PAUL H. BURGESS, ATTORNEY/CPA – “YIELDING A BETTER RESULT”

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Year-End Tax & Financial Strategies from the “Power of the Dual View”

Last year many non-business tax deductions were curtailed by the new tax laws. As such, a different focus is required to yield personal tax savings. Most business deductions remain. This ***Tax & Financial Newsletter*** includes many personal and business tax strategies to consider at year-end. First though, use the following five-step tax savings process as a general guide for reducing taxes. It starts with: (1) exclude from taxation the income and gains that you can; (2) defer the income that you must report; (3) use deductions to reduce your reported income; (4) pay taxes on the rest; and (5) pay on the latest date possible without incurring penalties or interest.

Business Tax Tips!

√ ***Oklahoma Business SALT Election:*** If for 2019 your flow through entity (S corporations and LLC partnerships) did not elect to deduct its Oklahoma income taxes at the business level, consider it for 2020. The election is due March 15, 2020. The election can essentially convert non-deductible state income taxes into a deduction. A conservative rule of thumb is a 1%+ tax yield is generated. Example, $100,000 of income saves $1,000+ in taxes. Caution: guidance is required because not all should and there are several factors to consider.

√ ***Qualify for Oklahoma SALT Election:*** Yield a better tax result by converting certain activities to a flow through (partnerships or S Corporations). Conversation candidates are sole proprietorships, single member LLCs, oil and gas activities, certain portfolio investments, and rental real estate operations; again, it essentially converts non-deductible state income taxes into a deduction for an extra 1% or so take home.

√ ***Year-end Business Asset Purchases:*** Buying assets at the end of the year can certainly save taxes. However, acquiring assets merely for the tax benefits is questionable. Use the four rules of thumb as a guide:

(1) November and December purchases typically make sense if the assets are going to be replaced in the following year anyway.

(2) Especially for longer term equipment, saving taxes now may be worth it for assets that will be replaced in over a year, but less than two.

(3) Tax savings from year-end purchases that increase efficiencies, expand needed capacity, or improve safety are usually good moves.

(4) Asset purchases that reduce 2019 taxes typically reduce 2020 estimated tax payments.

√ ***Business Vehicles:*** First year maximum automobile depreciation for 2019 is $18,100. The larger SUVs and Trucks enjoy up to a 100% first year deduction! Thus, December vehicle purchases will reduce taxable income.

√ ***Bonus Depreciation Percentages:*** *For* 2019 and 2020 bonus depreciation is 100% of the cost of the asset; and Bonus does not have a maximum dollar amount.

√ ***§179 Expense Election:*** For 2019 a business can 100% expense *up to* $1,020,000 of eligible business assets. The deduction starts phasing out when a taxpayer purchases over $2,550,000 of equipment.

√ ***More on Bonus and §179*** (1) Bonus is more common, but §179 is excellent to manage self-employment income to reduce SE tax; (2) There are numerous Bonus and §179 strategies, and at times knowing next year's income helps determine the best course, thus file an extension and wait; (3) Subject to fairly broad exceptions for certain nonresidential real property improvements, real property is not eligible for Bonus; and (4) §179 is for personal property, and also not typically for any rental real estate assets.

√ ***Tax Basis:*** IRS is requiring more verification for tax basis. Make sure you have tax basis in your partnerships and S corporations to deduct any losses. Increasing your tax basis can be accomplished by several methods including loans and capital investments.

√ ***Active Participation:*** Step up your level of participation in partnerships, S corporations, or LLCs to qualify as an "active participant" for flow-through entities reporting losses. See our October Newsletter re: qualifying rental real estate for the 20% business income deduction.

√ ***Specified Service Businesses:*** For doctors, lawyers, accountants, consultants, etc., maximize contributions to traditional IRAs, §401(k)s, and others pension plans to help qualify for the 20% business income deduction.

√ ***Business Losses:*** You are not in business to generate losses, but they do happen. This is a list of possible business loss deductions:

1. Business Bad Debts
2. Casualty and Theft losses
3. Capital Loss/Worthless Investments
4. Losses on the sale of Business Assets

Sometimes it can be difficult to ascertain what year a business or investment loss should be written off. The general rule is to deduct the loss in the earliest year possible.

√ ***Payment by Check:*** Cash basis businesses can date checks before the end of the year and mail them right before January 1, 2020 to obtain a 2019 deduction.

√ ***Pension Plans:*** Set up pension plans before year-end and fund those plans latter. In many cases if a plan is "set up" by December 31, you can contribute to the plan as late as October 15, 2020 for a 2019 tax deduction. A small employer can claim up to a $500 credit for administration costs for pension plans.

√ ***Pre-Paid Expenses & the 12 Month Rule:*** A cash basis business can typically deduct any amounts paid for a right or benefit that does not extend beyond 12 months after the date of the payment. Thus, a business can pre-pay expenses in December 2019 that are for 2020. For example, pre-paying rent, health insurance, etc. can yield sizable deductions.

√ ***Leasing Vehicles & the 12 Month Rule:*** In December make a one-time lump sum payment on a 36-month auto lease and deduct one-third of it in December under the 12-month rule.

√ ***Deferring Income to 2020:*** Deferring income is an excellent method to slow down paying taxes and estimated tax payments. Consider: (1) electing the cash method of accounting versus the accrual method of accounting (the new tax laws allow $25,000,000 gross sales businesses to use cash basis); (2) delay year-end billing to clients so that payments are not received until 2020; (3) take advantage of §1031 like-kind of exchanges for real estate; (4) elect the installment method of accounting; (5) elect quick depreciation methods/strategies for 2019 which increases 2020 income, and (6) delay selling gain assets until 2020.

Individual Tax Tips!

√ ***December W-2 Withholdings:*** Avoid underpayment of estimated tax payment penalties by increasing your withholdings from your December paychecks.

√ ***Employer Flexible Spending Accounts (FSAs).*** Increase the amount you set aside in your FSA account if you have set aside too little for 2019. The 2019 maximum is $2,700.

√ ***Health Saving Accounts (HSAs).*** If you become eligible in December 2019 to make HSA contributions, you can contribute a full year's worth by the end of 2019. Nevertheless, this year's maximum is $3,500 for self-only, and $7,500 for family plan.

√ ***Maximize Pension & IRA Contributions:*** Increase your retirement plan contributions to take advantage of the maximum write-offs. For 2019: (1) the §401(k) contribution limit is $19,000, and if age 50+ and an additional $6,000; (2) the Simple Plan limits are $13,000 and $3,000 age add on; (3) the IRA limits are $6,000 and $1,000 respectively, and (4) take full advantage of employer matching with additional contributions.

√ ***Sale of Loss Entities:*** Dispose of your interests in those flow-through entities in which you have "suspended" loss carryforwards.

√ ***IRA Distributions for Charity:*** If you are over 70 ½, you can donate up to $100,000 of your IRA to charity and: (1) it is not included in your income, (2) it counts toward your RMD, and (3) although not deductible, with less opportunities to itemize, it is particularly tax advantageous.

√ ***Charitable Contributions:*** Consider gifting appreciated property, typically publicly traded stock, to a charitable organization for a deduction equal to its fair market value without having to report the gain.

√ ***Achieving a Better Life Experience (ABLE) Accounts:*** This is a savings account for individuals with disabilities and their families. For 2019, taxpayers can contribute up to $15,000. Earnings are not taxable and distributions are tax-free if used to pay the beneficiary's qualified disability expenses.

√ ***Accelerating Income into 2019:*** If you are expecting a higher tax bracket next year or are in an unusually low bracket this year, consider accelerating income. Acceleration methods include: (1) selling gain assets before year-end; (2) taking distributions from pension plans; (3) converting a Roth IRA to a Traditional IRA; (4) electing out of the installment method of accounting; (5) settling business lawsuits and insurance claims prior to year-end; and, (6) elect slower depreciation methods which usually increasers 2019 income.

√ ***Single and Head of Household:*** If you are single and assist your parents financially, make sure you meet the support level test to file head of household instead of single.

√ ***State Tax Returns:*** A good tax advisor pays close attention to state income taxes to make sure all the state tax benefits are claimed. Most states have tax breaks that are not applicable to a federal return. Oklahoma's are extensive.

√ ***Lower College Tuition by 5%:*** Take advantage of the Oklahoma §529 plans now by contributing to it in December for a 2019 Oklahoma deduction, then use it for the January 2020 tuition invoice.

√ ***§529 Plans – Higher Education Costs:*** §529 plans can now be used for tuition paid in connection with enrollment or attendance at a public, private, or religious elementary or secondary school, but are subject to a $10,000 distribution annual limit.

Investment Tax Tips!

√ ***Short-Term (ST) vs. Long-Term (LT) Capital Gains:*** Capital gains on property held one year or less are ST and are taxed as high as 50%. If held over a year it is LT and taxed about half as much. For taxpayers not in the highest tax brackets, the tax rate for LT capital gains can be as low as zero!

√ ***Defer the Sale:*** If you have a borderline holding period, consider holding the asset a little longer than a year to take advantage of the favorable LT capital gains rates.

√ ***Offset Gains*****:** Consider selling capital assets that will generate a loss to offset any capital gains recognized earlier in the year. But, be careful not to waste the benefits of LT capital gains with ST capital losses.

√ ***Avoid Fluctuations:*** Realizing net capital gains in 2019 and then suffering net capital losses in 2020 increases the probability of wasting deductions. Thus, a good tax strategy is to try to realize losses in years with gains or sell loss assets in year #1, and sell gain assets in year #2.

√ ***Dividend Taxes:*** Most stock dividends are taxed at LT preferential rates. Thus, dividend paying stocks, and similar stocks held in mutual funds are tax advantageous investments.

√ ***Oklahoma Capital Gain Exclusion:*** If you have appreciated Oklahoma real property or own stock, partnership interest or LLC membership interests in companies that are located primarily in Oklahoma, the capital gain, under many circumstances, can be totally excluded from Oklahoma taxation.

√ ***Gift Appreciated Stock:*** One of the best tax savings strategies can be for a parent to gift appreciated stock to their lower tax bracket adult child.

√ ***Tax Strategy for Pension Plans and Personal Investments:*** Generally, if possible: (1) Hold capital appreciation stocks personally to take advantage of the lower capital gain rates, and (2) Hold bonds producing interest income in your 401(k) or traditional IRA: (3) typically holding any stocks or bonds in a Roth IRA is preferable to 401(k) or Traditional IRA money; and (4) utilizing a "Back Door Roth" is an excellent strategy for otherwise disallowed Roth contributions.

The Power of the Dual View!