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Three Strategic Midyear Tax Tips

With Summer 2019 now behind us, here are three strategic tax-planning tips to think about before the end of the year.

Itemizing Strategically Is A Thing. In 2018, for the first time, the Tax Cut and Jobs Act (TCJA) nearly doubled the standard deduction to $12,000 for single filers and $24,000 for married couples filing jointly. The number of taxpayers eligible to itemize was slashed by 60% by the TCJA. Only about 12% of taxpayers are still eligible to itemize expenses for medical, dental, home-mortgage and other loan interest, and charitable contributions. But with just a bit of forethought, you can plan to bunch deductions once every three years, or maybe two. Itemizing strategically may materially reduce your income tax bill. If you did not itemize deductions in 2018, bunching itemized deductions in 2019 may boost your total itemized deductions well beyond your standard deduction. If not, you may want to plan on bunching and itemizing next year. The near-doubling of the standard deduction was intended to simplify federal taxation but has actually complicated it. Millions of the nearly 20 million taxpayers no longer eligible for itemizing now must strategically plan to itemize every two or three years.

Donor-Advised Funds. One of the ways to boost your deductions this year is by giving to charity, and one of the easy ways to give is through a donor-advised fund (DAF). With a DAF, you can split gifts among different charities. You contribute securities or cash and claim the deduction that same year. If you know you will be taking a taxable capital gain on an investment before the end of 2019, it's wise to consider donating appreciated securities to a DAF. You receive a deduction on the

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Seize The Day!

If you spend your professional life giving tax advice, you learn to appreciate each day. As the Latin proverb has it, *carpe diem*.

We say that because life is joyous and missing out on daily pleasures is a terrible mistake. There are so many of those pleasures: the births of our children and grandchildren, their weddings, our own anniversaries, special (and even not-so-special) birthday celebrations, and graduations, to name a few.

At the same time, as we all know, life is fragile—another reason for appreciating the sweet times. No one likes to think about things like these, but career disappointments, illnesses, the deaths of loved ones, and other misfortunes come to us unwanted and unbidden.

We mention these two sides of life because our clients often call on us at moments of joy and at moments of upheaval or grief. In both cases, revised tax planning may be in order, and we have the specialized knowledge that's required.

When we relate to our clients like that, yes, it's a critical part of running our business. But it's also maintaining an emotional bond with clients who wish us to do so—a privilege we don't take lightly. It was one motivation for us to begin our new website, a 24/7 link to the help we can give you and your unique tax situation. You can peruse, log in, or set up your portal access, at www.gersteintaxservice.com.

And so, on those good days that you want to "seize" and on the days when you need to remember the good times, we'll be ready for you. As always, we thank you for your trust.

Warm regards,
The Gerstein Tax Service Client Team

Paying Off A Mortgage And The New Tax Code

Among the most prized deductions to get impacted by the Tax Cut And Jobs Act was the monthly mortgage interest. Should you pay off your mortgage, if your mortgage interest deduction is gone? The answer more often now is "Yes," providing you can afford to retire the debt. If you can't afford that now, aim to do it as soon as you can.

Due to a large increase in the standard deduction, fewer taxpayers qualify for the mortgage interest deduction. The standard deduction under the new tax law almost doubled, to $12,000 for single filers and $24,000 for married couples. Only people with deductions of more than those amounts can itemize and deduct their mortgage interest.

Piling up that much to itemize, especially for couples, will be difficult. As a result, the Tax Policy Center estimates that only 20 million Americans will itemize in 2018, as opposed to 46 million had the tax law not changed.

Other changes in the law also lessen the benefit of carrying the burden of a mortgage. There's now a $10,000 cap on deductions for state, local and property taxes. Before the law changed, the amount you could deduct was unlimited.

In addition, you are restricted from deducting interest on home equity loans if you use the debt for anything other than buying, building or upgrading a home. If you want to use the home equity loan for a tuition payment or to purchase a boat, Uncle Sam won't allow it anymore.

If you have deductions totaling more than the $12,000 and $24,000 thresholds, you will still itemize. In many cases, you can save more money by erasing your mortgage than you could earn in "risk-free" investments.

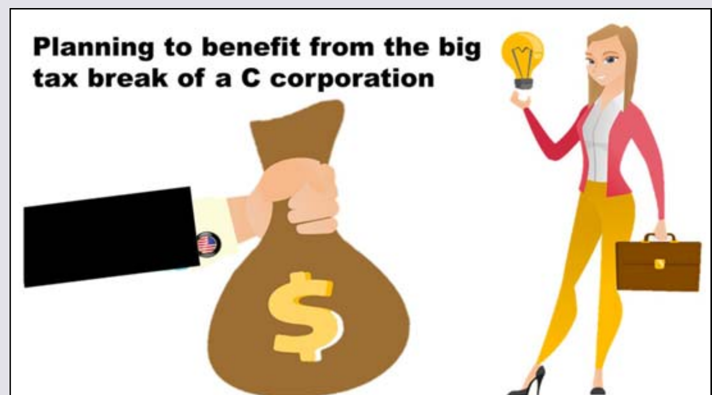
Here's the math. Say you have a $300,000 mortgage, which is about the average amount nationally, at a 4% yearly interest rate, and you're in the 30% marginal tax bracket - 24% federal and 6% state levies combined. If you pay off the mortgage, you no longer have to pay roughly $12,000 annually in interest. When you did pay it, you received a tax deduction worth $3,600 - 30% of the mortgage interest. So that means, after the loan is retired, you saved $8,400. That beats the risk-free Treasury bond return. ●

How To Sell Your Small Business And Pay No Taxes

So, you want to sell your small business? The good folks in Washington have a dandy tax break exempting you from all federal taxes on the sale—provided that you own a C corporation.

A lot of attention has gone to the special "pass-through business" break from the new tax law. This benefits income from S corporations and others like it, giving owners a 20% exemption on their businesses' earnings. That highly popular provision in the Tax Cuts and Jobs Act (TCJA) makes it seem like small business owners would question the decision to classify their companies as a C Corp.

Well, yes, except for the terrific advantage you get as a C corp seller, which has been available for many years. Aside from the TCJA exemption and the lack of double taxation, C corps are taxed at the corporate level and then the owners get taxed on what they reap after that. In contrast, pass-throughs, like S corps, LLCs, and other partnerships, are only taxed once. But C corp shareholders pay zero tax on a company sale, as long as



they acquired the shares on or after Sept.

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How To Swap Real Estate And Defer Taxes, Maybe Forever

A tax-savvy way to improve your real estate situation is to swap one property for a new one. Called a 1031 exchange, which refers to its section of the tax code, this works so long as you are switching business properties. Personal residences aren't eligible.

While 1031 exchanges are often used by big commercial real estate operators, there's nothing stopping you from using the strategy for much smaller-scale holdings. The maneuver defers capital gains taxes, perhaps forever.

This takes some planning. For instance, say you have a vacation house and would like to exchange it for a property in a location that is closer to your residence. If you rent the original vacation place out for at least 14 days per year for two successive years, in the eyes of the IRS, you have a business asset. The only caveat is that you must continue to rent out the new vacation house for 14 days over the next two back-to-back years.

A couple of more requirements: First, you must identify the substitute property within 45 days of selling the old real estate. Second, you need to buy the new property within 180 days of your sale.

The nice thing about 1031 exchanges is that you aren't confined to the exact same type of property. So, you can swap a condominium for a farm, or a house for a marina — as long as it's a business or investment property. We recommend coming to us for tax assistance on this issue.

The December 2017 tax-code rewrite barred applying Section 1031 to tax-free exchanges of collectibles but left intact tax-free exchanges for business- or investment-purpose real estate.

Federal long-term capital gains taxes now are 15% (for income of $38,601 to $425,800) or 20% (for $425,801 or more). You can postpone paying taxes for the rest of your life. And your heirs benefit, too. When they inherit the property, they get a "stepped-up basis." This means the property is valued at the market rate at the time of your death. So, the taxable amount adjusts upward. If your heirs turn around and sell it right away, they will owe little or nothing. The tax liability on the property is erased.

Of course, the swap must be a sensible business deal. Getting a tax-free sale of a profitable strip mall to buy an apartment building that has trouble keeping tenants, for example, would be an imprudent deal.

Accounting the value of a property properly is another important consideration, separating a capital investment in new appliances, for instance, from the fair value of the property.

Keeping Uncle Sam's hands off the proceeds of a sale of real estate is a highly advantageous part of financial planning for owners of real estate for business, investment, or rental purposes, as well as those who rent out a vacation home as required under federal rules.

Strict timing limitations are required in a 1031 exchange. If a 1031 exchange is not properly constructed and executed in a timely manner, then an investor could lose all the tax benefits of the transaction, including depreciation recapture. In addition, the property you sell must be a replaced with a like-kind property, and a Qualified Intermediary, as an independent third party, is needed to facilitate a 1031 exchange transaction and hold the funds on behalf of the investor.

Investors must also be leery of investments in private offerings created to sell 1031 exchange transactions. These are often illiquid investments, and do not offer guarantees of income or guarantees that any other of your investment objectives will be met. They may be speculative, and you could lose some, or all, of your principal investment. Please consult us if you're considering doing a 1031 Exchange. ●

28, 2010. That's a huge tax break!

The gracious 100% tax exclusion is available to anyone with stock in a C corp for over five years. Taxpayers get a smaller break on shares owned before Sept. 28, 2010. You're also entitled to a 5% exclusion on C corp shares owned from Aug. 9, 1993 to Feb. 17, 2009. C corp shares purchased between Feb. 18, 2009 to Sept. 17, 2010 receive an exclusion on 75% of the gain on the purchase price in the event of a sale. If you owned your C corp shares prior to the Aug. 9, 1993, date, you're out of luck.

To get this tax-favored status, called a Qualified Small Business Corporation, or QSBC, a small company must meet a batch of requirements. The business' gross assets must be less than $50 million, and the exclusion is capped at the greater of $10 million or 10 times the aggregate basis of the stock the taxpayer sold during the tax year.

Say you sell your business for $10 million. If the QSBC break didn't exist, and your capital gains rate is 23.8% (the top rate of 20%, plus a 3.8% surtax for singles making more than $200,000 annual or couples hauling in over $250,000), you'd owe $2.38 million to the IRS. But thanks to the QSBC benefit, you'd owe the government zilch.

And here's a kicker. Both C corps and pass-through businesses are helped by the new, lower federal tax on companies, 21%, down from 35%. ●

Europe's Growth Problem And Your Portfolio

Aging populations are reshaping the world's largest economies; they've caused a global savings glut and they're helping drive current U.S. financial economic conditions.

The demographic trends are a key factor behind the U.S. yield curve inversion and stock market volatility, but rarely make headlines in the financial press.

Here are the facts.

Germany's working age population is shrinking, as is all of Europe's, Japan's and China's, too.

In contrast, the U.S. working age population is expected to grow in the years ahead.

With the world's largest economies home to a growing population of retirees, demand for secure retirement income is driving prices for sovereign bonds higher.

The glut of savings from income-starved retirees is chasing the certainty of government guaranteed bonds, driving prices higher and yields down.

Exacerbating the bond market problem, Germany, the world's second largest supplier of sovereign bonds after the U.S., has been issuing *fewer* bonds to avoid burdening its growing population of retirees with paying down government debt.

Shrinking the supply adds to the upward pressure on sovereign debt prices and depresses yields.

Demand for secure retirement income is driving prices for sovereign bonds higher.

In addition, the rising likelihood of a recession in Germany, has forced its central bank to keep interest rates low to stimulate growth.

This confluence of demographic and economic slowdowns has boosted demand for U.S. Treasury bonds, driving prices on long-term bonds higher and yields lower.

With the yield on a three-month T-Bill at 1.99%, as of Aug. 30, 2019, higher than the yield on a 10-year Treasury bond, at 1.5%, the yield curve is inverted — as it has been for much of 2019.

For the past several decades, yield curve inversions were rare and usually were followed within 18 months by a recession.

So, the current inversion has spread fears of a U.S. recession and caused increased volatility in the stock market in recent months.

Retirement income investors may want to consider how lower yields on fixed income allocations in their portfolios might affect them in the years ahead, because the change in supply and demand for sovereign debt is being driven by long term demographics.

Significantly, the yield curve inversion is caused by bond market supply and demand and not U.S. economic fundamentals.

The baby-boom spawned an "echo" baby-boom generation and that makes the growth path of the U.S. comparatively favorable to the other major world economies. ●

Strategic Midyear Tax Tips

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amount you contribute and avoid paying a capital gains tax. In addition, the charity receives the full amount of your largesse. If you donate cash or securities to a DAF in 2019, you can take a deduction on your 2019 return but wait to grant the money to a charity next year, or in 2021. You can open a DAF through a brokerage firm. They invest your donations but charge an investment-management fee and administrative expenses. We offer strategic guidance and can answer your questions about this.

Large IRAs. If you live in a state with an income tax, you might want to consider setting up a non-grantor trust in a state with no income tax. Why? Say you have a $1 million IRA. Placing it in a non-grantor trust in a state with

no income tax avoids state income taxes. That can be a big deal! At your death, under the SECURE Act bill expected to be enacted before the end of 2019, your heirs would be required to distribute an IRA you leave them within 10 years. According to Financial Advisor News Service, placing your IRA in a non-grantor trust in a state with no income tax allows your beneficiaries to avoid paying state income tax on the distributions from the IRA. To be clear, capital appreciation as well as dividend and interest income from your IRA can be free of state income tax by applying this strategy! A recent U.S. Supreme Court decision upheld the legal concept behind this strategy and out-of-state trusts are likely a device that retirees will hear about in the mainstream financial press in the months ahead. ●

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