SLAGLE WOLF GROUP
Consultants & Certified Public Accountants

2017 Mid-Year Tax Planning

To Our Clients and Friends:

As we write this letter, the federal income tax rates for this year are still the same as last year: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. The rate bracket beginning and ending points are increased slightly to account for inflation. The maximum 39.6% bracket affects singles with 2017 taxable income above $418,400, married joint-filing couples with income above $470,700, heads of households with income above $444,550, and married individuals who file separate returns with income above $233,350.

Higher-income individuals may also be hit by the 0.9% additional Medicare tax on wages and self-employment income and the 3.8% Net Investment Income Tax (NIIT), which can both result in a higher-than-advertised marginal federal income tax rate. Finally, you must consider whether you are exposed to Alternative Minimum Tax (AMT). If so, tax planning moves that work for most folks may not work for you.

That's what we know right now. What we don't know is whether federal income tax rates will be changed by legislation enacted later this year and whether any rate changes that *are* enacted would actually take effect this year. President Trump and Republican House members have advanced proposals that would reduce the maximum rate on individuals to perhaps 33% or 35% and reduce the rate on business income to perhaps 15% or 20%. In addition, President Trump has proposed repealing the AMT and the federal estate tax. If the Affordable Care Act (Obamacare) is repealed, the 0.9% additional Medicare tax and the 3.8% NIIT could go down with it. Will any of this happen? Stay tuned.

Even with this uncertainty, there are some tax planning moves that should work regardless of what happens, if anything. There are other moves that you should be prepared to consider if tax changes are enacted. This letter presents some tax planning ideas to evaluate this summer while you have time to think. Some of the ideas may apply to you, some to family members, and others to your business.

Take Advantage of 0% Rate on Investment Income

Under the current rules, the federal income tax rate on long-term capital gains and qualified dividends recognized by individual taxpayers is still 0% when those gains and dividends fall within the 10% or 15% tax rate brackets. This will be the case to the extent your taxable income (including long-term capital gains and qualified dividends) does not exceed $75,900 if you're married and file jointly ($37,950 if you're single). If President Trump's tax plan is enacted, most individuals who are eligible for the 0% rate under the current rules would remain eligible under the proposed new rules. So, strategies to take advantage of the 0% rate should work regardless of what happens.

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who will be in the bottom two brackets. If so, consider giving them some appreciated stock or mutual fund shares which they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term as long as your ownership period plus the gift recipient's ownership period (before he or she sells) equals at least a year and a day.

Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 10% or 15% rate bracket, they will be federal-income-tax-free.

Watch out though, if you give away assets worth over $14,000 during 2017 to an individual gift recipient, it will generally reduce your $5.49 million unified federal gift and estate tax exemption. However, you and your spouse can together give away up to $28,000 without reducing your respective exemptions. Also, if you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting capital gains and dividends to be taxed at the parent's higher rates instead of at the gift recipient's lower rates. That would defeat the purpose. Please contact us if you have questions.

Time Investment Gains and Losses

Under the current rules, the 2017 federal income tax rates on long-term capital gains are the same as last year: 0%, 15%, and 20% for most categories of long-term gain. The maximum 20% rate affects singles with 2017 taxable income (including long-term gains) above $418,400, married joint-filing couples with income above $470,700, heads of households with income above $444,550, and married individuals who file separate returns with income above $235,350. Higher-income individuals may also be hit by the 3.8% NIIT, which can result in an effective marginal federal rate of up to 23.8% (20% + 3.8%) on long-term gains. Under the Trump tax plan the three rates on long-term gains would remain in place, but the 20% maximum rate would kick in at lower income levels. So, the same strategies for timing capital gains and losses should work regardless of what happens.

As you evaluate investments held in your taxable brokerage firm accounts, consider the tax impact of selling appreciated securities (currently worth more than you paid for them) before the end of this year. For most taxpayers, the federal income tax rate on long-term capital gains is still much lower than the rate on short-term gains. Therefore, it often makes sense to hold appreciated securities for at least a year and a day before selling in order to qualify for the lower long-term gain tax rate.

Biting the bullet and selling some loser securities (currently worth less than you paid for them) before year-end can also be a tax-smart idea. The resulting capital losses will offset capital gains from other sales this year, including high-taxed short-term gains from securities owned for one year or less. Under the current rules, the maximum rate on short-term gains is 39.6%, and the 3.8% NIIT may apply too—which can result in an effective marginal rate on short-term gains of up to 43.4% (39.6% + 3.8%). Future tax legislation could lower the maximum rate on short-term gains, but it will still be significantly higher than the rate on long-term gains. Whatever happens, you won't have to worry about paying a high rate on short-term gains that can be sheltered with capital losses because you will pay 0% on those gains.

If capital losses for this year exceed capital gains, you will have a net capital loss for 2017. You can use that net capital loss to shelter up to $3,000 of this year's higher-taxed ordinary income from salaries, bonuses, self-employment, and so forth ($1,500 if you're married and file separately). Any excess net capital loss is carried forward to next year.

Selling enough loser securities to create a bigger net capital loss that exceeds what you can use this year might also make sense. You can carry forward the excess capital loss to 2018 and beyond and use it to shelter both higher-taxed short-term gains and long-term gains recognized in those years.

Sell Loser Shares and Give Away the Resulting Cash;

Give Away Winner Shares

You may want to make gifts to favorite relatives and/or charities in conjunction with an overall revamping of your holdings of stocks and equity mutual fund shares held in taxable brokerage firm accounts. To get the best tax results from your generosity, *do not* give away shares that are currently worth less than you paid for them. Instead, sell the shares, and take advantage of the resulting tax-saving capital losses. Then, give the cash sales proceeds to the relative or charity.

On the other hand, *do* give away shares that are currently worth more than you paid for them. Because the charitable organization is tax-exempt, it can sell your donated shares without owing anything to the IRS. Most likely, your relative will pay lower tax rates than you would pay if you sold the shares. In fact, relatives who are in the 10% or 15% federal income tax brackets will generally pay a 0% federal tax rate on long-term gains from shares that were held for over a year before being sold. For purposes of meeting the more-than-one-year rule for gifted shares, count your ownership period plus the recipient relative's ownership period, however brief. Even if the shares are held for one year or less before being sold, your relative will probably pay a lower tax rate than you (typically only 10% or 15%). However, gains recognized by a relative under age 24 may be taxed at his or her parent's higher rates under the so-called Kiddie Tax rules (contact us if you are concerned about this issue).

Be Ready to Defer Some Income

It might also pay to defer some taxable income from this year into next year if you expect to be in the same or lower tax bracket in 2018. That would be more likely if tax rate reductions are enacted this year, but don't take effect until next year. For example, if you're in business for yourself and a cash-method taxpayer, you can postpone taxable income by waiting until late in the year to send out some client invoices. That way, you won't receive payment for them until early 2018. You can also postpone taxable income by accelerating some deductible business expenditures into this year. Both moves will defer taxable income from this year until next year. Deferring income may also be helpful if you're affected by unfavorable phase-out rules that reduce or eliminate various tax breaks (child tax credit, higher education tax credits, and so on).

Take Advantage of Principal Residence Gain Exclusion Break

Home prices are on the upswing in many areas. More good news: gains of up to $250,000 ($500,000 for qualifying married filing jointly) on the sale of a principal residence are completely federal-income-tax-free. To qualify for the gain exclusion break, you normally must have owned and used the home as your principal residence for a total of at least two years during the five-year period ending on the sale date. You'll definitely want to take these rules into consideration if you're planning on selling your home in today's improving real estate environment.

Watch out for Alternative Minimum Tax

Legislation enacted a few years ago slightly reduced the odds that you'll owe the AMT. While it's possible that tax legislation enacted later this year will eliminate the AMT, believe it when you see it. For now, it's still critical to evaluate tax planning strategies in light of the AMT rules before actually making any moves. Because the AMT rules are complicated, you may want some assistance. We stand ready to help. And if the AMT is repealed for this year, we stand ready to join you in cheering that development.

Tax-smart Strategies for Small Businesses

Consider Selling Rather Than Trading in Business Vehicles. Although a vehicle's value typically drops fairly rapidly, the tax rules limit the amount of annual depreciation that can be claimed on most cars and light trucks. So when it's time to replace a vehicle used in your business, it's not unusual for its tax basis to be higher than its value. If you trade the vehicle in on a new one, the undepreciated basis of the old vehicle simply tacks onto the basis of the new one (even though this extra basis generally doesn't generate any additional current depreciation because of the annual depreciation limits). However, if you sell the old vehicle rather than trading it in, any excess of basis over the vehicle's value can be claimed as a deductible loss to the extent of your business use of the vehicle.

Set up Tax-favored Retirement Plan. If your business doesn't already have a retirement plan, now might be the time to take the plunge. Current retirement plan rules allow for significant deductible contributions. Even if your business is only part-time or something you do on the side, contributing to a SEP-IRA or SIMPLE-IRA can enable you to reduce your current tax load while increasing your retirement savings. With a SEP-IRA, you generally can contribute up to 20% of your self-employment earnings, with a maximum contribution of $54,000 for 2017. A SIMPLE-IRA, on the other hand, allows you to set aside up to $12,500 for 2017 plus an employer match that could potentially be the same amount. In addition, if you will be age 50 or older as of year-end, you can contribute an additional $3,000 to a SIMPLE-IRA.

Employ Your Kid. If you are self-employed, you might want to consider employing your child to work in the business. Doing so has tax benefits in that it shifts income (which is not subject to the Kiddie tax) from you to your child, who normally is in a lower tax bracket or may avoid tax entirely due to your child's standard deduction. There can also be payroll tax savings since wages paid by sole proprietors to their children age 17 and younger are exempt from Social Security, Medicare, and federal unemployment taxes. Employing your children has the added benefit of providing them with earned income, which enables them to contribute to an IRA. Children with IRAs, particularly Roth IRAs, have a great start on retirement savings since the compounded growth of the funds can be significant. Remember a couple of things when employing your child. First, the wages paid must be reasonable given the child's age and work skills. Second, if the child is in college or entering soon, too much earned income can have a detrimental impact on the student's need-based financial aid eligibility.

Take Advantage of the Big 179 Deduction. Your business may be able to take advantage of very generous Section 179 deduction rules. Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions and eligible real property costs. For tax years beginning in 2017, the maximum Section 179 deduction is $510,000. While it's possible that Congress will curtail this break in conjunction with lowering tax rates, the favorable 179 deduction will probably stay in effect for this year.

Note: Watch out if your business is already expected to have a tax loss for the year (or close) before considering any Section 179 deduction as you cannot claim a Section 179 write-off that would create or increase an overall business tax loss. Please contact us if you think this might be an issue for your operation.

First-Year Bonus Depreciation. Above and beyond the Section 179 deduction, your business can also claim first-year bonus depreciation equal to 50% of the cost of most new (not used) equipment and software placed in service by 12/31/17. Note that 50% bonus depreciation deductions can create or increase a net operating loss (NOL) for your business's 2017 tax year. You can then carry back the NOL to 2015 and 2016 and collect a refund of taxes paid in one or both those years. Please contact us for details on the interaction between asset additions and NOLs.

Don’t Overlook Estate Planning

Currently, the unified federal gift and estate tax exemption for 2017 is a historically generous $5.49 million, and the federal estate tax rate is a historically reasonable 40%. While President Trump has proposed a repeal of the federal estate tax, we will believe it when we see it. In any case, your estate plan may need updating to reflect the current estate and gift tax rules, whatever they turn out to be. Also, you may need to make some changes for reasons that have nothing to do with taxes. Contact us if you think you could use an estate planning tune-up.

Conclusion

As we said at the beginning, this letter is to get you started thinking about tax planning moves for the rest of this year. Even with uncertainty about this year’s tax rates and rules, there are things you can do to improve your situation. Please don’t hesitate to contact us if you want more details or would like to schedule a tax planning strategy session.

Best regards,

The Slagle Wolf Group