OVERVIEW OF TAX-SAVING MOVES FOR THE REST OF 2017

This Hot Topic generally is oriented toward the time-honored approach of deferring income and accelerating deductions to minimize 2017 taxes. This approach may turn out to be even more valuable this year if Congress succeeds in enacting tax reform which reduces tax rates beginning next year in exchange for slimmed-down deductions. Regardless of whether tax reform is enacted, for individuals, deferring income also may help minimize or avoid AGI-based phase-outs of various tax breaks applicable for 2017.

Effective year-end tax planning must take into account each taxpayer's particular situation and planning goals, with the aim of minimizing taxes. For example, higher income individuals must consider the effect of the 39.6% top tax bracket, the 20% tax rate on long-term capital gains and qualified dividends for taxpayers taxed at a rate of 39.6% on ordinary income, the phase-out of itemized deductions and personal exemptions when income is over specified thresholds, and the 3.8% surtax (Medicare contribution tax) on net investment income for taxpayers whose income exceeds specified thresholds.

While many taxpayers will come out ahead by following the traditional approach (deferring income and accelerating deductions), others, including those with special circumstances, may want to consider accelerating income and deferring deductions. Most traditional techniques for deferring income and accelerating expenses can be reversed to achieve the opposite effect. For instance, a cash method professional who wants to accelerate income can do so by speeding up his business' billing and collection process instead of deferring income by slowing that process down. Or, a cash-method taxpayer who sells property in 2017 on the installment basis and realizes a large long-term capital gain can accelerate income by electing out of the installment method.

Some of the key considerations to take into account when formulating a year-end tax saving plan include the following:

- Capital gains. Long-term capital gains are taxed at a rate of:

  (a) 20% if they would be taxed at a rate of 39.6% if they were treated as ordinary income,

  (b) 15% if they would be taxed at above 15% but below 39.6% if they were treated as ordinary income, and

  © 0% if they would be taxed at a rate of 10% or 15% if they were treated as ordinary income. And, the 3.8% surtax on net investment income may apply.

- Low-taxed dividend income. Qualified dividend income is taxed at the same favorable tax rates which apply to long-term capital gains. Converting investment income taxable at regular rates into qualified dividend income can achieve tax savings and result in higher after-tax income. However, the 3.8% surtax on net investment income may apply.

- Electing to claim sales and use taxes as an itemized deduction instead of state income taxes. Individual taxpayers have the choice of claiming an itemized deduction for state and local sales and use taxes instead of state income taxes.

- Traditional IRA and Roth IRA year-end moves. One can convert traditional IRAs to Roth IRAs. And, one can then "recharacterize" (i.e., elect to treat a contribution made to one type of IRA as made to a different type of IRA) that conversion and can even, possibly, reconvert the recharacterized transaction.

- Expensing deduction. For qualified property placed in service in tax years beginning in 2017, the maximum dollar limitation amount which may be expensed is $510,000, and the beginning-of-phaseout amount is $2,030,000. Besides taking advantage of these rules, some businesses may be able to buy much-needed machinery and equipment at year-end and currently deduct the cost under a "de minimis" safe harbor election in the capitalization regulations.

- First-year depreciation deduction. Most new machinery and equipment bought and placed in service in 2017 qualifies for the 50% bonus first-year depreciation deduction. Bonus first-year depreciation has been extended through 2019 with a number of modifications, including a gradual reduction over that time (bonus depreciation declines to 40% for 2018, and 30% for 2019).

- Deduction for qualified production activities income. Taxpayers can claim a deduction, subject to limits, for 9% of the lesser of:

  (1) the taxpayer's "qualified production activities income" for the tax year (i.e., net income from U.S. manufacturing, production or extraction activities, U.S. film production, U.S. construction activities, and U.S. engineering and architectural services), or

  (2) the taxpayer's taxable income for that tax year (before taking this deduction into account). This deduction generally has the effect of a reduction in the taxpayer's marginal rate and, thus, should be taken into account when making decisions regarding income shifting strategies.

- Changes in an individual's tax status may call for acceleration of income. Changes in an individual's tax status, due, say, to divorce, marriage or loss of head of household status, must be considered.

- Alternative minimum tax (AMT). Watch out for the AMT, which applies to both individuals and many corporations. A decision to accelerate an expense or to defer an item of income to reduce taxable income for regular tax purposes may not save taxes if the taxpayer is subject to the AMT.

- Time value of money. Any decision to save taxes by accelerating income must take into account the fact that this means paying taxes early and losing the use of money which could have been otherwise invested.

- Estimated tax. Consider about how the estimated tax rules can be affected when taxable income is shifted from one tax year to another.

- Obstacles to deferring taxable income. The Code contains a number of rules which hinder the shifting of income and expenses. These include the passive activity loss rules, requirements that certain taxpayers use the accrual method and limitations on the deduction of investment interest.

- Charitable contributions. The timing of charitable contributions can have an important impact on year-end tax planning. Individual taxpayers who are at least 70-½ years old can contribute to charities directly from their IRAs without having the amount of their contribution included in their gross income. By making this move, some taxpayers reduce their tax liability even more than they would have if they had received the distribution from their IRA and then contributed the amount distributed to charity. Some taxpayers who could take advantage of this tax break for this year, should consider deferring until the end of the year their required minimum distributions (RMDs) for 2017.

- Net operating losses and debt cancellation income. A business with a loss this year may be able to use that loss to generate cash in the form of a quick net operating loss carryback refund. This type of refund may be of particular value to a financially troubled business which needs a fast cash transfusion to keep going. Also, a debtor who anticipates having the debt cancelled or debt reduced should consider steps to defer the resulting taxable income until 2018 .

- Energy tax incentives. Tax credits are available for residential energy-efficient solar property placed in service before 2022 (but a gradual phaseout applies).

If you need additional information on any of these individual topics, please feel to contact me.