Dear BMSS Clients and Friends,

As the end of 2018 approaches, you are likely giving consideration to year-end tax planning strategies. For 2018, the Tax Cuts and Jobs Act (TCJA) does away with many familiar long-standing tax rules and introduces a host of new ones. This letter highlights some of the planning opportunities and challenges for individuals, estates, trusts and businesses regarding federal taxes. BMSS can help you navigate through uncertainties and develop a year-end tax strategy to help minimize your federal tax liability. Please call your BMSS trusted advisor for assistance with your year-end tax planning.

Overview of General Goals And Objectives of Year-end Tax Planning

Most traditional income tax planning strategies focus on several key areas:

- planning the ***timing (deferral or acceleration)*** of particular items ***of income or deductions,*** to the extent that they can be shifted from one year to another in order to take advantage of possible differences in the effective tax rate for the current year and succeeding year(s), limitations on deductions, or other factors that may differ year-to-year;
- maximizing, within overall general planning, the ***character of income*** (for example, qualified dividends and capital gains) that is subject to preferential, lower tax rates than ordinary income; and
- taking advantage of ***special incentive provisions*** of the Internal Revenue Code ***when available*** such as Section 179 expensing, bonus depreciation, various credits related to different business or personal activities, and Qualified Opportunity Fund investments.

To complicate matters further, these general planning strategies must also consider the impact of taxes other than the regular income tax, such as the alternative minimum tax, the net investment income tax, the Medicare surtax and applicable state and local taxes to name a few. The limitation of certain itemized deductions must also be considered in planning for the timing of deductions.

As always, tax planning requires a combination of multi-layered strategies, taking into account a variety of possible scenarios and outcomes. There are various income and deduction items to consider and your BMSS trusted advisor will be glad to assist you in order to determine the most beneficial approach to take.

Individual Planning

Tax Rates and Phaseouts – Individuals

The income tax rates and brackets for 2018 are:

Tax Rate	Married Filing Jointly (MFJ)	Married Filing Separately (MFS)
10%	$0 - $19,050	$0 - $9,525
12%	$19,051 - $77,400	$9,526 - $38,700
22%	$77,401 - $165,000	$38,701 - $82,500
24%	$165,001 - $315,000	$82,501 - $157,500
32%	$315,001 - $400,000	$157,501 - $200,000
35%	$400,001 - $600,000	$200,001 - $300,000
37%	$600,001 and greater	$300,001 and greater

Tax Rate	Head of Household (HOH)	Single Taxpayers
10%	$0 - $13,600	$0 - $9,525
12%	$13,601 - $51,800	$9,526 - $38,700
22%	$51,801 - $82,500	$38,701 - $82,500
24%	$82,501 - $157,500	$82,501 - $157,500
32%	$157,501 - $200,000	$157,501 - $200,000
35%	$200,001 - $500,00	$200,001 - $500,00
37%	$500,001 and greater	$500,001 and greater

Tax rates for long-term capital gains and qualified dividends have changed due to the TCJA and will no longer be tied to ordinary income. The following table shows the new tax brackets for long-term capital gains and qualified dividends based on the taxable income listed:

Tax Rate	Single	Married Filing Jointly	Head of Household
0%	$0 - $38,600	$0 - $77,200	$0 - $51,700
15%	$38,601 - $425,800	$77,201 - $479,000	$51,701 - $452,400
20%	$425,801 and greater	$479,001 and greater	$452,401 and greater

Two other rates that apply to long-term capital gains and qualified dividends remain the same:

- 25% for unrecaptured Code Section 1250 gains
- 28% for collectible gains and gains on qualified small business stock

If you hold your assets for longer than a year, you can benefit from the reduced tax rate on your profits. Qualified dividends must be received from domestic corporations and held for more than sixty days.

Keep in mind the "wash sale rules" when reviewing year-end capital gains and dividends. Wash sales are sales of stock or securities in which losses are realized, but not recognized for tax purposes, because the seller acquires substantially identical stock or securities within 30 days before or after the sale. Nonrecognition, however, applies only to losses; gains are recognized in full.

In previous years, higher-income taxpayers were subject to the Pease limitation. The Pease limitation reduced itemized deductions by 3% of the amount that the taxpayer's adjusted gross income (AGI) exceeded the various thresholds, but not by more than 80%. With the passing of the TCJA, the Pease limitation was eliminated for 2018 through 2025.

Before 2018, taxpayers were allowed personal exemptions for themselves and any eligible dependents, subject to AGI limitations. The TCJA eliminated these exemptions through 2025.

Alternative Minimum Tax – Individuals

The possibility of being subject to alternative minimum tax (AMT) should not be ignored, as doing so may negate certain year-end tax strategies. While certain provisions of TCJA mean fewer individuals will be subject to AMT, the tax does still exist. An AMT exemption is allowed; however, the exemption is phased out as taxpayers reach high levels of alternative minimum taxable income (AMTI). For 2018, the exemption amounts are:

- $109,400 for MFJ and Surviving Spouse (SS), phaseout begins at $1,000,000 (complete phaseout at $1,437,600);
- $54,700 for MFS, phaseout begins at $500,000 (complete phaseout at $718,800); and
- $70,300 for HOH and Single, phaseout begins at $500,000 (complete phaseout at $781,200).

An individual's tentative minimum tax is generally equal to the sum of 28% of an individual's taxable excess up to a threshold amount ($95,550 for MFS and $191,100 for all other filers).

Net Investment Income Tax (NIIT) – Individuals

The NIIT is a 3.8% Medicare surtax imposed on the lesser of an individual's (a) net investment income (NII) or (b) the amount of modified adjusted gross income (AGI with foreign income added back) that exceeds the thresholds below:

- $250,000 for MFJ or SS
- $125,000 for MFS
- $200,000 for single taxpayers and HOH

The NIIT generally applies to passive income and is not imposed on income derived from a trade or business or from the sale of property used in a trade or business. NII includes the following:

- Gross income from interest, dividends, annuities, royalties, and rents, provided this income is not derived in the ordinary course of an active trade or business;
- Gross income from a trade or business that is a passive activity for the taxpayer;
- Gross income from a trade or business of trading in financial instruments or commodities; and
- Gain from the disposition of property not held in an active trade or business.

NII can be reduced by certain investment-related expenses, such as investment interest expense, investment brokerage fees, royalty-related expenses, and state and local taxes allocable to items included in net investment income.

Keeping income below the thresholds, spreading income out over a number of years or offsetting the income with both above-the-line and itemized deductions are possible approaches to avoid the NIIT. Of course, every taxpayer's situation is different and planning for the NIIT requires a very personalized strategy. BMSS can help you develop a personalized response.

Additional Medicare Tax – Individuals

An additional 0.9% high income Medicare tax is imposed on *wages and self-employment income* that exceeds the same thresholds as the NIIT thresholds listed above. Although the thresholds are the same, this additional tax should not be confused with the 3.8% Medicare surtax on NII.

If federal income tax withholdings and estimated tax payments have not been made under a "safe harbor," you can instruct your employer to withhold additional federal income taxes from your wages before year end to avoid an underpayment penalty related to this tax or the NIIT.

Child and Education Related Tax Benefits – Individuals

Adoption Credit and Adoption Assistance Programs

Most taxpayers can claim a credit for qualified expenses incurred in connection with the adoption of an eligible child. The credit for each adoption is limited to a maximum amount of $13,810 per child for 2018. Additionally, $13,810 received under an adoption assistance program may be excluded from gross income. Both the credit and gross income exclusion are phased out for higher income taxpayers. Different rules apply to domestic children, foreign children, and children with special needs.

Child and Dependent Care (CDC) Credit

Taxpayers who incur expenses to care for children under age 13 (or for an incapacitated dependent or spouse) in order to work or look for work can claim a credit for those expenses. The credit is calculated as a percentage of the expenses incurred, up to a maximum of $3,000 for taxpayers with one qualifying child or dependent and $6,000 for taxpayers with two or more qualifying children or dependents.

Child Tax Credit (CTC)

Taxpayers are allowed an income tax credit of $2,000 for each qualifying child under the age of 17 at the end of the calendar year. The child tax credit is refundable, up to $1,400, for some taxpayers, but begins to phaseout for higher-income taxpayers at the thresholds below:

- $400,000 for MFJ (complete phaseout at $440,000)
- $200,000 for single taxpayers, HOH and MFS (complete phaseout at $240,000)

Taxpayers are also allowed to take a $500 nonrefundable credit for qualifying dependents other than children.

American Opportunity Tax Credit (AOTC)

The maximum credit that can be taken is $2,500 per eligible student for the first four years of higher education and up to $1,000 is refundable. The AOTC is phased out for single taxpayers with income ranging from $80,000 to $90,000, and for joint taxpayers with income ranging from $160,000 to $180,000.

Lifetime Learning Tax Credit
The lifetime learning credit is a nonrefundable credit for qualified students and is available for all years of postsecondary education. The maximum credit is $2,000 and is phased out for single taxpayers with income ranging from $55,000 to $65,000 and joint taxpayers with income ranging from $112,000 to $131,000. The lifetime learning credit and American Opportunity credit cannot be taken in the same tax year.

Coverdell Education Savings Accounts (ESAs)
ESAs are trust or custodial accounts created exclusively to pay the qualified elementary, secondary and higher education expenses of a single named beneficiary. Annual contributions are limited to $2,000 per beneficiary, but this limit is phased out for higher-income contributors. Contributions may be made to an ESA up to the original due date of the return.

Qualified Tuition Programs (QTP)
A Qualified Tuition Program is an education savings plan designed to help families set aside funds for future college costs. Contributions to a QTP are not deductible, however, the earnings in the plan grow tax free, provided they are used for qualified expenses (e.g. tuition, fees, room and board, books, supplies, computers and software) while enrolled at an eligible educational institution.

Educational Assistance Programs
Employees are allowed to exclude from gross income and wages up to $5,250 in annual educational assistance provided under an employer's nondiscriminatory "educational assistance plan." Employer-provided educational benefits may also be excludable as a fringe benefit.

Scholarship Programs
Any amount received as a qualified scholarship and used for qualified tuition and related expenses is excludable from income. The exclusion does not apply to any portion of the amount received which represents payment for teaching, research, or other services by the student required as a condition for receiving the qualified scholarship (with limited exceptions).

Student Loan Interest Deduction
Taxpayers may deduct from gross income, subject to certain conditions, interest payments made on qualified education loans. The deduction is an above-the-line adjustment to income that can be claimed by all individuals, not just those who itemize. The maximum deduction of $2,500 is reduced when modified AGI exceeds $65,000 ($135,000 for joint returns) and is completely eliminated when modified AGI reaches $80,000 ($165,000 for joint returns).

Additional Above the Line Deduction Changes

There are two big changes in above the line deductions in determining your adjusted gross income (AGI). Previously, you were able to deduct moving expenses when relocating for a job. The TCJA eliminated this deduction and you are no longer allowed to deduct moving expenses in determining your AGI.

For divorces commencing after December 31, 2018, the deduction for alimony paid has been eliminated. Divorces finalized prior to this date are grandfathered into the previous rules, which allow alimony payments to be deducted from income in determining AGI.

Qualified Business Income Deduction

For tax years beginning after 2017, taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. For 2018, if taxable income exceeds $315,000 for married filing jointly, or $157,500 for all other taxpayers, the deduction may be limited based on whether the taxpayer is engaged in a service type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the trade or business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business. The limitations are phased in for joint filers between $315,000 and $415,000 and for all other taxpayers with taxable income between $157,500 and $207,500.

Standard and Itemized Deductions – Individuals

Standard Deduction
The standard deduction amounts for each filing status increased as follows:

Filing Status	2017	2018
Single	$6,350	$12,000
MFJ or SS	$12,700	$24,000
MFS	$6,350	$12,000
HOH	$9,350	$18,000

Itemized Deductions
The TCJA implemented many changes related to itemized deductions:

- State and local taxes (including personal property and real estate) are limited to $10,000.
- Miscellaneous itemized deductions (tax preparation fees or investment management fees) are no longer deductible.
- Unreimbursed employee expenses are no longer deductible.
- The limit for charitable contributions increased to 60% of AGI.
- For mortgages taken out after December 14, 2017, only interest on the first $750,000 of mortgage debt is deductible.
- Interest on home equity loans is no longer deductible if it is not connected to home improvement expenses. Interest on home equity loans is subject to the $750,000 mortgage limit.
- Personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster and only to the extent the $100 per casualty and 10% of AGI limits are met.

Affordable Care Act (ACA) – Individuals

Unless exempt, the ACA requires that all individuals carry minimum essential coverage or make a shared responsibility payment. Individuals with health insurance coverage should determine that their coverage satisfies the ACA's minimum essential coverage requirements. The following exemptions are available to qualified individuals:

- Religious conscience exemption
- Hardship exemption
- Exemption for members of federally-recognized Native American nations

- Exemption for members of a health care sharing ministry
- Exemption for incarcerated individuals
- Short coverage gap exemption
- Exemption for individuals not lawfully present in the United States

For 2018, the individual shared responsibility payment is the greater of 2.5% of household income that is above the tax return filing threshold for the individual's filing status, or the individual's flat dollar amount, which is $695 per adult and $347.50 per child, limited to a family maximum of $2,085. The shared responsibility payment is capped at the cost of the national average premium for a bronze level health plan available through the ACA Marketplace in 2018.

The TCJA repealed the tax penalty linked to the individual mandate starting in 2019. Most individuals are still required to obtain health insurance, but the penalty for not having it is removed beginning in 2019. The individual mandate is still in effect for the 2018 tax year.

ESTATE, TRUST AND GIFT TAXES

Key Figures

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. The maximum federal unified estate and gift tax rate is 40%. The annual gift tax exclusion allows taxpayers to give up to $15,000 during 2018 to any individual ($30,000 for married individuals who split the gifts), gift-tax free and without counting the amount of the gift toward the lifetime exclusion.

Exclusion for Educational and Medical Expenses

In addition to the $15,000 annual exclusion amount, nontaxable gifts or transfers may be made for certain educational and medical expenses. Any amount paid on behalf of an individual as tuition directly to certain educational organizations for the education or training of such individual is not treated as a transfer by gift for purposes of the gift tax. For medical expenses, the exclusion applies for certain medical expenses paid on behalf of an individual not reimbursed to the individual by insurance. The exclusion for educational and medical expenses is unlimited in amount and can be made on behalf of anyone you choose, as long as the payments are made directly to the educational institution or health care provider.

Year-End Trust Distribution Planning

For certain trusts that are not required to make distributions, distribution planning is important in order to minimize the overall tax due on the trust's income. In general, a trust not otherwise required to make distributions is liable for the tax on all of its income if no distributions are made to beneficiaries. If distributions are made, the beneficiary is taxed on the portion of the income distributed, not the trust. Trusts hit the top income tax rate of 37% for ordinary income in excess of $12,500 in 2018. For individuals, this amount is $500,000 for single filers, and $600,000 for joint filers. Due to the compressed tax bracket for trusts, distributions to beneficiaries often result in a lower overall tax burden. Of course, all factors should be considered as to whether a distribution is appropriate, not just income tax planning. If a trustee determines that distributions are appropriate, trusts have until 65 days after year end (March 6, 2019) to make a distribution and treat it as a distribution for the 2018 tax year.

BUSINESS PLANNING

Key Figures

C Corporations continue to face double taxation, with taxes paid once at the entity level and again when dividends are paid to shareholders. With the TCJA, the C Corporation tax rate was reduced to a rate of 21%. Corporate Alternative Minimum Tax and the Domestic Production Activities Deduction were both repealed under the new laws. Many businesses, however, are not taxed at the entity level as corporations; instead taxable profits and losses are passed through to their owners. With the highest individual tax rate at 37% and additional surtaxes on passive income by way of the 3.8% Net Investment Income Tax, minimizing tax remains a challenge in 2018.

Under the Tax Cuts and Jobs Act (H.R. 1), for tax years beginning 2018, the threshold for companies not allowed to use the cash method of accounting increases to average gross receipts of $25 million. Generally, NOLs can no longer be carried back, except for certain farming and insurance company losses, but can be carried forward indefinitely. NOL carrybacks or carryforwards would be limited to 80% of a taxpayer's taxable income.

Deductions and Credits – Business

Bonus Depreciation
The TCJA increased the bonus depreciation deduction for businesses. A depreciation deduction equal to 100% of the basis of qualifying property is available in 2018. In order to be eligible for bonus depreciation, qualifying property can be new (first-time use) or used tangible property. Any qualifying property acquired and placed in service after September 27, 2017 and before January 1, 2023 is eligible for bonus depreciation.

Code Section 179 Expensing
Code Section 179 property includes new or used tangible personal property that is purchased to use in an active trade or business. Under the enhanced expensing, for 2018, businesses can expense up to $1,000,000 in qualifying expenditures, with no reduction unless expenditures exceed $2,500,000.

Like-Kind Exchanges
Taxpayers can defer the gain (or portion of that gain) on the exchange of like-kind property. Both the relinquished property and the acquired property must be held for business or investment purposes. After TCJA, like-kind exchanges are limited to exchanges of real property. Exchanges of personal property no longer qualify for deferral.

Tangible Personal Property Regulations
The IRS issued final regulations in 2014 that refine and simplify the rules for expensing tangible personal property, including the *de minimis* safe harbor. For 2018, the safe harbor enables taxpayers to routinely deduct items whose cost is below $5,000 for taxpayers with an applicable financial statement (AFS) and $2,500 for taxpayers without an AFS.

Research Credit
The research credit provides a credit for 20% of qualified research expenses over a base amount. The research credit applies to any amounts paid or incurred for qualified research and experimentation. BMSS has a Research and Development team ready to meet with you to discuss your company's R&D potential.

Standard Mileage Rate
The standard business mileage allowance rate for 2018 is 54.5 cents-per-mile (up from 53.5 cents-per mile for 2017).

Health Care Reform – Businesses

Although the primary thrust of the Patient Protection and Affordable Care Act (PPAC) is health insurance reform, the tax law plays a key role in achieving this goal. Below are parts of the reform to health care that continue to impact businesses.

Small Employer Health Care Tax Credit
Eligible small employers that maintained a qualifying arrangement were able to claim a 50% tax credit (35% for eligible tax-exempt employers) for non-elective contributions (i.e., premiums) paid for health coverage for their employees. An employer must participate in an insurance SHOP exchange in order to claim the credit. The credit can only be claimed for two consecutive years.

Simple Cafeteria Plans
Certain small employers' cafeteria plans can qualify as simple cafeteria plans. In order to qualify, an employer's plan must meet strict contribution, eligibility, and participation requirements. The simple cafeteria plan's benefit to the employer is that certain nondiscrimination requirements, particularly those that a classic cafeteria plan must meet, are deemed as satisfied.

Shared Responsibility Payments for Large Employers
"Applicable large employers", employers with at least 50 full-time employees or a combination of 50 full-time and part-time employees, are subject to the employer mandate. Under these rules, if an applicable large employer does not offer minimum essential coverage, or offers coverage to fewer than 95 percent of their full-time employees, the employer's assessed shared responsibility payment will be based on the total number of its full-time employees (minus 30) multiplied by $2,000. If it does offer such coverage, the assessed payment amount will be based solely on the number of employees who claimed a premium tax credit for purchasing coverage through the Health Insurance Marketplace. An employee can claim this tax credit because the employee was offered no coverage, the coverage offered was unaffordable or the coverage did not meet minimum value standards. Safe harbors are available both for counting full-time employees, and for affordable coverage.

Reporting Requirements
The ACA also requires applicable large employers to file information returns with the IRS and provide statements to their full-time employees about the health insurance coverage the employer offered. This requirement applies even if an applicable large employer does not offer coverage to any of its full-time employees. In general, each applicable large employer may satisfy the information reporting requirement by filing a Form 1094-C (transmittal) and, for each full-time employee, a Form 1095-C (employee statement).

We’re Here to Help You

BMSS understands that the complexity of the tax law can make year-end tax planning overwhelming, but it is a necessity. This letter covered several of the high points, but there are many more strategies that can help reduce your tax liability over a period of time.

Additionally, this update discusses only federal tax planning. State taxes should also be considered since the tax laws of many states do not follow the federal tax laws.

Please contact BMSS if you have any questions regarding the opportunities presented in this letter or to schedule an appointment to develop a year-end tax plan for your particular circumstances. We look forward to serving you in the future.

Sincerely,

Barfield, Murphy, Shank & Smith, LLC

Barfield, Murphy, Shank & Smith, LLC

BARFIELD MURPHY SHANK & SMITH LLC
CERTIFIED PUBLIC ACCOUNTANTS