MHCS
McGowen Hurst Clark Smith

1601 West Lakes Pkwy, Ste 300
West Des Moines, Iowa 50266

PHONE 515-288-3279
FAX 515-280-1490

106 E. Jefferson St, P.O. Box 312
Winterset, Iowa 50273

PHONE 515-462-1882
FAX 515-462-1577

MHCScpa.com

Dear Clients and Friends:

Year-end tax planning in 2019 remains as complicated as ever. Notably, we are still coping with the massive changes included in the biggest tax law in decades — the Tax Cuts and Jobs Act (TCJA) of 2017 — and pinpointing the optimal strategies. This monumental tax legislation includes a myriad of provisions affecting a wide range of individual and business taxpayers.

Among other key changes for individuals, the TCJA reduced tax rates, suspended personal exemptions, increased the standard deduction and revamped the rules for itemized deductions. Generally, the provisions affecting individuals went into effect in 2018, but are scheduled to "sunset" after 2025. This provides a limited window of opportunity in some cases.

The impact on businesses was just as significant. For starters, the TCJA imposed a flat 21% tax rate on corporations, doubled the maximum Section 179 "expensing" allowance, limited business interest deductions and repealed write-offs for entertainment expenses. Unlike the changes for individuals, most of these provisions are permanent, but could be revised if Congress acts again.

Keeping all that in mind, we have prepared the following 2019 Year-End Tax Letter. For your convenience, the letter is divided into three sections:

INDIVIDUAL TAX PLANNING
Before year-end is the time to analyze necessary actions to maximize itemized deductions, charitable contributions, education tax breaks and avoid alternative minimum tax while verifying your estimated tax payments are enough to avoid penalties.

BUSINESS TAX PLANNING
December offers the last chance to implement a strategy related to depreciation related deductions, maximize the 20% qualified business income deduction, prepare for new overtime rules, and lower your business's overall tax burden.

FINANCIAL TAX PLANNING
Before closing out 2019, taxpayers should review their portfolios for potential capital loss harvesting while reviewing required minimum distributions and planning for year-end gifts.

Be aware that the concepts discussed in this letter are intended to provide only a general overview of year-end tax planning. It is recommended that you review your personal situation with a tax professional.

INDIVIDUAL TAX PLANNING

Before year-end is the time to analyze necessary actions to maximize itemized deductions, charitable contributions, education tax breaks and avoid alternative minimum tax while verifying your estimated tax payments are enough to avoid penalties.

Itemized Deductions

Among the most prominent tax changes for individuals, the TCJA essentially doubled the standard deduction while modifying the itemized deduction rules for 2018 through 2025. For 2019, the inflation-indexed standard deduction is $12,200 for single filers and $24,400 for joint filers.

YEAR-END ACTION:

With the assistance of your professional tax advisor, figure out if you will be claiming the standard deduction or itemizing deductions in 2019. The results of this analysis will likely dictate your tax planning approach at the end of the year.

Some or all of these TCJA provisions on itemized deductions may affect the outcome.

* The deduction for state and local taxes (SALT) is limited to $10,000 annually. This includes any combination of SALT payments for (1) property taxes and (2) income or sales taxes.

* The deduction for mortgage interest expenses is modified, but you can still write off interest on “acquisition debt” (e.g., to purchase your principal residence) within generous limits.

* The deduction for casualty and theft losses is eliminated (except for disaster-area losses).

* The deduction for miscellaneous expenses is eliminated, but certain reimbursements made by employers may be tax-free to employees.

* The threshold for deducting medical and dental expenses, which was temporarily lowered to 7.5% of adjusted gross income (AGI), reverts to 10% of AGI, beginning in 2019.

Tip: Depending on your situation, you may want to accelerate deductible expenses into the current year to offset your 2019 tax liability. However, if you do not expect to itemize deductions in 2019, you might as well postpone these expenses to 2020 or beyond.

Charitable Donations

Generally, itemizers can deduct amounts donated to qualified charitable organizations, as long as substantiation requirements are met. Note that the TCJA increased the annual deduction limit for monetary contributions from 50% of AGI to 60% for 2018 through 2025. Any excess is carried over for up to five years.

YEAR-END ACTION:

Absent extenuating circumstances, try to “bunch” charitable donations in the year they will do you the most tax good. For instance, if you will be itemizing in 2019, boost your gift giving at the end of

the year. Conversely, if you are claiming the standard deduction this year, you may decide to postpone contributions to 2020.

For donations of appreciated property that you have owned longer than one year, you can generally deduct an amount equal to the property's fair market value (FMV). Otherwise, the deduction is typically limited to your initial cost. Also, other special rules may apply to gifts of property. Notably, the annual deduction for property donations generally cannot exceed 30% of AGI.

If you intend to donate securities to a charity, you might choose securities that you have held longer than one year and have appreciated substantially in value. Conversely, it may be preferable to keep securities you have owned less than a year.

Tip: If you donate to a charity by credit card late in the year—for example, if you are making an online contribution—you can write off the donation on your 2019 return, even if you do not actually pay the credit card charge until 2020.

Alternative Minimum Tax

Briefly stated, the alternative minimum tax (AMT) is a complex calculation made parallel to your regular tax calculation. It features several technical adjustments, inclusion of "tax preference items" and subtraction of an exemption amount (subject to a phase-out based on your income). After comparing AMT liability to regular tax liability, you effectively pay the higher of the two.

YEAR-END ACTION:

Have your AMT status assessed. Depending on the results, you may then shift certain income items to 2020 to reduce AMT liability for 2019. For instance, you might postpone the exercise of incentive stock options (ISOs) that count as tax preference items.

Thanks to the TCJA, the AMT is now affecting fewer taxpayers. Notably, the TCJA substantially increased the AMT exemption amounts (and the thresholds for the phase-out), unlike the minor annual "patches" authorized by Congress in the recent past. The chart below illustrates the exemptions for the last five years and includes a dramatic jump for 2018-19.

Filing status	2015	2016	2017	2018	2019
Single filers	$53,600	$53,900	$54,300	$70,300	$71,700
Joint filers	$83,400	$83,800	$84,500	$109,400	$111,700
Married filing separately	$41,700	$41,900	$42,250	$54,700	$55,850

Tip: The two AMT rates for single and joint filers for 2019 are 26% on AMT income up to $194,800 ($97,400 if married and filing separately) and 28% on AMT income above this threshold. Note that the top AMT rate is still lower than the top ordinary income tax rate of 37%.

Education Tax Breaks

The tax law provides tax benefits to parents of children in college, within certain limits. These tax breaks, including a choice involving two higher education credits, have been preserved by the TCJA.

YEAR-END ACTION:
When appropriate, pay qualified expenses for next semester by the end of the year. Generally, the costs will be eligible for a credit in 2019, even though the semester does not begin until 2020. Therefore, you may be able to increase your current credit amount.

Typically, you must choose between the American Opportunity Tax Credit (AOTC) and the Lifetime Learning Credit (LLC). The maximum AOTC of $2,500 is available for qualified expenses of each student, while the maximum $2,000 LLC is claimed on a per-family basis. Thus, the AOTC is usually preferable. Both credits are phased out based on modified adjusted gross income (MAGI).

The TCJA also allows you to use Section 529 plan funds to pay for up to $10,000 of K-12 tuition expenses tax-free. Previously, qualified expenses only covered post-secondary schools.

Tip: In the past, a tuition deduction could be claimed in lieu of a credit. Although the deduction expired after 2018, Congress might reinstate it.

Estimated Tax Payments
The IRS requires you to pay federal income tax through any combination of quarterly installments and tax withholding. Otherwise, it may impose an "estimated tax" penalty.

YEAR-END ACTION:
No estimated tax penalty is assessed if you meet one of these three "safe harbor" exceptions under the tax law.

1. Your annual payments equal at least 90% of your current liability;

2. Your annual payments equal at least 100% of the prior year's tax liability (110% if your AGI for the prior year exceeded $150,000); or

3. You make installment payments under an "annualized income" method. This method may be available to taxpayers who receive most of their income during the holiday season.

Tip: Due to the complexity of the TCJA, the IRS lowered the 90% safe harbor rule to 80% for the 2018 tax year. There has been no word yet on any reduction for 2019.

Miscellaneous
* Bunch non-emergency medical expenses in the year in which you have the best chance of clearing the 10%-of-AGI threshold. For instance, you may schedule a physical exam or dental cleaning for 2019 or postpone those expenses to 2020 if it better suits your purposes.

* Make home improvements that qualify for mortgage interest deductions as acquisition debt. This includes loans to substantially improve your principal residence or one other home.

* Transfer income-producing property to family members in lower tax brackets. However, the "kiddie tax" generally applies to unearned income above $2,200 received in 2019 by a dependent child under age 18 or full-time student under age 24. Under the TCJA, the kiddie tax is based on the tax rates for estates and trusts, which will often produce a higher tax than it would have previously.

* Consider the tax impact of a divorce or separation. The TCJA repealed the deduction for alimony expenses for payers, and the corresponding inclusion in income for recipients, for divorce and separation agreements executed after 2018. Note that deductions may still be available for pre-2019 agreements that are modified after 2018.

* If you own property that was damaged in a federal disaster area in 2019, you may qualify for fast casualty loss relief by filing an amended 2018 return. The TCJA suspended the deduction for casualty losses for 2018 through 2025, but retained a current deduction for disaster-area losses.

BUSINESS TAX PLANNING

December offers the last chance to implement a strategy related to depreciation related deductions, maximize the 20% qualified business income deduction, prepare for new overtime rules, and lower your business's overall tax burden.

Depreciation-Related Deductions

Under the TCJA, a business may benefit from a combination of three depreciation-based tax breaks: (1) the Section 179 deduction, (2) "bonus" depreciation and (3) regular depreciation.

YEAR-END ACTION:

Acquire property and make sure it is placed in service before the end of the year. Typically, a small business can then write off most, if not all, of the cost in 2019.

1. Section 179 deductions: This tax code section allows you to "expense" (i.e., currently deduct) the cost of qualified property placed in service during the year. The maximum annual deduction is phased out on a dollar-for-dollar basis above a specified threshold.

The maximum Section 179 allowance has been raised gradually over the last decade, but the TCJA gave it a massive boost, beginning in 2018, as shown below.

Tax year	Deduction limit	Phase-out threshold
2009	$250,000	$800,000
2010–2015	$500,000	$2 million
2016	$500,000	$2.01 million
2017	$510,000	$2.03 million
2018	$1 million	$2.50 million
2019	$1.02 million	$2.55 million

However, note that the Section 179 deduction cannot exceed the taxable income from all your business activities this year. This could limit your deduction for 2019.

2. Bonus depreciation: The TCJA doubled the previous 50% first-year bonus depreciation deduction to 100% for property placed in service after September 27, 2017. It also expanded the definition of qualified property to include used, not just new, property.

Note that the TCJA gradually phases out bonus depreciation after 2022. This tax break is scheduled to disappear completely after 2026.

3. Regular depreciation: Finally, if there is any remaining acquisition cost, the balance may be deducted over time under the Modified Accelerated Cost Recovery System (MACRS).

Tip: A MACRS depreciation deduction may be reduced if the cost of business assets placed in service during the last quarter of 2019 (October 1 through December 31) exceeds 40% of the cost of all assets placed in service during the year (not counting real estate).

Travel Expenses
Although the TCJA repealed the deduction for entertainment expenses beginning in 2018, you can still deduct expenses for travel and meal expenses while you are away from home on business, subject to certain limits. The primary purpose of the trip must be business-related.

YEAR-END ACTION:
Schedule business trips for the end of 2019. If you meet the strict substantiation requirements, you may deduct 100% of your travel costs and 50% of meal costs for amounts paid or incurred this year.

If you travel by car, you may be able to deduct your actual expenses, including a depreciation allowance, or opt for the standard mileage deduction. The standard mileage rate for 2019 is 58 cents per business mile (plus tolls and parking fees). Annual depreciation deductions for "luxury cars" are limited, but the TCJA generally enhanced those deductions for vehicles placed in service in 2018 and thereafter.

Tip: The IRS recently issued a ruling that explains when food and beverage costs are deductible when those costs are stated separately from entertainment on invoices or receipts.

QBI Deductions
The TCJA authorized a deduction of up to 20% of the "qualified business income" (QBI) earned by a qualified taxpayer. This deduction may be claimed by owners of pass-through entities—partnerships, S corporations and limited liability companies (LLCs)—as well as sole proprietors.

YEAR-END ACTION:
The QBI deduction is reduced for some taxpayers based on the amount of their income. Depending on your situation, you may accelerate or defer income at the end of the year, according to the figures.

First, however, it must be determined if you are in a "specified service trade or business" (SSTB). This includes most personal service providers. Then three key rules apply.

1. If you are a single filer with income in 2019 below $160,725 or a joint filer below $321,400, you are entitled to the full 20% deduction.

2. If you are a single filer with income in 2019 above $210,700 or a joint filer above $421,400, your deduction is completely eliminated if you are in an SSTB. For non-SSTB taxpayers, the deduction is reduced, possibly down to zero.

3. If your income falls between the thresholds stated above, your QBI deduction is reduced, regardless of whether you are in an SSTB or not.

Tip: Other rules and limits may apply, including new guidelines for real estate activities. Consult with your tax advisor for more details about your situation.

Business Repairs
While expenses for business repairs are currently deductible, the cost of improvements to business property must be written off over time. The IRS recently issued regulations that clarify the distinctions between repairs and improvements.

YEAR-END ACTION:
When appropriate, complete minor repairs before the end of the year. The deductions can offset taxable business income in 2019.

As, a rule of thumb, a repair keeps property in efficient operating condition while an improvement prolongs the life of the property, enhances its value or adapts it for a different use. For example, fixing a broken window is a repair, but adding a new building wing is an improvement.

Tip: A safe harbor rule in the regulations allows a business to currently deduct costs of $2,500 or less, or $5,000 or less for a business with an "applicable financial statement" (AFS).

Business Interest
Prior to 2018, business interest was fully deductible. But now the TCJA generally limits the deduction for business interest to 30% of adjusted taxable income (ATI).

YEAR-END ACTION:
Determine if you qualify for a special exception. The limit does not apply to a business with average gross receipts of $25 million or less for the three prior years.

For these purposes, ATI is defined as your business income without regard to any income, deduction, gain or loss not properly allocable to a business; business interest income and expense; net operating losses (NOLs); the 20% QBI deduction; and, for tax years beginning before 2022, depreciation, amortization or depletion.

Tip: If the new business interest limit applies, you can carry forward the excess indefinitely until it is exhausted.

Miscellaneous
* Stock up on routine business supplies before the end of the year. Usually, your company can deduct the costs of the supplies in 2019, even if all of them are not used until 2020.

* If you buy a heavy-duty SUV or van for business, you may claim a first-year Section 179 deduction of up to $25,000. The "luxury car" limits do not apply to certain heavy-duty vehicles.

* If you pay year-end bonuses to employees in 2019, the bonuses are generally deductible by your company and taxable to the employees in 2019. A calendar-year company operating on the accrual basis may be able to deduct bonuses paid as late as March 16, 2020 on its 2019 return.

* Gather proof needed to claim a bad business debt deduction. Generally, the deduction is available in the year the debt becomes worthless, so step up collection activities and keep records.

* Hire disadvantaged workers eligible for the Work Opportunity Tax Credit (WOTC). The WOTC, which is generally a maximum of $2,400 per worker, is scheduled to expire after 2019.

* Get a start-up venture up and running. The tax law permits a small-business owner to claim a first-year deduction of up to $5,000 for qualified start-up costs. Any remainder must be amortized over 180 months. However, the $5,000 write-off is phased out for costs above $50,000.

* A business may qualify for an up-to-25% credit for paid family and medical leaves of up to 12 weeks. This credit, which only applies to wages paid to employees earning no more than $72,000 annually, is currently scheduled to expire after 2019.

Prepare for the new Overtime Rule

The Department of Labor (DOL) issued a final rule updating the earnings thresholds and allowing a portion of nondiscretionary payments to be included in the minimum salary level. The final rule will be effective on January 1, 2020. Be sure you're in compliance as you start the new year.

Overtime Final Rule Updates:

- The standard salary level raises from $455 to $684 per week; or $35,568 per year for a full-time employee.
- The "highly compensated employees (HCE)" annual compensation level increases from $100,000 to $107,432 per year
- Employers can include nondiscretionary bonuses and incentive payments up to 10 percent of the salary threshold if they are paid out at least annually. A "catch up" payment with first pay period after the 52-week period is allowed to reach the required level.
- Changes to special salary levels for workers in U.S. territories and the motion picture industry.

The earnings thresholds are necessary to exempt executive, administrative, or professional employees from the overtime requirement. This is the first time the overtime thresholds have been updated in 15 years. It's important to note other areas of the Fair Labor Standards Act (FLSA) remain unchanged. Please let us know if you have questions about any of these updates.

FINANCIAL TAX PLANNING

Before closing out 2019, taxpayers should review their portfolios for potential capital loss harvesting while reviewing required minimum distributions and planning for year-end gifts.

Securities Transactions

Frequently, investors engage in securities transactions at year-end to improve their tax situation. This requires a basic understanding of the current tax rules for capital gains and losses.

First, capital gains and losses are used to offset each other. Second, if you show an excess loss for the year, it then offsets up to $3,000 of ordinary income before being carried over to the next year. Third, long-term capital gains from sales of securities owned longer than one year are taxed at a maximum rate of 15% (20% for high-income investors). Conversely, short-term capital gains are taxed at ordinary income rates reaching up to 37% in 2019.

YEAR-END ACTION:

Review your investment portfolio. Depending on your situation, you may “harvest” capital losses to offset gains realized earlier in the year or cherry-pick capital gains that will be partially or wholly absorbed by prior losses, including capital loss carryovers.

Be aware of even more favorable tax treatment for certain long-term capital gains. Notably, a 0% rate applies to taxpayers below applicable income levels, such as young children or grandchildren. Furthermore, some taxpayers who ultimately pay ordinary income tax at higher rates due to their investments may qualify for the 0% tax rate on a portion of their long-term capital gains.

Tip: The tax rate structure for long-term capital gains also applies to qualified dividends. These are most dividends paid by U.S. companies or qualified foreign companies.

Installment Sales

Normally, when you sell real estate at a gain, you must pay tax on the full amount of capital gain in the year of the sale.

YEAR-END ACTION:

Arrange to sell real estate on the installment basis. If you receive installment payments over two or more tax years, the tax on a gain is paid over the years in which payments are actually received. This tax deferral treatment is automatic for most installment sales other than sales by “dealers” like real estate developers.

The taxable portion of each payment is based on the “gross profit ratio.” Gross profit ratio is determined by dividing the gross profit from the real estate sale by the price.

Not only does the installment sale technique defer some of the tax due on a real estate deal, it will often reduce your overall tax liability if you are a high-income taxpayer. Reason: By spreading out the taxable gain over several years, you may pay tax on a greater portion of gain at the 15% capital gains rate as opposed to the 20% rate.

Tip: If it suits your purpose, you may "elect out" of installment sale treatment when you file your tax return. This means the entire amount of tax is due on the return for the year of the sale. You might do this if 2019 is otherwise a low tax year.

Net Investment Income Tax

In addition to capital gains tax, a special 3.8% tax applies to the lesser of your "net investment income" (NII) or the amount by which your modified adjusted gross income (MAGI) for the year exceeds $200,000 for single filers and $250,000 for joint filers. (Note: These amounts are not indexed for inflation.) The definition of NII includes interest, dividends, capital gains and income from passive activities, but not Social Security benefits, tax-exempt interest and distributions from qualified retirement plans and IRAs.

YEAR-END ACTION:

Assess the amount of your NII and your MAGI at the end of the year. When it is possible, you may be able to reduce your NII tax liability in 2019 or avoid it altogether.

For example, you might add municipal bonds ("munis") to your portfolio. Interest income generated by munis does not count as NII, nor is it included in the calculation of MAGI. Similarly, if you turn a passive activity into an active business, the resulting income may be exempt from the NII tax. These rules are complex, so obtain professional assistance.

Tip: When you add the NII tax to your regular tax plus any applicable state income tax, the overall rate may approach or even exceed 50%. Factor this into your investment decisions.

Required Minimum Distributions

As a general rule, you must receive "required minimum distributions" (RMDs) from qualified retirement plans and IRAs after reaching age 70½. The amount of the distribution is based on IRS life expectancy tables and your account balance at the end of last year.

YEAR-END ACTION:

Arrange to receive RMDs before December 31. Otherwise, you will have to pay a stiff tax penalty equal to 50% of the required amount (less any amount you have received) in addition to your regular tax liability.

Do not procrastinate if you have not arranged RMDs for 2019 yet. It may take some time for your financial institution to accommodate these transactions.

Conversely, if you are still working and do not own 5% or more of the business employing you, you can postpone RMDs from an employer's qualified plan until you retire. This "still working exception" does not apply to RMDs from IRAs or plans of employers where you do not work.

Tip: RMDs are not treated as NII for purposes of the 3.8% tax. Nevertheless, an RMD may still increase your MAGI used in the NII tax calculation.

Estate and Gift Taxes

Since the turn of the century, Congress has gradually increased the federal estate tax exemption, while eventually establishing a top estate tax rate of 40%. At one point, the estate tax was

repealed—but only for 2010—while the unified estate and gift tax exclusion was severed and then reunified. Finally, the TCJA doubled the exemption from $5 million to $10 million, inflation-indexed to $11.4 million in 2019. The following table shows the progression of the estate tax exemption and top estate tax rate during the last decade.

Tax year	Estate tax exemption	Top estate tax rate
2009	$3.5 million	45%
2010	Not applicable	Repealed
2011	$5 million	35%
2012	$5.12 million	35%
2013	$5.25 million	40%
2014	$5.34 million	40%
2015	$5.43 million	40%
2016	$5.45 million	40%
2017	$5.49 million	40%
2018	$11.18 million	40%
2019	$11.40 million	40%

YEAR-END ACTION:
Update your estate plan to reflect existing law. For instance, wills and trusts may be revised to accommodate the rule allowing portability of the estate tax exemption.

Under the “portability” provision for a married couple, the unused portion of the estate tax exemption of the first spouse to die may be carried over to the estate of the surviving spouse. This tax break is now permanent, so incorporate it into your estate planning decisions.

Tip: With the gift tax exclusion, you can give each recipient, such as a younger family member, up $15,000 in 2019 without paying any federal gift tax. This annual gift tax exclusion is effectively doubled to $30,000 for joint gifts made by a married couple. These gifts reduce the size of your taxable estate.

Miscellaneous
* Contribute up to $19,000 to a 401(k) in 2019 ($25,000 if you are age 50 or older). If you clear the 2019 Social Security wage base of $132,900 and promptly allocate the payroll tax savings to a 401(k), you can increase your deferral without any further reduction in your take-home pay.

* From a tax perspective, it is often beneficial to sell mutual fund shares before the fund declares dividends (the ex-dividend date) and buy shares after the date the fund declares dividends.

* Be wary of the “wash sale” rule. If you sell securities at a loss and reacquire substantially identical securities within 30 days of the sale, the tax loss is disallowed. An easy way to avoid this result is to wait at least 31 days to buy back the same or similar securities.

* Consider a Roth IRA conversion. Although the conversion is subject to current tax, you generally can receive tax-free distributions in retirement, unlike the taxable distributions from a traditional IRA. But note that the TCJA removed the ability to “recharacterize” a Roth conversion back into a traditional IRA for 2018 and thereafter.

* If you are age 70½ or older, transfer IRA funds directly to a charity. Even though the contribution cannot be deducted as a charitable donation on your 2019 tax return, the distribution is not subject to tax and counts as an RMD.

CONCLUSION

This year-end tax-planning letter is based on the prevailing federal tax laws, rules and regulations. Of course, it is subject to change, especially if additional tax legislation is enacted by Congress before the end of the year. And finally, please remember that this letter is intended to serve only as a general guideline. Your personal circumstances will likely require careful examination. We would be glad to schedule a meeting with you to assist with all your tax-planning needs.

This year-end tax-planning letter is published for our clients, friends and professional associates. It is designed to provide accurate and authoritative information with respect to the subject matter covered. The information contained in this letter is not intended or written to be used for the purpose of avoiding any penalties that may be imposed under federal tax law and cannot be used by you or any other taxpayer for the purpose of avoiding such penalties. Before any action is taken based on this information, it is essential that competent, individual, professional advice be obtained.