2017 Year-End Tax Planning

WINDES
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Year-End Tax Planning and Looking Forward

November 2017

Dear Clients and Friends:

As the end of the year approaches, it is a good time to think of tax planning moves that will help to lower your tax bill for 2017 and possibly realize even greater tax savings in the event the tax rates change in 2018. We have a unique set of challenges this year due to the comprehensive tax reform and other legislative changes that are expected to happen soon. Although the new provisions will most likely not go into effect until 2018 or later, they could still impact the 2017 year-end planning. Reforms, if enacted, will likely bring down the tax rates, particularly for business income. Another unknown is the Trump Administration's initiative to "streamline" rules and regulations coming out of the Treasury and the IRS. Meanwhile, the usual flood of court decisions and IRS guidance has continued, which also presents new opportunities and pitfalls that require year-end consideration.

Planning for Tax Reform:

Following the release of the Trump Administration/GOP "Tax Reform Framework" on September 27, 2017, tax writers in Congress have apparently been drafting legislative language for change. Taxpayers should be ready to execute strategies as late as December, while preparing for a variety of final scenarios without locking themselves into any final course. Here are the year-end strategies for three possible tax reform outcomes:

1. No tax reform until 2018 - Accelerate 2018 deductions and defer income
2. Tax reform for 2017 and 2018 - Maximize new/enhanced deductions
3. No tax reform at all - Balance taxable income and consider impact of reform later in 2018

Individual tax rates: The Trump/GOP framework calls for replacing the current individual tax rates with a new, three-bracket structure: 12, 25 and 35%. The framework leaves open the possibility of a fourth "additional top rate" applicable to high-income taxpayers.

Capital Gains Rates:

Current Rate	Possible New Rate
20% for 39.6% bracket	15%
15% for 35, 33, 28 & 25% bracket	15%
0% for 15% bracket	0%

Pass-through business income: The framework sets a 25% maximum tax rate applied to the business income of small and family-owned business income passed through to the owner's individual income tax return as sole proprietor, LLC member, partner, or S corporation shareholder. The Trump/GOP framework, as well as Trump Administration officials, have promised to consider rules that would prevent pass-through owners from converting their compensation income taxed at higher rates into profits taxed at the 25% level. *Taxpayers who are the owners of a pass-through entity or a sole proprietorship should consider using income deferral and deduction acceleration techniques to move as much taxable income into 2018 in order to take advantage of the lower tax rate.*

The framework also proposes to end the alternative minimum tax (AMT). However, until it is eliminated, taxpayers should still include AMT in their year-end tax projections and consider implementing strategies to reduce certain "preference items."

Standard deduction: The framework calls for almost doubling the standard deduction to $24,000 for married filing jointly and $12,000 for single filers (currently at $12,700 and $6,350, respectively). For taxpayers who would not otherwise itemize deductions, this net increase ($11,300 and $5,650) would translate into about a $2,825 and $1,412 tax savings for those in the 25% marginal tax rate if the personal exemption is not eliminated under this framework.

Personal exemptions: The personal exemption is currently at $4,050 per person. If this exemption is eliminated, the tax benefit of the higher standard deduction would be reduced by $1,013 per exemption for those in the 25% marginal tax bracket. The framework proposes to eliminate not only all personal exemptions, but also the exemption for dependents. To counterbalance that loss for families, an unspecified increase in the child credit and the child care credit, as well as a new $500 credit to care for an elderly or disabled family member, have been proposed.

Itemized deductions: The Trump/GOP framework, as initially proposed, would eliminate all individual itemized deductions, except for mortgage interest and charitable contributions. Since the proposal was released, states with high income/property taxes, as well as real estate groups and charities, have pushed back on the scope of these changes. On the further assumption that the elimination or reduction of certain deductions and credits will not take place until 2018, acceleration of at least some of these items into 2017 seems to be shaping up to be one of the go-to tax strategies for this year-end. *California taxpayers who are not subject to AMT may want to consider prepaying their California income tax and property taxes before the end of 2017.*

Businesses: The framework calls for a 20% corporate tax rate. The maximum corporate tax rate currently tops out at 35%. The framework also calls for the elimination of the corporate AMT. For year-end planning purposes, corporations that pay taxes at a tax rate higher than 20% should consider deferring income into 2018. However, there are also a significant number of corporations now paying an effective rate lower than 20%, due to tax preference items. Those corporations should be aware of, and prepared for, the likelihood that these tax preference items are eliminated or significantly reduced in a trade-off for the 20% rate. For example, the framework calls for elimination of the domestic-production-activity deduction and limitation on the net-interest-expense deduction.

Expensing: The framework proposes to allow businesses to immediately write off (or "expense") the cost of new investments in depreciable assets (other than buildings) acquired after September 27, 2017. This policy represents an unprecedented level of expensing with respect to depreciable assets.

It also poses an incentive for the purchase of qualifying equipment between now and 2017 year-end. Bonus depreciation under the current law is subject to phase-down (see below). Therefore, accelerating purchase and use of depreciable assets into year-end 2017 will qualify the business for no less than a 50% bonus depreciation and, if the full expensing provision passes under tax reform, may entitle the business to the equivalent of 100% bonus depreciation.

Estate Tax: The framework repeals the estate tax and generation skipping transfer tax. It is not clear what will happen to the gift tax.

Traditional Year-End Tax Strategies:

Traditional year-end planning techniques nevertheless remain important both to maximize benefits in connection with what is new and to do so within the taxpayer's personal finances. Postponing income until 2018 and accelerating deductions into 2017 may enable you to lower your tax bill.

The following techniques should be considered:

Income Deferral (to accelerate income in 2017, take opposite actions):

- Sell asset in installment arrangement
- Receive bonuses after January 2018
- Delay on selling appreciated investments or assets
- Postpone redemption of U.S. Savings bonds
- Delay on billing and collections
- Take minimum retirement distributions
- Postpone Roth IRA conversions
- Use like-kind exchange arrangement
- Postpone on taking corporate liquidation distributions until 2018

Deductions/Credit Acceleration (take contrary actions for deferral):

- Bunch itemized deductions into 2017 and take standard deduction in 2018
- Pay all the outstanding bills in 2017
- Make last state estimated tax payment in 2017
- Watch adjusted gross income (AGI) limitations on deductions/credits
- Accelerate economic performance
- Watch net investment interest limitations
- Match passive activity income and losses to maximize deduction
- Consider disposing a passive activity to deduct passive loss carryover
- Increase basis in the pass-through business entity to deduct current-year loss

For Businesses

Businesses seeking to maximize tax benefits through 2017 year-end tax planning may want to consider several general strategies, such as use of traditional timing techniques for income and deductions. General tax planning strategies to consider include:

1. Adopting a qualified retirement plan before the year-end. As long as plan documents are executed before the end of the year, a deduction can be claimed for 2017 and funding delayed until the tax return due date.
2. Delaying payment of a properly accrued bonus in the year of service (for example, 2017) until up to 2-1/2 months into 2018; the accrual-basis employer can get its deduction in 2017 while the employee (if "unrelated" for tax purposes) will be taxed in 2018.
3. Considering recent tax developments from the IRS and the courts that may present either new tax saving opportunities or pitfalls.

Section 179 Expensing and Bonus Depreciation

Businesses should consider making capital expenditures that qualify for the business property expensing option. For tax years beginning in 2017, the expensing limit is $510,000 and the investment ceiling limit is $2,030,000. Expensing is generally available for most depreciable property (other than buildings), off-the-shelf computer software, air conditioning and heating units, and qualified real property, including qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. The generous dollar ceilings mean that many small and mid-sized businesses who make timely purchases can deduct most (if not all) of their outlays for machinery and equipment in the current year. What is more, the expensing deduction is not prorated for the time the asset is in service during the year. The fact that the expensing deduction may be claimed in full regardless of how long the property is held during the year can be a potent tool for year-end tax planning. Therefore, property acquired and placed in service in the last days of 2017 can result in a full expensing deduction for 2017.

If you are skeptical that tax reform will be enacted, you should also consider buying property that will qualify for the 50% first-year depreciation if bought and placed in service in 2017. Under current law, the original 50% bonus depreciation will phase down to 40% for property placed in service in 2018 and to 30% for property placed in service in 2019. The bonus depreciation deduction is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 50% first-year bonus write-off is available even if qualifying assets are placed in service for only a few days in 2017.

Strategy: Year-end purchases of qualifying Section 179 property entitle the taxpayer to a full deduction up to the $510,000 limit. When comparing the possible benefits of the Section 179 deduction versus bonus depreciation, a taxpayer should keep in mind that Section 179 is available for both new and used property. However, bonus depreciation is available only for new (first-time use) property. Bonus depreciation is optional and a business can elect not to use it. Electing out may be appropriate if the business wants to spread its depreciation deductions over future years more evenly.

Repair Regulations

***De minimis* safe harbor:** The tangible property regulations dealing with repairs include a *de minimis* expensing safe harbor that allows taxpayers to annually elect to deduct the cost of materials and supplies and units of property produced or acquired subject to a per-item dollar limit. Effective January 1, 2016, the *de minimis* safe harbor limit was set at $2,500 for many business taxpayers.

Remodel-refresh: The IRS supplemented the tangible property regs with a safe harbor that allows a taxpayer operating a retail establishment or a restaurant to change to a method of accounting that allows the taxpayer to treat 25% of qualified remodel-refresh costs as capital expenditures under Internal Revenue Code (IRC) Section 263 and 75% of such costs as currently deductible repair and maintenance expenses. The IRS also provided procedures on how taxpayers may obtain automatic consent to change to the safe harbor method of accounting. There are certain retailers who cannot use the remodel-refresh safe harbor. These non-qualified retailers include: automobile dealers, other motor vehicle dealers, gas stations, manufactured home dealers, and nonstore retailers.

Business Use of Vehicles

Several year-end strategies involving both business expense deduction for vehicles and the fringe-benefit use of vehicles by employees involve an awareness of certain rate and dollar caps that change annually.

Standard Mileage Rate:
The standard business mileage allowance rate for 2017 is 53.5 cents per mile (down from 54 cents per mile for 2016).

Depreciation Limits:
The maximum depreciation limits under IRC Section 280F for passenger automobiles first placed in service during the 2017 calendar year are:

- $3,160 for the first tax year ($11,160 if bonus depreciation is claimed);
- $5,100 for the second tax year;
- $3,050 for the third tax year; and
- $1,875 for each succeeding tax year.

The maximum depreciation limits for small trucks and vans first placed in service during 2017 calendar year are:

- $3,560 for the first tax year ($11,560 if bonus depreciation is claimed);
- $5,700 for the second tax year;
- $3,450 for the third tax year; and
- $2,075 for each succeeding tax year.

Strategy: Sport utility vehicles (SUVs) and pickup trucks with a gross vehicle weight rating (GVWR) in excess of 6,000 pounds continue to be exempt from the luxury vehicle depreciation caps based on a loop-hole in the operative definition. In 2004, Congress placed a $25,000 limit on IRC Section 179 expensing of heavy SUVs but has not extended it to Section 280F.

Research Tax Credit

The PATH Act made the research credit permanent. The credit was also modified to be more useful to small businesses. Eligible businesses with $50 million or less in gross receipts can claim the credit against their AMT liability. Also, certain small businesses can now claim the credit against their payroll tax liability. This year, the IRS issued guidance explaining how a qualifying small business may elect to claim a payroll tax credit of up to $250,000 in lieu of the research credit. This election may be useful to a small business with no income tax liability against which to claim the research credit. The tax credit is still available for the state of California if the business conducts research activities and paid qualified expenditures in California.

The "gig" Economy

Approximately 2.5 million taxpayers are now earning income each month in the "gig" economy, also commonly referred to as the "sharing" or "on-demand" economy. Participation continues to swell and is expected to double by 2020, according to the IRS. The IRS opened a "Sharing Economy Tax Center" this year on its website. It also is reportedly stepping up its audit coverage of taxpayers working in the "gig" economy.

Affordable Care Act (ACA)

Individuals and businesses should remain aware of their obligations as year-end approaches and stay alert to any changes that may be made by the Trump Administration. At this time, it is unclear whether the ACA's taxes will be addressed in any tax reform package. These include the net investment income (NII) tax, the additional Medicare Tax, and more. Taxpayers should do the calculations for one scenario that include repeal of the ACA's taxes and another that does not.

Partnership Agreements

Audits of many partnerships for tax years starting in 2018 will be subject to several changes in new rules governing the liability of each partner. Any additional tax due to the examination will be assessed at the partnership level, instead of separately imposed on each partner's individual income tax return. It may create an issue if there is a change in ownership between the tax year that is audited and the time the additional tax is assessed by the IRS. Amending partnership agreements before these rules start to apply in 2018 can avoid later headaches.

For Individuals

Tax Rates Exposure

Balancing the impact of the existing tax rates on a variety of transactions during the year and at year-end can be challenging: the ordinary income tax rates, the capital gain rates, the net investment income (NII) tax rate, and the AMT, all may play a role.

For individuals, the income tax rates for 2017 are unchanged from 2016: 10, 15, 25, 28, 33, 35 and 39.6%, although the start of each bracket continues to be inflation-adjusted upward each year. The tax rates for qualified (net long-term) capital gains and dividends are also unchanged for 2017, ranging from 20% for those in the 39.6% income tax bracket, down to 15% for those within the 25 to 35% brackets, and to 0% for those otherwise in the 10 to 15% income tax brackets.

The NII threshold amount is equal to $250,000 in the case of joint returns or a surviving spouse, $125,000 in the case of a married taxpayer filing a separate return, and $200,000 in most other cases. These threshold amounts are not indexed for inflation. The tax rate on NII is 3.8%. There is also an additional Medicare Tax of 0.9% on covered wages and other compensation above the threshold dollar amounts that mirror the threshold amounts of the NII tax regime.

Strategy: If possible, keep general income below the threshold amounts by spreading income out over a number of years or offsetting the income with above-the-line deductions. Grouping related activities can provide an opportunity to reclassify investment income as nonpassive business income. Also spikes in income, whether capital gains or other income, may push gains into either the 39.6% bracket for short-term gain or the 20% capital gains bracket. Spreading the recognition of certain income between 2017 and 2018 may help minimize the total tax paid for the 2017 and 2018 tax years.

Investments

Capital losses: Cashing out stocks with a built-in loss may be a simple way of providing a loss to be taken against current capital gains and ordinary income. Individuals can deduct up to $3,000 of additional losses, whether net long-term or short-term; losses above $3,000 can be carried over and deducted in succeeding years. If the investment remains economically attractive, taxpayers can buy the same stock more than 30 days before or after they sell shares in the same company. This avoids the wash-sale rules, which would disallow the loss. The wash-sale rule, however, applies only to losses; gains are recognized in full.

Another popular strategy for saving taxes on the sale of appreciated stock while helping children financially is to gift appreciated stock to them. If the child has earned income and is taxed in the bottom two income tax brackets, the capital gains generated on the stock sale is taxed at 0% (rather than the 15% or more that would be paid by the parent), assuming the gain on the sale does not push the child past the 15% federal tax bracket. This scenario also assumes that the kiddie tax does not apply.

Electing out of the First-In-First-Out ("FIFO") method for reporting stock trades:

Treasury Regulations Section 1.1012-1(c)(1) specifies that, if a taxpayer owns identical stock that he or she acquired at different times or for different prices, the taxpayer may determine his or her basis in such shares based upon a FIFO method. Alternatively, if a taxpayer can adequately identify the specific shares of stock he or she wishes to sell or transfer, the regulation permits a taxpayer to opt out of the default FIFO method and use the basis correlated to those specifically identified shares.

Many taxpayers have equity holdings in a discount brokerage, such as Scottrade, Fidelity, and TD Ameritrade. All of them utilize the FIFO method as a default for selling identical shares. In order to "opt out" of the FIFO regime, the taxpayer must direct his or her broker and adequately identify the particular shares to sell. "Adequate identification" has been defined by the U.S. Tax Court if (a) the taxpayer at the time of the sale designates a particular lot or lots to be sold, and (b) the broker confirms the taxpayer's instructions in writing within a reasonable time thereafter, which the Regulations state must be completed no later than the settlement date of the sale.

As part of year-end tax planning strategies, the taxpayers should consider instructing their brokers to elect out of the FIFO rule for all trades by writing a standing order. This would allow the taxpayers to specify which shares they want to sell based upon the income tax outcome that they want to accomplish.

Alternative Minimum Tax (AMT)

For 2017, the AMT exemption amounts are $54,300 for single individuals and heads of household; $84,500 for married couples filing a joint return and surviving spouses; and $42,250 for married couples filing separate returns. No single factor automatically triggers AMT liability, but some common factors are itemized deductions for state and local income taxes, miscellaneous expenditures, home equity loan interest (not including interest on a loan to build, buy or improve a residence) and changes in income from installment sales. Investments, especially in oil and gas, may also generate "tax preferences" that may add up to AMT liability.

Pease Limitation (Limitation on Itemized Deductions) / Personal Exemption Phase-out

For 2017, the Pease limitation threshold is $313,800 for married couples and surviving spouses; $287,650 for heads of households; $261,500 for unmarried taxpayers; and $156,900 for married taxpayers filing separately. The threshold adjusted gross income amounts for personal exemption phase-out (PEP) are the same as the threshold amounts for Pease limitation. Potential reduction of the value of certain itemized deductions and personal exemptions may be lessened by some individuals by managing adjusted gross income as well as affected itemized deductions. For purposes of the limitation on itemized deductions, a taxpayer's total, itemized deductions, do not include deductions for medical expenses, investment interest expenses, casualty or theft losses, and allowable wagering losses.

Estate and Gift Planning

The maximum federal unified estate and gift tax rate is 40%, with an inflation-adjusted $5 million exclusion for gifts made and estates of decedents dying after December 31, 2012. The gift tax exclusion allows taxpayers to give up to an inflation-adjusted $14,000 ($15,000 in 2018) to any individual, gift-tax free and

without counting the amount of the gift toward the lifetime $5 million exclusion, adjusted for inflation. The applicable exclusion amount, as adjusted for inflation, is $5,490,000 for gifts made and estates of decedents dying in 2017 ($5,600,000 in 2018). There is no limit on the number of individual donees to whom gifts may be made under the $14,000 exclusion. Spouses may split their gifts to each donee, effectively raising the per donee annual maximum exclusion to $28,000. Spouses may give an unlimited amount of gifts to one another without any gift tax imposed. You cannot carry over unused annual exclusions from one year to the next.

Gifts made before the end of the year can be sheltered by the annual gift tax exclusion, thereby saving gift and estate taxes. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

Year-End Retirement Planning

One of the first steps for retirement savings is to contribute to an employer-sponsored elective salary deferral plan. These salary deferral plans include 401(k) plans, 403(b) plans, and 457 plans, depending on the type of employer. For 2017, the inflation-adjusted elective salary deferral limit for 401(k), 403(b), and 457 plans is the lesser of $18,000 or 100% of compensation. If an employer makes contributions, the total contribution for the 2017 year from both the employee and the employer is capped at $54,000, not including an additional $6,000 for catch-up contributions. Plans rules vary on the extent to which you have the ability to increase your elective deferral contributions at year-end.

Relief for late rollovers: The IRS unveiled a new self-certification procedure for taxpayers who inadvertently miss the 60-day time limit for certain retirement plan distribution rollovers. Distributions to plan participants must be rolled over (i.e. deposited) into another qualified retirement account (usually an IRA) within 60 days. The procedure eliminates the costs associated with requesting a private letter ruling for the 60-day waiver. The procedure, however, does not rubber-stamp any excuse; it must be reasonable and is subject to IRS verification.

Minimum distribution requirements: Most retirement arrangements (other than Roth IRAs) require that participants begin to take annual payments of benefits in the year they reach age 70-1/2. While distributions generally must be made at the end of the calendar year, distributions for the first year can be delayed until April 1 of the following year.

Roth Conversions / Reconversions: A traditional IRA may be converted to a Roth IRA. As with rollovers to traditional IRAs, the 10% additional tax on early distributions does not apply; however, unlike rollovers to traditional IRAs, the amount converted is taxable in the year of conversion. Once a Roth IRA has been recharacterized back to a (new) traditional IRA, the (new) traditional IRA can be (re)converted to a Roth IRA, provided the taxpayer meets the eligibility requirements in the reconversion year. This reconversion option is most often used to allow a "do-over" when assets that are transferred lose value before year-end.

Strategy: Any amount converted to a Roth IRA is included in gross income for the tax year in which the amount is distributed or transferred from the traditional IRA. When a rollover spans two tax years, the taxable amounts from the traditional IRA are included in gross income in the year in which the amounts are withdrawn from the traditional IRA.

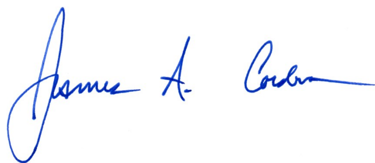
IMPORTANT LIFE CYCLE CHANGES THAT AFFECT YEAR-END TAX PLANNING

In addition to changes in the tax law, taxpayers should also consider personal circumstances that changed during 2017 as well as what may change in 2018. These changes include:

- Change in filing status due to marriage, divorce, death, or head of household changes
- Change in dependent such as new-born child or outgrown child
- Losses from casualty or theft
- Change in medical expenses
- Moving/relocation due to change in job
- College and other higher education expenses
- Change in employer
- Start retirement
- Personal bankruptcy
- Inheritance
- Business successes or failures

Every tax situation is different and requires a careful and comprehensive plan. We can assist you in aligning traditional year-end techniques with strategies to be more tax efficient. If you have any further questions or need assistance from us regarding your year-end tax planning, please do not hesitate to contact us at taxalerts@windes.com or toll free at **844.4WINDES** (844.494.6337).

Sincerely,
WINDES, INC.



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