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## Year-End Tax Planning Opportunities

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With year-end quickly approaching, taxpayers still have a few weeks left to plan ahead with strategies that could provide meaningful tax savings. We included several planning opportunities below to consider before December 31<sup>st</sup>.



### Harvest Losses

Review unrealized gains and losses in taxable investment accounts and harvest losses where available. Realized losses can offset other realized gains. To the extent that realized losses exceed realized gains, net realized losses can offset up to \$3,000 of ordinary income with any remainder resulting in a loss carryforward to be used in future years.

With global equities having pulled back sharply in the fourth quarter, investors likely have more loss harvesting opportunities than were available 60 days ago. International and emerging market investments represent the most likely candidates, though additional harvesting opportunities may also exist.

Beware of the 'wash sale' rule which states that a loss cannot be realized for tax purposes if a *substantially identical* position was bought within 30 days before or after the sale. As a practical example, an investor could sell an actively managed international equity fund and could redeploy the sales proceeds to an international equity index fund; in doing so, the investor recognizes a tax loss while also keeping similar, but not identical, portfolio exposure.

### Watch Out for Mutual Fund Year-End Capital Gain Distributions

Mutual funds are required to pass along capital gains to fund shareholders. Regardless of whether the fund shareholder actually benefited from the fund's sale of underlying securities, the shareholder would receive the capital gain distribution if the mutual fund is held as of the dividend record date.

Mutual fund families typically provide estimates for year-end dividend distributions from mid-October to early November with such distributions most commonly occurring in December. Capital gain distributions can be either short-term or long-term. Short-term capital gain dividends are treated as *ordinary income* and thus *cannot* be offset by realized losses. In contrast, long-term capital gain dividends can be offset by realized losses. It is important to review unrealized gains and losses across mutual fund holdings in taxable accounts and to then compare those figures against capital gain distribution estimates to determine if selling a mutual fund position before the year-end dividend distribution could result in tax savings.



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### Accelerate Charitable Giving (“Bunching”)

The charitable giving landscape changed substantially in 2018 due to the new tax law. The Tax Cut and Jobs Act nearly doubled the standard deduction from \$6,350 to \$12,000 for single filers and from \$12,700 to \$24,000 for married couples, while the state and local tax (SALT) deduction is now capped at \$10,000. As a result of these (and other) tax changes, far fewer taxpayers will itemize deductions in 2018 and will instead take the now-increased standard deduction. An analysis by the Tax Policy Center estimates that the number of households claiming an itemized deduction for charitable gifts will fall from 37 million to 16 million<sup>1</sup>. The net impact of these developments on charitable giving is expected to be profound, with studies projecting a decline of \$12 billion to \$20 billion for annual giving.

Due to the notable changes to the standard deduction and the SALT deduction, charitably inclined taxpayers may benefit from a “bunching strategy” whereby several years of charitable gifts are made within a single tax year to produce a large itemized deduction with the standard deduction to be taken in subsequent years.

#### Scenario #1: Level Annual Charitable Giving

	2018	2019	2020	2021	TOTAL
Mortgage Interest	\$9,000	\$9,000	\$9,000	\$9,000	\$36,000
State & Local Tax (SALT)	\$10,000	\$10,000	\$10,000	\$10,000	\$40,000
Charitable Gifts	\$30,000	\$30,000	\$30,000	\$30,000	\$120,000
Itemized Deduction Total	\$49,000	\$49,000	\$49,000	\$49,000	\$196,000
Greater of Itemized Deductions or \$24,000 Standard Deduction	\$49,000	\$49,000	\$49,000	\$49,000	\$196,000

#### Scenario #2: Accelerated Charitable Giving

	2018	2019	2020	2021	TOTAL
Mortgage Interest	\$9,000	\$9,000	\$9,000	\$9,000	\$36,000
State & Local Tax (SALT)	\$10,000	\$10,000	\$10,000	\$10,000	\$40,000
Charitable Gifts	\$120,000	\$0	\$0	\$0	\$120,000
Itemized Deduction Total	\$139,000	\$19,000	\$19,000	\$19,000	\$196,000
Greater of Itemized Deductions or \$24,000 Standard Deduction	\$139,000	\$24,000	\$24,000	\$24,000	\$211,000

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In the simplified example above, the taxpayers' itemized deductions *before* charitables is \$19,000; since the standard deduction for married filing jointly taxpayers is \$24,000, the taxpayers' first \$5,000 of charitable gifts do not produce a tax savings, while charitable gifts above \$5,000 produce tax savings. By accelerating four years of charitable gifts into a single tax year (scenario 2), the taxpayers avoid the situation of the first \$5,000 of charitables not providing a tax benefit in years two-four, which thus results in greater tax savings over the illustrated four-year timeframe.



### **Gift Long-Term Appreciated Securities**

Many taxpayers opt for the convenience of donating cash or writing checks to charities, though it is preferable from a tax planning standpoint to instead gift long-term appreciated securities from a taxable investment account. By gifting long-term appreciated securities, the charity receives the same benefit as a cash donation, while the taxpayer receives a tax deduction for the full market value of the gift and avoids paying capital gains taxes on the gifted security.

In high income years, a taxpayer might benefit from giving a greater amount to charity, though the taxpayer may not have a list of charities in mind. In such a situation, giving to a donor-advised fund can be an effective strategy, as the taxpayer receives a current year tax deduction for the charitable gift while grants from the donor-advised fund can be made at a later date.



### **Satisfy Required Minimum Distributions (RMDs) using the IRA Charitable Rollover**

Taxpayers over age 70½ are required to take minimum distributions from retirement accounts (except for Roth IRAs). Under the Qualified Charitable Distribution provision, taxpayers over age 70½ can transfer up to \$100,000 each year from an IRA to qualified 501(c)(3) organizations (donor-advised funds, private foundations and supporting organizations are excluded). The taxpayer must be at least 70½ as of the date of the charitable transfer. A qualified charitable distribution neither counts as an itemized deduction nor as taxable income. This provision may be helpful to charitably inclined individuals who now receive a greater tax benefit from the increased standard deduction rather than itemizing deductions.



### **Make Annual Exclusion Gifts**

The Tax Cut and Jobs Act provided a significant increase to the federal estate exemption, which adjusted from \$5.49 million per person in 2017 to \$11.18 million per person in 2018 (\$11.40 million per person for 2019). Given the greatly increased exemption amount, it is now estimated that less than one in 1,000 estates will be taxable estates.

Taxpayers with assets in excess of the federal estate exemption might consider making annual exclusion gifts (\$15,000 per person for 2018 and 2019) which do not count against the exemption amount. In addition, payments for tuition and medical expenses which are made directly to the educational/medical institution do not constitute gifts. Utilizing annual exclusion gifts as well as direct payments for tuition and medical expenses can be beneficial for high net worth individuals as it effectively reduces the size of a taxable estate.

The consultants in The Wealth Office™ at DiMEO Schneider & Associates are prepared to help clients address financial planning matters such as these. Please contact any of the professionals in The Wealth Office™ for more information.

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<https://www.taxpolicycenter.org/taxvox/21-million-taxpayers-will-stop-taking-charitable-deduction-under-tcja> <https://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0001-impact-number>

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Nick provides investment consulting services to nonprofit organizations, corporate executives, family trusts and other high net worth investors. He services clients by providing advice and expertise on asset allocation, portfolio design, investment policy statements, manager search process and overall investment management. Nick is also a member of the firm's Core Investment Strategy Group. Prior to joining the firm in 2007, Nick was a Senior Financial Planner with The Ayco Company where he provided comprehensive advice to affluent clientele. Nick earned a BA in Finance and Economics from the University of Illinois at Urbana-Champaign. He obtained the designation of Certified Financial Planner (CFP®) from the College of Financial Planning and is a CFA® charterholder and member of the CFA Society of Chicago. Nick enjoys long distance running (having completed three marathons and multiple half-marathons) and spending time with his family.

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