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Tax Briefing | Wolters Kluwer

2017 Year-End Tax Planning

November, 2017

Highlights

- ✔ Tax Reform – Different Paths
- ✔ Rate Cuts – 2017 or 2018?
- ✔ Standard v. Itemized Deductions
- ✔ Depreciation Strategies
- ✔ Life-Cycle Considerations
- ✔ Timing Strategies

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SPECIAL REPORT

Tax Reform, IRS, Court Decisions, and More Add to Uncertainties at Year-End

Year-end 2017 presents a unique set of challenges for taxpayers. At the top of the list are the uncertainties created by the possibilities within proposed tax reform legislation – what changes might be made, and whether those changes would be retroactive for 2017.

Also presenting a unique challenge before year-end is the Trump Administration's initiative to "streamline" rules and regulations coming out of the Treasury and IRS. Meanwhile, the usual flood of court decisions and IRS guidance has continued, also presenting new opportunities --and pitfalls--that require year-end action.

Traditional considerations. Equally important to 2017 year-end tax planning is a look at what has changed in the life of the specific taxpayer under consideration. Recent and anticipated changes in a taxpayer's personal, investment and business situations often require some year-end reaction, either to capitalize on targeted tax rules or mitigate against their application.

COMMENT. *At the time this briefing was prepared, legislative text to implement tax reform had not been unveiled. Legislative language could vary from the principles described in the Trump/GOP framework (discussed below).*

PLANNING FOR TAX REFORM

Following release of the Trump Administration/GOP "Tax Reform Framework" on September 27, tax writers in Congress have apparently been drafting legislative language. That language, and negotiations to follow, are expected to reflect input from a variety of sources, as well as from opposition factions and lobbying groups. Final legislation is expected to impact virtually every taxpayer in some way.

IMPACT. *Year-end strategies will become clearer over the coming weeks as proposals are negotiated and prospects for final passage become more certain. For now, flexibility and preparedness are key. 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.*

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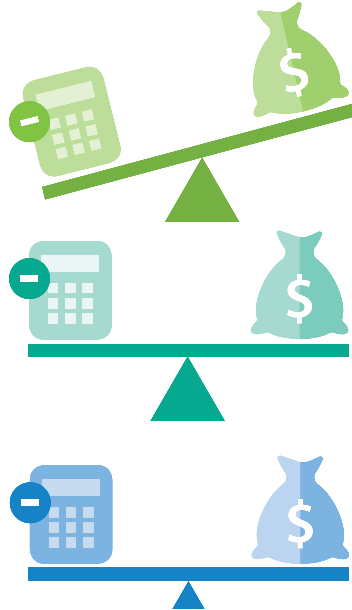
Year-End Strategies for 3 Tax Reform Outcomes

Objective: lowest overall tax for 2017 & 2018

No tax reform until 2018
- *Accelerate 2018 deductions*
- *Defer income*

Tax reform for 2017 and 2018
- *Maximize new/ enhanced deductions*

No tax reform at all
- *Balance taxable income*
- *Consider impact of reform later in 2018*



Individuals

Individual tax rates. The Trump/GOP framework calls for replacing and lowering the current individual tax rates with a new, three-bracket structure: 12, 25, and 35 percent. Under current law, individual income tax rates are 10, 15, 25, 28, 33, 35, and 39.6 percent. The framework leaves open the possibility of a fourth, "additional top rate" applicable to high-income taxpayers.

> **IMPACT.** *Standard year-end tax planning advice continues to apply: balance taxable income between this year and the next to produce the lowest possible combined tax liability. That usually means manipulating income and deductions between tax years.*

Capital Gains Rates*

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

*28 percent rate applies to long-term gains from collectible and small business stock, while a 25 percent rate applies to unrecaptured Code Sec. 1250 gain realized on the sale of depreciable real property.

Note: short-term capital gains (on assets held for one year or less) are taxed at regular ordinary income rates. However, long-term losses as well as short-term losses can offset short-term gains, a fact that can be capitalized on by strategic year-end selling to "harvest losses" to reduce both short-term and net long term capital gain.

> **IMPACT.** *The framework did not include proposed income ranges for the new brackets.*

Additionally, the framework limits to 25 percent the maximum tax rate applied to the business income of small and family-owned businesses passed through onto the owner's Form 1040 as sole proprietor, partner or S corporation shareholder *(see Businesses, below).*

> **Comment.** *The framework proposes to end the alternative minimum tax (AMT). Until it is eliminated, however, taxpayers should project AMT liability for the year and implement strategies to reduce certain "preference items."*

Capital gains. Capital gains and losses were not addressed directly in the Trump/GOP framework but obviously will need to be addressed in final legislation. One possible outcome is that the rate structure will not change at all but only applicable bracket ranges may be affected.

Standard deduction. The Trump/GOP 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 percent marginal tax rate. ...if it were not for the elimination of personal exemptions under the framework.

Personal exemptions. Currently at $8,100 and $4,050 for married and single filers respectively, elimination of the personal exemption would reduce the benefit of the higher standard deduction by another $2,025 and $1,012.50 respectively for those in the 25 percent marginal 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.

> **IMPACT.** *Taking inventory of the dependency rules at year-end to qualify the care of a family member for a tax benefit remains a smart move. These rules can be especially complex in divorce situations.*

Deductions. The Trump/GOP framework, as initially proposed, would eliminate all individual itemized tax deductions except for the mortgage interest deduction and the charitable contribution deduction. Since the

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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, which in turn may threatened the increased size of the standard deduction and tax rate cuts in general.

IMPACT. *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.*

Businesses

Corporate taxes. The Trump/GOP framework calls for a 20 percent corporate tax rate. The maximum corporate tax rate currently tops out at 35 percent. The framework also calls for the elimination of the corporate alternative minimum tax.

IMPACT. *For year-end planning purposes, strategy to defer income should generally make sense for many corporations because of the probable drop from 35 percent rate to 20 percent (or possibly somewhere in the low-20s). A significant number of corporations, however, now pay an effective rate of lower than 20 percent because of tax preference items that presumably would be eliminated or significantly reduced in trade-off for the 20 percent rate.*

Passthrough taxes. Currently, owners of partnerships, S corporations, and sole proprietorships pay tax at the individual rates, with the highest rate at 39.6 percent. The framework proposes a 25 percent tax rate for pass-through income, aimed primarily at small-business owners.

Comment. *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 percent level, particularly service providers, such as accountants, doctors, lawyers, etc.*

IMPACT. *Year-end planning for small business owners should monitor this "pass-through" provision as it develops to make certain that the maximum amount of pass-through income would qualify for the 25 percent rate as soon as possible. Taxpayers should consider using income deferral and deduction acceleration techniques to move as much taxable income into the 25 percent rate from the 39.6 percent tax bracket for individuals*

Expensing. Expensing would be enhanced under the Trump/GOP Framework. The framework proposes to allow businesses to immediately write off (or "expense") the cost of new investments in depreciable assets, other than structures, made after September 27, 2017, for at least five years.

IMPACT. *This policy represents an unprecedented level of expensing with respect to the duration and scope of eligible assets. It also poses a win-win for the purchase of qualifying equipment between now and year-end 2017. Bonus depreciation under current law is subject to a phase-down schedule over five years: 50 percent for 2015-2017, dropping to 40 percent for 2018. Therefore, accelerating purchase and use into year-end 2017 will qualify the business for no less than at least*

Tuition and Fees Deduction

Mortgage Insurance Premium Deduction

Various Energy Credits

Exclusion of Discharge of Principal Residence Indebtedness

Incentives for Biodiesel and Alternative

Expired Tax Extenders

Certain "extenders" provisions were not renewed by the so-called PATH Act, passed in late 2015. They await either a roll-in into a tax reform bill, passage within their own year-end tax bill, or simply lapsing and without retroactive reinstatement.

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Major Regulatory Modifications

In response to Executive Order 13789, the Treasury Department proposes to withdraw or significantly revise regulations dealing with the following issues:

- Valuation of Business Interests for Estate and Gift Taxes—withdraw
- Definition of Political Subdivision for Municipal Bonds—withdraw
- Certain Interests in Corporations as Stock or Debt—documentation rules revoked
- Participation of non-IRS Person in Summons Interview—partial revocation
- Liabilities Recognized as Recourse Partnership Liabilities—partial revocation
- Certain Transfers of Property to REITS and RICs—application narrowed
- Certain Transfers of Property to Foreign Corporations—exceptions to be developed
- Foreign Currency Transactions with Qualified Business Units—simplification

Treasury also reported that the IRS has identified over 200 additional regulations for potential revocation, most of which have been in existence for many years. As further information becomes available before year-end 2017, year-end planning should take advantage of the new opportunities that these changes will bring.

50 percent bonus depreciation and may, if the full expensing provision passes under tax reform, entitle the business to the equivalent of 100 percent bonus depreciation instead.

International. The Trump/GOP framework contains a number of "playing field" levelers to help U.S. companies better compete in the global marketplace. The 20 percent corporate rate, anti-inversion provisions and other restrictions on outbound transactions are part of this carrot-stick approach.

Proposed as a revenue raiser and also as a transition to a territorial system of taxation, the framework calls for a one-time tax on repatriated profits at a yet-unspecified tax rate. Anticipated revenues from repatriation would help offset some of the expense for the corporate rate reduction to 20 percent.

OTHER NEW BUSINESS DEVELOPMENTS

The last few months of the year provide an important "last chance" to change the final course of the business' tax year before it closes for good. Among the reasons why year-end tax planning toward the end of 2017 may be particularly fruitful are the following new developments in addition to the major shift in regulatory actions now underway by the Trump Administration:

Business credits and deductions. Many business-related tax credits and deductions were permanently extended by the Protecting Americans from Tax Hikes Act of 2015 (PATH Act). Others were only extended through 2016 and will not be available for the 2017 filing season unless extender legislation is enacted. A few were extended for a five-year period. Taking action on an inventory of what deductions and credits a business has been using and whether they remain available, or will be removed in the near future, could significantly impact the bottom line.

Repair regulations. The "repair regs" impact virtually all asset-based businesses by providing the rules for distinguishing between capital expenditures and deductible repairs or other types of deductible expenses. While taxpayers were expected to file change in accounting methods using the automatic consent procedure to retroactively comply with the repair regs for their first tax year beginning in 2014, taxpayers who are not yet subject to a capitalization audit may continue to file these accounting method changes using certain automatic consent procedures.

Payroll tax credit for small businesses. The IRS issued guidance this year 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.

Business use of vehicles. Several year-end strategies involving both business expense deductions for vehicles and the fringe-benefit use of vehicles by employees require an awareness of certain rates and dollar caps that change annually. Changes affecting 2017 include a drop in the standard business mileage allowance rate to 53.5 cents-per-mile, down from 54 cents-per-mile for 2016. The maximum depreciation limits under Code Sec. 280F for passenger automobiles first placed in service during the 2017 calendar year were also revised.

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. Individuals and businesses should remain aware of their obligations as year-end approaches,

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and stay alert to any changes that may be made by the Trump administration.

> **IMPACT.** *It is unclear if 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 run the numbers for one scenario that incudes 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 a sea-change of new rules governing the liability of each partner. Amending partnership agreements before these rules start to apply in 2018 can avoid later headaches.

OTHER NEW INDIVIDUAL DEVELOPMENTS

In addition to "tax reform" efforts, other tax law changes by the IRS and the courts that have taken place during 2017 are worth a look in mapping out year-end strategies.

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.

Per taxpayer mortgage deduction. The IRS announced that it would not contest a Ninth Circuit Court of Appeals defeat that found that multiple unmarried taxpayers co-owning a qualifying residence can double the normal $1.1 million mortgage debt limit for interest deduction purposes.

Hurricane disaster relief. For victims of Hurricanes Harvey, Irma and Maria in 2017, a variety of tax relief measures for both individuals and businesses are now available, through a special Disaster Relief Act of 2017 and numerous IRS measures to extend compliance deadlines and other requirements.

Offers in compromise. The IRS updated its policy covering offer in compromise (OIC) applications received on or after March 27, 2017.

Interest rates. Interest rates have slowly been rising throughout 2017 and are expected to continue to rise into 2018, which points to various tax planning opportunities as well as the closing of certain tax advantages.

GENERAL & SPECIFIC TIMING RULES

Effective year-end tax planning by its nature requires the correct execution of specific timing rules under the tax code. Due especially to the current uncertainties surrounding tax reform, taxpayers must be particularly nimble and prepared to implement timing strategies well into December.

- For businesses, the IRS and the courts generally require use of the accrual method whenever inventories are used. For an accrual-basis taxpayer, the right to receive income, rather than actual receipt, determines the year of inclusion in income.
- Under the cash receipts and disbursements method (cash method), all items constituting income, whether in the form of cash, property, or services, must generally be included in income for the tax year in which the items are actually or constructively received; and deductions are generally taken into account for the tax year in which actually paid.

The cash method, which is required to be used by almost all individual taxpayers, generally allows a cash-basis taxpayer to exercise some control over the year of income or deduction by accelerating or deferring receipts and payments.

Income acceleration/deferral. Taxpayers using the cash method basis of accounting can defer or accelerate income using a variety of strategies. For example:

- Sell or hold appreciated assets
- Accelerate or delay bonuses
- Use installment contracts
- Qualify for (or purposely fail) like-kind exchange treatment
- Manage year-end bills and receipts
- Manage debt forgiveness income
- Declare special dividend and
- Consider Roth conversions.

Life Cycle Changes Important To Year-End Planning

While tax considerations are important, sometimes life gets in the way. Year-end tax strategies should also consider personal circumstances that changed during 2017 as well as what may change in 2018. These "life cycle" changes include:

- Change in filing status: marriage, divorce, death or head of household status
- Birth of a child
- Child no longer young enough for child credit
- Child who has outgrown the "kiddie" tax
- Casualty losses
- Changes in medical expenses
- Moving/relocation
- College and other tuition expenses
- Employment changes
- Retirement
- Personal bankruptcy
- Large inheritance
- Business successes or failures

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Overall Strategies: Data & Timing

Among of the variables to be faced in tax planning for 2017, two constants continue to apply:

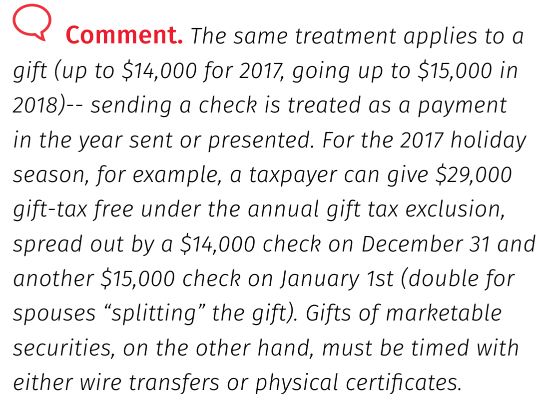
(1) *Data gathering:* evaluation of external forces such as current and potential tax law changes and internal shifts within a taxpayer's personal or business profile; and

(2) *Timing rules:* application of timing rules against that data, to accelerate or defer income and/or accelerate or defer deductions and tax credits as appropriate for the lowest net tax result for the current tax year and the tax year on the horizon.

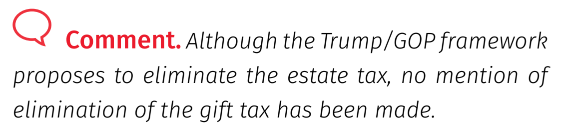
Deduction acceleration/deferral. A cash basis taxpayer generally deducts an expense in the year it is paid, although prepayment of an expense generally will not accelerate a deduction (there are exceptions). Some techniques to accelerate or defer deductions and credits are to:

- Bunch itemized deductions into 2017/Standard deduction into 2018
- Don't delay bill payments until 2018
- Pay last state estimated tax installment in 2017
- Pay in 2017 college tuition for semester beginning during first three months in 2018
- Contribute to retirement plans
- Don't delay economic performance
- Watch AGI limitations on deductions/credits
- Watch net investment interest restrictions
- Match passive activity income and losses

Year-end payments. It is not necessary to use cash to qualify for a deduction or other tax benefit for 2017. More frequently, taxpayers can write a check or can charge an item by credit card and treat these actions as immediate payments. It does not matter, for example, when the recipient –whether a business or a charity-- receives a check mailed by the payor, when a bank honors the check, or when the taxpayer pays the credit card bill, as long as it is done or delivered "in due course."

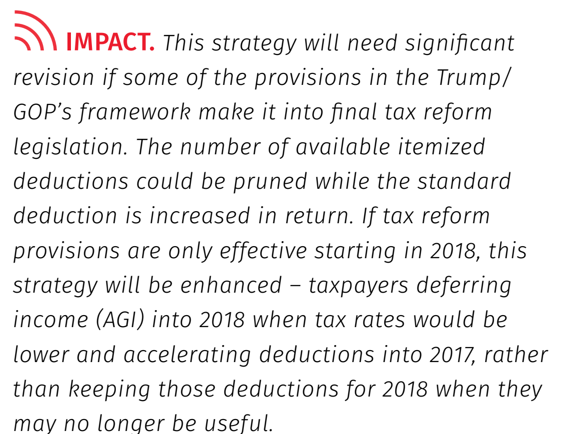


Comment. *The same treatment applies to a gift (up to $14,000 for 2017, going up to $15,000 in 2018)-- sending a check is treated as a payment in the year sent or presented. For the 2017 holiday season, for example, a taxpayer can give $29,000 gift-tax free under the annual gift tax exclusion, spread out by a $14,000 check on December 31 and another $15,000 check on January 1st (double for spouses "splitting" the gift). Gifts of marketable securities, on the other hand, must be timed with either wire transfers or physical certificates.*



Comment. *Although the Trump/GOP framework proposes to eliminate the estate tax, no mention of elimination of the gift tax has been made.*

Bunching strategies. Certain items are deductible only to the extent they exceed an adjusted gross income (AGI) floor; for example, aggregate miscellaneous itemized deductions are deductible only to the extent they exceed two percent of the taxpayer's AGI. Thus, year-end and new-year tax planning might consider ways to bunch AGI-sensitive expenditures in a single year, so that particular deductions exceed their applicable floors and the taxpayer's total itemized deductions exceed the standard deduction.



IMPACT. *This strategy will need significant revision if some of the provisions in the Trump/GOP's framework make it into final tax reform legislation. The number of available itemized deductions could be pruned while the standard deduction is increased in return. If tax reform provisions are only effective starting in 2018, this strategy will be enhanced – taxpayers deferring income (AGI) into 2018 when tax rates would be lower and accelerating deductions into 2017, rather than keeping those deductions for 2018 when they may no longer be useful.*

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