2017 Year-End Tax Planning

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Given the current uncertainty surrounding the potential for tax reform, year-end tax planning has become more challenging – and more important – than in other years. The Senate passed a tax bill early Saturday morning, following the passage of a comparable bill by the House of Representatives. This week, the Senate and House look to reconcile the differences in the two tax bills. While both include a decrease in the corporate tax rate, significant differences remain, including the elimination of the alternative minimum tax (AMT) in the House bill. At the time of this letter, it is unknown whether a final reconciliation bill will be passed and signed by the President before the end of 2017. So, what steps can be taken to minimize taxes during these uncertain times?

The standard principles that traditionally have driven year-end tax planning still apply. Generally, income should be deferred, and deductions should be accelerated to limit current year adjusted gross income (AGI) and taxable income. These steps may be even more beneficial in 2017 if a tax bill is passed, as income tax rates may be reduced beginning in 2018 and a number of deductions eliminated. *With proactive planning, there is an opportunity to realize "permanent" tax savings in 2017.*

Reducing AGI: Both the House and Senate plans feature lower base tax rates, so reducing current year income and deferring income into 2018 are key. AGI generally can be thought of as gross income less "above the line deductions" for items such as contributions to IRAs, health savings accounts, self-employed health insurance, and alimony (among other items).

To reduce AGI, taxpayers should focus on reducing items such as taxable wages, self-employment income, or capital gains. For example, employees looking to reduce taxable wages should try to maximize their pre-tax deductions by contributing to flexible spending accounts and maximizing their 401(k) contributions. It may also be advantageous to defer a year-end bonus until early 2018.

Taxpayers who are self-employed have even more flexibility. Deductions

In This Letter

Reducing AGI 1
Accelerating Deductions 2
Other Considerations 3
Estate and Gift Tax 3

can be accelerated into 2017 by paying invoices before year-end. It is also possible to defer income for cash-basis taxpayers by waiting until January to send invoices. They may further qualify for a significant contribution to a self-employed (SEP) IRA, directly reducing AGI.

This is also the perfect time of year for taxpayers to review their investment portfolios. Taxpayers may want to consider gifting appreciated securities to charity. Donating appreciated securities that have been held for over one year provides a double tax benefit. Taxpayers using this strategy can realize a deduction for the full fair market value of the securities while not paying income tax on the inherent gain. If your portfolio has significant realized capital gains, you should consider selling securities whose value has decreased relative to the cost. Recognizing capital losses can offset your capital gains for the year and reduce AGI.

Taxpayers taking discretionary distributions from their retirement plans could defer a year-end distribution until January to help lower AGI. Even those over age 70½ with required minimum distributions (RMDs) may be able to lower AGI by making a qualified charitable distribution to satisfy some or all of the their 2017 RMDs.

Regardless of whether we are operating under the current tax system or the House and Senate proposals, reducing your AGI is a key to lowering your tax liability, as it lowers your income subject to tax and also helps you avoid or limit exposure to various taxes and restrictions on deductions.

Accelerating Deductions: Once you have taken steps to reduce your AGI, itemized deductions are available to help you further reduce your taxable income. While the House and Senate plans differ in the specifics, both have the same core philosophy. The standard deduction would be approximately doubled, and many itemized deductions would be eliminated or significantly reduced. If possible, taxpayers generally should accelerate these deductions into 2017. The exception to this rule is if taxpayers are subject to the alternative minimum tax (AMT). Taxpayers in the AMT will receive little to no benefit by accelerating certain itemized deductions.

Deductions to be considered include:

- ***State Income and Property Taxes:*** Both the House and Senate plans eliminate the deduction for state and local income taxes paid. If taxpayers will be making fourth-quarter state estimated tax payments, they should consider making the payments by December 31st. The Senate and House plans both cap the deduction for local property taxes at $10,000. If possible, taxpayers should consider making an extra real estate tax payment before year end.
- ***Medical Expense Deductions:*** The House and Senate plans differ when it comes to eliminating the medical expense deduction. If you anticipate having any large medical expenses in the near future, please check with your advisor to see if it makes sense to schedule procedures before the end of the year.
- ***Charitable Contributions:*** Contributions, including non-cash gifts, are great way to reduce your taxable income. Because of the possible increase in the standard deduction, many taxpayers will not receive a tax benefit for making charitable contributions after 2017, creating a potential incentive for some to accelerate their contributions into 2017. Keep in mind that when donating used clothing or household items, it is important to keep good records of the items given. Taking pictures on a smartphone is a great way to record the quantity and quality of the items given.
- ***Investment and Employee Business Expenses:*** Both the House and Senate plans eliminate deductions for tax-preparation fees and unreimbursed employee business expenses. Taxpayers that have significant employee business expenses should consider accelerating them into 2017. Investment fees continue to be deductible under the House bill, but the Senate bill eliminates deductions for investment fees.

Smart Tax-Planning Tips

◊ Reduce AGI by contributing to flexible spending accounts, maximizing 401(k) contributions, deferring income and bonuses, and paying select bills prior to year-end.

◊ Make charitable contributions, including non-cash gifts, and consider gifting to family members as well.

◊ Consider accelerating tax payments and significant medical expenses before year-end.

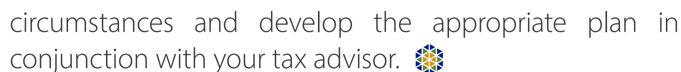
Other Considerations: The House bill proposes eliminating the AMT, while the Senate bill retains the AMT with modifications. One of the common reasons taxpayers are forced to pay AMT is because they have large itemized deductions that are not allowed for AMT purposes. Eliminating the AMT should, in theory, make planning easier. The issue is complex, however, as the House and Senate bills vary widely over which itemized deductions are kept and which are eliminated or reduced. For those taxpayers who may consider exercising Incentive Stock Options, they should consider deferring to 2018 when the AMT may be eliminated.

When taxpayers are subject to the AMT, conventional wisdom has been that accelerating itemized deductions has little or no benefit. The Affordable Care Act has changed this wisdom slightly. In general, state income tax payments and miscellaneous investment expenses are deductions for the Net Investment Income Tax (NIIT). There is now an incentive to make these payments by year-end to reduce income subject to the NIIT even if taxpayers are in the AMT.

Estate and Gift Tax: In addition to proposed income tax changes, the Senate and House plans feature changes for the estate tax. The Senate and House plans both call for the lifetime exemption to be doubled to approximately $11 million per taxpayer (double for married individuals). The Senate exemption increase is only temporary, while the House version completely eliminates the estate tax by 2024.

Given the possibility of repeal, how should taxpayers approach year-end gifting to family members? In most cases, reducing the taxable estate is only part of the motivation for donors. For those still looking to help friends and relatives financially, there are still many tax-efficient ways to make year-end gifts.

You can make annual exclusion gifts of up to $14,000 per person ($28,000 for a married couple) as a way to reduce your taxable estate. For donations to a Section 529 Education Plan, you may be able make gifts up to $70,000 per person ($140,000 for a married couple) at one time. Additionally, taxpayers generally can pay medical expenses or tuition directly on behalf of a donee without any limitations.

This is a sampling of the most common year-end tax planning strategies, but it is important to note that each taxpayer has unique tax circumstances. You should contact your financial counselor to discuss your unique circumstances and develop the appropriate plan in conjunction with your tax advisor. 

Current versus Proposed Tax Rates

Single Taxpayers

Income Level	Current Rate	House Rate	Senate Rate
$0 - $9,525	10%	12%	10%
$9,526 - $38,700	15%	12%	12%
$38,701 - $45,000	25%	12%	22%
$45,001 - $70,000	25%	25%	22%
$70,001 - $93,700	25%	25%	24%
$93,701 - $160,000	28%	25%	24%
$160,001 - $195,450	28%	25%	32%
$195,451 - $200,000	33%	25%	32%
$200,001 - $424,950	33%	35%	35%
$424,951 - $426,700	35%	35%	35%
$426,701 - $500,000	39.6%	35%	35%
> $500,000	39.6%	39.6%	38.5%

Married Taxpayers

Income Level	Current Rate	House Rate	Senate Rate
$0 - $19,050	10%	12%	10%
$19,051 - $77,400	15%	12%	12%
$77,401 - $90,000	25%	12%	22%
$90,001 - $140,000	25%	25%	22%
$140,001 - $156,150	25%	25%	24%
$156,151 - $237,950	28%	25%	24%
$237,951 - $260,000	33%	25%	24%
$260,001 - $320,000	33%	35%	24%
$320,001 - $400,000	33%	35%	32%
$400,001 - $424,950	33%	35%	35%
$424,951 - $480,050	35%	35%	35%
$480,051 - $1,000,000	39.6%	35%	35%
> $1,000,000	39.6%	39.6%	38.5%

This letter is general and educational in nature. Individuals should seek advice for their particular circumstances from their financial counselors or other tax advisors before undertaking actions in response to the matters discussed.