Year-End Tax Planning

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The holidays are coming and people start thinking about year-end moves to minimize their taxes. Every day between Christmas and New Year's Day we field a zillion questions on year-end tax planning. While some ideas are great, there are pitfalls and sucker-holes. We'll talk about tax deductions in general. We'll talk about last-minute tax moves. And Yes, we'll talk about automobiles. They always seems to top the list of good ideas (or at least most business owners think so). First, let's chat about the recent 2017 Tax Cuts & Jobs Act reform and how it applies to 2019.

SALT Deductions

The deduction for what you pay in state and local income, sales and property taxes is also getting squeezed. This is commonly referred to as SALT deductions (State And Local Tax). People commonly say SALT deductions and property taxes. Property taxes are inclusive of state and local tax… it is like saying drugs and alcohol. Alcohol is a drug. SALT deductions include all taxes imposed by your state or local jurisdiction. This was defined as such by the Revenue Act of 1913 and later clarified in 1964. Riveting. But somehow we've managed to say SALT deductions and property taxes as separate items. At least it is not as bad as saying ATM Machine or ABS Brakes. Who says that? We digress…

Starting in 2018, the new law sets a $10,000 limit on how much you can deduct of the state and local taxes you pay. In 2017 there was a way around this by paying your property taxes early (versus pre-paying them), but that was a one and done tax arbitrage.

Another thing states are doing is taxing business owners for income tax and then giving them a credit on their individual tax returns to avoid the SALT limit. Huh? A business owner would pay an income tax on his or her business tax return for the state and get a deduction on the same tax return, and then get this as a credit on his or her federal income tax return. Therefore, income tax is being deducted on the business income tax return for the state and only property taxes are deducted on the federal income tax return.

Medical Expenses

To deduct qualified medical expenses, you must be able to itemize your deductions and exceed 10% of your adjusted gross income (AGI). This 10% was 7.5% for 2017 and 2018, but now it is 10% for all people, all ages.

Section 199A Qualified Business Income Deduction

This was a big win for small businesses where owners can now deduct 20% of their net business income from their tax returns. There are all kinds of rules… controversy… and confusion. The IRS also came out in August of 2018 with **Proposed Regulations 1.199A** which expand on a bunch of things including specified service trade or business definitions. A lot of these proposed regulations were adopted as final regulations in January 2019.

If you are a small business owner and need to know how the tax reform and specific Section 199A deductions affect you, you need to read our summary of that portion as well-

100% Bonus Depreciation

Let's talk about the Hummer Loophole since that is where most taxpayer confusion comes from. Yes, at some point, long ago, in a galaxy far far away, businesses could buy heavy trucks and deduct them 100%. Was this a loophole of sorts? **Yes.** Does Congress and the IRS like loopholes? **Not really**, unless it benefits them. Did Congress and the Joint Committee on Taxation change the Hummer Loophole? **Yes**. How does the Tax Cuts and Jobs Act of 2017 change this? That F-150 pickup truck or the big bucks crossover that weighs over 6,000 pounds theoretically has no limit for first-year depreciation under Section 179 and 100% Bonus Depreciation. The Hummer Loophole is back. So there you go. The problem still remains with luxury passenger vehicles weighing under 6,000. Those limits are $18,000 for the first year under **Section 280F** and there are problems in subsequent years that we don't want to bore you with, but if you want to read **IRS Rev. Proc. 2011-21** for nauseating examples, then go for it.

2019 tax brackets

RATE	SINGLE FILERS	MARRIED FILERS
10%	$0 – $9,700	$0 – $19,400
12%	$9,701 – $39,475	$19,401 – $78,950
22%	$39,476 – $84,200	$78,951 – $168,400
24%	$84,201 – $160,725	$168,401 – $321,450
32%	$160,726 – $204,100	$321,451 – $408,200
35%	$204,101 – $510,300	$408,201 – $612,350
37%	$510,301+	$612,351+
	Standard Deduction: $12,200 Personal Exemption: Eliminated	Standard Deduction: $24,400 Personal Exemption: Eliminated

Source: IRS

Insider Inc.

Marginal Tax Rates

Quick lesson on tax deductions. When you write a check and it has a tax savings element (401k, IRA, charity, etc.) it is not a dollar for dollar savings. For example, if you are in the 22% marginal tax bracket, you must write a check for $4,000 just to save $880 in taxes. Keep this in mind as you read this information on year-end tax savings. Also keep in mind that cash is king, and that perhaps paying a few more taxes today with the added flexibility of cash in the bank can be comforting. Another way to look at this is this- most people say “I want to save taxes” but really what they are saying is “I want to save cash.” In other words, **most people are in the cash-saving business** not the tax-saving business. If we can do both, great. However, most tax-savings moves take cash, and cash is what you want to keep. So keep this concept in mind as review some of the year end tax moves listed below.

Building Wealth

At the end of your life, you’ll measure your financial success on the wealth you built not the tax you saved. We agree that a part of wealth building includes tax savings, but be careful not to sacrifice wealth for the thrill of a tax deduction (or deferral). Here is an example- let’s say you stuff all your available cash into a tax-advantaged retirement account such a 401k. A few years go by and a great rental comes on the market but your cash is all tied up in a 401k. So, you sacrificed potential building of wealth by not having an intermediate investment strategy for the sake of tax deferrals.

The Trick

Here’s the trick. The Holy Grail if you will. You need to find a way to deduct money you are already spending. Read that again. For example, if you have a travel budget then you are already comfortable with a certain amount of money leaving your person, let’s find a way to deduct it. Automobile depreciation? Same thing. You are already comfortable with automobiles losing thousands of dollars in value especially in the early years, so let’s a find a way to make this degradation in value a tax windfall.The button above is Chapter 11 labeled Tax Deductions and Fringe Benefits which is an excerpt from **our book**. These examples are more aimed at small business owners, but there might be some things you can do on your individual tax return. Remember that the greatest trick the devil ever pulled was convincing the world he didn’t exist. The second greatest trick was finding a way to deduct the expense. You gotta love The Usual Suspects. Classic!

Next Year

Another consideration is your income in 2018 versus 2019. If you are going to have a better year in 2019, then delay your tax deduction until January 1. Why pile on tax deductions in a low income year? Silly. Conversely, if 2018 is unusually high, then Yes, pile on those tax deductions. Either way, have a plan! Don’t be shortsighted. Don’t save taxes just because you can- make sure it is the right move.

Refund Kept by the IRS

Some taxpayers have their refunds kept by the IRS because of back taxes, or other obligations such as student loans. In these situations, you can put yourself in a “tax due” position by decreasing your withholdings on your pay checks and putting more money in your pocket today. Yes, you will still owe whatever it is you owe, but at least the extra cash you pay in the form of excess income taxes withheld won’t be used to accelerate your debt payoff.

401k / IRA

The simplest way to save taxes is to contribute to your 401k plan or traditional IRA. You saves taxes and pay yourself in the meantime. Remember this as well- this is an IOU to the IRS. When you retire and are forced to withdraw this money, you will be taxed on it. IRA and Roth IRA contributions are due **Monday, April 15, 2019** (the typical filing deadline for individual tax returns Form 1040), no exceptions. **Business owners-** SEP IRAs are old school. Lousy contribution limits. No Roth options. A 401k plan is much better. Ask how we can help. **Roth conversions-** perhaps you should have us review the conversion of your traditional IRA into a Roth IRA. Yes, pay more taxes today, but perhaps your 2018 income is lower and it makes sense. Or your income is on a rocket trajectory, and this year is the only year it makes sense. Remember that it is usually easier to pay for taxes during your wage-earning years than when you are 80 years old and only have savings to "dip into."

Charity

Writing a check to your church is good. Don't forget the theater, educational organizations, and others. Also, what is not just good, but actually great, is donating to **Goodwill,** Salvation Army, Arc Thrift, etc. Donating items from the hollows of your closet doesn't require cash since that money is already spent. Keep in mind that some states, such as Arizona, offer huge tax credits (much better than tax deductions) for donations to schools and charities.

Profit Harvesting

Need some cash? Sell some of your profitable stocks along with your dogs. Not literally your dogs, but your under-performing stocks. Sell enough stock to create a $3,000 gain and sell some more to add a $6,000 loss, and presto! You've pulled out some cash and create a $3,000 loss and tax deduction.

Pay Bills Earlier

You can pay some bills early such as property taxes, child care, tuition (possibly) and other deductions. Even for business owners, you can pre-pay rent up to 12 months, insurance, stock up on some office supplies, etc.

Automobiles

What a beautiful color! 2017 Porsche 911 in Carmine Red. Someday. Ok. Here we are on everyone's favorite topic. Buckle up… A question we entertain almost daily is "I want to save taxes. Should I have the company buy me a car?" Our auto-attendant replies with, "Do you need a car?" If you answer with "Yes" the auto-attendant replies with, "Hold please." If your "Yes" is not quick or mumbled, or if there is any recognition of hesitation, the auto-attendant is unhappy and will send you to our call center in Hawaii.

We digress. There are **only a few questions you need to ask yourself when considering a car purchase**. Are you the type of person who buys new? How long do you typically keep your cars? Is the car 100% business use? How many miles do you plan to drive? There is a decision tree you can review on our website (see below). Back up for a bit. Remember our previous discussions about tax deductions, and how only a fraction of the money you spend is returned to you? So, back to our auto-attendant, "Do you need a car?" If the answer is "Yes" because your bucket of bolts is getting exceedingly dangerous, then Yes, buy a much-needed car out of a sense of safety. If the answer is "Not really, but I want to save taxes," then don't. Two rules to live by-

- Cash is King (keep it!)
- Depreciation is a tax deferral not a tax avoidance system (typically)

There might be some other external forces at play. For example, if you need a car next year but your income is ridiculously and unusually high in the current tax year, then reducing your income now makes sense. Again, tax modeling and planning is critical. Here is some more information-We encourage you to read the **blog post** since it has several examples and takes a deeper dive into the Section 179 and 100% Bonus Depreciation. Wait! There's more… the Automobiles in Businesses button is an excerpt from our book, **Taxpayer's Comprehensive Guide to LLCs and S Corps**, which is a good read too.

Tax Planning with Depreciation Recapture

Please understand that depreciation is a tax deferral system rather than a tax avoidance system. Huh? When you sell or dispose of an asset, you might have to pay tax on the portion that was depreciated.

For example, you buy a $200,000 piece of machinery and use **Section 179 depreciation** to deduct the entire $200,000 in the first year. Five years later you sell the equipment for $150,000 because you slapped some new paint on it and you are a shrewd negotiator with your buyer. You will now have to recognize $150,000 of taxable ordinary income. Yuck. But there is a silver lining- depreciation recapture is taxed at your marginal tax rate up to a maximum of 25% tax rate. So, you could have depreciated your asset during 37% marginal tax rate years just to pay it all back at 25%. Bonus. Tax planning is a must! How many times have we mentioned that?

You can kick this depreciation recapture can down the road with a **Section 1031 exchange** (also referred to as a like-kind exchange). Perform your favorite internet search on this topic- way too involved to explain here except that a Section 1031 exchange in most situations allows the deferral of depreciation recapture and capital gains. And if you think you know what a 1031 exchange is, try learning about a reverse 1031 exchange- where you buy the replacement property first. Yup. It exists.

Income Shifting

This one gets a little tricky. Let's say you are a commercial real estate agent, and you sell a lease and collect a $10,000 commission. But there are provisions that if the tenant breaks the lease within three years, you have to pay some of the $10,000 back. Accountants would call this "Unearned Revenue" and we can kick this revenue into the subsequent years. So if you collect money today and there is a bona fide chance you might lose it, then perhaps you should consider accrual based accounting and defer some of this income. Again, this gets tricky.

Paying Bonuses

If you're Ebenezer Scrooge then you're done reading. If you are paying out year-end bonuses, then keep reading. This might be a no-brainer, but make sure paychecks that are for bonuses are dated for 2018.

Secret Tax Deduction Club

Contrary to popular belief, there is no secret tax deduction club that only a few of us know about, and even fewer talk about. This isn't fight club, OK? Thanks to all the internets the speed and volume of data simply puts all ideas and thoughts on the forefront. Are there little tricks that some accountants aren't aware of? Sure. Do accountants routinely inject their level of risk aversion into your decision-making? Yes. At WCG (formerly Watson CPA Group) we will ensure ethical guidelines are met and clear tax positions are followed. But please do not call us and let us know that your neighbor… the one with two homes and a yacht… does not pay taxes. Stop believing everything heard at a cocktail party.

Having completed our rant, we swim in the grey waters with slivers of white and black. We will provide you with options, arguments and counter-arguments. Ultimately it is your life, and we will offer guidance as you walk thru it.