TAX STRATEGIES

Smart Tax Moves to Make Before Year's End

During December, you still have the ability to alter the timing of when various deductions and liabilities are realized to minimize taxes.

BY CHARLES ROTBLUT, CFA

December 2019 is the last time you will be able to adjust many of the levers affecting how much you will owe in 2019 taxes. It also presents a good time to start taking action on your 2020 taxes, especially because you still have the ability to alter the timing of when various deductions and liabilities are realized.

To assist you with your tax planning, we've assembled the following list of year-end tax tips. The suggestions focus on areas applicable to large numbers of individual investors and serve as a supplement to our annual tax guide in this issue. If your taxes are complex or you have specific questions regarding the tax code, contact a tax professional. Meeting with them before the end of the year may allow you to reduce or adjust your tax liabilities for 2019 and/or 2020.

Review Your 2018 Tax Return

Last year's return was the first to be directly impacted by the Tax Cuts and Jobs Act of 2017 (TCJA). If reasonable to do so, compare it against your 2017 tax return. Pay attention to what you paid in taxes as well as what you owed or how much of a refund you received for each of the two years. Also, take note of your investment losses.

If you unexpectedly owed money last year or received a larger refund than you anticipated, you may need to adjust your withholdings or estimated tax payments.

Those of you who are working should take advantage of the Internal Revenue Service's Tax Withholding Estimator (www.irs.gov/individuals/tax-withholding-estimator). This tool calculates what you could end up owing or receiving based on data provided in your paycheck and a short questionnaire. It then offers suggestions for adjusting your Form W-4.

If you are retired or are otherwise making quarterly payments, you should estimate your 2019 tax liabilities. Our Tax Forecasting Worksheet, which is included with the tax guide, can help. If you use tax software such as

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TurboTax, fill out a new return based on the data you have. Don't worry about the software using 2018 tax figures; the inflation adjustments for 2019 are small enough for the program to give you a good estimate to work off of. If it looks like you're going to owe or receive a big refund, adjust your fourth-quarter estimated payment. The payment is due on January 15. It can be paid by January 31 if you file your return by then.

Adjust the Timing of Expenses

If there are expenses where timing is variable, run the numbers as to whether it will be more beneficial to pay them in 2019 or in 2020. An example is the mortgage interest deduction. If you make an extra payment before the end of the year, you may be able to claim the extra interest paid on your 2019 taxes.

Educational spending is another area. Adjusting the timing of planned expenses to this year could qualify you to take advantage of the Lifetime Learning Credit on your 2019 tax return. If you live in a state allowing deductions for contributions to 529 college savings plans, you could lower your state tax bill by acting before year's end.

Total Up All Investment Gains and Losses

If you bought or sold investments in a taxable account, calculate how much in capital gains and losses you've realized this year. This includes the sale of stocks, mutual funds, closed-end funds, exchange-traded funds (ETFs), real estate investment trusts (REITs), preferred stock, bonds, options and master limited partnerships (MLPs). Don't forget any fund distributions. Check with your fund family to see if they've announced this year's distribution and how large it is.

Losses offset gains up to an excess of $3,000. If you had in excess of $3,000 in net losses in 2018, you can apply the amount to your 2019 taxes up to the $3,000 limit. Any remaining excess can be carried over to 2020.

High earners should be conscious of the 3.8% net investment income tax. The tax applies to both short- and long-term capital gains realized by married filing joint taxpayers with modified adjusted income above $250,000. If you are close to this threshold, it may make sense to postpone realizing gains until next year, or to realize losses this year on investments that have declined in value.

Tax harvesting can help investors with lower incomes as well. Married couples filing joint returns and single filers with income below $78,750 or $39,375, respectively, will pay a 0% tax on long-term capital gains for 2019. If you fall into this bracket this year but expect to be above the inflation-adjusted limits next year, it may make sense to realize the gains now and buy back the investment. If instead you sell at a loss and repurchase the investment within 30 days, you will violate the wash-sale rule. Be aware that there is always a risk of the investment potentially appreciating by an amount greater than your tax savings while you are out of it.

Strategize Your Charitable Donations

Deducting charitable donations has become harder as well under the TCJA. The standard deduction for married couples filing joint returns is $24,400 and $12,200 for single filers in 2019. These higher levels combined with the $10,000 cap on deducting state and local taxes (SALT) make it difficult for many to itemize.

One method around this hurdle is to bunch charitable donations into a single year. Rather than giving every year, combine the amounts you would give over a period of a few years into a single year. This will result in a bigger deduction for the year in which the donation is given.

Those age 70½ or older can take advantage of qualified charitable donations (QCDs). These donations are made directly from an individual retirement account (IRA). They offset required minimum distributions (RMDs) dollar-for-dollar up to $100,000 per year. Furthermore, they directly reduce your taxable income, which means the donor gets the tax break automatically regardless of whether they take the standard deduction or choose to itemize.

Be Aware of the 10% Medical Deduction Threshold

The threshold for claiming medical deductions rose to 10% for 2019 and beyond. If your medical expenses for 2019 are already close to this level, it can make sense to realize additional expenses this calendar year. You'll have to act quickly to schedule any appointments because the expenses must be realized by December 31. Alternatively, if you won't hit the threshold, consider delaying any qualifying expenses until after January 1, 2020, if medically safe to do so. This may help you reach the threshold in 2020.

A wide range of expenses qualify for the deduction, including mileage and transportation. If you're near or above the threshold, consider refilling your prescriptions by December 31 if possible. IRS Publication 502 (www.irs.gov/publications/p502) lists what types of expenses qualify for the medical deduction.

Take Your Full RMD

Distributions are mandatory from most retirement accounts by December 31 for those age 70½ or older. Roth IRAs do not have any required distributions. Neither do 401(k) plan accounts where the employee is still working and is not a 5% owner of the firm. [Those not meeting this specific requirement must take an RMD from a 401(k) account.] A person who turned 70½ in 2019 can wait until April 1, 2020, to take their first RMD but must take their second one no later than December 31, 2020.

Failure to take an RMD by the end of a calendar year will result in the amounts not withdrawn being taxed at 50%.

A person with multiple IRAs can combine the RMDs from each account into a single withdrawal from just one of the IRAs. If more than one 401(k) account is owned, the RMDs must be taken from each account.

Check with your broker or mutual fund company to see if RMDs can be automated. You may be able to have your distributions paid monthly, quarterly or annually. Not only will this provide a steady stream of cash, it will also ensure that the full amount is withdrawn each year. You may also be able to have taxes withheld from the distribution.

Plan Retirement Savings Contributions

Those who are still working should take the time to plan out contributions to be made in 2020. These include contributions for the 2019 tax year, which can be made up until April 15, 2020, to traditional and Roth IRA plans. Making contributions throughout the year as opposed to the end of the year gives the amounts invested more time to benefit from compounded returns.

The Saver's Credit may also be a consideration. Married joint filers and single filers with adjusted gross income below $64,000 and $32,000 respectively for the 2019 tax year can receive a credit of up to $2,000/$1,000. Contributions to an employer-sponsored plan or an IRA qualify for the credit.

Make a Roth IRA Conversion

If you expect your taxes or Medicare premiums to be higher in the future, a Roth IRA conversion may make sense. The advantages of a Roth IRA conversion include tax-free withdrawals, and no distributions are required. Conversions are, however, taxable in the year they occur and once completed, they cannot be undone.

Because they are taxable, it's often prudent to spread

(continued on page 31)

TAX STRATEGIES (CONTINUED FROM PAGE 30)

these conversions out over a period of years. A rule of thumb is to only roll over enough to put you up to, but not above, the thresholds for a higher tax bracket and higher Medicare premiums. (Medicare premiums are based on income from two years prior.) Estimating your 2019 taxes now can help you decide how much you can rollover without incurring a much higher-than-expected tax bill. See page 32 for a Roth versus traditional IRA decision tree.

The deadline for when the assets must leave the traditional IRA is December 31, 2019. It's best to file your paperwork as early in December as is possible to ensure the conversion is started before the end of the year.

Make Gifts to Loved Ones

The annual gift tax limit is $15,000. Gifting to heirs now allows tax-free transfers—up to the annual limit—and does not count against the lifetime tax exclusion. ■

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Converting to a Roth IRA Can Minimize RMDs by Judith Ward, March 2015
The Tax Advantages of Qualified Charitable Distributions From IRAs by Kirsten A. Cook, Ph.D., Harry Harelik, CPA, and William Reichenstein, CFA, October 2016