Dear Reader,

As we approach the end of 2019, our initial journey through the maze of tax reform is coming to an end. We have encountered much along this tax reform journey. In the first two installments of Deloitte’s 2019 essential tax and wealth planning guide, we offered insights on tax planning for individual income, international, and wealth transfer taxes, as well as timely tax policy updates. As this year winds down, now is the time to reflect on where you have been and where you want to go in the years to come.

Deloitte has provided the first two installments of the Guide, charting current tax planning alternatives and shedding light on the possible paths ahead with tax policy perspectives. Now, this third installment will further illuminate possible paths forward to consider as you reflect on goals established at the start of this year’s journey, including the following sections:

• The individual loss limitations section examines how the utilization of individual business losses has evolved over time. The passage of the 2017 Tax Act significantly altered the tax landscape, adding new hurdles before a loss can be monetized. These new rules require owners of pass-through businesses to view the world of business losses through a different lens.

• The wealth transfer planning section continues the exploration of the wealth transfer planning environment that began in the second installment of the 2019 Guide, providing further observations regarding potential uses of the enhanced applicable exclusion amount—including “tuning up” prior planning transactions, transfers structured to avoid “donor’s remorse,” transfers that contemplate the generation-skipping transfer tax, and state estate and inheritance tax considerations.

• The year-end tax planning considerations section assembles a variety of factors to help you assess where you are in your tax planning journey and suggests alternative routes to consider as the year comes to a close.

• The tax policy section provides resources to help you stay up to date on the latest news and analysis from Washington.

While the year is almost over, our message remains the same. Stay vigilant. Continue to learn. Adjust direction as needed. We hope these three installments of the 2019 Guide help you explore the new territory created by tax reform and prepare you for the decisions made at each crossroad so you can continue to move forward with confidence.

To find a member of the Deloitte Private Wealth practice who specializes in your area of interest, please contact us at ustaxprivatewealth@deloitte.com.

Regards,

Wendy Diamond
Private Wealth Tax Leader
Deloitte Tax LLP
The new individual loss limitation landscape

Familiar but different. Be prepared.
Owners of pass-through businesses that incur losses have a myriad of issues to contend with, not the least of which are financial and cash flow concerns. However, the financial challenge of these losses has historically been shared with the government through tax laws that allowed the business loss to offset other current year income of the owner. To the extent a loss exceeded current year taxable income, the owner could generate a net operating loss (NOL), which could create a refund of prior year tax paid. The result of these elements of the tax law allowed business owners to “monetize” the tax benefit of their tax loss and either reinvest it in their business or create additional liquidity to lessen their cash flow concerns.

The rules relating to utilization of an individual’s business losses are highly complex, having evolved over time. The passage of the 2017 Tax Act1 significantly altered the landscape of loss utilization for 2018 and beyond by adding new hurdles before a loss can be monetized. Examples of changes in the 2017 Tax Act include the new excess business loss rules and material modifications to the NOL rule set. These hurdles, coupled with the existing loss limitation provisions, may require owners of pass-through businesses to view the world of business losses through a different lens.

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1 P.L. 115-97, known informally as the Tax Cuts and Jobs Act and officially as An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.
Individual loss limitations

The evolution of loss limitation rules

To assist with understanding the impact of the 2017 Tax Act, we first need to review the evolution of the rules that have made it increasingly more difficult to monetize business losses.

Prior to the Tax Reform Act of 1986 (the “1986 Act”)2 there were few limitations in place preventing individual taxpayers from offsetting any form of income (for example, wage or portfolio income) with ordinary business losses. To the extent a taxpayer had sufficient basis in an activity, and the basis was at-risk, the losses were generally fully deductible to the extent of income. Further, to the extent the loss exceeded income, an NOL was created. The taxpayer could carry back the NOL and obtain a refund of tax paid in a prior year or elect to carry the loss forward to offset taxable income in a subsequent year. In fact, NOL carryback claims filed under the quick refund procedures were required to be processed by the Internal Revenue Service (IRS) within 90 days, which provided taxpayers the opportunity to carry back their losses to a prior year and obtain refunds swiftly to inject cash back into their businesses.

A new landscape for business losses was ushered in with the 1986 Act. The 1986 Act, a landmark piece of legislation that completely overhauled the income tax code, generally lowered income tax rates and offset the cost of doing so by modifying or eliminating certain tax benefits to broaden the tax base. One such base-broadening measure was the introduction of the passive activity loss rules. The creation of the passive activity loss rules established a roadblock between individuals with business losses from passive activities and their ability to monetize those losses.

To understand how the passive activity loss rules work, first note that they only apply to a passive activity, which is any trade or business in which a taxpayer does not actively participate. Generally, the passive activity loss rules operate by limiting the losses from passive activities to the extent of income from passive activities. To the extent passive losses exceed passive income, the passive losses are carried forward to the next tax year, and once again limited to passive income. As previously discussed, prior to the enactment of the passive activity loss rules, taxpayers could use losses from these types of activities to offset any other income.

The stated principal purpose for enacting the passive activity loss rules was to curb abusive tax shelters formed solely to avoid tax. Lawmakers stated that tax shelter activity was fueling the public belief that the tax system was unfair to the average American.3 The codification of these rules had a significant impact on the utilization of losses generated by passive activities and, in turn, broadened the tax base.

Although the passive activity loss rules made monetization of losses more challenging for many, taxpayers with losses from operating businesses in which they actively participated were generally not affected, as the passive activity loss rules do not apply when the owner actively participates in the business. Thus, in these situations, owners would continue to be able to deduct their business losses against any type of income.

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Individual loss limitations

The evolution of loss limitation rules

Fast forward to the close of 2017, which brought the most comprehensive tax reform of recent generations. Two significant changes enacted by the 2017 Tax Act—the new excess business loss rules and material changes to the NOL rule set—further complicate the loss utilization landscape and impact not only taxpayers already grappling with existing loss limitation provisions like the passive activity loss rules, but also extend to taxpayers with losses from businesses in which they actively participate.

Business loss limitation rules

A business loss encounters numerous limitation provisions before it is monetized. The enactment of section 461(l) adds yet another limitation for the loss to traverse through before arriving at a deduction.

Section 704(d)/1366(d) (tax basis)  
Section 465 (at-risk basis)  
Section 469 (passive activity loss rules)  
Section 461(l) (excess business loss rules)  
DEDUCTION
Individual loss limitations

Loss planning in a post-tax reform world

As discussed throughout this chapter, loss limitation provisions such as the basis limitations and the passive activity loss rules have long existed as barriers for taxpayers with losses to overcome. The excess business loss rules create a new hurdle impacting a group of taxpayers unimpeded by the challenges of the passive activity loss rules: Individuals with losses from trades or businesses in which they actively participate. Under newly-enacted section 461(l), an excess business loss arises when a taxpayer’s aggregate trade or business deductions exceed the sum of the taxpayer’s aggregate trade or business gross income and gain plus a threshold amount (for 2018, $250,000 or $500,000 for a married couple filing jointly). If an excess business loss exists, it is not allowed in the current year and is instead converted into an NOL that must be carried forward to a subsequent year.

In addition to the enactment of the excess business loss rules, the 2017 Tax Act modified the NOL rule set such that NOLs arising in tax years beginning after 2017 generally must be carried forward, not back. The inability to carry back NOLs means that taxpayers generally are no longer able to utilize the quick refund procedures, as discussed above, to generate cash flow that could be used to support their business operations. While it is true that an NOL can now be carried forward indefinitely and can still offset any type of income, under the new law an NOL can only be used to offset 80 percent of regular taxable income rather than 100 percent of regular taxable income under the prior law. To the extent the NOL carried forward to the next year exceeds 80 percent of the taxable income in that year, it will continue to be carried forward to a future year until it can be utilized. Thus, taxpayers who generate an NOL because of an excess business loss could find themselves in a position where the recognition of such a loss is deferred for greater than one year.

Further, an excess business loss is computed after applying the passive activity loss rules; thus, the recognition of a previously suspended passive loss may give rise to or increase the excess business loss for that year. The excess business loss rules apply for tax years beginning after December 31, 2017 and ending before January 1, 2026. The changes to the NOL rule set are permanent.

The combined impact of the new excess business loss limitation provisions and changes to the NOL rule set can have a significant impact on owners of businesses that incur losses. In any year where a taxpayer incurs a loss from an active trade or business that is limited by the excess business loss rules, an income tax liability may now occur if nonbusiness income exceeds the allowable loss. As a result, taxpayers with cash flow constraints inherent in a loss situation may be faced with financing a tax liability despite the absence of net income from their business or positive cash flow.
Individual loss limitations

Loss planning in a post-tax reform world

It is important to consider that excess business losses will create NOLs that would not have existed under prior law, likely resulting in more taxpayers with NOLs. Taxpayers who own businesses that incur losses for many years could be faced with the issue of perpetual NOLs and the challenge of utilizing them. Because of the potential for perpetual NOLs, it is now more likely that at a taxpayer’s death, he or she may still have unutilized NOLs. Without further guidance clarifying otherwise, NOLs resulting from an excess business loss not utilized prior to a taxpayer’s death appear to die with the taxpayer.

NOL in year of death

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
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<tbody>
<tr>
<td>Aggregate trade or business deductions</td>
<td>(3,000,000)</td>
<td>(3,000,000)</td>
<td>(3,000,000)</td>
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<tr>
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<td>–</td>
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<td>Married filing joint threshold*</td>
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<tr>
<td>Excess business loss</td>
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<td>(2,500,000)</td>
<td>(2,500,000)</td>
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<tr>
<td>Allowed trade or business loss</td>
<td>(500,000)</td>
<td>(500,000)</td>
<td>(500,000)</td>
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<tr>
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<td>10,000,000</td>
</tr>
<tr>
<td>Trade or business income</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Allowed trade or business loss</td>
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<td>Tentative taxable income</td>
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<tr>
<td>NOL allowed (up to 80% of taxable income)</td>
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<td>(2,500,000)</td>
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<td>Taxable income</td>
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<tr>
<td>NOL carryforward</td>
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<td>(2,500,000)</td>
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</tbody>
</table>

*Does not reflect annual inflation adjustments to threshold amounts.

OBSERVATION:
See a pattern? Depending on a taxpayer’s circumstances, the new loss limitation rules have the potential to increase the likelihood of a taxpayer dying with an NOL. Without further guidance clarifying otherwise, NOLs resulting from an excess business loss not utilized prior to a taxpayer’s death appear to die with the taxpayer.
Individual loss limitations

Loss planning in a post-tax reform world

Unlike the stated reason for the enactment of the passive activity loss rules (curbing abusive tax shelters), we are not aware of a similar sentiment communicated by lawmakers providing a policy-related justification for the enactment of the excess business loss rules. Further, to date, there have been no regulations promulgated under section 461(l), which leaves many unanswered questions for taxpayers and their advisers to ponder.

As illustrated throughout this chapter, navigating the world of loss utilization is complex. The hurdles introduced over time have created challenges for taxpayers who incur business losses. Taxpayers must be aware that although they may incur true economic losses and, as a result, have significant cash flow constraints, they still may be faced with the task of financing a tax liability. Careful modeling is critical to avoid unwelcome cash flow surprises. We recommend that you work closely with your tax adviser to understand the rules, how they interact with each other, and to model the impact on cash flow.

Working closely with your tax adviser can also result in uncovering some potential planning considerations that may exist to mitigate the negative impact of these provisions. For example, consider a married couple filing jointly for 2018 that has a $10 million long-term capital gain from the sale of an investment and a business loss in the amount of $7 million. The excess business loss rules will limit the deductible business loss in 2018 to $500,000 and create a $6.5 million excess business loss, which will be treated as an NOL and carried forward. Although the loss is no longer able to fully offset the capital gain in 2018, causing the individual to finance a larger tax liability than they would have under previous law, this situation may present planning considerations. If the loss had been fully utilized in 2018, it would have offset long-term capital gain income that is taxed at a preferential rate. Now, due to the excess business loss rules, the couple has a potential opportunity to generate ordinary income in 2019 and utilize the NOL against income that would otherwise be taxed at higher ordinary income tax rates. Careful modeling through multiyear income tax projections can uncover potentially beneficial scenarios, assist you with understanding cash flow considerations, and arm you with the information needed to make tax efficient decisions.

Now, more than ever, it is critical for taxpayers to understand the loss limitation rules and how they interact. We encourage you to work closely with your tax adviser to understand the rules and to model over multiple years to gain perspective on your income tax posture, to understand your cash flow requirements and to identify potential tax planning considerations available to ease the financial pain of an ordinary business loss.
Further observations on wealth transfer planning

Take action today, but then remain vigilant.

As discussed in the second installment of the Guide, the truly transformative nature of the 2017 Tax Act with respect to the estate tax is how relatively few people remain subject to tax. We also discussed how wealth is generated at an exponentially quicker pace than the inflation adjustment, thus propelling a growing population into the reach of the estate tax, and how the statistics do not include those persons who actively plan themselves out of the estate tax by engaging in affirmative, *inter vivos* (lifetime) gift tax planning. Most importantly, we noted how the opportunity provided by the 2017 Tax Act is fleeting—because it is to sunset in 2026, leaving the exclusion amount for each taxpayer roughly half of what it is currently. In this installment, we will discuss more subtle uses of the enhanced applicable exclusion amount—including “tuning up” prior planning transactions, transfers structured to avoid “donor’s remorse,” transfers that concentrate on the generation-skipping transfer tax, and state estate and inheritance tax considerations.
Wealth transfer planning

Tuning up prior planning

If you have prior wealth transfer transactions that have not performed as forecasted, you are not alone; few plans develop as modeled for any number of reasons. As was described in the second installment of the Guide, intra-family debt—for example, notes issued by trusts to purchase assets from a senior family member, or simply loans from a senior family member to children, trusts for children, or businesses of children—often plays a role in estate plans. Not surprisingly, one of the most common issues in troubled estate plans is disturbed debt service when either economics or other priorities intervene to preclude the payment of the debt as scheduled.

Failure to act when a note is in default raises issues regarding the propriety of the original sale or loan transaction and, in itself, raises gift tax issues. In such situations, consider foreclosing if the borrower is unlikely to meet its debt obligations because its underlying assets are unlikely to generate sufficient cash flow or otherwise recover their value. Alternatively, if the borrower’s underlying assets are likely to recover but not in a fashion that permits the original terms of the note to be met, consider renegotiating the formal terms of the note including, perhaps, forgiving the note in whole or in part. Keep in mind, though, that the forgiveness of a \textit{bona fide} loan that subsequently became troubled may be subject to the income tax rules governing bad debts and cancelation of indebtedness. Use caution when forgiving a note to a business entity, it will likely be considered a gift to each entity owner equal to the face amount of the note properly apportioned among the owners. A better use of the increased applicable exclusion amount ($11.4 million, or $22.8 million per couple, in 2019) might be to subscribe for a new or increased interest in the entity for cash and then use the increased working capital to cure the default on the nonperforming loan. Similarly, with respect to loans involving individuals and trusts, consider additional gifts to the borrower to increase the probability of the original transaction’s success.
Wealth transfer planning

Tuning up prior planning

In the present economic environment, a qualified personal residence trust (QPRT), which is a trust where the grantor retains rent-free use of the residence for a stated period of years and otherwise behaves much as a grantor retained annuity trust or GRAT (as discussed in the second installment of the Guide), is costly because low prevailing interest rates inflate the value of the transferred remainder interest. Yet because a residence—particularly a vacation residence—is both illiquid and often characterized as an heirloom asset, it is often easier to part with than other assets. Consider whether QPRTs should be a gift plan of last resort due to post-termination rental issues mentioned below, but lacking better gift candidates, using the increased exclusion amount to move the remainder interest in a personal residence may be better than letting the $11.4 million exclusion go unused.

If a QPRT terminates because the rent-free period has ended, the grantors of the QPRT are now renting their home from the QPRT or its remainderman beneficiary. The rent, while necessary to preserve the tax benefits of the original transfer, can nevertheless be uncomfortable for those involved. In such situations, a gift of the life use interest in the residence by the QPRT remaindermen (if individuals) back to the QPRT grantors (thus precluding continued rent payments) may be an appropriate use of the expanded exclusion amount.

Basic blocking and tackling

While the unexpected increase of the $11.4 million exclusion amount has greatly increased planning flexibility and opportunity, it should not detract from the use of other estate planning alternatives that do not require use of the exclusion amount:

- Shift wealth down generational lines through use of the annual gift tax exclusion ($15,000 in 2019).
- Make a cash gift to a child or grandchild who has earned income, which the donee(s) may then use to make contributions to a traditional or Roth IRA.
- Make payments on behalf of others directly to the providers of medical and educational services. These direct payments are not treated as taxable gifts.
- Consider funding future education expenses through gifts into a Section 529 educational plan for children or grandchildren. A special election allows you to fund up to five years of annual exclusions into these plans in one year without incurring a taxable gift or GST tax. Note that, if you make other gifts to your children or grandchildren during 2019 through 2025, these gifts would use some of your $11.4 million gift tax exclusion and, if set up for a grandchild, your $11.4 million GST tax exemption.
Wealth transfer planning

On the topic of donor’s remorse

Because of the anticipated sunset of the increased exclusion amount, we point out again that the failure to fully utilize the existing exclusion amount may lead to an otherwise avoidable and potentially substantial estate tax liability. Yet, to so give requires one to relinquish all “dominion and control” over the transferred property. In other words, one’s access to previously transferred assets is generally eliminated or, where permitted, is at the discretion of another, such as an independent trustee. Failure to eliminate the donor’s access to and control over previously transferred assets will result in their inclusion in the donor’s taxable estate as if no gift planning had occurred.

In addition, recall the relative income tax disadvantage of lifetime gifts relative to testamentary bequests: The donee of a lifetime transfer takes the donor’s income tax basis, whereas the beneficiary of a bequest receives the transferred asset with a basis equal to its fair market value at the time of the decedent’s death. Thus, if the basis of gifted property is relatively low and it is anticipated that the donee will dispose of the property soon after the gift occurs, then the donee’s after-tax proceeds will be significantly less than the gift tax value of the transferred asset.

What has made it possible to bridge the competing considerations regarding affirmative use of the increased exclusion amount and income tax basis is the IRS’s guidance on how the exclusion amount available at death is affected by prior gifts that used up the exclusion amount during life but are nevertheless included in the taxable estate because of retained access to (or control over) the gifted property at the donor’s death. Specifically, the guidance holds that while the previously transferred assets are included in the estate (and receive fair market value basis for income tax purposes), the applicable exclusion amount previously used at the time those gifts were made will remain available to the decedent to offset estate taxes unless the prevailing inflation-adjusted exclusion amount at the date of death is greater.

Armed with this realization, variations of existing gift plans have started to emerge—specifically, techniques that utilize the currently large exemption, but are deliberately structured to cause estate tax inclusion of the transferred assets to achieve the income tax basis step-up. Such planning assumes that there is a good possibility that the donor will pass away before the inflation adjusted post-2025 exclusion amount has exceeded the current exemption of $11.4 million per taxpayer. Remember, the post-2025 exclusion amount, while roughly half of the current exemption, is still to be inflation adjusted under current law. Thus, at some future point in time it will grow beyond what the exemption is today. While that year cannot be known, given recent inflation adjustments, a 25-year life expectancy is likely to leave one with a greater exclusion amount than exists currently.
Wealth transfer planning

On the topic of donor’s remorse

Perhaps a simplified example might help. Prior to 1991, the most popular estate planning vehicle was the grantor retained income trust (GRIT), which had three prevailing characteristics. First, the grantor retained the right to all future income produced by the trust during a defined period of years; consequently, the actuarial value of the income interest reduced the value of the taxable gift because it had not been transferred. Second, the actuarial value of the income interest had nothing to do with the amount of income actually produced or expected to be produced, rather it was based on three factors: The prevailing interest rate in the month the GRIT was funded, the actuarial life expectancy of the donor, and the period of time over which the income was retained. Stated differently, the trust could produce no income at all and the same reduction in gift value would apply. Third, the GRIT was subject to a profound mortality risk. If the grantor died during the retained income period, the entire value of the GRIT’s assets would be included in the grantor’s taxable estate at their date of death value.

In 1990, the law was changed to require a sum certain to be distributed annually, thus preventing the manipulation of the retained income feature. Thus, the GRIT became the GRAT. If one failed to express the retained interest in the trust as an annuity, then the value of the retained right to cash flow was statutorily set at zero, and thus arbitrarily increased the size of the gift. Yet, notwithstanding declaring a gift of the full value of the property contributed to the GRAT, one still had the risk of full inclusion of the trust property in the taxable estate if one’s death occurred during the period the cash flow was being received.

Further observations on wealth transfer planning
Tuning up prior planning
On the topic of donor’s remorse
What about the generation-skipping transfer (GST) tax?
A cautionary note on state estate and inheritance taxes
Take action today, but then remain vigilant
Wealth transfer planning

On the topic of donor’s remorse

In a very simplified form, what advisers are now contemplating is a GRIT that deliberately lasts for life with the result that:

1. The grantor keeps all the cash flow produced during life,
2. The grantor uses up more of the exclusion amount during life (since the full value of the assets contributed to the GRIT is considered a taxable gift), but,
3. The value of all trust assets will be included in the grantor’s taxable estate (for which they will receive fair market value basis), and
4. The larger amount of exclusion used will still be available to offset the value of the GRIT assets, unless the exclusion available in the year of the grantor’s death is higher than the amount that had been used in the year the GRIT was formed.

Thus, the grantor has hedged against donor’s remorse: Investment control and income distribution are retained (but not the ability to fully liquidate the trust in the grantor’s favor), fair market value basis at death is achieved, and the full amount of the utilized tax exemption is preserved for use against the estate tax even if the exemption amount actually available at the date of death is a lower number. However, one must consider that, if the GRIT is highly successful, the assets that might have been out of the estate at death if a classic GRAT had been used are now back in the estate and a much greater estate tax obligation will arise notwithstanding the grantor kept the higher exclusion amount actually used in the year the GRIT was formed.

Further observations on wealth transfer planning

Tuning up prior planning

On the topic of donor’s remorse

What about the generation-skipping transfer (GST) tax?

A cautionary note on state estate and inheritance taxes

Take action today, but then remain vigilant
Wealth transfer planning

On the topic of donor’s remorse

EXAMPLE:
An upstream gift from Daughter (Joan) to Father (James)

The planning alternative illustrated below allows for a partnership interest, any future appreciation, and cashflow to be excluded from the daughter’s estate. After the father’s passing, the trust beneficiaries (not the daughter) may achieve income tax savings via a depreciation deduction. Significant estate tax savings may be achieved if there is significant appreciation between the time of the father’s passing and the time of the daughter’s passing. Note that the outcomes illustrated are very fact specific.

Joan owns an interest in a partnership holding commercial property, currently worth $11.4M with a cost basis of $1M.

Joan sets up a trust for the benefit of Joan, her father (James, who has only a modest estate and has not used any of his exclusion amount), and Joan’s heirs, which:
1. Grants James a testamentary general power of appointment, and
2. Provides Joan the right to the income and cashflow from the trust assets during James’ life. Her interest in the trust terminates on James’ death.

Joan gifts her partnership interest to the trust. No gift tax is due (and none of Joan’s exclusion amount is used) because Joan’s retained interest in the trust makes the gift incomplete until James passes away.

James passes away. Upon James’ death, Joan’s gift to the trust becomes complete using Joan’s lifetime gift tax exclusion. In addition, the trust assets are included in James’ estate (assume no appreciation for this example) and therefore get a step-up in basis to $11.4M and the estate tax may be offset by James’ unused lifetime gift and GST tax exemption.

After James’ death, the partnership’s cash flow and the additional depreciation allowed due to the step-up in basis on James’ death will benefit the family.

Joan passes away. Upon Joan’s death, the appreciation and the cash flow since James’ death are not included in Joan’s estate. The $11.4 million gift value is included in the estate tax base as an adjusted prior gift.

A CLOSER LOOK AT THE POTENTIAL ESTATE TAX SAVINGS:

| Appreciation (2%, 15 years) | $6.36M |
| Cash flow (13 years) | $1.30M |
| Total value excluded from Joan’s estate | $7.66M |
| Estate Tax Savings | $3.06M |

A CLOSER LOOK AT THE POTENTIAL INCOME TAX SAVINGS:

The basis is stepped up from $1M to $11.4M. Assuming 60% improvements and a 15-year asset life, that represents a depreciation expense of $456,000 per year. At the current top tax rate of 37%, the annual income tax savings is $168,720 and 15-year savings is $2,530,800. Note that this accelerates the re-depreciation of the property by a generation.
Wealth transfer planning

On the topic of donor’s remorse

This isn’t an isolated example. Many forms of existing estate tax planning, usually involving trusts, originally designed to keep their assets out of the grantor’s taxable estate at death can be modified to accomplish estate inclusion and use up the current exemption. But these modifications can be complicating and are, as yet, untested. Thus, as with all tax planning, there are both real economic risks and tax risks arising from such plans. One should go into the planning process with open eyes and obtain a real understanding of where difficulties might arise.

There are other options to assuage potential donor’s remorse, such as enjoying, within limits, indirect access to the transferred assets. For example, if you are married, you could consider transferring $11.4 million in property to an inter vivos trust that provides for income distributions (and periodic or discretionary corpus distributions) primarily for the benefit of your spouse. Such a trust, so long as you remain married, would indirectly help preserve much of your cash flow as it existed prior to any planning. This planning, however, has limits. The law does not respect trusts set up by each spouse for the benefit of the other spouse if the trusts’ dispositive terms are substantially identical. Where “reciprocal” trusts are important to the overall estate plan, you and your advisers must take care to differentiate the dispositive provisions of the trusts so that each trust will avoid inclusion in the donor’s gross estate. Further, this option does not give rise to estate inclusion and thus there will be no fair market value basis available at death. Lastly, this option responds poorly to a divorce.
The GST tax is a separate tax regime that augments the gift and estate taxes. It provides a mechanism to collect a transfer tax at each generational level by imposing a tax when a gift, bequest, or trust benefit acts to skip a generation. For example, a gift from a grandparent to a grandchild, while subject to a gift tax, avoids the tax that would have been imposed upon a transfer of the same assets from child to grandchild. The prior sentence should not be read to imply that gifts to unrelated persons may not also be subject to GST tax. A gift to an unrelated person 37.5 or more years younger than the transferor is also subject to GST tax. But, GST is only imposed upon the value of transfers in excess of a statutory amount—the GST exemption amount. The 2017 Tax Act increased the GST tax exemption to $11.4 million in 2019, coinciding with the estate and gift exclusion. If legislators take no action, the GST exemption will revert to $5 million indexed for inflation from 2010 (which is expected to be about $5.6 million in 2026). The GST tax rate remains equal to the highest estate tax rate in effect—40 percent through 2025.

The GST tax is elaborate in scope, particularly as it relates to transfers to trusts that will extend over multiple generations. However, if a taxpayer applies his or her GST exemption to a trust in an amount equal to his or her gifts to the trust, then under current law all future distributions from that trust, whether during its term or upon its termination, will be exempt from GST tax.

**Leveraging the GST exemption: Dynasty trusts**

A typical GST tax-exempt dynasty trust—a trust to which the transferor has allocated his or her GST exemption in an amount equal to his or her gifts to the trust—transfers income and/or principal to multiple generations, including children (hence the title “dynasty trust”), while paying estate or gift tax only upon the initial gift to the trust. The wealth accumulated in the trust thereafter avoids both estate tax and GST tax at each subsequent generation until such time as the trust terminates. Because dynasty trusts are intended to skip multiple generations, they represent the most tax-efficient use of a taxpayer’s GST exemption.

Dynasty trusts are permitted in all states, but laws in many states limit the duration of a trust to a term from 80 to 110 years. Most states allow the trust to continue until 21 years after the death of the last descendant of the transferor who was living at the time of the trust’s creation. Other states have recently amended their trust statutes to permit trusts to exist in perpetuity. An individual may create a trust in a state other than his or her state of residence; consequently, perpetual dynasty trust planning is substantially open to everyone. (The relative merits of availing oneself of such a perpetual trust is a topic beyond the scope of this chapter.)

The most leveraged form of such a transaction would have each spouse fund a dynasty trust, each in the form of a grantor trust, with $11.4 million. Thereafter each trust would engage in a purchase of property, at a reasonable multiple of the $11.4 million value of the trust, from the grantor (a planning consideration described in the second installment of this Guide). Without belaboring the math of the example, assuming a leveraged purchase over 20 years, for a trust with a term of 110 years and an after-income tax yield of 4 percent, the value of each such trust would have grown to $3.4 billion, even assuming that all cash receipts were distributed. Although a trust leaving its corpus intact for the entire 110-year term is unlikely, the example demonstrates the wealth accumulation possibilities inherent in a dynasty trust where the undistributed wealth is subject only to income taxes—not transfer taxes—and the income taxes are only imposed after the grantor’s death when the trust’s grantor trust status terminates.
Wealth transfer planning

A cautionary note on state estate and inheritance taxes

Many states do not now and will not in the future conform to the federal estate tax exclusion amount. Consequently, an immediate state estate/inheritance tax may arise where the $11.4 million federal exclusion amount is being utilized in a testamentary transfer and it exceeds the corresponding state applicable exclusion amount. Most states have started to adjust their exclusions upward from the universal $1 million in place in 2000, but none are likely to match the federal inflation-adjusted exclusion. Thus, in a state that does not provide for its “own” state-only marital deduction protocol, fully funding a bypass trust with the federal $11.4 million federal exclusion amount would give rise to a considerable state estate tax.

State estate and inheritance tax rate and exemptions in 2018

<table>
<thead>
<tr>
<th>State</th>
<th>Estate tax</th>
<th>Inheritance tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>$2.6M; 7.2%–12%</td>
<td></td>
</tr>
<tr>
<td>Hawaii</td>
<td>$11.2M; 10%–15.7%</td>
<td></td>
</tr>
<tr>
<td>Iowa</td>
<td></td>
<td>0%–15%</td>
</tr>
<tr>
<td>Illinois</td>
<td>$4M; 0.8%–16%</td>
<td></td>
</tr>
<tr>
<td>Kentucky</td>
<td></td>
<td>0%–16%</td>
</tr>
<tr>
<td>Maine</td>
<td>$5.6M; 8%–12%</td>
<td></td>
</tr>
<tr>
<td>Maryland</td>
<td>$4M; 16%</td>
<td>0%–10%</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>$1M; 0.8%–16%</td>
<td></td>
</tr>
<tr>
<td>Minnesota</td>
<td>$2.4M; 13%–16%</td>
<td></td>
</tr>
<tr>
<td>Nebraska</td>
<td></td>
<td>1%–18%</td>
</tr>
<tr>
<td>New Jersey</td>
<td></td>
<td>0%–16%</td>
</tr>
<tr>
<td>New York</td>
<td>$5.25M; 3.06%–16%</td>
<td></td>
</tr>
<tr>
<td>Oregon</td>
<td>$1M; 10%–16%</td>
<td></td>
</tr>
<tr>
<td>Pennsylvania</td>
<td></td>
<td>0%–15%</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>$1.538M; 0.8%–16%</td>
<td></td>
</tr>
<tr>
<td>Vermont</td>
<td>$2.75M; 16%</td>
<td></td>
</tr>
<tr>
<td>Washington</td>
<td>$2.193M; 10%–20%</td>
<td></td>
</tr>
<tr>
<td>District of Columbia</td>
<td>$11.2M; 6.4%–16%</td>
<td></td>
</tr>
</tbody>
</table>

Note: Exemption amounts are shown for state estate taxes only. Inheritance taxes are levied on the posthumous transfer of assets based on the relationship to the descendant; different rates and exemptions apply depending on the relationship.

Further observations on wealth transfer planning
Tuning up prior planning
On the topic of donor’s remorse
What about the generation-skipping transfer (GST) tax?
A cautionary note on state estate and inheritance taxes
Take action today, but then remain vigilant
Thoughtful marital deduction planning may postpone the problem noted above, but at a price. Specifically, if all assets pass to the surviving spouse in a manner qualifying for the marital deduction and the trust described above is not funded, there is no transfer subject to state estate taxation until the surviving spouse dies. At that time, for federal estate tax purposes, both the decedent’s exclusion and the deceased spouse’s unused exclusion is also utilized; however, many states do not permit the use of state exclusion amounts other than that of the decedent. The question then is whether the subsequent gain in the size of the estate subject to state estate tax will produce a tax result that would suggest that paying the state estate tax at the death of the first spouse might have been more tax efficient. By paying state estate tax at the first death, all future appreciation on the trust’s assets is not subject to state estate taxation upon the death of the surviving spouse. Whether that future savings justifies a current state estate tax liability is ultimately a function of nontax factors.

If you are domiciled in a state with a state estate or inheritance tax or you own assets in such a jurisdiction, consider whether lifetime gifting will remove assets from your state taxable estate. With the exception of Connecticut, states do not currently levy a gift tax. States other than Connecticut may not include prior taxable gifts in the state estate tax base, notwithstanding they are an element in the federal estate tax base.
Wealth transfer planning

Take action today, but then remain vigilant

What does the future hold for the transfer tax system? Hard to say, but since it has now survived for more than a century, its continued survival would appear more likely than not, particularly since a review of its history indicates its frequent use as a means to raise quick revenue when politically expedient. What of the current exclusion amounts? Harder to say. It will depend on which direction the political winds blow between now and 2025. However, given expected federal budget constraints, to assume that the exclusion amounts will remain at current levels entails substantial risk. This is the type of uncertainty that has paralyzed taxpayers and their advisers before. Yet, there is an important reason to resist the planning paralysis now—the rare opportunity to employ the enhanced gift and estate tax exclusion and GST exemption amounts under the 2017 Tax Act. This chapter and the related chapter in the second installment of the Guide is intended to inform you of the possibilities to do just that. If the current rules sunset, it is unlikely that you will see a similar circumstance rise again.

So, to reiterate, if you are in a position to do so, consider doing something now, before the end of 2025. At the same time, you and your advisers should remain vigilant as the 2020 election season approaches given the possibility that in 2021, the future of the federal estate, gift, and GST taxes may once again become unclear. Keeping informed of tax legislative developments will give you a more effective opportunity to plan ahead and react quickly as more changes transpire.

Seeking the advice and guidance of an experienced tax professional in implementing a wealth transfer plan that reduces your estate, gift, and GST tax liabilities is a prudent course of action. Now, in these times of unprecedented wealth-transfer opportunity (but also significant longer-term uncertainty), obtaining planning guidance is imperative. As with any aspect of wealth transfer, you should work closely with your advisers to identify and evaluate opportunities relevant to your situation, goals, and needs.
Year-end tax planning considerations

Move forward with confidence.

As we discussed in the first installment of the Guide, the passage of the 2017 Tax Act significantly altered the individual income tax planning landscape for 2018 and beyond. Almost two years later, aided by regulatory and other guidance, we have completed our initial pass through the maze of tax reform and come out with a better understanding of the tax impacts and potential pivot points, some of which may require action before the end of 2019. The following list of considerations is not meant to be exhaustive. It is meant to begin the conversation and may require that you revisit other sections of the Guide for a more in-depth discussion of complex topics.
With a solid understanding of the various taxes that may be assessed on your income and the importance of planning for this meaningful liability, you are now equipped to consider the issues that are presented to you based on your personal tax situation. When we say considerations, we like to think of those as levers that you can engage. Maybe your lever is to take steps to defer income to a subsequent year, or maybe it is to accelerate a deduction or expense into the current year. Or maybe your lever is to take action based on the implications of tax reform. Think of these levers as tools within your control that you can use to affect your tax result.

By implementing a long-term commitment to broad-based tax planning, you likely will identify many different levers to consider each year and position yourself to navigate today’s tax environment more efficiently. To be more effective in your efforts, consider thinking of your tax situation beyond just the income you expect to realize or the deductions you expect to incur. To only think of income planning approaches or deduction planning considerations is to think in a vacuum. That is not the way that it works when you file your tax returns—even more so after tax reform. Everything is taken into consideration when calculating your tax bill. So we encourage you to think of planning as a year-round process, taking into consideration all the levers you can pull, be they income or deduction decisions—to create a more efficient tax result.

Year-end tax planning considerations

Year-end planning: A year-round process

Future events, goals, and objectives

Planning for types of income

Planning for entity ownership

Planning for foreign investments

Planning for itemized deductions

Planning for qualified business income deductions

Audit readiness and identity theft

Tax attributes

Putting it all into perspective

Putting it all into perspective
Year-end tax planning considerations

Future events, goals, and objectives

The biggest drivers of tax planning are your personal goals and objectives. Of course, as your life and investments change, those goals may need to be reconsidered.

- Are there 2019 and 2020 life events (such as, changes in marital status, sale of a business, change in residency, etc.) that should be considered?
- Are you considering more international investments or moving globally?
- Have you, or your immediate family members, changed employers?
- Are you considering the creation of a family office?
- Did you purchase or sell cryptocurrency, tokens, participate in an initial coin offering, or open a wallet at a cryptocurrency wallet hosting service?
- Are you considering a change related to tax reform, such as changing your choice of entity?
- Are you considering an investment in a qualified opportunity zone?

MARKET AND REGULATORY FACTORS

Increasing globalization

Sharp change in the capital and equity markets

Significant tax law changes

What's important to you?
- Identify your needs
- Quantify your aspirations
- Define your goals

How do you stay in check?
- Perform regular performance reviews
- Adjust planning in light of life events and market conditions

How do you plan?
- Determine risk tolerance
- Collaborate with advisers
- Develop a wealth and tax strategy
- Identify asset protection plans

How will you distribute
- Determine to whom, when, and under what circumstances
- Evaluate wealth transfer strategies
- Implement and monitor the chosen strategies

Year-end tax planning considerations
Future events, goals, and objectives
In order to plan regarding income, you must consider both the character and timing of that income, both of which affect the applicable tax rate.

**Ordinary income**

If your primary source of income comes from employment, then you will generate ordinary income in the form of wages, salaries, tips, commissions, bonuses, and other types of compensation. Other investments may also generate ordinary income in the form of interest, nonqualified dividends, net income from a sole proprietorship, partnership or limited liability company (LLC), rents, royalties, or gambling winnings.

**Individual ordinary income tax rates**

<table>
<thead>
<tr>
<th>FOR TAX YEAR 2018</th>
<th>Single</th>
<th>Married couples filing jointly</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary income tax rate</td>
<td>Taxable income over</td>
<td>But not more than</td>
</tr>
<tr>
<td>10%</td>
<td>–</td>
<td>$9,525</td>
</tr>
<tr>
<td>12%</td>
<td>$9,525</td>
<td>$38,700</td>
</tr>
<tr>
<td>22%</td>
<td>$38,700</td>
<td>$82,500</td>
</tr>
<tr>
<td>24%</td>
<td>$82,500</td>
<td>$157,500</td>
</tr>
<tr>
<td>32%</td>
<td>$157,500</td>
<td>$200,000</td>
</tr>
<tr>
<td>35%</td>
<td>$200,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>37%</td>
<td>$500,000</td>
<td>–</td>
</tr>
</tbody>
</table>

**Capital gains**

If you have invested in a capital asset, then the gain on the sale or exchange of such an asset results in capital gain. Generally, the short-term capital gains tax rate (for assets held up to 12 months) is equal to the ordinary income tax rate. The long-term capital gains tax rate brackets (generally, assets held for more than 12 months) are shown below.

**Long-term capital gains tax rates**

<table>
<thead>
<tr>
<th>FOR TAX YEAR 2018</th>
<th>Single</th>
<th>Married couples filing jointly</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net long-term capital gains rate</td>
<td>Taxable income over</td>
<td>But not more than</td>
</tr>
<tr>
<td>0%</td>
<td>–</td>
<td>$38,600</td>
</tr>
<tr>
<td>15%</td>
<td>$38,600</td>
<td>$425,800</td>
</tr>
<tr>
<td>20%</td>
<td>$425,800</td>
<td>–</td>
</tr>
</tbody>
</table>
At the root of almost every individual and family fortune is (or was at one time) a successful business. Effective tax planning may contribute to the business’ success as the business moves through its life cycle from start-up through growth, maturity, sale or ownership transition by gift or inheritance. Ultimately, the fruits of business success lie in compensation, equity distributions (including to pay related estate taxes) and other economic benefits to owners and others holding a stake in the business. Tax planning can enhance the relative benefit of these business and stakeholder interactions.

Integrated tax planning is particularly important when the business is structured as a pass-through entity. The lens through which owners will make decisions about structure or financing is now colored by lower overall individual rates, the new deduction for qualified business income and the new limitation on business interest. While no one provision can stand on its own when making important decisions—such as what type of entity structure to use in forming a business—collectively, these new planning considerations alter the analysis that an owner must undertake when determining how to move forward. (For more information, review “Choice of entity and addressing entity conversion considerations: Key provisions to consider” from installment one).

Individuals can gain significant value when they work with an adviser who can understand the entire picture, from the entity to the owners. Any tax planning you undertake at the business level needs to take into account the implications to the owners.

Year-end tax planning considerations
Planning for entity ownership
Planning for foreign investments
Planning for itemized deductions
Planning for qualified business income deductions
Audit readiness and identity theft
Tax attributes
Putting it all into perspective

CONSIDERATIONS FOR BUSINESS ENTITIES:
- Entity choice and classification
- Cash management and distribution policies
- Federal and state accounting methods
- Federal and state credits and incentives
- Tax elections
- Succession planning

CONSIDERATIONS FOR INDIVIDUAL, FIDUCIARY, AND CHARITABLE OWNERS:
- Cash flow and liquidity
- Wealth accumulation
- Tax efficiency
- Wealth transfer planning

Year-end planning: A year-round process
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Year-end tax planning considerations

Planning for entity ownership

Business loss limitations
When thinking about entity ownership, it is also important to remember various considerations, including those listed below, regarding the deductibility of losses. For more information, read the chapter on losses.

- Do you have sufficient tax basis?
- Do you have sufficient at-risk basis?
- Are you subject to the passive loss rules?
- Are you subject to the excess business loss rules?

Self-employment income
If your income is generated by operating a business as a sole proprietor, a partner in a partnership, or a member of a multi-member LLC, you may be subject to self-employment tax in addition to your ordinary income tax. Consider establishing an appropriate retirement savings vehicle, such as a Keogh or a SEP IRA, which would allow for maximum contribution to a qualified plan based on self-employment income.
Year-end tax planning considerations

Planning for foreign investments

As we discussed in the second installment of the Guide, if you and your family are thinking of joining the globalization trend and moving and/or investing internationally, consider these questions:

• How will you manage investment, legal, immigration, tax, and accounting issues?
• What types of investment vehicles should you consider?
• Should potential estate taxes or inheritance taxes affect the structuring of your international investments?
• What are some of the tax considerations for non-US families making US investments?
• What are the potential issues for US families making investments in foreign countries?
• What effect does family mobility have on investment planning and taxation?
• Do you understand how to comply with your US and foreign country tax obligations?
• Do you know what your overall tax position will be across the globe?
• How will the 2017 Tax Act impact your global structure and cash flow?
• Are you considering selling or expanding your business or investing in new foreign investments?
• What are the considerations involved with moving your non-US business onshore?
Year-end tax planning considerations
Planning for itemized deductions

Similar to income, when planning for deductions, you must consider the nature of the deduction. If it is an itemized deduction, as opposed to a business expense, then how has tax reform changed the way you should plan?

**When navigating changes regarding itemized deductions, consider:**
- Changes to charitable contribution deduction and substantiation requirements
- Newly increased (60%) AGI limit for cash contributions
- New limitations on state and local tax deductions
- Deduction for foreign property tax repealed
- Repeal of miscellaneous itemized deductions
- Investment interest expense deduction
- New limitations on mortgage interest deduction
- New business interest expense limitation
- 10% of AGI limitation on medical expenses

Also consider the impact of the alternative minimum tax (AMT) (for most taxpayers, impact reduced due to tax reform and increased exemptions).

**Considerations for charitable giving**

**Before starting charitable giving, ask yourself:**
- How much wealth am I willing to part with?
- What type of assets do I have to work with?
- How much control do I want?
- What is the desired income stream for me, my family and my charity?
- What percentage of my income do I want to spend on philanthropy?
- Do I anticipate an income event that will enhance or limit the benefit I receive from a charitable donation?
- When does the charity need the funds to meet both my goals and the charity’s need for the funds?
- What is my desired timing for receiving an income tax deduction for the charitable gift?
Year-end tax planning considerations

Planning for qualified business income deductions

As we discussed in the second installment of the Guide, considerations abound regarding the new section 199A qualified business income deduction, including (but not limited to):

- Consider the qualified trade or business and specified service trade or business (SSTB) determinations and threshold application.
- Effective aggregation planning requires modeling the potential impacts of aggregating (or not) over multiple years.
- Owners of relevant pass-through entities (RPEs) will get Schedules K-1 informing them of whether any trade or business is a SSTB, but may not receive all the information necessary to conduct an aggregation analysis (especially if no aggregation is made at the RPE level). Consider if you have all of the relevant necessary information.
- Consider the impact of the overall limitation of 20 percent of the taxpayer’s taxable income without regard to net capital gain (which for this purpose includes any qualified dividend income).
- Consider the interplay with other tax rules (for example, passive activity losses and charitable contribution deduction limitations). For example, are you offsetting all of your ordinary income with a charitable contribution and therefore have no remaining income against which you can take the qualified business income deduction?
Year-end tax planning considerations

Audit readiness and identity theft

In reviewing your income tax information, you should consider the increased federal and state audit activity of high net worth individuals in areas, such as:

- Substantiation of active participation
- Substantiation of charitable donations
- Substantiation of S corporation stock and debt basis adjustment schedules for losses and stock basis for tax free distribution

Tax reform has introduced multiple areas of ambiguity. The tremendous amount of uncertainty surrounding tax reform points to an increasing risk of audit adjustments for taxpayers.

Additionally, you should safeguard your information and consider the potential for identity theft. If you need additional information about these issues, then you should consider consulting with a tax controversy specialist.

Key questions:

- How is the IRS examination approach changing?
- What information should you be prepared to provide to the IRS during an examination?
- What common tax issues arise in Global High Wealth exams?
- What leading practices help effectively manage an examination?
- What else should an individual, trustee or family office be aware of?

Exam readiness

1. Opening letter
2. Notice of adjustment prepared
3. 30-day letter
4. 90-day letter

IRS documentation

Examination

Respond

Fast track appeal

Protest

Appeals

Court (choice of forum)

Key questions:

- How is the IRS examination approach changing?
- What information should you be prepared to provide to the IRS during an examination?
- What common tax issues arise in Global High Wealth exams?
- What leading practices help effectively manage an examination?
- What else should an individual, trustee or family office be aware of?
Year-end tax planning considerations

Tax attributes

Consider what, if any, factors from your 2018 tax returns impact your 2019 tax liability, such as:

- Tax overpayments applied to 2019
- Carryovers of certain types of losses or credits, such as:
  - Short-term or long-term capital loss
  - Passive activity loss
  - Net operating loss, including those as a result of an excess business loss
  - Excess business interest expense
  - Qualified business loss
  - Charitable contribution deduction, keeping in mind the potential for expiration of the amount carried forward
  - Foreign tax credit
  - AMT credit
Putting all of this into perspective may be easier when you consider these important points:

1. Items that are controllable provide flexibility for determining the more optimal time for tax recognition. This is equally applicable to items of income as it is to losses and items of deduction.

2. Some items are automatically going to occur—you will pay your real estate taxes when they are due (or face a penalty for not doing so), and you will earn your wages when they are earned. Often these automatic events lay the foundation of your planning. In essence, enhance the efficiency you can gain from your controllable events against the backdrop of your noncontrollable events.

3. Controllable deductions may be one of your biggest levers. Again, an example would be when and how you fund your charitable gifts. Will you use securities or an alternative asset? Recognizing that there are more efficient ways to fund these deductions—both in terms of the when and the how—allows you to reach a greater level of tax efficiency.

4. Your personal tax situation will afford you some additional considerations today and in future years. Making sure you review it broadly and commit to thoughtful tax planning is likely to position you to realize a greater degree of tax efficiency than you otherwise might expect.

5. If you are an owner of, or invest in, pass-through entities, do not lose sight of the fact that tax reform has changed the lens for more thoughtful planning at the entity level to position yourself for an efficient tax result. Perhaps planning within those entities to structure for the qualified business income deduction or business interest expense will take priority. Failing to coordinate tax planning between a flow-through entity and the owners of that flow-through entity may undercut tax efficiency.

6. Before acquiring new investments, take time to understand the character of the income that will be generated by the investment as well as when you will recognize the income. Furthermore, analyze whether you will benefit from the expenses and losses allocated to you. For example, losses may be disallowed in the current year if you are subject to the passive loss or excess business loss rules. Failing to understand the character of income and expenses that the pass-through entity will pass through to you may lead to unwelcome surprises when you receive the final tax information.

This Guide is meant to begin the conversation as you navigate your personal income tax planning path, specifically at the close of 2019, but more importantly year-round.
Tax policy update

What happens in Washington directly affects your bottom line.

Deloitte’s Tax Policy group provides cutting-edge news, information, and analysis to help you stay on top of the latest developments in Congress and guide you through the legislative maze. Its email news service, Tax News & Views, provides a convenient way to keep up with "the big picture."
Tax policy update

Tax policy decisions ahead: Divided government, divided attention

After last year’s midterm elections ushered in a new era of divided government, with Democrats in control of the House of Representatives and Republicans in charge of the Senate and the White House, the conventional wisdom was that any talk of sweeping changes to the tax code from either party would serve largely as talking points for the 2020 elections and that any near-term action on the tax policy front in Congress would be limited to more narrowly focused legislation that had the potential to attract bipartisan support.

But with just a few weeks left in 2019, the House and Senate are still addressing several tax priorities that various lawmakers and outside stakeholders hope will be addressed this year, such as:

• The future of temporary tax “extenders” provisions that expired in 2017 and 2018 or are set to expire at the end of this year;
• Further suspensions of certain taxes enacted as part of the Patient Protection and Affordable Care Act, which are slated to come into force next year;
• Technical corrections to the 2017 Tax Act; and
• Senate action on the SECURE Act (H.R. 1994)—a bipartisan, House-passed retirement security measure that also would address unintended consequences of a change to the so-called “kiddie tax” that was included in the 2017 Tax Act.

Progress on these agenda items has been stymied by a number of political policy debates including partisan disagreements over whether the budgetary cost of the tax extenders should be offset; a separate debate among Democrats as to whether they should work with Republicans to fix technical glitches in the GOP-drafted 2017 Tax Act and if so, at what price; and efforts by a few disparate Senate Republicans to block expedited passage of the SECURE Act because they want to strike certain provisions from the House-passed bill, such as pension funding relief for certain financially challenged community newspapers, or add others in, such as a 2017 Tax Act technical correction that would clarify the depreciation rules for qualified improvement property.

These seemingly intractable differences have led many observers to conclude that the underlying tax proposals are unlikely to advance through Congress on their own and will instead have to be attached to a larger, “must-pass” legislative package, such as a government funding bill. But that path is proving to be more difficult to navigate than lawmakers might have imagined. The House and Senate did not complete work on the 12 spending bills needed to fund government agencies with the start of fiscal year 2020 on October 1 and instead approved a short-term continuing resolution in late September that keeps the government open (at fiscal year 2019 funding levels) through November 21.

In theory, then, that means the next possible opportunity for lawmakers to move tax legislation may be in late November when the continuing resolution is set to expire. But in addition to tax and spending legislation, Congress already faces a crowded agenda that could include such diverse and potentially divisive issues as trade, gun safety and regulation, prescription drug pricing, judicial nominations in the Senate, and proceedings in the House related to a formal impeachment inquiry against President Trump that has been authorized by Speaker Nancy Pelosi, D-CA. These competing claims for lawmakers’ time and attention have the potential to drag out work on appropriations and may require additional stop-gap spending bills to keep the government open. And each delay in finalizing a fiscal year 2020 spending package likewise could mean a delay in wrapping up an agreement on tax legislation.

For continuing updates on the federal tax policy outlook, read Tax News & Views from Deloitte Tax LLP’s Tax Policy Group.