - Assets that provide basis for owners of pass-through entities

Maximizing Basis Step-Up

- Assets with Least Tax Benefit from Basis Step-Up
 - High basis assets including cash
 - Qualified plan assets such as pre-tax IRAs and 401(k) plans
 - Assets with income in respect of a decedent such as deferred compensation

Georgia Tax Rates

- For 2018 and previous years, top rate was 6%
- For 2019, top rate is 5.75% – expires 12/31/2025
- For 2020, top rate is 5.5% if passed by joint resolution of Georgia legislature and governor during 2020 legislative session

Georgia Film Credits

- Tax incentives introduced in 2002 and strengthened in 2008
- \$800 million of credits issued in 2018, 3% of State of Georgia's budget
- Supply of credits is up and prices are down
- Average price paid by Windham Brannon clients during
 - 2018 – 90.1 cents per dollar
 - 2019 – 88.9 cents per dollar
- Best credits
 - Comfort letter from CPA firm or audited by Georgia Department of Revenue
 - Guarantees from production company or broker
- Consider skipping Georgia withholding and estimated tax payments

Georgia Low Income Housing Tax Credits

- Program established in 2000
- Taxpayer invests in a partnership; receives Schedule K-1 with credits
- Credits can be recaptured
- Pricing for recent transactions
 - Early purchase of 1-year strip at 86 cents
 - Later purchase of 1-year strip at 88 cents, with IRR of 14%
 - 5-year strip at 81 cents, with IRR of 12%

Georgia Credit for Taxes Paid to Other States

- States are lowering thresholds for amount of business activity which require a person to file income tax return in that state
- If Georgia resident, the person gets a tax credit for taxes paid to other states
- Full credit if that state's tax rate is lower than Georgia's rate
- Credit is limited to Georgia tax on income if other state's rate is higher than Georgia's
- Decrease in Georgia tax rates will make it more difficult to fully use credit

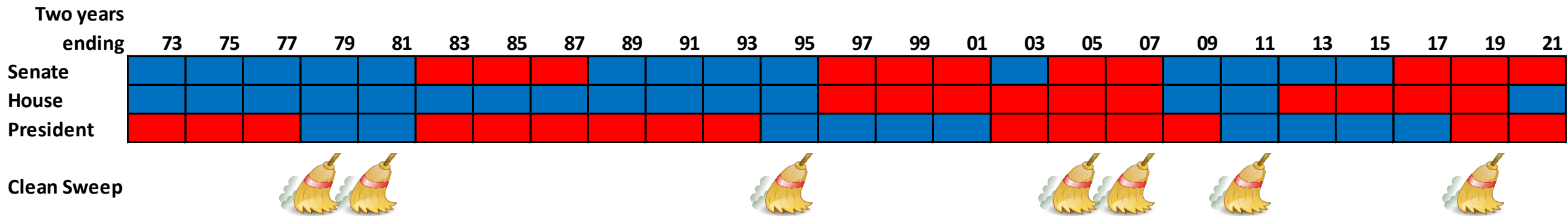
Georgia – Education and Rural Hospital Credits

- Tax law previously allowed a Georgia tax credit and a federal tax deduction for contributions to Georgia qualified education expense credit programs (such as Georgia GOAL and Apogee) and rural hospital tax credit programs (such as Georgia HEART)
- Under old rules, tax benefit from contributions exceeded the amount of the contributions
- New federal rules eliminate federal tax deduction for contributions to these programs
- Participating in programs under new rules provide tax benefit equal to contribution

Composition of 116th Congress

- Senate
 - 45 Democrats
 - 53 Republicans
 - 2 Independents who caucus with Democrats
- House
 - 235 Democrats
 - 198 Republicans
 - 2 Vacancies

Political Parties of President and Congress



Impact of 2020 Elections on Tax Planning

- 2020 Presidential and Congressional elections are 316 days away – November 3, 2020
- What is the impact on tax planning if there is a “blue wave”?
- Acting between November 2020 and January 2021

Increasing Income Tax Rates?

- If income tax rates increase in 2021, consider accelerating income into 2020
 - Roth IRA conversions
 - Bonuses and deferred compensation
 - Capital gains
 - Business income
- Delay of deductions until 2021
 - Charitable contributions – use of donor advised fund
 - Purchase of depreciable fixed assets, but watch end of bonus depreciation

Estate and Gift Tax Planning

- Lower exemption – \$11.58 million per person in 2020 to \$3 million per person?
- Gifting to use higher exemption before law change will not be “clawed back”
- Use of both spouses’ higher exemptions
- What if couple can only afford to use one person’s higher exemption (need enough money to live on); do not gift split

Other Tax Increases

- Increasing cap on Social Security tax
 - Currently 6.2% on both employer and employee, on compensation of up to \$132,900 for 2019 (\$136,800 for 2020)
- Wealth tax
 - Senator Warren – 2% annual tax on net worth over \$350 million and 6% tax on net worth over \$1 billion
 - Senator Sanders – 1% annual tax on net worth over \$32 million, reaching 8% tax net worth over \$10 billion



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