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Dear Clients and Friends:

YEAR-END TAX PLANNING

As 2018 draws to a close, you should make a final review of your 2018 tax situation to determine if you can take advantage of year-end tax planning. This letter and other useful accounting and tax information is available on my website at **www.solakco.com**.

TAX HORIZON

In late 2017 Congress passed and President Trump signed the Tax Cuts and Jobs Act that reduced tax rates, simplified rules so that most taxpayers will claim the increased standard deduction instead of itemizing deductions, allows an increased child tax credit all with the effect that everyone will be paying less tax. It should be noted that because of procedure rules, the tax law changes are only in effect through 2025. Congress and President Trump are working at this time on additional tax changes that should include a provision to make the Tax Cuts and Jobs Act provisions permanent.

TAX RATES

For 2018, there are seven tax brackets ranging from ***10% to 37%*** for federal income tax purposes. The following table shows the tax brackets at the various levels of taxable income:

Bracket	Joint Returns	Single
10%	To $ 19,050	To $ 9,525
12%	To $ 77,400	To $ 38,700
22%	To $165,000	To $ 82,500
24%	To $315,000	To $157,500
32%	To $400,000	To $200,000
35%	To $600,000	To $500,000
37%	Over $600,000	Over $500,000

Net long-term capital gains and qualifying dividends are subject to a maximum tax rate of 15% (***Zero if you are in the 15% or less tax bracket***) for all tax brackets below the 37% bracket. ***If you are in the 37% tax bracket, the tax on net long-term capital gains and qualifying dividends is 20%.***

NEW QUALIFIED BUSINESS INCOME DEDUCTION

The Tax Cuts and Jobs Act provides for a new deduction for noncorporate taxpayers of 20% of qualified business income for sole proprietorships, partnerships and S Corporations. Several restrictions and limitation apply but the intent of the new deduction is to provide small businesses with a tax reduction in lieu of the regular corporation tax reduction from 35% to 21%.

ALTERNATIVE MINIMUM TAX

Federal income tax rules require a separate computation to be made to determine if the Alternative Minimum Tax (AMT) applies for a given year. The effect of the AMT is to ***eliminate the benefit of tax certain deductions***.

With the passage of the ***Tax Cuts and Jobs Act***, most taxpayers will not be subject to the alternative minimum tax (AMT) for tax years 2018 through 2025 since tax preferential deductions have either been eliminated or greatly reduced.

It is important to note that the AMT still exists but will only apply to very high-income groups. The AMT exemption amounts for 2018 are $109,400 for joint returns and $70,300 for single returns and will not be phased out until AMTI exceeds $1,000,000 joint or $500,000 single.

The following tabulation shows which common itemized (Schedule A) deductions are deductible under the respective tax computation:

	Regular Tax Computation	**AMT Computation**
Interest		
Qualified Housing Interest	Yes	Yes
Home Equity Interest, other than Qualified Housing Interest on debt up to $100,000	No	No
(any excess)	No	No
Investment Interest to the extent of Investment Income	Yes	Yes
(any excess)	No	No
Personal Interest	No	No
Contributions	Yes	Yes
Taxes – All Types (Up to $10,000)	Yes	No
Misc. Deductions – Subject to 2% floor	No	No

In addition to the above, several other items are used to compute regular and alternative minimum taxable incomes. Therefore, careful tax planning is necessary to make sure tax motivated transactions will provide the intended result.

PASSIVE ACTIVITY LOSSES

Generally, losses incurred from passive activities are deductible only to the extent of passive income. Losses not deductible in a given year will be labeled “suspended losses” and carried over to future years to offset future passive income. Rental properties are classified as passive activities and therefore are subject to the passive loss rules on deductibility. An exception is provided to taxpayers who actively participate and own a 10% or more interest in real estate rental properties in that a maximum amount of $25,000 of losses may be deducted without regard to the passive loss rules. The $25,000 maximum amount is reduced by 50% of the amount of adjusted gross income (AGI) over $100,000 and is completely phased out after the AGI exceeds $150,000.

TIMING OF INCOME – SALARIES, BONUSES AND FEES

The acceleration of income items may be appropriate if it appears deductions may exceed income or the AMT applies, thereby reducing or eliminating the tax benefit for deductions. The deceleration of income may be appropriate if your 2019 income will be substantially less than your 2018 income.

TIMING OF DEDUCTIONS

Deductions – General Beginning in 2018 itemized deduction rules have been changed significantly including the almost doubling of the standard deduction and elimination or reduction of certain deductions. The 2018 standard deduction is $12,000, single and $24,000 for a married couple. An additional standard deduction is available if over age 65 on December 31, 2018 of $1,300 each or $26,600 for a married couple both over age 65.

If you will be at or near the standard deduction amount, you could defer or accelerate certain deductions so that in a tax year (2018 or 2019) you can exceed the standard deduction. For example, you should consider "***deferring deductions***" if you fall short of the standard deduction in 2018 and then claim them in 2019 when you may be above the standard deduction.

The payment of a deduction by December 31, 2018 will be considered valid if a check is mailed on or before December 31, 2018 with adequate postage and if you have sufficient funds in your account to cover the check.

Deductions – Interest Home mortgage interest is usually paid in the month following its accrual (your January mortgage payment usually pays December's interest). Therefore, payment of your January 2019 mortgage payment by December 31, 2018 allows the December interest to be deducted in 2018. Mortgage companies are required to report to the IRS interest paid during the year.

Deductions – Home Equity Interest Beginning in 2018, home equity interest is ***no longer tax deductible***.

Personal interest, i.e., auto loans and credit cards are not tax deductible. You should therefore attempt to liquidate personal debts as soon as practicable.

Deductions – State and Local Taxes Beginning in 2018, state and local taxes, (including income and property taxes) are limited to a maximum of $10,000.

Deductions – Charitable Contributions You should maintain adequate receipts for all charitable contributions. If the contribution is $250 or more, you must have a written receipt from the charity with the date and amount along with a statement to the effect that ***"no goods or services were provided in exchange for the gift"***.

Deductions – *Miscellaneous* The tax deduction for unreimbursed employee expenses, accounting fees, tax return preparation fees, investment advisory fees, and others ***have been eliminated*** beginning in 2018.

CAPITAL ASSET TRANSACTIONS

The holding period for long-term capital assets is ***"more than twelve months"***. If you have realized capital losses in 2018 or have a capital loss carryover from 2017, you should consider realizing capital gains to offset the capital losses. In addition, if you have "paper losses" in your stock portfolio, you may wish to realize such losses by selling the security. A net capital loss for the year can be used to offset other income up to $3,000 per year with the balance being carried over to future years. The trade date rather than settlement date controls the tax reporting of a stock transaction. Therefore, if you desire to realize stock transactions in 2018, make sure the ***trade date*** is on or before December 31, 2018.

PERSONAL RESIDENCE

Federal and State tax laws afford special tax benefits to personal residence ownership, i.e., tax-free gains ***up to $500,000*** and deduction for qualified housing interest. Interest on certain refinancing may not be deductible. Loan fees should be paid by a separate payment versus adding the amount to the loan. The determination of what interest is or is not qualified housing interest generally refers to the original purchase price plus the cost of improvements. ***You should be maintaining adequate records (updated at least annually) to substantiate your total cost basis of the residence including improvements.***

ESTIMATED TAX PENALTIES AND WITHHOLDINGS

If your 2018 withholdings and estimated tax payments are less than 90% of your 2018 tax liabilities, you could be subject to the nondeductible penalty for underpayment of estimated tax. You <u>may</u> be able to avoid this penalty by having paid in an amount equal to the prior year's (2017) total tax liability, or in some cases 110% of your prior year's (2017) total tax liability. You should review your 2018 withholdings and estimated tax payments to see if you meet one of the exceptions noted above. You can authorize your employer to increase your December 2018 income tax withholdings to reduce or eliminate your exposure to the penalty.

INDIVIDUAL RETIREMENT ACCOUNT (IRA)

A $5,500 IRA contribution can be made by individuals that are not covered by an employer sponsored retirement plan. If you are 50 or over by December 31, 2018, you can make an additional "catch-up" contribution of $1,000 for 2018. Contributions to an IRA for 2018 must be made by April 15, 2019.

ROTH IRA CONVERSIONS

You should note that most IRA and Qualified plan retirement accounts are eligible for rollover conversion to a Roth IRA. A Roth IRA conversion is subject to tax at the time of conversion. However, ***qualified distributions*** from a Roth IRA are tax free. Roth IRA conversions are complex and should only be done after careful analysis.

SELF-EMPLOYED RETIREMENT PLANS

If you are self-employed, you may establish a Self-employed 401(k) Retirement Plan (Keogh) or a Simplified Employee Plan (SEP) for 2018. To be eligible for a 401(k) Keogh for 2018, the plan must be established by **December 31, 2018**. A SEP can be established by the due date of your return. The maximum contribution to a 401(k) Keogh or a SEP for 2018 is $55,000. If you are 50 or over by December 31, 2018, you can make an additional "catch-up" contribution to a 401(k) Keogh of $6,000 for 2018. Contributions to Keoghs and SEPs for 2018 need not be made until the due date of your tax returns, usually April 15, 2019. However, if you file a valid extension application to October 15, 2019, your 2018 contribution can be deferred to the extended due date.

ANNUAL GIFT TAX EXCLUSIONS

Certain gifts are subject to gift taxes. If you are contemplating making a gift, you should note that you may gift, in general, $15,000 in cash or value to each donee in a calendar year without being subject to gift taxes. January 1, 2019 starts a new calendar year for gift tax purposes therefore, you may gift $15,000 in December 2018 and $15,000 in January 2019 without incurring a gift tax liability.

REVIEW OF TAX REPORTING INFORMATION

Banks, stock brokers and others are required to report to the IRS certain amounts paid during the year on Forms 1099. You should periodically review all your account information and received Forms 1099 to determine if the paying agency has your correct reporting (social security) number. Incorrect reporting numbers or income usually results in communications from the tax authorities that could easily be avoided.

EMPLOYEE WITHHOLDING CERTIFICATE (FORM W-4)

Employees should submit updated withholding allowance information to their employer each year. As part of my tax preparation service, I provide my clients with appropriate withholding allowance information for the upcoming year.

In conclusion, November and December are the months to make a final review of your 2018 tax status. I am available to advise you on these or any other tax planning opportunities should you so desire.

Very truly yours,

Charles E. Solak

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