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Tax Topics

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IRS releases 2019 inflation-adjusted numbers

On November 1st, the IRS released its inflation-adjusted numbers for 2019 pension plan limitations (see Notice 2018-83 and IR-2018-211), and on November 15th, released its 2019 inflation-adjusted numbers for various tax rate schedules (see Revenue Procedure 2018-57 and IR-2018-222). Here is a selected run-down of these 2019 figures, along with other points to keep in mind, both for year-end and in general.

Income tax – top brackets. ***Individuals*** are subject to the following rates: 10%, 12%, 22%, 24%, 32%, 35% and 37%. The 35% and 37% rates will apply to taxable income that exceeds the following amounts:

	35%	37%
Married filing jointly, surviving spouses	$408,200	$612,350
Heads of households	$204,100	$510,300
Single taxpayers	$204,100	$510,300
Married filing separately	$204,100	$306,175

Trusts and estates are subject to the following rates: 10%, 24%, 35% and 37%. They will hit these rates if their taxable income exceeds the following amounts:

10%	24%	35%	37%
0	$2,600	$9,300	$12,750

"Kiddie tax." The "kiddie tax" applies to: a) children under age 18, and b) children who don't earn more than half of their own support and are: i) age 18 or ii) full time students, ages 19-23. Under prior law – as in, before the Tax Cuts and Jobs Act (TCJA), which was enacted on December 22, 2017 – the kiddie tax meant that if affected children had more than $2,100 of unearned income, it was effectively taxed at their parent's top rate. ("Unearned income" refers to items such as interest, dividends and capital gains.) TCJA, from 2018 through 2025, aims to simplify the kiddie tax and provides that an affected child's unearned income will be taxed at the same rates that would apply if this were income of a trust or an estate (see above).

AMT Exemption. The alternative minimum tax (AMT) is a parallel tax system that originally targeted a relative handful of wealthy taxpayers, but has reached deep into the middle class. From 2018 through 2025, TCJA has attempted to lessen this exposure by increasing the AMT exemption and the amount at which it phases out. In addition, because TCJA temporarily has imposed a $10,000 cap on the deduction for state and local taxes ("SALT") and eliminated personal exemptions – items that the AMT already disallowed – far fewer taxpayers will be subject to the AMT. The 2019 numbers for the AMT exemption are as follows:

Married filing jointly, surviving spouses	$111,700
Heads of households & single taxpayers	$ 71,700
Married filing separately	$ 55,850
Estates and trusts	$ 25,000

These exemptions are phased out, and disappear completely, if the taxpayer has "too much" alternative minimum taxable income (AMTI):

	AMT Exemption Phase-out Begins	AMT Exemption Fully Eliminated
Married filing jointly, surviving spouses	$1,020,600	$1,467,400
Heads of households & single taxpayers	$ 510,300	$ 797,100
Married filing separately	$ 510,300	$ 733,700
Estates and trusts	$ 83,500	$ 183,500

AMT brackets. The 26% AMT rate applies to AMTI up to the threshold amounts below; the 28% AMT rate applies to AMTI above these amounts:

Married filing jointly, single taxpayers, estates & trusts	$194,800
Married filing separately	$ 97,400

Standard deduction. The standard deduction reduces a taxpayer's taxable income, and is used when a taxpayer does not itemize deductions to reflect payments for items such as state and local income taxes, mortgage interest, and charitable contributions. Because TCJA has capped the SALT deduction at $10,000 (see above) and effectively doubled the standard deduction, from 2018 through 2025, far more taxpayers are likely to take the standard deduction rather than itemize their deductions. (As with many itemized deductions, the standard deduction is not deductible against the AMT.) The 2019 standard deduction is as follows:

Married filing jointly, surviving spouses	$24,400
Heads of households	$18,350
Single taxpayers & married filing separately	$12,200

The additional standard deduction for married taxpayers who are at least 65 or blind remains at $1,300 per category in 2019, but increases from $1,600 to $1,650 per category for single taxpayers. Thus, for example, a married couple filing jointly in 2019 will have a standard deduction of $25,700 if one of the spouses is 65 or older ($27,000 if both spouses are 65 or older).

Personal exemptions, PEP and "Pease." From 2018 through 2025, TCJA has eliminated personal exemptions, the personal exemption phase-out (PEP), along with "Pease," the requisite haircut for itemized deductions if taxpayers had "too much" adjusted gross income (AGI). Note that a "qualified disability trust" will be allowed a personal exemption of $4,200 in 2019.

Retirement accounts:

— **IRAs.** The contribution limit for IRAs will go up to $6,000 from $5,500. Taxpayers who are ***at least 50*** can make ***"catch-up" contributions*** of $1,000 (this number is not indexed for inflation and is frozen).

— **Roth IRAs.** Roth IRAs are funded with after-tax dollars, and have the same contribution limits as the IRAs mentioned above. Taxpayers can't contribute to a Roth, however, if they have "too much" modified adjusted gross income (this is generally the same as adjusted gross income). In 2019, contributions will be phased-out at the following income levels:

Married filing jointly	$193,000 to $203,000
Heads of households & single taxpayers	$122,000 to $137,000
Married filing separately (not indexed)	$ 0 to $ 10,000

Note: as of 2010, any taxpayer – regardless of income level and filing status – can convert a "traditional" IRA into a Roth, a move that may trigger significant current income tax. Under TCJA, taxpayers who convert after 2017 are no longer able to "undo" (or "recharacterize") that conversion in the following calendar year – a permanent change to the tax law.

— **401(k) contributions and other elective deferrals.** The contribution limit for deferred plans such as 401(k)s increases to $19,000 from $18,500; ***catch-up contributions*** for taxpayers who are ***at least 50*** are unchanged at $6,000 (such taxpayers can therefore contribute up to $25,000 to their accounts).

Estate and gift taxes:

— **Basic exclusion amount (BEA).** The BEA protects transfers from gift and estate taxes; from 2018 through 2025, TCJA has doubled the BEA from $5 million, indexed for inflation, to $10 million, indexed for inflation. For 2018, the doubled inflation-indexed BEA is $11.18 million ($22.36 million per married couple) and for 2019, it will rise to $11.4 million ($22.8 million per married couple), thereby giving wealthy taxpayers an even greater opportunity to transfer property to their heirs free of gift or estate tax.

— **Generation-skipping transfer tax (GST) exemption.** The GST exemption protects transfers (outright or in trust) to people such as grandchildren from GST, an additional transfer tax. The GST exemption equals the BEA, and is therefore $11.18 million in 2018, and will rise to $11.4 million in 2019. For a married couple to take full advantage of their respective GST exemptions and protect property worth $22.36 million in 2018 and $22.4 million in 2019 from GST, proper planning is required.

- **Annual exclusion gifts.** These gifts will still be **$15,000 per donee**, or $30,000 if the taxpayer's spouse joins in the gift; they do not erode the BEA, and often take the form of cash or marketable securities.

- **Annual exclusion gifts to non-U.S. citizen spouses.** These gifts rise to $155,000 (up from $152,000).

Social Security. The Social Security Administration announced that there will be a 2.8% cost of living increase in Social Security benefits for 2019. The maximum amount of taxable earnings subject to the 6.2% payroll tax will increase to $132,900 from $128,400. (The 6.2% payroll tax represents the OASDI, or old age, survivors and disability insurance portion of FICA, the Federal Insurance Contributions Act.) The 1.45% Medicare hospital insurance portion of FICA applies to an unlimited amount of wages, and increases by another 0.90% (90 basis points) for wage income that exceeds the following unindexed (and therefore frozen) amounts: $250,000 (married filing jointly), $200,000 (single taxpayers) and $125,000 (married filing separately); the total Medicare tax for wage income above those amounts is thus 2.35%. Once a wage-earner's income exceeds $200,000, the employer must withhold this additional tax, regardless of the wage-earner's filing status.

3.8% tax on net investment income. Like the additional 0.90% Medicare tax on wage income mentioned above, the 3.8% tax on net investment income took effect in 2013; both were part of the Affordable Care Act, or "Obamacare," as many refer to it. Net investment income refers to items such as interest, dividends, capital gains and royalties. The 3.8% tax can apply if the taxpayer's "modified adjusted gross income" (AGI plus otherwise excluded foreign income) exceeds the same frozen thresholds as the additional 0.90% Medicare tax: $250,000/$200,000/$125,000. Because there is no automatic withholding for this 3.8% tax, taxpayers should be mindful of it when determining whether they are "current" with their tax payments (see below).

Other income tax points:

- **Charitable IRA rollovers.** Charitable IRA rollovers have been permanent since 2015, and let taxpayers who are at least 70½ give up to $100,000 from their IRA to a public charity such as the taxpayer's favorite museum or alma mater (donor-advised funds, supporting organizations and private foundations are ineligible for the gift). The distribution:

  - Counts towards the taxpayer's "required minimum distribution"
  - Is not subject to federal income tax, and
  - Is not deductible as a charitable contribution (it nevertheless equates to a 100% deduction *because* it is not subject to federal income tax)

  In addition, the taxpayer can't receive anything in exchange for the contribution (no chicken dinners at the local charity event!), but can use it to satisfy an outstanding pledge. Although the check must be payable directly to the charity, the taxpayer can still deliver it herself; the charity must provide the usual written acknowledgement of the contribution. (Note that the *state* income tax treatment of charitable IRA rollovers may differ.)

- **Being "current" with tax payments.** To avoid interest and penalties on underpayments of income tax, taxpayers must be current with their tax obligations. This means that taxpayers must either pay in 90% of their current year's liability (through a combination of withholding and quarterly estimated tax payments) OR use the so-called "safe harbor": paying in 100% of their prior year's income tax liability (110% if their adjusted gross income in the prior year exceeded $150,000 ($75,000, if married filing separately)).

  Note that **for purposes of the accuracy-related penalty**, taxpayers who claim the **20% deduction for "qualified business income" (QBI)** – another temporary provision under TCJA that runs from 2018 through 2025 – will be subject to a lower threshold for what is considered a "substantial understatement" of income tax, for which there is a 20% penalty. That is, an understatement of income tax typically is "substantial" to the extent it exceeds the greater of 10% of the tax that should have been shown on the return or $5,000; if the taxpayer takes the QBI deduction, however, an understatement of tax is "substantial" to the extent it exceeds the greater of ***5%*** of the tax that should have been shown or $5,000. In other words, taxpayers taking the 20% QBI deduction are more vulnerable to an accuracy-related penalty, even if their underpayment has nothing to do with that deduction.

- **"Married" versus "single" filing status.** Prior to TCJA, the "marriage bonus" could reduce a married couple's federal taxes if the spouses had a significant income disparity, but the "marriage penalty" could significantly increase the couple's taxes if they had similar amounts of income (this is compared to what the taxes would be if the couple were unmarried and treated as single taxpayers). Post-TCJA, from 2018 through 2025, there is generally still a marriage bonus, but the marriage penalty largely has been neutralized (it seems to start recurring at about $700,000 of taxable income). Despite that equalizing change, a married couple is more likely to be caught by the 3.8% tax on net investment income than single taxpayers. That is because an unmarried couple can have household income of $400,000 ($200,000 each) and not be subject to the 3.8% net investment income tax, whereas a married couple can be subject to that tax at $250,000 of household income (see above). Note that individuals in a civil union or a registered domestic partnership are treated as single taxpayers for federal tax purposes (though not necessarily for state purposes), whereas same-sex married couples are treated as married for both federal and state tax purposes.

- **Avoid the wash sale rule.** The end of the year is often when taxpayers look carefully at their investment portfolios and "harvest losses" to offset realized gains. So if Mom, for example, is selling stock or securities that are worth less than her "adjusted basis" (generally, what she paid for the asset), she'll be caught by the wash sale rule if she repurchases those same assets within 30 days before or after the sale (even if she repurchases them in her IRA). If the wash sale rule applies, Mom can't take the current loss – it's added to the cost basis of the repurchased stock or security and is thereby deferred (there's no issue if Mom is merely selling winners and "harvesting gains").

- **"Bunch" rather than accelerate deductions?** Prior to TCJA, it often made sense for taxpayers to accelerate deductions, such as fourth quarter estimated state income tax payments or real estate tax payments. Because of the $10,000 SALT deduction cap, however, many taxpayers will no longer have enough separate deductions to warrant itemizing them, and will therefore take the (now) much larger standard deduction; therefore, accelerating deductions may not make sense. Nevertheless, taxpayers who are charitably inclined may wish to "bunch" their charitable contributions into a single year so that these donations are larger than usual and make it worthwhile to itemize deductions; a possible vehicle for this approach is a donor-advised fund – the contribution to the fund garners a charitable deduction and the donor can then advise the fund to make gifts to favorite charities in ensuing years (or the current one, if time permits).

Things to remember for year-end gifts:

— **Gifts to individuals.** Time is running out for 2018 annual exclusion gifts of $15,000 to family and friends ($30,000 for a married donor whose spouse agrees to split the gift). Cash gifts may be given up to 11:59 p.m. on December 31st and still count as a 2018 gift. Checks, however, must be cashed *before* January 1, 2019 to count as 2018 gifts (p.s.: the generous donor must also stay alive until the bank makes good on the check).

In addition to annual exclusion gifts, generous donors can make direct payments for tuition, medical expenses and health insurance premiums – none of which count against the donor's $11.18 million BEA.

— **Gifts to charities.** Assuming the taxpayer will be itemizing deductions, last-minute gifts to charities will qualify as a 2018 deduction if the check is postmarked *before* January 1, 2019 (it need not be cashed before then, however). Credit card gifts or other electronic forms of gifts can presumably be made until 11:59 p.m. and still count as a 2018 deduction.

December 7520 rate

The December 2018 7520 rate remains at 3.6%, where it was in November. The December mid-term applicable federal rates (AFRs) are up a hair: 3.07% (annual), 3.05% (semi-annual), 3.04% (quarterly) and 3.03% (monthly). The November mid-term AFRs were: 3.04% (annual), 3.02% (semi-annual), 3.01% (quarterly) and 3.00% (monthly).

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