Tax & Business Alert

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AN INTRAFAMILY LOAN IS WORTH CAREFUL CONSIDERATION

Lending money — rather than giving it — to loved ones is an idea worth considering. Perhaps you're not ready to part with your wealth. For example, maybe you're concerned about having enough money to fund your retirement or you feel that your children aren't ready to handle the responsibility.

Intrafamily loans allow you to provide family members with financial support while hanging on to your nest egg and encouraging your children to be financially responsible.

HOW DOES IT WORK?

The key to transferring wealth is the borrower's ability to take advantage of investment opportunities that offer relatively high returns. In other words, after paying back the principal, the borrower essentially receives the "spread" between the investment returns and the loan interest — free of gift and estate taxes.

With this in mind, when you lend money to family members, it's important to charge interest at the applicable federal rate (AFR) or higher. Otherwise you'll trigger unintended income and gift tax consequences.

AFRs are published monthly and vary depending on whether the loan is:

- Short-term (three years or less),
- Mid-term (more than three years but not more than nine years) or
- Long-term (more than nine years).

They also vary depending on how frequently interest is compounded.

Keep in mind that the loan balance is still included in your taxable estate. Even if you die before the loan is paid off, the borrower must repay the loan to your estate, though an intrafamily loan can be structured to provide that the loan will be forgiven if you die before it's paid off.

WHAT ARE THE RISKS?

The biggest risk is that the invested funds will fail to outperform the AFR. If that happens, your child or other borrower will have to use his or her own funds to pay some or all of the interest — and, if he or she experiences a loss on the investment, even some of the

NO-INTEREST LOANS ARE A BIG NO-NO

When making an intrafamily loan, you must avoid the temptation to charge no interest or charge interest below the current applicable federal rate (AFR). If you do, you'll be subject to income tax (with certain exceptions for smaller loans) on imputed interest — that is, the excess of the AFR over the interest you collect. In other words, you'll be taxed on interest that you didn't receive. In addition, the imputed interest will be treated as a taxable gift to the borrower.

principal. In other words, instead of transferring wealth to your child, your child will transfer wealth to you. As noted above, however, low AFRs minimize this risk.

There's also a risk that the IRS will challenge the loan as a disguised gift, potentially triggering gift tax liability or using up some of your lifetime exemption. To avoid this result, you must treat the transaction as a legitimate loan. That means documenting the loan with a promissory note and adhering to its payment and enforcement terms. If, for example, your child is unable to make a payment, you should make a genuine effort to collect the funds from the child.

WHO CAN HELP?

The intrafamily loan is just one of many tools available for transferring wealth to your loved ones in a tax-efficient manner. Contact our firm for help developing a strategy that reflects your financial situation and goals. ■

USE CAPITAL LOSSES TO OFFSET CAPITAL GAINS

When is a loss actually a gain? When that loss becomes an opportunity to lower tax liability, of course. Now's a good time to begin your year-end tax planning and attempt to neutralize gains and losses by year end. To do so, it might make sense to sell investments at a loss in 2018 to offset capital gains that you've already realized this year.

NOW AND LATER

A capital loss occurs when you sell a security for less than your "basis," generally the original purchase price. You can use capital losses to offset any capital gains you realize in that same tax year — even if one is short term and the other is long term.

When your capital losses *exceed* your capital gains, you can use up to $3,000 of the excess to offset wages, interest and other ordinary income ($1,500 for married people filing separately) and carry the remainder forward to future years until it's used up.

RESEARCH AND REPLACE

Years ago, investors realized it could be beneficial to sell a security to recognize a capital loss for a given tax year and then — if they still liked the security's prospects — buy it back immediately. To counter this strategy, Congress imposed the wash sale rule, which disallows losses when an investor sells a security and then buys the same or a "substantially identical" security within 30 days of the sale, before or after.

Waiting 30 days to repurchase a security you've sold might be fine in some situations. But there may be times when you'd rather not be forced to sit on the sidelines for a month.

Fortunately, there's an alternative. With a little research, you might be able to identify a security in the same sector you like just as well as, or better than, the old one. Your solution is now simple and straightforward: Simultaneously sell the stock you own at a loss and buy the competitor's stock, thereby

avoiding violation of the "same or substantially identical" provision of the wash sale rule. You maintain your position in that sector or industry and might even add to your portfolio a stock you believe has more potential or less risk.

If you bought shares of a security at different times, give some thought to which lot can be sold most advantageously. The IRS allows investors to choose among several methods of designating lots when selling securities, and those methods sometimes produce radically different results.

GOOD WITH THE BAD

Investing always carries the risk that you will lose some or even all of your money. But you have to take the good with the bad. In terms of tax planning, you can turn investment losses into opportunities — and potentially end the year on a high note. ■

ACCELERATING YOUR PROPERTY TAX DEDUCTION TO REDUCE YOUR TAX BILL

Smart timing of deductible expenses can reduce your tax liability, and poor timing can increase it unnecessarily. One deductible expense you may be able to control to your advantage is your property tax payment.

You can prepay (by December 31) property taxes that relate to 2018 (the taxes must be assessed in 2018) but that are due in 2019, and deduct the payment on your return for this year. But you generally can't prepay property taxes that relate to 2019 (they must be assessed in 2019) and deduct the payment on this year's return. Also beware of the dollar-amount limitation discussed below.

A BIG DECISION

Accelerating deductible expenses such as property tax payments is typically beneficial. Prepaying your property tax may be especially advantageous if your tax rate under the Tax Cuts and Jobs Act (TCJA) is expected to decrease in the next year. Deductions save more tax when tax rates are higher.

But not every tax rate has dropped for the 2018 tax year under the TCJA — the very lowest rate, 10%, has been retained, as well as the 35% rate (though the income brackets for these rates have changed). So, some taxpayers may not save any more by prepaying. Also, taxpayers who expect to substantially increase their income next year, pushing them into a higher tax bracket, may benefit by *not* prepaying their property tax bill.

Another important point is that, under the TCJA, for tax years 2018 through 2025 the itemized deduction for all state and local taxes is limited to $10,000 ($5,000 for married filing separately).

MORE CONSIDERATIONS

Property tax isn't deductible for purposes of the alternative minimum tax (AMT). So, if you're subject to the AMT this year, a prepayment may hurt you because you'll lose the benefit of the deduction. Before prepaying your property tax, make sure you aren't at AMT risk for 2018.

Also, don't forget that, for 2018 to 2025, the TCJA suspends personal itemized exemptions but roughly doubles the standard deduction amounts (for 2018) to $12,000 for singles and separate filers, $18,000 for heads of households, and $24,000 for joint filers. This may affect your decision on whether to prepay.

SPECIFIC STRATEGIES

Not sure whether you should prepay your property tax bill or what other deductions you might be able to accelerate into 2018 (or should consider deferring to 2019)? Contact us. We can help you determine your optimal year-end tax planning strategies. ■

IS A PTO CONTRIBUTION ARRANGEMENT RIGHT FOR YOUR BUSINESS?

Many businesses find themselves short-staffed from Thanksgiving through December 31 as workers scramble to use, rather than lose, their remaining time off. Indeed, your workplace may resemble a ghost town if you limit how many vacation days employees can roll over to the new year. A paid time off (PTO) contribution arrangement may be the solution.

A PTO contribution program allows employees with unused vacation hours to elect to convert them to retirement plan contributions. If the plan has a 401(k) feature, it can treat these amounts as a pretax benefit, similar to normal employee deferrals. Alternatively, the plan can treat the amounts as employer profit sharing, converting excess PTO amounts to employer contributions.

A PTO contribution arrangement may be a better option than increasing the number of days employees can roll over. Larger rollover limits can

result in employees building up large balances that create a significant liability on your books.

To offer a PTO contribution arrangement, simply amend your 401(k) plan. However, you must still follow the plan document's eligibility, vesting, rollover, distribution and loan terms. Additional rules may apply. To learn more about PTO contribution arrangements, including their tax implications, please contact us. ■