SEI Private Wealth Tax Planning Guide

Considerations for your 2019 tax planning

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Last year, we saw the most significant tax reform since 1986. This year, we will see if we reap the intended tax savings from the reform—which was meant to positively affect people across every wealth level. However, these law changes require interpretation by the Treasury and Internal Revenue Service. As Americans file their first set of tax returns in 2019, we will begin to gain clarity on the actual impact of the "new" 2018 tax laws.

The following summarizes notable points, broken down by tax areas. We provide some education relevant to higher-income taxpayers. At a high level, whether looking at individual or business taxes, the most basic principles of year-end tax savings are **deferring income into the subsequent year** and/or **accelerating deductible expenses into the current year**. It's important to consider additional practical planning, such as making cash management (lending/borrowing), typical annual gifts, completing charitable plans, integrating life insurance, reviewing current trusts or considering new trusts to your benefit.

As always, we advise that your first step should be to contact your tax accountant and request a tax projection, which can highlight areas where you may be able to reduce your tax exposure. Your tax accountant can identify techniques that may provide tax savings to you in 2018/2019 and beyond.

SUMMARY: The new Tax Cuts and Jobs Act (TCJA)[1,2]
Individual income tax

Tax category	2019							
	Graduated tax rates	10%	12%	22%	24%	32%	35%	37%
Individual income tax rates and brackets (inflation adjusted)	Single	$0 to $9,700	$9,701 to $39,475	$39,476 to $84,200	$84,201 to $160,725	$160,726 to $204,100	$204,101 to $510,300	Over $510,300
	Married	$0 to $19,400	$19,401 to $78,950	$78,951 to $168,400	$168,401 to $321,450	$321,451 to $408,200	$408,201 to $612,350	Over $612,350
	Head of household	$0 to $13,850	$13,850 to $52,850	$52,850 to $84,200	$84,200 to $160,700	$160,700 to $204,100	$204,100 to $510,300	Over $510,300
Capital gains tax rates and brackets	Rate	0%		15%		20%		
	Single	$0 to $39,375		$39,376 to $434,550		Over $434,550		
	Married	$0 to $78,750		$78,851 to $488,850		Over $488,850		
	Head of household	$0 to $52,750		$52,751 to $461,700		Over $461,700		

Tax category	2019
Net investment income tax/Medicare tax (non-qualified dividend income, interest income, qualified dividends and capital gains)	3.8%
Alternative minimum tax	26% tax rate for income over $71,700 (single); $111,700 (married joint) 28% tax rate for income over $97,400 (single); $194,800 (married joint) Phase-out of exemption begins at $510,300 (single)
Capital gain exclusion on primary residence	Up to $500,000 (joint)
Personal exemptions	Repealed
Standard deduction	$12,000 (single) $24,000 (married joint) $18,350 (head of household)
Itemized deductions	PEASE limitation (cap on how much one could claim on itemized deductions based on certain income levels) was repealed in 2017. Gambling losses and investment interest are still deductible. Most deductions subject to 2% AGI floor are no longer allowed (e.g., tax preparation fees, unreimbursed work-related expenses, union dues, hobby expenses, and investment advisory and management expenses).
State and local tax deduction (SALT)	State and local income, sales and property taxes limited to $10,000 in aggregate (single or married joint)
Mortgage interest deduction	Allowed on principal and second residence up to $750,000 on the principal HELOC interest is no longer deductible unless used for home capital improvement purposes.
Charitable deductions	Cash gifts to public charities up to 60% AGI
Medical expense deduction	Excess of 7.5% of AGI
Student loan interest deduction	The deduction phases out ratably for individual taxpayers with AGI between $70,000 and $85,000, and AGI between $140,000 and $170,000 for joint filers.

Child tax credit	$2,000/qualified child Phase-out begins at $200,000 (single) and $400,000 (married) Note, the child credit is refundable up to $1,400.
Other credits	Elderly and permanently disabled Plug-in electric vehicles Interest on certain home mortgages

Commentary[2]

Given the continued uncertainty on the interpretation of the TCJA, as well as how "permanent" it is, planning to minimize the tax impact is critical. You should strive to implement the best strategies. Overall, the TCJA increased exclusions, reduced itemized deductions, increased the standard deduction and lowered the tax rates in each expanded income bracket.

Withholding/estimated tax: Review your income projections, W-2 withholdings and estimated tax payment calculations with your CPA to ensure you avoid underpayment penalties.

The kiddie tax: While you may consider shifting income-producing assets to family members in lower tax brackets, be aware that the kiddie tax was significantly revamped. Earned income of children under 18 is taxed at the ordinary income and capital gains tax rates applicable for estate and trusts, not at their parents' marginal tax rate as was the prior rule. But note, you will be able to elect to include your child's income on your tax return for 2019 if your child's income is more than $1,100 and less than $11,000. Otherwise, the kiddie tax (and estate and trusts) is calculated as follows: 10% for income up to $2,550; 24% for income $2,551 to $9,150; 35% for income $9,151 to $12,500; 37% for income $12,501+. Therefore, consider shifting children's investments to avoid kiddie tax.

Investment management: This continues to be important. Tax loss harvesting is a year-round process, because long-term capital gains continue to have a top tax rate of 23.8%. Plan to match capital gains with capital losses to shield your exposure to capital gains tax. Find ways to reduce net investment income (e.g., offset margin interest with short-term capital gains). Consider positioning a portfolio to maximize the benefit of the lower tax rate on long-term capital gains investments and qualified dividends. Use proceeds to reposition your portfolio. Consider municipal bonds (generally no federal income tax) if you're in a higher tax bracket.

Itemized deductions: Evaluate whether you will benefit from the same itemized deductions for which you qualified in the past. The repeal of the miscellaneous deductions subject to a 2% floor, plus the limitation of SALT deductions, combined with an increase in standard deductions, will significantly impact many taxpayers' ability to itemize deductions. Offsetting the reduced itemized deductions is the reduced threshold for deducting medical expenses.

- Depending on your individual analysis, consider paying off your Home Equity Line of Credit (HELOC) or part of your mortgage since you may lose interest deduction benefits.
- Consider contributing to Flexible Spending Accounts (FSA) up to $2,700 or Health Savings Accounts (HSA) up to $3,500 for self-only coverage or $7,000 for family coverage to use pretax dollars to pay for certain healthcare expenses.

Charitable giving: This remains a topic to plan around. An increase in allowable deduction for cash donations to public charities may be beneficial to some. Charitable remainder trusts and gifts of a vehicle after its useful life are powerful planning concepts. Consider donating appreciated stock to charity to get a deduction for its fair market value (no tax will be due on the gain).

Alternative Minimum Tax (AMT): The increases to exemptions and thresholds combined with changes to itemized deductions should significantly cut down on those subject to AMT. Therefore, planning for AMT contingencies becomes less critical. If you are subject to AMT, consider the impact of paying certain deductions in the current calendar year that would be disallowed for AMT purposes. Consider the impact of exercising incentive stock options on AMT or prepaying next year's deductions in the current year, for example, charitable contributions, estimated taxes and property taxes (subject to the $10,000 cap).

Other notable considerations and changes:

- Section 529 plan distributions have been expanded beyond higher education to include up to $10,000 distributions to K-12 private or religious schools.
- Section 1031 like-kind exchanges are limited to real property that is not held primarily for sale.
- Individual mandate to require most Americans to purchase health insurance is repealed.
- Alimony is no longer taxable to the recipient or deductible to the payer for agreements after Dec. 31, 2018.
- Educator classroom expenses for above-the-line $250 deduction remains available.
- Moving expense deduction was repealed through 2025.

Estate and gift tax

Tax category	2019
Lifetime gift, estate and generation skipping transfer tax	40% rate for gifts or estates over $11.4 million (individual)* $22.8 million (married couple)*
Income tax for estates and trusts	10% for taxable income less than $2,600 $2,601 to $9,300 = $260 plus 24% of the excess over $2,600 $9,301 to $12,750 = $1,868 plus 35% of the excess over $9,300 Over $12,750 = $3,075.50 plus 37% of the excess over $12,750
Annual gift exclusion	$15,000 individual; $30,000 married jointly
Capital gains tax at death	None–basis step-up for estate assets

*Increased for inflation annually

Commentary

The new exemptions sunset after 2025 and revert back to the law in effect for 2017. There is also a feeling that "anything can happen" over the next five to 10 years, particularly with estate and gift taxation. This creates opportunity for current planning, while estate and gift laws are more taxpayer-friendly.

Estate freeze techniques: These remain popular options as a way to power way to gift assets out of your estate and achieve tax-free growth. Grantor Retained Annuity Trusts (GRATs) can provide tax-free gifting given low interest rate hurdles, which provide cash flow in the form of annuities, back to the grantor. Spousal Lifetime Access Trusts (SLATs) are a powerful way for married couples to make efficient use of the lifetime gift-tax exemption while retaining access to income and principal if the need arises. Using an Intentionally Defective Grantor Trust (IDGT) can help freeze the value of your estate assets. Family Limited Partnerships (FLPs) can use valuation discounts and are less risky, given the pull back of FLP regulations in 2017.[3]

Reverse Qualified Terminal Interest Property (QTIP) election: The tax reform created an opportunity for high-net-worth individuals to strengthen their estate plan, particularly in wealth accumulation. Estate plans could be flawed, no longer capturing a step-up in income tax basis at second death. Adjustments to the plan to build in flexibility for surviving spouses and using a complex technique called a "reverse QTIP election trust" could be valuable, depending on your personal circumstances. The goal would be to minimize exposure to estate tax and give a step-up in income tax basis at both first and second deaths.

Applicable Federal Rates (AFR) for February, 2019[4]

Period	Annual	Semi-annual	Quarterly	Monthly
Short-term (3 years or less)	2.57%	2.55%	2.54%	2.54%
Mid-term (>3 but <9 years)	2.63%	2.61%	2.60%	2.60%
Long-term (>9 years)	2.91%	2.89%	2.88%	2.87%
The section 7520 rate is 3.4% (used to determine the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest).				

Commentary

Interest rates are still at or close to historical lows. The opportunity to refinance debt (i.e., mortgages), integrate cheaper interfamily loans or integrate a powerful Grantor Retained Annuity Trust (GRAT) is still available. These techniques should continue to be beneficial while the IRS-prescribed AFR remains taxpayer-friendly.

Business and corporate taxes[5]

Tax category	2019
Corporate tax rate	21%
Pass-through deduction	New 20% deduction for qualified business income from a partnership, S Corporation or sole proprietorship
Net Operating Losses (NOLs)	NOL deduction is limited to 80% of taxable income. NOLs are no longer able to be carried back but allowed for indefinite carryforward.
Business interest deduction	Limited to the sum of business interest income + 30% of adjusted taxable income + the floor plan financing interest for the tax year. Any disallowed interest can be carried forward.
Bonus depreciation	The TCJA was modified to allow 100% deduction for eligible property until 2022. This will be phased down over four years by 20% each year.
Payroll taxes	A 12.4% Social Security (SS) tax applies to wages up to $132,900. The employee portion is 6.2%. The Medicare portion is an additional 1.45% on all earnings; for individuals with earned income of more than $200,000 ($250,000 for married joint), an additional 9% is paid for Medicare taxes.

Commentary

Be aware of the Section 199A deduction for Qualified Business Income of Pass-through Entities. Non-corporate entities (S-Corps, Partnerships, Sole Proprietorship, Qualified REIT Dividends, Qualified Cooperative Dividends, Qualified Publicly Traded Partnership Income) can deduct

20% of Qualified Business Income (up to $160,700 of qualified business income for unmarried taxpayers and $321,400 for married taxpayers), with limitations based on W-2 wages and reductions based on Specified Service Businesses (law, accounting, financial services, medical, performing arts and consulting).

Other notable considerations and changes:

- If self-employed, evaluate the cost of buying health insurance through your business versus individually purchasing insurance. You may be able to capture the full benefit of the deduction.
- If in a cash basis business, consider delaying income by sending invoices in the subsequent year.
- Entertainment, including activities for amusement, recreation, membership dues and related facility expenses are disallowed business expenses.
- Meal (food and beverage) expenses associated with operating a trade or business continue to receive a 50% deduction, but has been expanded to include providing food to employees through a facility that meets the *de minimis* fringe and convenience of employer standards.
- The TCJA modified numerous business credits as opposed to repealing them as previously proposed. If relevant to you, some credits to be aware of are for the rehabilitation for pre-1936 buildings as well as credit for paid family or medical leave.

Retirement planning[6]

Contribution limits	2019
401(k) and 403(b)	$19,000 plus $6,000 catch-up*
IRA and Roth IRA†	$6,000 plus $1,000 catch-up*
SEP IRA, Keoghs and profit-sharing plans‡	25% of up to $280,000, maximum $56,000
Simple IRA	$3,000 plus $3,000 catch-up*
Phase-Out Ranges for IRA	Single and heads of household: $64,000 to $74,000 Married Joint: $101,000 to $121,000
Roth IRA Phase-out Limits for Contributions	Single and heads of household: $122,000 to $137,000 Married Joint: $193,000 to $203,000

*Those who are 50 or older at year end.
†Contributions can be made up until due date of the tax return, no extensions.
‡Contributions can be made up until the due date of the tax return, including extensions.

Commentary

The TCJA should result in a declining tax bill for many Americans. As such, this gives many individuals the opportunity to save more for retirement or future goals.

Roth conversions: Evaluate whether a ROTH conversion is beneficial. While the TCJA disallows the reversal of a Roth conversion, current income taxes may be lower than before, making the ROTH more attractive. A conversion may result in opportunities for reduced kiddie tax as well.[7]

If you expect not to need IRA distributions during your lifetime, a conversion to a Roth IRA will avoid Required Minimum Distributions at 70½, allowing your children to inherit the IRA and stretch distributions for their life span.

Similarly, many 401(k) plans allow you to convert to a Roth 401(k) plan during continued employment. This could be valuable if your administrator allows it.

Charitable planning: The Qualified Charitable Distribution (QCD) rule was made permanent. IRA holders who are 70½ can make a tax-free distribution from your IRA of up to $100,000 to charities.

Business owner retirement planning: As is in prior years, business owners should consider the benefits of profit-sharing plans, Simplified Employee Pension (SEP) plans and defined benefit plans. Succession planning continues to be critical. Buy-sell agreements and employee stock ownership plans (ESOP) are important vehicles to understand.

Concluding remarks

We continue to believe the TCJA created the need to evaluate your personal and business tax matters starting in 2018. This need extends into 2019 because the Treasury and IRS will likely issue regulations clarifying their view of the tax reform. Understanding the laws and their impact on you will require tax planning initiatives during 2019 and beyond for many of our clients. More than ever, your CPA should be providing **income tax projections** as a starting point for planning. Your personal circumstances could dictate whether to consider additional opportunities. Please contact your wealth manager and CPA today for further guidance.

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1 The Tax Cuts and Jobs Act (TCJA), www.congress.gov/115/bills/hr1/BILLS-115hr1enr.pdf

2 https://tax.thomsonreuters.com/news/key-2019-individual-tax-items-as-calculated-by-thomson-reuters-checkpoint-based-on-inflation-data/

3 https://apps.irs.gov/app/picklist/list/federalRates.html

4 Ibid.

5 The Tax Cuts and Jobs Act, www.congress.gov/115/bills/hr1/BILLS-115hr1enr.pdf

6 Ibid.

7 https://www.financial-planning.com/news/roth-ira-conversions-the-new-tax-law-changes-conversions

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