Year-End Tax Planning Summary
December 2018

Overview

Tax planning at year-end always presents opportunities, especially in a year that involves significant new tax legislation. This memorandum outlines key provisions of the 2017 Tax Cuts and Jobs Act even though many of the basic principles remain for year-end planning: defer the recognition of taxable income into 2019 and accelerate deductible expenses or investment losses into 2018. Below is a summary of year-end planning considerations we have been evaluating and/or implementing. For your reference, the Appendix includes tables with key rates and exemption amounts reflecting IRS inflation adjustments.

Income Tax & Alternative Minimum Tax Planning

- Compare 2018 and 2019 marginal tax rates (considering Alternative Minimum Tax) and evaluate benefits of accelerating or deferring income and/or deductions
- For assets in trust, re-evaluate the allocation of non-deductible investment advisory fees and deductible trustee fees and evaluate the situs of trusts and state tax implications based upon the grantor or non-grantor trust status of the trust

Family and Education Planning

- The act increases the child tax credit to $2,000 per qualifying child; $1,400 of this amount is refundable. Notably, the act increases the phaseout for the child tax credit to $400,000 from $110,000 for married taxpayers filing a joint return and to $200,000 from $75,000 for other taxpayers.

- The “kiddie tax,” which was a tax on unearned income of children, was completely overhauled by the act. Earned income of a child is taxed according to an unmarried taxpayer’s rates. Taxable income attributable to a child’s net unearned income is now taxed at the same tax rates applicable to trusts and estates.

- Qualified education expenses of a 529 account are expanded to include up to $10,000 per year for a child’s elementary and secondary education whether it is in a public, private or religious environment.

IRAs & Charitable Planning

- Facilitate annual IRA contributions, Required Minimum Distributions and related tax withholding
- Facilitate charitable contributions (e.g., utilization of RMDs from IRAs and appreciated securities)
- Consider Roth conversions

Investment & Estate Planning

- Recognize unrealized capital losses (subject to wash-sale rules) to offset capital gains
- Facilitate annual exclusion gifts and utilization of remaining lifetime exemptions
- Accelerate intra-family sales/gifts to take advantage of valuation discount opportunities to transfer wealth more efficiently before the new tax law sunsets
- Consider Spousal Lifetime Access Trusts (SLATs) to shift wealth outside the taxable estate while retaining indirect access to the transferred asset via the spouse’s beneficial interest

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Itemized Deductions

Itemized deductions are significantly different under the new act:

- The floor for deductible medical expenses is reduced to 7.5% (from 10%) for 2018 and 2019. It makes sense to schedule discretionary medical procedures in 2018 and 2019 if doing so will lead to a medical expense deduction.

- State and local income, sales and real and personal property taxes are limited to $10,000. Individuals with capped state and local tax deductions should keep their eyes on efforts by their state legislatures to circumvent the federal cap. Some states have proposed restructuring “tax payments” as charitable contributions in order to keep the federal tax deductions for its taxpayers, but the IRS has mentioned it will attack some of these efforts by high tax states.

- Although existing mortgages in effect prior to December 16, 2018, are grandfathered to the previous cap of $1 million, interest expense on acquisition indebtedness for up to two homes is now capped at $750,000 in total for loans incurred after December 15, 2017, through 2025. Interest on home equity loans is not deductible from 2018 through 2025 unless the loan is used to pay for things such as an addition or improvement to the taxpayer’s home that secures the loan.

- The percentage limitation for charitable contributions of cash is increased from 50% to 60% of adjusted gross income (assuming only cash gifts are made during the year). The previous charitable deduction for payments connected to the purchase of tickets and preferential seating at college athletic events is repealed.

- Miscellaneous itemized deductions, such as tax preparation fees, investment advisory fees and unreimbursed employee expenses are now disallowed. Trustee fees remain fully deductible.

Estate, Gift and Generation-Skipping Tax Changes

The exemption amounts for the gift, estate and generation-skipping taxes are doubled from $5.6 million to $11.2 million ($22.4 million for couples), and the income tax basis step up/down to fair market value at death continues under the act. These changes provide high net worth individuals a significant planning window to make gifts, set up irrevocable trusts and analyze strategies to swap high basis assets included in their taxable estate with low basis assets currently titled in irrevocable trusts. This can be done without “clawback” when the exemption amount reverts to the lower levels under prior law in 2026.

Real Estate Investors

Real estate investors could see significant savings from the new provisions applicable to bonus depreciation, deductions for rental and nonresidential property costs and deductions for pass-through income (discussed below). For example, first-year bonus depreciation has increased from 50% to 100%. Additionally, owners can now apply bonus depreciation to both new and used “qualified property” (defined by the IRS). The bonus depreciation allowance will be reduced by 20% each year from 2023 through 2026.

Other Miscellaneous Changes

There are a number of other changes made by the new act. We have highlighted a few of the more notable changes below.

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- Section 199A of the act introduced a new tax deduction of 20% for certain owners of pass-through entities including S-corporations, partnerships, limited liability companies and sole proprietorships. This new deduction could be an attractive option for reducing taxes, but it's important to work with your tax professional to make sure you qualify for it. Calculating the deduction is complex given the number of factors that need to be taken into account.

- Under prior law, alimony and separate maintenance payments were deductible by the payor and includible in income by the payee. For divorce and separation instruments executed or modified after December 31, 2018, alimony and separate maintenance payments are not deductible by the payor spouse or includible in the income of the payee spouse. These changes will profoundly affect the structure of divorce settlements.

- Individuals can no longer unwind a Roth conversion by recharacterizing it. However, in the year of contribution, an individual may continue to make a contribution to a Roth IRA and, before the due date for the individual's income tax return for that year, recharacterize it as a contribution to a traditional IRA, and vice versa.

Netting Process for Gains/Losses

The prior law treatment of capital gains continues under the new law. The proposal to require the use of the first-in, first-out method to calculate gains was not enacted, meaning individuals are still able to specifically identify "tax lots" to cherry pick gains and losses. Throughout the year, Colony Family Offices has reviewed portfolios to determine appropriate securities that qualify for tax loss harvesting based on the following IRS mandated "netting" process (in the order listed) where applicable:

- Net short-term gains and short-term losses
- Net long-term gains and long-term losses
- Net short-term gain/loss against net long-term gain/loss
- Taxpayers incur higher taxes on net short-term gains (after netting against net long-term gains and losses)
- Taxpayers incur more favorable tax on net long-term gains (after netting against net short-term gains and losses)
- Regardless of whether net short or net long-term losses are projected, taxpayers may only deduct up to $3,000 of excess net losses against ordinary income each year
- All unused net losses are carried forward and may be applied against future tax years

Income & Expense Deferral/Acceleration

Throughout the year, Colony Family Offices proactively identified and recommended (as applicable) one or more of the following strategies to defer income and accelerate deductions for clients:

- Accelerate income to utilize available carry forward losses
- Defer or accelerate payment of bonuses before January
- Accumulate/declare dividends (especially C corporation owners)
- Delay/accelerate Roth IRA conversions
- Pay bills in 2018 and/or postpone receipts until 2019

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- Increase withholding of state and federal taxes to minimize exposure to estimated tax underpayment penalties on W-2 and "non-wage" income
- Accelerate/delay charitable gifts and/or medical expenses
- Consider charitable gifts of appreciated securities to avoid tax on imbedded capital gains
- Consider "bunching" charitable contributions to increase itemized deductions now that the standard deduction is $24,000 for a married couple

Net Investment Income Tax

The NIIT is a Medicare surtax of 3.8% imposed on the lesser of Net Investment Income (NII) or Modified Adjust Gross Income (MAGI) above a specified threshold. Distributions from IRAs, pensions, 401(k) plans, tax-sheltered annuities and eligible Code Sec. 457 plans are excluded from NII and NIIT.

NII includes various types of investment income reduced by certain investment-related expenses, such as: investment brokerage fees, royalty-related expenses and state and local taxes allocable to items included in NII. Taxpayers that are subject to NIIT may find the following planning opportunities helpful:

- Differentiate income derived from an active business and passive income that is subject to NIIT
- Consider recognizing unrealized losses to offset capital gains
- Evaluate closely-held business interests owned by non-grantor trusts and whether or not the trustee's active participation can be utilized when calculating the NII for the trust

Alternative Minimum Tax (AMT)

The AMT is a separate tax calculation that requires taxpayers to add back certain deductions that would otherwise be deductible against their regular tax calculation. The AMT tax rate is generally lower than the highest regular income tax rate, but the base upon which the tax is applied is higher due to the addback of various deductions. While there are several factors that could contribute to a taxpayer being subject to AMT, a combination of the following preferences typically will trigger an AMT liability now that the deduction for state and local taxes is capped at $10,000:

- Significant long-term capital gains
- Exercise of Incentive Stock Options
- Accelerated depreciation deductions

To the extent that a taxpayer is subject to AMT, a common practice is to consider deferring certain deductions (preference items) into the subsequent year and/or accelerating income into the current year if doing so is favorable when factoring in the lower AMT tax rates versus the higher regular ordinary income tax rates.

State Income Tax Planning With Irrevocable Non-Grantor Trusts – Why Jurisdiction Matters

Now that Colony Trust Company has been established, we think there are significant opportunities to reposition assets away from high tax states to avoid or minimize state income taxes via the creation of one or more non-grantor irrevocable trusts that name the spouse as a permissible beneficiary. States impose state income taxes on trusts differently. Analyzing each state's rules could result in significant state income tax savings with proper planning. See Appendix D for a survey of various states and how they define a "resident trust" for purposes of imposing state income taxes.

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Appendix A: Key Income, Net Investment Tax, AMT Exemptions and Rates

The following tables reflect applicable ordinary income, long and short-term capital gains, qualifying dividends and net investment income tax brackets for 2018 and 2019 tax years.

Total Income		Long Term Capital Gains Rate
Single Filers	Married Filing Joint	
Up to $38,600	Up to $77,200	0%
$38,601 to $425,800	$77,201 to $479,000	15%
$425,801 and above	$479,901 and above	20%

2018 Federal Income Tax Brackets					
Single	Married Filing Jointly	Married Filing Separate	Head of Household	Estates & Trusts	Marginal Rate
Up to $9,525	Up to $19,050	Up to $9,525	Up to $13,600	Up to $2,550	10%
$9,526 to $38,700	$19,051 to $77,400	$9,526 to $38,700	$13,601 to $51,800	NA	12%
$38,701 to $82,500	$77,401 to $165,000	$38,701 to $82,500	$51,801 to $82,500	NA	22%
$82,501 to $157,500	$165,001 to $ 315,000	$82,501 to $157,500	$82,501 to $157,500	$2,551 to $9,150	24%
$157,501 to $$200,000	$315,001 to $400,000	$157,501 to $200,000	$157,501 to $200,000	NA	32%
$200,001 to $500,000	$400,001 to $600,000	$200,001 to $300,000	$200,001 to $ 500,000	$9,151 to $12,500	35%
500,001 and above	$600,001 and above	$301,000 and above	$500,001 and above	$12,501 and above	37%

2019 Federal Income Tax Brackets					
Single	Married Filing Jointly	Married Filing Separate	Head of Household	Estates & Trusts	Marginal Rate
Up to $9,700	Up to $19,400	Up to $9,700	Up to $13,850	Up to $2,600	10%
$9,701 to $ 39,475	$19,401 to $78,950	$9,701 to $ 39,475	$13,851 to $52,850	NA	12%
$39,476 to $ 84,200	$78,951 to $168,400	$39,476 to $ 84,200	$52,851 to $84,200	NA	22%
$84,201 to $160,725	$168,401 to $321,450	$84,201 to $160,725	$84,201 to $160,700	$2,601 to $9,300	24%
$160,726 to $ 204,100	$321,451 to $408,200	$160,726 to $ 204,100	$160,701 to $ 204,100	NA	32%
$204,101 to $ 510,300	$408,201 to $612,350	$204,101 to $306,175	$204,101 to $510,300	$9,301 to $12,750	35%
$510,301 and above	$612,351 and above	$306,176 and above	$510,301 and oabove	$12,751 and above	37%

2019 Top Federal Income Tax Rates	
Ordinary earned income, not including short-term capital gains or passive income [1]	37.0%
Net investment income (interest, short-term capital gains, non-qualified dividends and other passive income) [2]	40.8%
Long-term capital gains [3]	23.8%
Qualified dividends [4]	23.8%

Notes:

1 Medicare surcharge of 0.9% applied to wages and self-employment income that exceeds $200K for singles and $250K for couples

2 Includes interest, dividends, royalties, net rental income and other passive income

3 Includes 3.8% surtax on net investment income over $200K for singles and over $250K for couples

4 Includes 3.8% surtax on net investment income over $200K for singles and over $250K for couples

Source: Internal Revenue Service

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Alternative Minimum Tax (AMT)	2018	2019
Maximum AMT exemption amount	Married, Filing Joint $109,400 Single $70,300	Married, Filing Joint $111,700 Single $71,700
Exemption phaseout threshold	Married, Filing Joint $1,000,000 Single $500,000	Married, Filing Joint $1,020,600 Single $510,300
26% rate applies to AMT income (AMTI) at or below this amount (28% rate applies to AMTI above this amount)	Married, Filing Joint $191,500 Single $95,750	Married, Filing Joint $194,800 Single $97,400

Appendix B: Key Exemptions and Estate, Gift & GST Tax Rates – 2018 and 2019 Tax Years

The following tables reflect Estate, Gift and GST Exemptions and Tax Rates for 2018 and 2019 tax years.

Calendar Year	Estate Tax Exemption (Less Lifetime Gift Tax Exemption Utilized)	Gift Tax Exemption	Generation Skipping Transfer Exemption	Tax Rate
2018	$11,180,000	$11,180,000	$11,180,000	40%
2019	$11,400,000	$11,400,000	$11,400,000	40%

** In addition to the foregoing exemptions, annual exclusion gifts for 2019 remain $15,000 ($30,000 for married couples who elect to split their gifts)*

Appendix C: Retirement Plan and IRA Key Numbers

The following tables reflect IRS elective deferral limits, IRA contribution limits and income phase-out ranges for traditional and Roth IRAs.

Elective Deferral Limits	2018	2019
401(k), 403(b), 457(b), Profit-Sharing Plans	Lesser of $18,500 or 100% of participant's compensation ($24,500 if age 50 or older)[2]	Lesser of $19,000 or 100% of participant's compensation ($25,000 if age 50 or older)[2]
SEPs	Lesser of $55,000 or 100% of participant's compensation	Lesser of $56,000 or 100% of participant's compensation
SIMPLE 401(k) plans and SIMPLE IRA plans[1]	Lesser of $12,500 or 100% of participant's compensation ($15,500 if age 50 or older)	Lesser of $13,000 or 100% of participant's compensation ($16,000 if age 50 or older)

1 Must aggregate employee deferrals to all 401(k), 403(b) and SIMPLE plans of all employers; 457(b) contributions are not aggregated.
2 Special catch-up limits may also apply to 403(b) and 457(b) plan participants.

The chart below compares the 2018 and 2019 IRA contribution limits.

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IRA contribution limits	2018	2019
Traditional and Roth IRAs	Lesser of $5,500 or 100% of earned income ($6,500 if age 50 or older)	Lesser of $6,000 or 100% of earned income ($7,000 if age 50 or older)

Income phaseout range for determining deductibility of traditional IRA contributions for taxpayers:	2018	2019
1. Covered by an employer-sponsored plan and filing as:		
Single/Head of household	$63,000 - $73,000	$64,000 - $74,000
Married filing jointly	$101,000 - $121,000	$103,000 - $123,000
Married filing separately	$0 - $10,000	$0 - $10,000
2. Not covered by an employer-sponsored retirement plan, but filing joint return with a spouse who is covered by a plan	$189,000 - $199,000	$193,000 - $203,000

Income phaseout range for determining ability to fund a Roth IRA for taxpayers filing as:	2018	2019
Single/Head of household	$120,000 - $135,000	$122,000 - $137,000
Married filing jointly	$189,000 - $199,000	$193,000 to $203,000

Source: Internal Revenue Service

Spousal IRA Planning

A contribution to a Traditional or Roth IRA is allowed only if the taxpayer has compensation from earned income. An exception exists for non-working spouses as long as the couple has at least $11,000 of combined earned income. Unless deduction limits apply because the taxpayer's income is too high, a couple may qualify for up to a $11,000 deduction in 2018 if the working spouse contributes $5,500 to their own IRA and another $5,500 to an IRA created for their non-working spouse. Deductible contributions for 2018 are allowed until the return due date (April 2019 plus extensions).

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Appendix D: Why Irrevocable Non-Grantor Trust Jurisdiction Matters

The chart below depicts how various states define a "resident trust" for purposes of imposing a state income tax on the undistributed income of an irrevocable non-grantor trust.

State	Taxing Statute	Top 2018 Tax Rate	Under What Conditions Does The State Tax a Non-Grantor Trust?
AL	Ala. Code 40-18-1(33)	5.00%	If the trust is set up by the Will of an AL resident or settlor was an AL resident at time trust became irrevocable and an AL resident is a beneficiary or trustee for more than seven months during the tax year
FL	No tax	0.00%	No tax
GA	O.C.G.A. 48-7-22	6.00%	If there is trust property located in GA or if the trustee is "managing funds for the benefit of a resident of" GA
MS	Miss. Code Ann. 27-7-5(1)	5.00%	If the trust is administered in MS
NC	N.C. Gen Stat. 105-160.2	5.49%	If there is a NC beneficiary (but see *Kaestner* where NC Sup. Ct. ruled unconstitutional if only connection is NC beneficiary)
SC	S.C. Code Ann. 12-6-30(5)	7.00%	If the trust is administered in SC
VA	Va. Code Ann. 58.1-302	5.75%	If the trust is set up by the Will of a VA resident; or if a trust was created by a settlor who was a VA resident; or a trust which is being administered in VA
TN	Tenn. Code Ann. 67-2-110(a)	3.00% (int./div. only)	If there is a TN beneficiary
DE	30 Del. Code. 1601(8)-(9)	6.60%	If the trust is set up by the Will of a DE resident, or settlor of trust was a DE resident, or the majority of the trustees are DE residents for more than ½ the year; in all of such cases only if there is a DE beneficiary

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