2017 YEAR-END TAX PLANNING CHECKLIST

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As another tax year comes to a close, it is time to consider your tax planning opportunities. With the GOP tax bill making its way through congress, the potential for big change is on the horizon and tax planning has never been so relevant. Being proactive when it comes to tax planning can help you and your business make smarter and more thoughtful decisions that have the power to lower your overall tax liability to Uncle Sam.

Executive Summary

In this article, we will expand on the following year-end planning tips:

- Consider the effects of the proposed tax legislation on the best timing for recognizing income and taking deductions.
- Minimize taxable income in order to ensure that your tax breaks are not reduced or eliminated due to phase-outs.
- Consider the timing of controllable income that can be deferred and deductions that can be accelerated. Take advantage of any available expensing and accelerated depreciation deductions.
- Gift appreciated property at year-end to shift taxable gain to lower-bracket family members while taking advantage of the annual gift tax exclusion.
- Use appreciated assets to meet your charitable giving intentions and obligations.
- Make the best use of your tax losses.
- Dispose of passive activities in order to use suspended passive losses.
- Increase the withholding on wages in order to prevent an estimated tax underpayment penalty.
- Review your year-to-date contributions to your retirement plans and/or 401(k) and consider increasing the amounts before year-end.
- Consider a conversion from a traditional IRA to a Roth IRA. If you converted earlier in the year and asset values have declined, consider reversing the conversion in order to avoid paying taxes on the higher value.

Tax Cuts and Job Act Highlights

Congress is moving forward with their overhaul of the tax code. The House and Senate have each passed their version of the tax cuts and job act and now they must reconcile them. Once a compromised bill has passed both chambers it can be presented to President Trump to sign into law. Republicans are still hopeful this can be accomplished by year end. If this act gets passed it would be the biggest transformation of the code in more than 30 years affecting nearly all U.S. companies and individuals.

Change in tax rates coming. Both the tax bill that passed the House of Representatives and the Senate would reduce tax rates for most taxpayers, effective for the 2018 tax year. However, due to the elimination of many deductions (discussed below) the effective tax rate could actually increase for some. Additionally, businesses may see their tax bills cut, although the final form of the relief isn't completely clear right now. The general plan of action to take advantage of lower tax rates next year would be to defer income into next year.

Disappearing deductions, larger standard deduction. Beginning next year, both the House-passed tax reform bill and the Senate-passed tax reform bill would repeal or reduce many popular tax deductions in exchange for a larger standard deduction.

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2017 Tax Planning Checklist — Individuals

The following checklist contains actions that you can take before year-end in order to help reduce your tax liability:

- ☐ Defer income until 2018 and accelerate deductions for 2017. By employing this strategy, you may be able to claim larger deductions, credits, and other tax breaks for 2017 that are phased out over varying levels of income. Consider using a credit card to incur expense that can generate deductions for this year. Deferring income is also favorable for those taxpayers who anticipate being in a lower tax bracket next year. It must be noted, however, that in some cases, it may be beneficial to accelerate income into 2017. This may be the case for a taxpayer whose marginal tax rate is much lower this year than it will be the following year. In light of the potential change in tax brackets with the new GOP bill, it could be beneficial to defer income until 2018 if moving into a higher bracket this year can be prevented. However, it is important to note many other items deductible under current law could also be reduced or eliminated under the new tax plan.

- ☐ Though the new GOP tax bill has the potential to eliminate AMT, it is still relevant for the 2017 tax year. You should determine whether you are likely to be subject to the Alternative Minimum Tax (AMT) and if any actions you are considering will trigger it. Many deductions used to calculate regular tax are disallowed for AMT purposes, some of which include the deductions for state income taxes, real estate taxes, miscellaneous itemized deductions, and personal exemption deductions. Do not accelerate these deductions when you are subject to the AMT or suspect you might be.

- ☐ If possible, it may be beneficial to have your employer defer a year-end bonus until 2018.

- ☐ Take losses on stocks and mutual funds in order to offset any taxable gains realized during the year. However, annual deductible capital losses are limited to $3,000 in excess of your gains. Any unused loss can be carried over to future years.

- ☐ In order to reduce 2017 taxable income, consider disposing of a passive activity if you have suspended passive activity losses.

- ☐ If you plan to make charitable donations, consider donating appreciated capital gain assets (such as stocks) rather than cash. By doing so, you avoid the capital gain tax and 3.8% net investment income tax.

- ☐ Consider using a credit card to pay for charitable contributions before year-end. Even if you don't pay your credit card bill until 2018, you will still receive the deduction in 2017. Don't forget to document your out-of-pocket expenses included when volunteering for a charity. Though both GOP tax bills keep the charitable deduction, with the standard deduction increasing, it may be harder to utilize. Consider accelerating contributions, if possible.

- ☐ If you expect to owe state income taxes, consider paying your fourth quarter estimated state income tax payment and any additional amounts due in December 2017. The House and Senate GOP tax plans both eliminate the Federal deduction for state taxes for years 2018 and beyond, so this could be the last year for this deduction. However, you should only use this strategy if you are not affected by the AMT as that would reduce or eliminate this deduction.

- ☐ Consider prepaying property taxes in current year if not in AMT. Both the House and Senate passed GOP tax reform bills would limit this deduction to $10,000 in future years. Many counties treat this process differently, so call your county for specific instructions on how to do this.

- ☐ You can also ask your employer to increase your 2017 state tax withholding, unless you are likely to be subject to AMT.

- ☐ It may be beneficial to bunch in the current year or next year miscellaneous itemized deductions, which are allowed only to the extent they exceed 2% of adjusted gross income. The new GOP tax plan has proposed limiting or eliminating many of these deductions for years 2018 and beyond, so you should consider accelerating these expenses when possible into 2017.

- ☐ Consider accelerating medical expenses. The House-passed bill would eliminate the itemized deduction for medical expenses, while the Senate-passed bill would keep it. If this deduction is indeed eliminated in the final tax bill, and you are able to claim medical expenses as an itemized deduction this year, consider accelerating "discretionary" medical expenses into this year. For example, order and pay for new glasses, arrange to take care of needed dental work, or install a stair lift for a disabled person before the end of the year.

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- [ ] Maximize your contributions to retirement plans and 401(k) plans. When you have a business, contributions to the business's plan may reduce your taxable income.

- [ ] If you currently have a traditional IRA, you may benefit from converting to a Roth IRA, which will allow you to transform tax-deferred future growth into tax-free growth. However, if you expect to be in a lower tax bracket in 2018, it may be worth postponing this move until next year.

  - You will pay taxes on the IRA asset value converted to a Roth, but the assets will continue to grow tax-free and can later be withdrawn tax-free.
  - Converting your IRA to a Roth IRA is more desirable if your current IRA balance includes significant non-deductible IRA contributions, since these amounts will reduce the taxable portion of the conversion.
  - Be aware that the income from the conversion will raise your AGI, and may trigger NIIT, Additional Medicare tax, or itemized deduction phase-outs.
  - If you have converted assets from a traditional IRA to a Roth IRA earlier this year and the assets in the Roth IRA account declined in value, you will end up paying higher taxes than needed. In this case, you can choose to reverse the transaction by transferring the converted amount from the Roth IRA back to a traditional IRA using a trustee-to-trustee transfer. You can then choose to re-convert the IRA to a Roth IRA at the current, lower market value.
  - Roth conversions are not appropriate for everyone, and you should consult your tax advisor before taking action on a conversion.

- [ ] Depending on your income and filing status, up to 85% of your Social Security benefits can be taxable. If your income is close to thresholds, consider deferring other income to minimize how much your social security benefits will be taxed.

- [ ] When you reach the age of 70½, you must take required minimum distributions (RMDs) from your IRA, 401(k) plan, and other qualified retirement plans. If you turned 70½ this year, you should consider delaying the first required distribution to 2018, and hence, defer the income for one more year. This will benefit many, but not everyone, depending on changes in tax rates and personal income changes.

- [ ] If you are facing a penalty for underpayment of estimated tax, consider requesting Federal withholding on your RMDs. The IRS considers withholding to be paid pro rate over the year, which may reduce underpayments of quarterly estimated tax.

- [ ] If you are eligible to make contributions to your Health Savings Account (HSA), you can still maximize your 2017 contribution so you will have a full year's worth of deductible HSA contributions. The deadline for making HSA contributions for 2017 is April 15, 2018. If you do not have an HSA and your insurance plan allows for one, consider establishing and contributing to the account before the April 15 deadline. However, keep in mind that you cannot use HSA funds to pay for expenses incurred prior to opening the account.

- [ ] For 2018, increase the amount in your employer-sponsored Flexible Spending Account (FSA) if you set aside too little for this year.

- [ ] Consider making a $14,000 ($28,000, if married) gift to family members before the end of year. This will not only reduce the estate taxes ultimately paid, but will also reduce income taxes on the earnings of that money. The benefits are multiplied if the gifts are those of appreciated property.

- [ ] Tuition and medical expenses paid on someone's behalf are free of gift tax and also do not count against the annual gift exclusion. The payments must be paid directly to the school and medical care expenses directly to the healthcare provider. You may want to consider a plan to systematically pay these expenses for certain family members.

- [ ] Avoid potential penalties related to foreign asset reporting by gathering necessary tax records.

- [ ] If you're in the process of selling your principal residence and you wrap up the sale before year end, up to $250,000 of your profit ($500,000 for certain joint filers) will be tax-free if you owned and used the property as your main home for at least two of the five years before the sale. However, under the House and Senate passed bill the $250,000/$500,000 tax free amounts would apply to post-2017 sales only if you own and use the property as your main home for five out of the previous eight years. In addition to the longer ownership requirement, there would be a phase-out of this deduction for higher income taxpayers.

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2017 Tax Planning Checklist – Businesses and Business Owners

- [ ] In light of the potential change in tax brackets with the GOP tax plan, it could be beneficial to defer income until 2018 if moving into a higher bracket this year can be prevented. However, it is important to note many other items deductible under current law could also be reduced or eliminated under the new tax plan.

    - If you run a business that renders services and operates on the cash basis, the income you earn isn't taxed until your clients or patients pay. So if you hold off on billings until next year or until so late in the year that no payment can be received this year, you will succeed in deferring income until next year.
    - If your business is on the accrual basis, deferral of income till next year is difficult but not impossible. For example, you might, with due regard to business considerations, be able to postpone completion of a job until 2018, or defer deliveries of merchandise until next year. Taking one or more of these steps would postpone your right to payment, and the income from the job or the merchandise, until next year. Keep in mind that the rules in this area are complex and may require a tax professional's input.

- [ ] The reduction or cancellation of debt generally results in taxable income to the debtor. So if you are planning to make a deal with creditors involving debt reduction, consider postponing action until January to defer any debt cancellation income into 2018.

- [ ] The Section 179 expensing limit for 2017 is $510,000 with a $2, 030,000 overall investment limit (before phase-out). This allows businesses to expense the cost of fixed assets such as equipment and furniture and fixtures. Both the House and Senate tax reform bills would significantly expand the Section 179 deduction for tax years beginning in 2018 through 2022.

- [ ] You can claim 50% first-year bonus depreciation for qualified new (not used) assets (including most software) that are placed in service in calendar year 2017. Both the House and Senate tax reform bills would allow unlimited 100% first-year depreciation for qualified assets acquired and placed in service after September 27, 2017 and before January 1, 2023.

- [ ] If a business purchases machinery and equipment before year-end, it could secure a half-year's worth of depreciation deductions under the half-year convention. This works unless 40% or more of the total depreciable assets purchased are purchased in the last three months of the year. The purchase may also be eligible for 50% bonus depreciation and/or the Section 179 expensing election.

- [ ] Businesses should consider the "de minimis safe harbor election" to expense the costs of lower value capital assets as allowed by the regulations. The amount that can be written off is up to $5,000 per item if you have an audited financial statement or $2,500 if you do not. These are only the IRS safe-harbor amounts. You may find that a higher dollar amount makes more sense for your business without distorting income. To take advantage of this provision, you must adopt and follow the policy not only for tax purposes but also for financial statement purposes. We suggest the policy be in writing.

- [ ] Both the House and Senate passed bills repeal certain common business deductions such as the deduction for entertainment, amusement or recreation activities, membership dues, and personal amenities provided to employees. Consider accelerating the payment of these types of expenses before the end of 2017.

- [ ] An accrual basis business can accrue and deduct employee bonuses, commissions, independent contractor services in 2017 and pay them in 2018. The employee will be taxed in 2017, and the payment must be made within 2 ½ months after yearend to qualify.

- [ ] If your business is planning on purchasing new vehicles through use of a trade-in of a currently owned vehicle, consider completing the purchase before year-end. Both the House and Senate passed bills eliminate the deferral of gain for like-kind exchanges of personal property. The like-kind exchange of real property will still be allowed.

- [ ] Consider an assessment of your company's retirement plans to determine if a change in plans could allow you to contribute more toward your retirement and provide additional tax deductions. If there is an older owner who is an employee, a defined benefit plan or cash balance plan could allow you to quickly build a substantial retirement fund. If the company does not have a current retirement plan, consider putting one in place before the end of the year.

- [ ] A C corporation that anticipates a small net operating loss (NOL) in 2017 and significant net income in 2018 should consider accelerating some of its 2018 income or deferring some of its 2017 deductions in order to produce a small amount of net income for 2017. This will allow it to base its 2017 estimated tax installments on the smaller amount of income shown on its 2017 return, instead of paying estimated taxes on 100% of its much larger 2018 taxable income.

- [ ] A C corporation that currently has net operating loss (NOL) carryforwards should also consider accelerating income into 2017 as the House and Senate passed bills would limit the use of NOLs to 90% of taxable income in future years.

- [ ] Determine if you should increase your basis in a partnership or S corporation so that you can deduct current year losses by loaning or contributing additional capital to the business.

- [ ] Ensure required informational 1099s are filed. Reportable payments include: rent, interest, and fees exceeding $600.

- [ ] Be aware the following states have tax on gross receipts, regardless of nexus:

  - Ohio – Taxpayers are subject to the Ohio commercial activity tax (CAT) if Ohio gross receipts are over $150,000 in the calendar year.
  - Washington – Taxpayers are subject to the business and occupation (B&O) tax if Washington gross receipts are over $250,000 per tax year.
  - Nevada – Taxpayers are subject to the Nevada commerce tax if Nevada gross receipts are over $4,000,000 per tax year.

GOP Tax Planning

As with prior years, 2017 year-end planning should start with data collection and a review of prior year tax returns. This includes losses or other carryovers, estimated tax installments, and items that were unusual. Conversations with your tax advisor about the next year should include review of any plans for significant purchases or dispositions, as well as any possible life-cycle changes.

If the general goal for year-end planning has been to balance taxable income between the current and upcoming year to the extent tax bracket rates are equal, this year offers some unique challenges. Please keep in mind that we've described only some of the year-end moves that should be considered in light of the tax reform package currently before Congress, which, it bears emphasizing, has not been finalized into law at this time. It will be more important than ever to be watching this bill as it makes its way through Congress and potentially into law.

If you have any additional questions about year-end tax planning, or if you need further assistance, please do not hesitate to contact us.

Judy Mason, CPA, CVA, has over 20 years of tax, accounting, business consulting, and compliance experience, serving closely-held and start-up businesses, entrepreneurial and family-owned companies, their owners and families. Her expertise is in federal, state, local, and employment taxation, guiding clients through the complexities of conducting business in a dynamic tax environment. She has successfully defended a broad range of federal income, state income, and sales tax audits for her clients.

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