These rules are complicated, but may provide tax-planning opportunities if securities held in IRAs fluctuate significantly within short periods of time. Your advisor can help you with your Roth IRA questions.

COVERDELL EDUCATION SAVINGS ACCOUNTS (EDUCATION IRAS)

Education IRAs may be established to help meet the cost of education for certain individuals. For 2018, annual, nondeductible contributions to an education IRA are limited to $2,000 per beneficiary and may not be made after the beneficiary reaches age 18. Contributions cannot be made prior to the child's birth. Contributions must be made by the due date of the return without extension. Only eligible donors within certain income limits can make contributions to education IRAs. Eligibility is phased out for single donors with AGI between $95,000 and $110,000, and married donors filing jointly with AGI between $190,000 and $220,000.

Planning Suggestion: If you are not eligible to make a contribution to your education IRA, consider making a gift to an eligible person.

Distributions from an education IRA are not subject to tax to the extent the distributions do not exceed qualified education expenses. Qualified education expenses include elementary, secondary and higher education school expenses. In the year amounts are distributed from an education IRA, the beneficiary is also eligible for an American Opportunity Tax (Hope) Credit or Lifetime Learning Credit (**see page 34**) provided the same expenses are not used for each credit. Education IRAs can be rolled over, before the beneficiary reaches age 30, to benefit another person in the same family. If the beneficiary does not use the funds for qualified education expenses by age 30, the money must be withdrawn and will be subject to tax and penalty on the portion attributable to the earnings.

Planning Suggestion: Taxpayers who desire a larger nondeductible contribution to an education fund should consider a 529 account. Tax reform expanded the allowable expenses that may be paid from a 529 account to include up to $10,000 of expenses for tuition at an elementary or secondary public, private, or religious school in addition to qualified higher education expenses.

Moving Expenses

Individuals were previously allowed to deduct qualified moving expenses paid or incurred in connection with starting work in a new location if specific distance and length of service requirements were met that were not reimbursed by an employer. For tax years 2018 through 2025, the new tax law requires employers to report any moving expenses it pays to vendors or employees as taxable wages to the employee and eliminates the employees' deduction for moving expenses.

Expenses related to a move that occurred in 2017 but were paid in 2018 remain tax-free. An exception also applies to military members on active duty who move pursuant to a military order related to a permanent change of station that continues to allow tax free moving expenses. Some states decouple from federal law regarding moving expenses and may allow taxpayers to deduct qualified moving expenses from their state taxes for 2018 and onwards.

Interest Expense

PERSONAL INTEREST

Interest is not deductible on tax deficiencies, car loans, personal credit card balances, student loans (except for taxpayers eligible for the above-the-line deduction for interest paid on qualified education loans), or other personal debts.

HOME MORTGAGE INTEREST

A full regular tax deduction is allowed for interest on home acquisition debt used to acquire, construct, or improve a principal or secondary residence to the extent this debt does not exceed $750,000 for joint filers ($375,000 for single filers or married taxpayers filing separate returns). Home acquisition debt incurred on or before December 15, 2017, is grandfathered under the previous $1,000,000 limitation for joint filers ($500,000 for single filers or married taxpayers filing separate returns).

Caution: These debts must be secured by the principal or secondary residence such that your home is at risk if the loan is not repaid.

A residence includes a house, condominium, mobile home, house trailer, or boat containing sleeping space, commode, and cooking facilities. If you own more than two residences, you can annually elect which one will be your secondary residence.

INVESTMENT INTEREST EXPENSE

If you want to add to your investment portfolio through borrowing, consider borrowing from your stockbroker through a margin loan. The interest paid is investment interest expense and will be deductible to the extent of your net investment income (dividends, interest, etc.). Investment interest expense in excess of investment income may be carried forward indefinitely.

Planning Suggestion: Net long-term capital gain (long-term gains over short-term losses) and any qualified dividend income are not included as investment income for purposes of determining how much investment interest expense is deductible, unless you elect to subject the capital gain and dividend income to ordinary income rates.

You might consider switching your investments to those types of investments generating taxable investment income to absorb any excess investment interest expense.

Interest expense, to the extent that it is related to tax-exempt income, is not deductible. Interest expense relating to a passive activity, such as a limited partnership investment, is subject to the passive loss limitations on deductibility (see page 23).

ALLOCATION RULES

Interest payments are generally allocated among the various categories –personal interest, home mortgage interest, investment interest, etc. – based on the ultimate use of the loan proceeds.

Example: An individual borrows $25,000 on margin and uses the proceeds to purchase an automobile for personal use. The interest expense is treated as personal interest.

The Service has issued complex regulations for determining how these allocations are made, which may require maintaining separate bank accounts or other records. Your advisor can help you maximize tax deductions for your interest payments.

Miscellaneous Deductions

The 2017 tax reform suspended most miscellaneous itemized deductions for tax years 2018 through 2025, including:

- Deductions for employee business expenses
- Tax preparation fees
- Investment expenses, including investment management fees
- Employment related educational expenses
- Job search expenses
- Hobby losses
- Safe deposit box fees
- Investment expenses from pass-through entities

Previously, unreimbursed employee business expenses, investment expenses, personal tax advice and preparation fees, and most other miscellaneous itemized deductions, were deductible only if they exceed 2 percent of AGI.

Business Meals and Entertainment

Beginning in 2018, the tax act eliminated the deduction for unreimbursed employee expenses. Therefore, it is important for employees to comply with their employer's documentation and other policies in order to receive reimbursement of expenses incurred for all business expenses included meals and entertainment.

If you own a business, the deduction for the cost of client entertainment is no longer allowed for 2018 and beyond as a result of tax reform. The IRS confirmed in Notice 2018-76 that businesses can generally continue to deduct 50 percent of the cost of business meals, including those incurred while meeting with or entertaining customers and clients.

Until proposed regulations are effective taxpayers may deduct an otherwise allowable business expense under Notice 2018-76 if:

- The expense is an ordinary and necessary expense under Section 162(a) paid or incurred during the taxable year in carrying on any trade or business.
- The expense is not lavish or extravagant under
  the circumstances.
- The taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages.
- The food and beverages are provided to a current or potential business customer, client, consultant, or similar business contact.

In the case of food and beverages provided during or at an entertainment activity, the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages.

Leased Automobiles

In prior years, the Service permitted salaried employees with unreimbursed business expenses as well as self-employed sole proprietors, partners, and S corporation shareholders to deduct only actual expenses incurred with respect to leased automobiles. Now, the Service allows taxpayers, beginning in the first year a leased automobile is placed in service, to use the standard mileage rate for business activity (54.5 cents per mile for travel during 2018).

Planning Suggestion: Consider claiming the standard mileage rate for leased automobiles. There is less recordkeeping, and the standard mileage rate may result in a larger deduction.

Alimony Provision

For divorce or separation agreements entered into after December 31, 2018, the deduction for alimony or separate maintenance payments is repealed. When the divorce needs to be executed by for the alimony deduction depends on state law, individuals should consult their attorneys.

Foreign Earned Income Exclusion and Housing Allowance

For United States citizens working abroad, beginning in 2006, there were three changes made to the foreign earned income exclusion and housing allowance. They are as follows:

- The income exclusion is indexed for inflation starting in 2006.
- The base housing amount used in calculating the foreign housing cost exclusion is 16 percent of the amount of the foreign earned income exclusion limitation. Reasonable foreign housing expenses in excess of the base housing amount remain excluded from gross income, but the amount of the exclusion is limited to 30 percent of the taxpayer's foreign earned income exclusion.
- Income excluded as either foreign earned income or as a housing allowance is included for purposes of determining the marginal tax rates applicable to non-excluded income.

The foreign earned income exclusion for 2018 is $104,100.

State and Local Deduction

Tax reform introduced a $10,000 cap on the itemized deduction for state and local, sales, income or property taxes for tax years beginning in 2018 and before 2026. While the limitation impacts all individual taxpayers, it will especially impact taxpayers who will file returns in states with high income and property taxes, including New York, New Jersey, Connecticut, California, Maryland, and Oregon, and on married couples (regardless of whether they file jointly or separately).

The cap limits taxpayers' SALT deductions to $10,000 per return, and married taxpayers who file separately can only deduct up to $5,000 each, for itemized deductions. The cap does not apply to deductions resulting from a trade or business.

Standard Deduction

A significant change for individuals resulting from tax reform was the near doubling of the standard deduction amounts. However, individual tax reform is temporary and is scheduled to sunset in 2026. Your advisor can assist you in adapting to the temporary changes based on your individual circumstances. Where individuals can strategically increase their itemized deductions, including by using their retirement plan contribution if they are charitably inclined, they should consider contributing.

The 2018 standard deduction is:

Filing Status	Amount
Single	$12,000
Married filing joint return and qualifying surviving spouse with dependent child	$24,000
Married filing separate return	$12,000
Head of household	$18,000

An additional $1,300 standard deduction may be claimed by a married taxpayer who is at least 65 years old or blind for tax year 2018. In 2018, a total additional deduction of $2,600 ($1,600 by a single taxpayer) standard deduction can be claimed if the taxpayer is at least 65 years old and blind.

Planning Suggestion: A taxpayer benefits from itemizing deductions only if the deductions exceed the standard deduction. If your itemized deductions fluctuate from year to year, consider bunching your itemized deductions in one year and claiming the standard deduction in other years.

Personal Exemptions

The deduction for personal exemptions is suspended through 2025; however, the $100 and $300 exemptions for complex and simple trusts, respectively, were retained.

The $4,150 exemption for qualified disability trusts was also retained but is to be adjusted for inflation in future years.

Passive Activities, Rental and Vacation Homes

Losses from passive activities (which, as discussed below, generally include the rental of real estate) are deductible only against passive income. Passive losses cannot be used to reduce non-passive income, such as compensation, dividends, or interest. Similarly, credits from passive activities can be used only to offset the regular tax liability allocable to passive activities. Unused passive losses are carried over to future years and can be used to offset future passive income. Any remaining loss is deductible when the activity, which gave rise to the passive loss, is disposed of in a transaction in which gain or loss is recognized.

A passive activity is one in which the taxpayer does not materially participate. Material participation is involvement in operations on a regular, continuous, and substantial basis. You

are considered to materially participate in an activity if, for example:

- You participate in the activity for more than 500 hours in the taxable year.
- Your participation for the taxable year was substantially all of the participation in the activity.
- You participated for more than 100 hours during the taxable year, and you participated at least as much as any other individual for that year.

In determining material participation, a spouse's participation can be taken into account. Limited partners are presumed not to materially participate in the partnership's activity.

Rental activities are generally considered passive. However, there are two significant exceptions to this rule (see "Rental Real Estate").

A working interest in an oil or gas property is not treated as a passive activity, regardless of whether the owner materially participates, unless liability is limited (such as in the case of a limited partner or S corporation shareholder).

Planning Suggestion: Avoid investments producing passive losses unless there is an overriding economic reason to make the investment. If you already have such investments, consider acquiring an investment that generates passive income. If you own a corporation other than an S corporation or personal service corporation, consider transferring investments that generate passive losses to the corporation. The corporation can deduct passive losses against its active business income, but not against its dividends, interest, or other portfolio income.

Additionally, some partnerships receive a special tax treatment under the current law that allow the income/expenses of the investment to be treated by the taxpayer as neither passive income nor portfolio income, meaning that the taxpayer may be able to offset ordinary income with any nonpassive losses. If the partnership receives this special treatment, it will be disclosed as a footnote in the investment. Please consult your tax advisor regarding the entity's classification.

RENTAL REAL ESTATE

For real estate professionals, rental real estate activities are not subject to the passive loss rules if, during a taxable year:

- More than 50 percent of the taxpayer's personal services are performed in real property businesses, and
- More than 750 hours are spent in real property businesses.

For both of these tests, the taxpayer must materially participate in the real property businesses. If a joint return is filed, these two tests must be satisfied by the same spouse.

Services performed as an employee are ignored unless the employee owns more than 5 percent of the employer.

A closely-held C corporation that is generally subject to the passive loss rules will satisfy these tests if more than 50 percent of its gross receipts are derived from real property businesses in which the corporation materially participates. Real property businesses are those involving real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage.

For non-real estate professionals, another exception to the passive loss limitations exists for rental real estate activities in which the taxpayer "actively" participates. This requires the taxpayer to own at least a 10 percent interest in the activity. If the taxpayer actively participates in the activity, the taxpayer can offset up to $25,000 of losses and credits from the activity against non-passive income, subject to an AGI phaseout.

Active participation does not require regular, continuous, and substantial involvement in

operations as long as the taxpayer participates in a significant and bona fide way by, for example:

- Arranging for others to provide services such as cleaning; or
- Making management decisions, which include approving new tenants, deciding rental terms, and approving repairs and capital expenditures.

The $25,000 allowance begins to phase out when the taxpayer's AGI exceeds $100,000 and is completely eliminated when AGI reaches $150,000. In that event, the regular passive loss rules determine the amount of any deductible loss. The $25,000 allowance and AGI thresholds are cut in half for a married taxpayer who files separately and does not live with his or her spouse. However, there is no $25,000 allowance if a married individual files separately and lives with his or her spouse at any time during the taxable year.

Planning Suggestion: If your AGI is approaching $100,000, consider shifting income to 2019 to obtain a full $25,000 rental real estate loss for 2018.

If you think you may be affected by the passive loss rules, you should consider speaking with your advisor. In certain cases with proper planning, the adverse effect of these rules may be minimized.

VACATION HOMES

Expenses of a rental property are deductible, even if they exceed gross rents and produce a loss. However, the current deduction of such a loss may be restricted due to the passive activity rules discussed above. A vacation home is treated as rental property if personal use during the year does not exceed the greater of:

- 14 days, or
- 10 percent of the number of days the home is rented at a fair rental value.

If personal use exceeds these limits, the property is considered to be a residence. In that event, the deductibility of expenses is limited, although property taxes, mortgage interest, and casualty losses can generally be deducted currently.

Planning Suggestion: If you rent your home for less than 15 days during the year, the total rental income you receive is not subject to income tax.

DISPOSITION OF LEASEHOLD IMPROVEMENTS

When a lessor disposes of leasehold improvements upon termination of a lease, the lessor can generally write off the adjusted basis of those improvements.

Planning Suggestion: If you have leases terminating early in 2019 where there is substantial remaining basis in the leasehold improvements, it may make sense to provide the lessees with an incentive to leave before the end of 2018 so that you can write off the remaining basis in the applicable leasehold improvements before the end of 2018.

Excess Business Loss Limitation

Introduced in the 2017 tax reform under Section 461(l), a taxpayer will only be able to deduct net business losses of up to $250,000 ($500,000 in the case of a joint return) for taxable years beginning after December 31, 2017, and before January 1, 2026. Excess business losses are disallowed and added to the taxpayer's NOL carryforward. Previously, suspended passive activity losses were allowed in full upon the taxable disposition of the passive activity.

Additionally, non-corporate NOL rules now limit deductible NOL carryforwards to the lesser of

the carryforward amount or 80-percent of taxable income. Taxpayers are no longer permitted to carry back their NOLs to the previous two taxable years, but they may carryforward their NOLs indefinitely.

Section 199A

Tax reform lowered the corporate tax rate to a flat rate of 21 percent. In turn, under the new law (under Section 199A), for taxable years beginning after December 31, 2017, taxpayers other than C corporations with taxable income (before computing the Qualified Business Income (QBI)) at or below the threshold amount, are entitled to a deduction equal to the lesser of:

1. The combined QBI amount of the taxpayer, or
2. An amount equal to 20 percent of the excess, if any, of the taxable income of the taxpayer for the taxable year over the net capital gain of the taxpayer for such taxable year.

The combined QBI amount is generally equal to the sum of (A) 20 percent of the taxpayer's QBI with respect to each qualified trade or business plus (B) 20 percent of the aggregate amount of the qualified REIT dividends and qualified publicly traded partnership (PTP) income of the taxpayer for the taxable year. The Section 199A deduction may reduce a pass-through owner's maximum individual effective tax rate from 37 percent to 29.6 percent. It is critical to begin evaluating the extent the pass-through owner will be eligible for this deduction. For further information regarding the Section 199A deduction, please see our *2018 Year-End Tax Planning Letter for Businesses*.

Alternative Minimum Tax

A taxpayer must pay either the regular income tax or the AMT, whichever is higher. The AMT tax system is parallel to the regular tax, but it treats some items of income and deduction differently.

The established exemption amounts for 2018 are $70,300 for unmarried individuals and individuals claiming the head of household status, $109,400 for married individuals filing jointly and surviving spouses, and $54,700 for married individuals filing separately. These exemption amounts are significantly higher than in prior years (in 2017 the amounts were $54,300 for unmarried individuals and individuals claiming head of household status, $84,500 for married individuals filing jointly and surviving spouses, and $42,250 for married individuals filing separately). Further, with the introduction of the SALT deduction cap and end of miscellaneous itemized deduction for 2018 through 2025, the likelihood that an individual taxpayer will be subject to AMT is low.

With increased AMT exemptions for individuals, such taxpayers are likely to use more of the R&D credits passing through to them from their businesses.

The exemption for estates and trusts was unchanged by tax reform at $24,600.

AMT paid on "timing" preferences and adjustments (such as accelerated depreciation) for prior years is allowed as a credit against a later year's regular income tax to the extent it exceeds the later year's tentative AMT. Therefore, this AMT credit cannot reduce the regular income tax below the AMT for that later year.

Example: T's 2018 AMT attributable to timing preferences was $80,000. T's 2019 regular tax is $100,000, and T's tentative AMT is $70,000. T may reduce the regular tax by $30,000. Generally, T's remaining AMT credit of $50,000 ($80,000 less $30,000) may be carried forward indefinitely. No carryback is permitted.

A full discussion of the AMT is beyond the scope of this letter. AMT considerations are exceedingly complex and require careful planning. Please consult your advisor prior to year-end to discuss how the AMT might affect you.

Stock Options

INCENTIVE STOCK OPTIONS

An incentive stock option (ISO) is an option issued to an employee that allows all increases in value to be subject to long-term capital gain treatment if the taxpayer disposes of the option shares more than two years after the date the option is granted and more than one year after the date the option shares are purchased. Also, the employee must continue to be an employee until at least three months before the option is exercised. If these rules are not met, a portion of the gains from ISOs are ordinary income subject to federal tax rates as high as 37 percent.

However, there is a hidden cost to obtaining long-term capital gain treatment from an ISO. The "spread" (the difference between the fair market value of the shares on the purchase date and the option price paid for the shares) must be added into the taxpayer's AMT calculation for the year the options are exercised. Any AMT attributable to the ISO spread generally is allowed as an AMT credit carryforward to offset regular taxes owed in future years. Thus, any AMT attributable to the ISO is effectively a prepayment of tax, not additional tax.

Planning Suggestion: If you are planning to exercise ISOs before December 31, 2018, that trigger AMT, consider deferring the exercise until **early in 2019. Any AMT on such exercise would likely not be due until April 15, 2020, after the required one-year holding period for the stock has been met. At that time the option shares can be sold at long-term capital gains rates, with a portion of the proceeds used to pay the 2019 AMT liability.**

Additional Planning: Consider a plan to exercise options each year up to the level that generates AMT. Tax reform increased the amount of preference items you can have before owing AMT tax.

If you have exercised an ISO in 2018 and the value of the stock has decreased, consider a sale before the end of 2018. This action should reduce the AMT effect. The sale must be made to a non-family member (or to an entity not considered to be related to the taxpayer under applicable rules) and the stock cannot be repurchased (even through an exercise of a different option or new compensatory award) for at least 30 days.

NONQUALIFIED STOCK OPTIONS

When a taxpayer exercises a non-qualified stock option (NQSO) that does not have a readily ascertainable fair market value at the time of issuance (generally the case where the option or the option stock is not publicly traded), the spread (the difference between the stock's fair market value and option price) is taxed as compensation income. When the taxpayer sells the NQSO stock, any subsequent appreciation is taxed as long- or short-term capital gain depending upon the stock's holding period. Because the spread is taxed as ordinary income, taxpayers in the highest marginal federal tax bracket are taxed at 37 percent.

Planning Suggestion: If a taxpayer expects to be subject to AMT for 2018 and no AMT credit carryforward is expected, the taxpayer should consider increased ordinary taxable income to at least the AMT level by exercising NQSOs. The accelerated ordinary income from the NQSO is effectively taxed at the AMT marginal rate of 28 percent as opposed to 37 percent. In addition, all future appreciation is capital gain. When making this decision, the potential tax savings should be compared with the opportunity cost of accelerating the income taking into account the time value of money.

Children's Taxes (Kiddie Tax)

Beginning in 2018, unearned income of a child under age 18 is taxed at ordinary income and preferential rates applied to trusts and estates. Earned (compensation) income received by a child under age 18 is taxed at the rates applied to single filers.

The kiddie tax applies to full-time students who have not attained the age of 24 by the end of the taxable year and non-full-time students who have not attained the age of 19 by the end of the taxable year, but in either case, only if the child's earned income does not exceed one-half of the amount of the child's support.

A child with earned income may claim a standard deduction up to $12,000 for 2018 and may be eligible for the $5,500 deductible IRA contribution. Therefore, the child may earn $17,500 without paying federal income tax. The child should also consider a contribution to a nondeductible Roth IRA.

Planning Suggestion: If you own a business, consider hiring and paying a salary to your child. This income will be taxed at the child's rates, and the payment will be deductible by your business. This technique can be used to fund a college education. Of course, the child must perform services to earn the compensation, and the compensation must be reasonable for the services provided.

If the child is 18 or over, this compensation will be subject to social security tax. It will also be subject to federal unemployment insurance tax if the child is 21 or older. The child's compensation could also be subject to state and local income and payroll taxes.

For 2018, a child under age 18 is not required to file a tax return if the child only has interest and dividend income up to $1,050, has not made estimated payments, has total gross income less than $10,500, and is not subject to backup withholding. However, the parents must include the child's income exceeding $2,100 on his/her tax return.

Caution: A child under 18 who has capital gains or earned income must file his or her own tax return. Estimated taxes may have to be paid during the year if withholding taxes are not sufficient to cover the child's tax liability.

Planning Suggestion: Consider making gifts of growth stock or Series EE bonds (which can defer taxation of the interest until maturity) to a child under age 18 (or 24, if appropriate). These investments can be converted to investments producing current income after the child reaches 18 (or 24, if appropriate). The resulting income will be taxed at the child's rates rather than the parents' top rate. Further, parents in the higher tax brackets should consider making gifts of income-producing property to a child who is 18 (or 24, if appropriate) or older to take advantage of the child's lower tax bracket (see "Year-End Gifts" (see page 30)).

Reminder: Your income tax return must report social security numbers for all children whom you claim as dependents. A social security number can be obtained by filing an application on Form SS-5 with your local Social Security Administration office.

If you claim a dependent care credit, you must report the service provider's social security or employer identification number on your tax return. You should use IRS Form W-10 to obtain this number from the provider.

Adoption Expenses

Up to $13,810 for 2018 of eligible adoption expenses are allowed to be claimed as a nonrefundable credit. The credit limitation is the same for special-needs children (children that cannot or should not be returned to the home of the birth parents because of specific factors, or who could not otherwise be adopted because of certain conditions). The credit is per adoption, not per year.

Thus, if a person adopts two children in 2018 and incurs $30,000 of qualified expenses, the credit limitation is $27,620. In 2018, the adoption credit is phased out for higher income individuals with modified AGI between $207,140 and $247,140. Unused adoption credit can be carried forward for up to five years.

Nanny Tax Reporting

During 2018, if you paid $2,100 or more to a person 18 or over for household services, you are required to report his or her social security and federal unemployment taxes on your personal tax return. These amounts are reported on Schedule H.

These employment taxes must be paid by the due date of the return, April 15, 2019, without extensions. Inasmuch as these taxes are part of your tax liability, your estimated taxes or withholding must be sufficient to cover them.

Planning Suggestion: As the $2,100 amount applies to each household employee, if possible, try to keep payments to each person below $2,100 per year. In 2018, you can also give your household employee up to $260 per month for expenses to commute by public transportation without this amount counting toward the $2,100 threshold or being included in the employee's gross income.

Caution: Payments to household employees may also be subject to state unemployment and other state taxes.

Estate and Gift Taxes

Tax reform increased the applicable estate and gift exemption for individual taxpayers and doubled the generation-skipping transfer tax exemption amounts to $11,180,000 ($22,360,000 for married couples), for tax years beginning after December 31, 2017, and before January 1, 2026. These amounts will be adjusted for inflation each year. Further, inflation will be measured using the Chained-Consumer Price Index (CPI), a lower rate of inflation. Chained-CPI is estimated once in February and is finalized the following February.

Planning Suggestion: Affluent families should consider developing a lifetime gifting strategy to use some or all of their increased exemptions prior to December 31, 2025. The spousal limited access trust is an oft-used, time tested strategy that can help such taxpayers to do so.

Estimated Taxes

Generally, all individuals must make quarterly estimated tax payments if they have income that is not subject to withholding. This includes individuals who are self-employed or retired or who have investment income, such as interest, dividends, and capital gains. It also includes partners and S corporation shareholders.

The law provides several safe harbors for determining the minimum estimated tax that must be paid to avoid penalties. If your 2017 adjusted gross income was more than $150,000 ($75,000 if you are married filing a separate return), you must pay the smaller of 90% of your expected tax for 2018 or 110%* of the tax shown on your 2017 return to avoid an estimated tax penalty. (*If your 2017 AGI was under these high-income thresholds, cover 100% of the tax shown on your 2017 tax return). Where an individual expects 2018 income to be lower than 2017 income, the individual should pay estimated taxes for 2018 in an amount equal to at least 90 percent of projected 2018 tax liability.

Planning Suggestion: Deferring a large gain from December 2018 to January 2019 may postpone all or a portion of the federal tax payment on that gain to April 15, 2020. While the gain deferral may postpone the timing of tax payment, the tax rates for 2018 should also be considered when making such decisions. Unless you are subject to AMT, it may be beneficial to pay estimated state income taxes on a 2018 gain prior to the end of 2018 in order to obtain an itemized deduction on your federal 2018 return.

Two other safe harbor exceptions are available to eliminate penalties for insufficient payments of estimated taxes. No penalty will be imposed for underpayment of estimated taxes if the unpaid tax liability for the year (after taking into account any withholding) is less than $1,000. In addition, if your income varies throughout the year, you may use an annualized installment method to reduce or eliminate potential penalties.

The same rules apply to certain estates and trusts.

Planning Suggestion: If you have underpaid an installment of 2018 estimated taxes, increasing a later installment will not completely eliminate the underpayment penalty. However, increased withholding on year-end salary or bonus payments may be used to make up the underpayment. That is because withholding on compensation is deemed paid evenly over all quarters of the year.

Note: Voluntary withholding of income taxes from social security payments and certain other federal payments is permitted. This withholding may eliminate the need to file quarterly estimated payments for certain retired persons.

Year-end and Other Gifts; Portability

The end of the year is the traditional time for making gifts. For 2018 you may give up to $15,000 to a person without incurring any federal gift tax liability. The $15,000 annual limit applies to each donee. Thus, you may make $15,000 gifts to as many people as you like. If you are married, you and your spouse can give a combined $30,000 to each donee, if your spouse consents to splitting the gift or if you give community property. To qualify for this annual exclusion, the property must be given outright to the donee or put into a trust that meets certain conditions.

In addition to the annual exclusion, the lifetime exemption (made available in the form of a credit against tax based on an exemption-equivalent amount) allows each person to transfer $11,180,000 for 2018 by gift without incurring any gift tax liability (reduced by the amount of any lifetime exemption that may have been used in a prior year). Using this credit

now will keep future appreciation on the transferred property out of your estate. However, using the lifetime credit against 2018 gifts reduces the credit available for future years.

A widow or widower may have an increased lifetime exemption if the deceased spouse died after 2010 with an unused exemption amount and an estate tax return was filed. Please note that an estate tax return must be filed on a timely basis for the surviving spouse to obtain the increased exemption. This is true even if an estate tax return was otherwise not required to be filed because the value of the gross estate was less than the threshold required for filing an estate tax return. A full discussion of the portability of the lifetime exemption between spouses is beyond the scope of this letter. Please consult with your advisor for a more complete explanation of the portability rules.

In addition to gifts subject to the annual exclusion and the lifetime credit, direct payments of tuition made on another person's behalf to a university or other qualified educational organization are also excluded from gift tax, as are direct payments of medical expenses to a medical care provider.

Planning Suggestion: You should consider using appreciated property in making gifts. If the recipients are in lower income tax brackets than you, income from the transferred property, including any gain on sale, will be taxed at lower rates.

Additional Suggestion: It is generally unwise to give property that has declined in value. Rather, you should consider selling the property and realize the tax benefits of the loss.

All outright gifts to a spouse (who is a United States citizen) are free of federal gift tax. However, for 2018, only the first $152,000 of gifts to a non-United States citizen spouse are excluded from the total amount of taxable gifts for the year. You should coordinate your year-end gift giving with your overall estate planning. Your advisor can assist you with these matters.

Opportunity Zone Program

The opportunity zone program was created under tax reform to promote investment in economically distressed communities. There are now over 8,700 certified QOZs in all 50 states, the District of Columbia, Puerto Rico and the Virgin Islands. Investors must invest in a qualified opportunity fund (QOF) within 180 days after the sale or exchange of a capital asset. The QOF is an investment vehicle that must hold at least 90 percent of its assets in qualified opportunity zone property, which includes qualified opportunity zone stock, qualified opportunity zone partnership interest, or qualified opportunity zone business property. Investment of capital gains in a QOF can result in beneficial tax incentives, including the following:

- Deferral of tax due on the capital gains invested in the QOF until December 21, 2026.
- Basis step-up on the capital gains invested of 10 percent if the investment is held for five years and 15 percent if the investment is held for seven years.
- Permanent exclusion from taxable income post-acquisition capital gains on investments in QOFs that are held at least ten years.

Treasury released proposed regulations, a revenue ruling and a draft form on October 19, 2018. Although this guidance answered many questions, the preamble to the Proposed Regulations states that Treasury is working on additional regulations to address other issues. This was the first step of a larger regulatory project that should provide greater certainty in the near future.

Planning Suggestion: Taxpayers with recognized capital gain should consider making an investment in a QOF to obtain significant tax savings. Your advisor can be consulted for further information and assistance.

Conclusion

Like an annual physical examination is important for maintaining good health, an annual financial examination that includes year-end tax planning can enhance your financial well-being. Your advisor is available to help you achieve your tax and financial objectives.

2018 FEDERAL INCOME TAX RATES

Tax Rate	Joint/Surviving Spouse	Single	Head of Household	Married Filing Separately	Estate & Trusts
10%	$0-$19,050	$0-$9,525	$0-$13,600	$0-$9,525	$0-$2,550
12%	$19,050-$77,400	$9,525-$38,700	$13,600-$51,800	$9,525-$38,700	-
22%	$77,400-$165,000	$38,700-$82,500	$51,800-$82,500	$38,700-$82,500	-
24%	$165,000-$315,000	$82,500-$157,500	$82,500-$157,500	$82,500-$157,500	$2,550-$9,150
32%	$315,000-$400,000	$157,500-$200,000	$157,500-$200,000	$157,500-$200,000	-
35%	$400,000-$600,000	$200,000-$500,000	$200,000-$500,000	$200,000-$300,000	$9,150-$12,500
37%	Over $600,000	Over $500,000	Over $500,000	Over $300,000	Over $12,500

TAX TIPS FOR THE SELF-EMPLOYED

- Establish a Simplified Employee Pension (SEP) Plan by the due date of your 2018 return, including extensions. The contribution to the plan must be made by that due date. For 2018, the maximum allowable contribution to a SEP an employee can make independently of an employer is $5,500 ($6,500 if a catch-up contribution). However, the maximum combined deduction for an active participant's elective deferrals and other SEP contributions is $55,000 for 2018.
- Alternatively, establish a Keogh Plan in 2018, before December 31. The full contribution to the plan need not be made until the due date of your 2018 return, including extensions.
- Consider placing business assets in service in 2018. If qualified, Section 179 expense allows you to deduct the full cost of depreciable assets in the tax year they are placed in service subject to an expense level of $1,000,000 and the phase out threshold amount commences at $2,500,00 for 2018
- For taxable year 2018, a taxpayer can deduct start-up expenditures up to $5,000 with the phase out threshold at $50,000.
- A self-employed individual generally may deduct the employer-equivalent portion of his or her self-employment tax in figuring adjusted gross income. This deduction only affects the taxpayer's income tax. It does not affect net earnings from self-employment or self-employment tax.
- 100 percent of medical and long-term care insurance premiums, subject to the limitations on long term insurance premiums paid by a self-employed person are deductible from gross income to arrive at AGI.
- Effective for payments made on or after March 30, 2010, the Affordable Care Act allows the self-employed health insurance deduction to include an adult child who has not attained the age of 27 before the end of the taxpayer's taxable year.

* See our *2018 Year-End Tax Planning Considerations for Businesses* Including Year-End Ideas for further information.

TAX PROVISIONS RELATING TO HIGHER EDUCATION COSTS / 2018

The Taxpayer Relief Act of 1997, the Economic Growth and Tax Relief Reconciliation Act of 2001 and the American Recovery and Reinvestment Act of 2009 added several provisions to the federal tax law to help moderate-income individuals and families save and pay for higher education costs. The American Taxpayer Relief Act of 2012 extended the effective date of some of these provisions. The Protecting Americans from Tax Hikes Act of 2015 again extended or made permanent some of these provisions. These provisions are as follows:

Provision	AGI Limitation for Complete Phase-out Single/Joint	Description
American Opportunity Tax (Hope) Credit	$80,000/160,000*	Tax credit of up to $2,500 per student for each of the first four years of college (2015 PATH Act made permanent)
Lifetime Learning Credit	$57,000/$114,000*	Tax credit of up to $2,000 per taxpayer for university juniors, seniors and graduate students
Education IRAs	$110,000/$220,000*	Income exemption for accumulated earnings from annual nondeductible contributions of $2,000 per beneficiary used to pay for higher education expenses
Regular IRAs	Unlimited	Penalty-free distributions from regular IRAs used to pay qualified higher education expenses
Education loans	$65,000/$135,000	Limited above-the-line deduction for interest on qualified education loans
State tuition programs	Unlimited	Earnings accumulated from contributions to qualified state tuition programs distributed
Student loan cancellations	Unlimited	Exclusion for student loan cancellations by tax-exempt organizations is prescribed situations

State tuition programs, also known as 529 plans are popular education funding plans because there are no income level limits to funding such plans. There is no federal deduction for funding such plans, but the income within the funds grows income tax free. Some states do permit an income tax deduction for state income tax purposes. Although the funding of such funds is a taxable gift by the donor, the annual exclusion is available. Furthermore, an election can be made on a gift tax return to up front fund the 529 plan with an amount equal to five times the annual exclusion amount and have such lump sum gift attributed over a five year period. Since the 2018 annual exclusion is $15,000 a taxpayer could fund up to $75,000 into a 529 plan and have no taxable gifts with the proper election.

*Limitation is on MAGI

6611 W. North Avenue
Oak Park, IL 60302
708.386.1433

1776 Legacy Circle, Suite 118
Naperville, IL 60563
630.577.9074

Sassetti.com