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INSIGHTS

ESTATE PLANNING

4 Tax Moves to Consider Before Filing Your Return

THE BIG PICTURE

Want to lower your 2019 tax bill?
A number of opportunities to offset prior-year income and capture credits are still available until the April 15 tax filing deadline.

Areas to look at include:

1. Retirement plan contributions
2. Deductions
3. Penalties
4. Credits

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Taxpayers who were looking to minimize their tax liability, of course, had dozens of tools at their disposal before the New Year hit, including potentially deferring income, accelerating deductions, or selling off losing stocks to offset capital gains – a concept known as tax-loss harvesting. But those opportunities abruptly ended on Dec. 31 for the 2019 tax-filing season.

"There were a whole host of tax moves you could make before the end of the year," said Paul Morrone, a certified public account and financial planner for U.S. Wealth Management in North Haven, Connecticut, in an interview. "Most have expired, but not all."

Those that remain, he said, revolve primarily around retirement plan contributions, tax credits, and penalty avoidance.

Retirement Plans: Retroactive Contributions

Your traditional Individual Retirement Account, or IRA, offers the biggest potential bang for the buck.

The Internal Revenue Service (IRS) allows taxpayers to make deductible prior-year contributions all the way up to the tax-filing deadline.

For tax year 2019, total contributions to all of your traditional and Roth IRAs for taxpayers under age 50 cannot be more than either $6,000, or your total compensation for the year if you earned less than that amount. Those 50 and older can make an additional $1,000 catch-up contribution, for a total of $7,000.[1]

Deductible contributions could save you big. A taxpayer in the 25 percent federal and 5 percent state tax brackets, said Morrone, "effectively gets a 30 percent return right out of the gate by virtue of a reduction in their federal and state tax bill." On a $5,500 contribution, that amounts to a $1,650 tax savings.

Your actual tax deduction, however, may be limited if you or your spouse are covered by a retirement plan at work and your income exceeds certain levels.

For those covered by a workplace retirement plan, the deduction begins to phase out for single tax filers who made more than $64,000 in 2019 and disappears completely at $74,000 and beyond – $103,000 and $123,000 respectively, for married taxpayers who file jointly.[2]

Eligible taxpayers can also make retroactive contributions to their Roth IRA until April 15. Different phaseout limits apply for Roth contributions.

Because Roth IRAs are funded with after-tax dollars, your contribution will not yield a current-year tax deduction, but it could potentially produce a better investment return since earnings upon retirement can be distributed tax free.

Simplified Employee Pension IRA (SEP IRA) account owners who get an extension to file can potentially delay their contribution further still, until October.

Contributions to a SEP-IRA, geared for small-business owners and the self-employed, cannot exceed the lesser of 25 percent of total compensation or $57,000 for 2019.

If you operated a business last year, the "SEP may be a terrific way to receive a deduction and save for retirement with contribution limits well over those available with regular IRAs," said Elliot Herman, a CFP® and CPA with PRW Wealth Management in Quincy, Massachusetts, in an interview.

Tax Deductions: Roll Up Your Sleeves

Most taxpayers take the standard deduction, a fixed dollar amount set forth by the IRS that reduces the amount of income on which they are taxed.

Why? Because it's a lot less work. You don't have to keep track of your expenses, or individually deduct them on IRS Schedule A. Under the tax-reform legislation known as the Tax Cuts and Jobs Act (TCJA), which took effect in 2018, the standard deduction has nearly doubled in 2019 to $12,200 for single filers, $24,400 for married taxpayers filing jointly, and $18,350 for heads of household.

As a result, many taxpayers who previously itemized deductions may find it more beneficial to claim the standard deduction this year.

Big Changes for Itemized Deductions

To determine whether you might come out ahead by itemizing, you must first be aware that the TCJA changed the rules significantly for how taxpayers itemize deductions.

According to the IRS:

- The income-based phaseout of certain itemized deductions no longer applies. That means some taxpayers may be able to deduct more of their total itemized deductions if those deductions were previously limited because their income exceeded certain thresholds.
- A taxpayer's deduction for state and local income, sales, and property taxes is limited to a combined total deduction. That limit is $10,000, or $5,000 if married filing separately. Any amount above that limit is not deductible.
- There is also a new dollar limit on total qualified residence loan balances. If your loan was originated or treated as originating before Dec. 15, 2017, you may deduct interest on up to $1 million in qualifying debt, or $500,000 for married taxpayers who file separately. If the loan originated after that date, you may only deduct interest on up to $750,000 in qualifying debt, or $375,000 for taxpayers who are married filing separately. The limits apply to the combined amount of loans used to buy, build, or substantially improve the taxpayer's main home and second home.
- The deduction for home equity interest was also modified. Interest paid on most home equity loans is not deductible unless the interest is paid on loan proceeds used to buy, build, or substantially improve a main home or second home. As it was previously, the loan must be secured by the taxpayer's main home or second home, not exceed the cost of the home, and meet other requirements. Any such home equity loan contributes to the qualifying debt limit of $750,000 (or $375,000 for taxpayers who are married, filing separately).

- The limit for deductible charitable contributions of cash was also increased to 60 percent of a taxpayer's adjusted gross income, up from 50 percent in prior years. Thus, generous donors may be able to deduct more of what they give this year.
- A taxpayer's net personal casualty and theft losses must now be attributed to a federally declared disaster to be deductible.
- Lastly, the ability to itemize miscellaneous deductions was suspended. Taxpayers are no longer able to itemize deductions that exceed 2 percent of their adjusted gross income.[3]

Tax Penalties

The only thing worse than giving Uncle Sam his due is leaving him a tip.

To avoid a potentially hefty late-filing penalty, you must submit your income tax return on time, regardless of whether or not you can afford to pay.

Indeed, the failure-to-file penalty can be as much as 5 percent of your unpaid taxes for each month or part of a month that your tax return is late, up to 25 percent of your unpaid taxes.

By comparison, the penalty for failure to pay is far less: one-half of 1 percent of your unpaid taxes for each month or part of a month for which your balance is unpaid after the due date, up to a maximum of 25 percent.

If you can't afford to pay your taxes in full, you can reduce additional interest and penalties by paying as much as you can with your tax return, according to the IRS.

Remember, too, that simple mistakes on your tax return may result in a rejected claim or underpayment of your balance due, which opens the door to late-payment penalties. According to the government, the most common errors include missing signatures, math errors, insufficient postage, and incorrect identification information such as name, taxpayer identification number, and current address. Others select the wrong filing status, forget to date their return, or check the wrong exemption boxes for their personal, spousal, and dependency exemptions.

Double-check before you file to minimize the risk of costly penalties.

Submitting your tax return electronically ensures greater accuracy than mailing it in since the IRS e-file system flags common errors and kicks back returns for correction.

Tax Credits

When it comes to lowering your taxable income, you are your best advocate.

Tax deductions, which reduce the amount of your income subject to tax, are great, but tax credits, which reduce your tax bill dollar for dollar, are even better. So don't leave any tax credits or deductions for which you are eligible on the table.

Families with dependent children may be eligible to claim a credit of up to $2,000 per qualifying child under the Child Tax Credit. The tax-reform law increased the modified adjusted gross income phaseout limit for joint filers to $400,000 from $110,000, making it easier for many families to qualify. The phaseout limit for all other filers is $200,000. Additionally, a non-refundable credit of $500 is provided for certain non-child dependents.

If you paid for someone to care for your child, spouse, or dependent so you could work or look for a job, you may be able to claim the Child

and Dependent Care Credit. The amount of the credit is a percentage of the amount of work-related expenses you paid to a caregiver, and is based on your income. Total expenses may not exceed $3,000 for one child or dependent or $6,000 for two or more qualifying individuals, and the amount of your credit is between 20 percent and 35 percent of allowable expenses.

Low- to moderate-income taxpayers, especially families, should also check to see if they can claim the valuable Earned Income Tax Credit. For tax year 2019, the maximum credit for those with no children is $529, while those with one child may receive a credit of $3,526, two children $5,828, and three or more children $6,557. To qualify, you must meet certain federal requirements and file a tax return, even if you owe no taxes.

Single taxpayers with adjusted gross income of $32,000 or less in 2019 ($64,000 for married couples filing jointly) may also be able to claim the Retirement Savings Contributions Credit, or Saver's Credit, which provides a credit up to $2,000 ($4,000 for married couples filing jointly) for amounts they voluntarily save for retirement, including amounts contributed to their IRAs, 401(k) plans, and other workplace savings plans.

Similarly, those paying for higher education expenses may be able to claim one of two tax credits: the American Opportunity Tax Credit, which provides up to $2,500 in tax credits on qualifying education expenses, or the Lifetime Learning Credit, which may be as high as $2,000 per eligible student. You cannot claim both credits for the same student in the same year.

If you haven't yet filed your tax return for 2019, there's still much you can potentially do to minimize the amount you may owe.

By taking advantage of tax-favored retirement tools, filing an accurate return, and educating yourself on available deductions and credits, you might just save enough to pay off your credit card debt or catch a flight somewhere warm.

By Shelly Gigante

Shelly Gigante specializes in personal finance issues. Her work has appeared in a variety of publications and news websites.

[1]Internal Revenue Service, "Retirement Topics – Contribution," Nov. 22, 2019.

[2]Internal Revenue Service, "2019 IRA Deduction Limits – Effect of Modified AGI on Deduction if You Are Covered by a Retirement Plan at Work," Nov. 18, 2019.

[3]Internal Revenue Service, "Publication 529 Miscellaneous Deductions," December 2019.

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