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2017 YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

INTRODUCTION

With year-end approaching, this is the time we *"normally"* suggest possible year-end tax strategies for our clients. However, from a tax-planning standpoint, 2017 is not a *"normal"* year. For the first time in over 30 years, we are facing the real possibility that Congress could pass major tax reform legislation, which could happen by the end of this year. As we completed this letter, the House Ways and Means Committee had recently released (on November 2, 2017) the initial draft of its Tax Reform Bill which, if enacted, would make significant changes impacting individuals. For example, if enacted, this proposed legislation would: Lower individual tax rates; Substantially increase the standard deduction; Reduce and/or eliminate most itemized deductions; Eliminate the alternative minimum tax. We have included in this letter a general overview of key provisions in this recently-released proposed legislation.

Caution! The status of this legislation is fluid. It is not possible to predict with precision what changes will be included in any *"final"* tax bill, when it will be passed, or even whether final tax reform legislation will be passed at all. Moreover, many of the changes that are currently being discussed could be modified or even dropped altogether in the final legislation. **Planning Alert!** We are ***closely monitoring this proposed tax legislation. Feel free to call our firm for a status report.***

Notwithstanding the uncertainty of tax reform, this letter outlines certain traditional year-end tax planning strategies we think you should consider. Traditional year-end tax planning strategies include deferring *"income"* to a later year and accelerating *"deductions"* into the current year. If tax reform legislation passes this year, these strategies may prove even more beneficial than expected. For example, the proposed legislation calls for a reduction in tax rates. If tax rate reduction is enacted and becomes effective in 2018, there will likely be many more individuals in higher tax brackets in 2017 as compared to 2018. Therefore, it is possible that deferring income into 2018 may benefit a larger number of individuals than otherwise expected. Moreover, if tax reform eliminates or limits current deductions starting in 2018, accelerating those deductions into 2017 may preserve a deduction that might otherwise be lost altogether.

Planning Alert! Due to the uncertainty of tax reform, we believe the best approach is to delay the implementation of tax-savings strategies as long as possible - but be ***prepared to act quickly near the end of 2017!***

Be Careful! Tax planning strategies suggested in this letter may subject you to the alternative minimum tax (AMT). For example, many deductions are not allowed for AMT purposes, such as: personal exemptions, the standard deduction, state and local income taxes, and real estate taxes. Therefore, ***we suggest that you call our firm before implementing any tax planning technique discussed in this letter.*** You cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the AMT and any state income tax) with and without that strategy. **Please Note!** This letter contains ideas for Federal income tax planning only. ***State income tax issues are not addressed.***

PROPOSED TAX REFORM LEGISLATION RELEASED NOVEMBER 2, 2017 – GENERAL OVERVIEW

As noted in the Introduction, on ***November 2, 2017,*** the House Ways and Means Committee released its initial proposed tax reform bill entitled **"The Tax Cuts And Jobs Act of 2017"** (the ***"Act"***). As this proposed legislation works its way through Congress, new proposals will likely be added and certain current proposals will be modified or even eliminated altogether. Moreover, it is still up in the air whether and when this promised tax reform legislation will be enacted. However, this initial bill provides us with the most detailed guidance to date regarding the types of tax changes Congress and President Trump will be debating. **Caution!** Over the upcoming weeks, there will likely be reports of proposed tax changes that we do not discuss below. However, we closely monitor major proposed tax legislation in Congress, so feel free to call our firm if you have questions about proposals not discussed below or you simply need a status report.

The ***Act*** contains over 400 pages of detailed legislative proposals. It is well beyond the scope of this letter to provide a detailed discussion of this mammoth bill. Therefore, we highlight below only selected provisions in the ***Act*** that we believe, if enacted, could have a significant impact on ***"Individual"*** taxpayers.

Unless stated otherwise, the proposals listed below *would not be effective until 2018*!

Lower Tax Rates. The *Act* would generally reduce the current seven individual tax-rate brackets to four (12%, 25%, 35%, and 39.6%). The lowest 12% rate would apply to the first $90,000 of taxable income for joint filers ($45,000 for singles), and the top 39.6% rate would apply to taxable income exceeding $1,000,000 for joint filers (exceeding $500,000 for singles). The tax rate on long-term capital gains (and presumably qualified dividends) would generally be consistent with current law.

Increased Standard Deduction And The Elimination Of Personal And Dependancy Exemptions. The *Act* would eliminate the personal and dependancy exemptions altogether, and replace them with a larger standard deduction ($24,400 for joint filers; $18,300 for unmarried individuals with a qualifying child; and $12,200 for singles).

Targeted Family Tax Credits. The *Act* would increase the child credit to $1,600 (up from the current $1,000) per qualifying child, and create a new $300 credit for each individual and each dependent of that individual (other than a qualifying child).

Repeal Of Certain Deductions And Credits. The *Act* would repeal the following deductions: State and local ***"income"*** taxes; Personal casualty losses; Alimony; Medical expenses; Moving expenses; and, several others. The Act would also repeal several individual tax credits, including the *"Adoption Credit"* and the credit for *"Plug-in Electric"* cars.

Certain Deductions Would Be Retained. The *Act* would generally retain deductions for: Home mortgage interest (However, it would lower loan amounts and make other changes for loans after November 2, 2017); State and local ***"property"*** taxes (up to $10,000); and, Charitable contributions.

Education Tax Relief Provisions. The *Act* would repeal many of the tax breaks for education costs, including: Student loan interest deduction; Life-Time Learning Credit; Deduction (up to $4,000) for qualified tuition; and several others. However, the *Act* would retain and expand: the *"American Opportunity Tax Credit,"* and tax-favored 529 College-Savings Plans.

Exclusions For Home-Sale Gains. Effective for ***sales or exchanges after 2017,*** the *Act* would make the following changes to the home-sale gain exclusion rules: **1)** Require an individual to own and use a home as the individual's principal residence for ***5 out of the previous 8 years*** (instead of 2 out of the previous 5 years) to qualify for the up to $500,000 or $250,000 home-sale exclusion, **2)** Allow the taxpayer to use the home-sale exclusion ***only once every five years*** (instead of once every two years as under current law), and

3) ***Reduce the exclusion for*** each dollar of an individual's ***average AGI*** (average of the current and prior two years) ***in excess of $500,000*** ($250,000 for single filers).

Elimination Of The Alternative Minimum Tax And Estate Tax. The Act would repeal the *"Alternative Minimum Tax"* (AMT) after 2017. It would also repeal the *Estate Tax* for ***individuals dying after 2023.*** The Gift Tax would be retained.

Caution! We have highlighted only *selected* tax changes contained in the *Act* that would impact individuals, there are many more changes in this mammoth tax bill! If you have heard about other proposed tax changes not discussed above, and you need more information, please call our office.

LEGISLATIVE AND ADMINISTRATIVE TAX RELIEF FOR HURRICANE VICTIMS

On September 29, 2017, President Trump signed the ***"Disaster Tax Relief and Airport and Airway Extension Act of 2017"*** (*"Disaster Relief Act"*) providing tax relief for victims of Hurricanes Harvey, Irma, and Maria. The IRS has also released a series *of* ***Announcements*** providing additional administrative relief for taxpayers impacted by the hurricanes. The relief generally applies to individuals and businesses located in Florida, Georgia, certain counties in Texas, certain counties in South Carolina, certain parishes in Louisiana, parts of Puerto Rico, and the Virgin Islands. In some situations, taxpayers not located in those disaster areas may qualify for relief (e.g., Where business records are located in the designated disaster areas or where taxpayers own an interest in an S corporation or partnership with primary business operations in the designated disaster areas).

Tax relief under the *Disaster Relief Act* generally includes: Larger deductions for personal casualty losses; Expanded options to take tax-favored withdrawals or loans from retirement plans; Option of using current or prior year's income for purposes of claiming the earned income and child tax credits; and Increased limitation on charitable contribution deductions for individuals making qualifying charitable contributions for hurricane disaster relief.

IRS administrative relief includes automatic extensions of various IRS deadlines. ***For example,*** the IRS has extended ***until January 31, 2018*** the deadlines for filing the following returns: Individual, corporate, and estate and trust income tax returns that were ***otherwise due*****: 1)** On or after ***August 23, 2017*** for ***qualifying Texas taxpayers*****, 2)** On or after **August 27, 2017 for qualifying Louisiana taxpayers, 3)** On or after ***September 4, 2017 for Florida taxpayers,*** **4)** On or after ***September 6, 2017 for qualifying South Carolina taxpayers,*** and **5)** On or after ***September 7, 2017 for Georgia taxpayers*****.** **Caution!** This automatic extension generally applies to ***individual filers*** with ***extensions of time to file until October 16, 2017*****,** and to ***business returns*** with ***extensions until September 15, 2017.***

TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

POSTPONING TAXABLE INCOME MAY SAVE TAXES

Deferring taxable income from 2017 to 2018 may reduce your income taxes if your effective income tax rate for 2018 will be lower than your effective income tax rate for 2017. For example, the deferral of income could cause your 2017 taxable income to fall below the thresholds for the highest 39.6% tax bracket (i.e., $470,700 for joint returns; $418,400 if single). In addition, if you have income subject to the 3.8% Net Investment Income Tax (3.8% NIIT) and the income deferral reduces your 2017 modified adjusted gross income (MAGI) below the thresholds for the 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single), you may avoid this additional 3.8% tax on your investment income. **Planning Alert!** If tax reform is enacted and the tax rates for 2018 are reduced, deferring income beyond 2017 could generate even larger tax benefits than expected under the current tax rules.

If, after considering all factors, you believe that deferring taxable income into 2018 will save you taxes, consider the following strategies:

Deferring Self-Employment Income. If you are a self-employed individual using the cash method of accounting, consider delaying year-end billings to defer income until 2018. **Planning Alert!** If you have already received the check in 2017, deferring the deposit of the check does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

Using Installment Sales To Defer Taxable Gain. If you plan to sell certain appreciated property in 2017, you might be able to defer the gain until later years by taking back a promissory note instead of cash. By taking a promissory note, you may qualify for the *"installment method"* which allows you to pay tax on the gain only as you collect payments on the note. Qualifying for the *installment method* not only defers the time you must pay the tax on the gain, but could also defer all or a portion of the gain into later years when your expected tax rate is less than your 2017 tax rate. For example, spreading the gain over several years could reduce the seller's income tax in the year of sale (and possibly subsequent years) by reducing the tax rates on long-term capital gains below the top 20% capital gains rate. This could also prevent the seller's income from exceeding the thresholds for the 3.8% NIIT (discussed in more detail below). **Caution!** You may not want to take back a promissory note in lieu of cash if you believe this reduces your chances of getting paid.

Postponing Cancellation Of Debt Income. If you negotiate or arrange a reduction or cancellation of a debt you owe to others, unless you meet certain exceptions, you will generally have to report *"cancellation of debt"* (COD) income. For example, you could have COD income where: Your creditor, such as a credit card company, agrees to accept as full payment an amount which is less than the amount you owe; You own real estate subject to a mortgage and the lender forecloses on the property (or, you enter into a short sale of the mortgaged property); You own an interest in a partnership (or LLC) or "S" corporation and the partnership or S corporation has COD income. **Planning Alert!** If you are in the process of negotiating an agreement with your creditors that involves a debt reduction that would trigger COD income, consider postponing the action ***until after 2017*** to defer any debt cancellation income into 2018.

Planning For Required Distributions From IRAs. Generally, once you reach age 70½, you are required to begin taking "*Required Minimum Distributions*" (RMDs) from your IRA or qualified retirement plan account. A 50% penalty applies to the excess of the *"Required Minimum Distribution"* (RMD) over the amount actually distributed. You might wish to consider the following ideas concerning RMDs which might save you money.

- **IRA Owners Who Attain Age 70½ During 2017.** If you reached age 70½ at any time during 2017, you must begin distributions from a traditional IRA account ***no later than April 1st of 2018.*** In addition, if you wait until 2018 to take your first payment, you will still be required to take your second RMD no later than December 31, 2018, which will cause you to *"bunch"* two payments into 2018. This *"bunching"* of the first two annual payments into one tax year (2018) could cause you to pay higher overall taxes if the bunching puts you in a higher tax bracket for 2018 than for 2017. However, if you expect your 2018 tax rate on the "bunched" payments to be lower than your tax rate on the first payment, if made in 2017, it could save you overall taxes to "bunch" the 2017 and 2018 RMDs into 2018.

- **Individuals Making Charitable Contributions Who Are Age 70½ Or Older.** If you have reached ***age 70½*** and you are planning to make charitable contributions before the end of 2017, there is a special tax break that could apply to you. If you ***have reached age 70½,*** you may have your IRA trustee write a check, ***up to $100,000,*** from ***your IRA directly to a qualified charity*** and ***exclude the IRA contribution to the charity from income.*** The IRA trustee's contribution to the charity also counts toward your "*Required Minimum Distributions"* (RMDs) for the year. This tax break effectively allows you to exclude all or a portion of your otherwise taxable RMDs from taxable income.

This, in turn: **1)** Could cause your 2017 modified adjusted gross income (MAGI) to stay below the thresholds for the 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single), that might otherwise be imposed on your investment income (e.g., dividends, interest, capital gains), and **2)** Could also increase various credits and deductions for 2017 that would otherwise be phased out as your *adjusted gross income* increases. **Tax Tip.** To qualify, the check from your IRA must be made out *"directly"* to your designated charity. In addition, if the ***contribution is $250 or more***, you must get a ***timely, qualifying receipt*** from the charity for the charitable contribution. **Planning Alert!** To take advantage of this exclusion for 2017, the **trustee** of your IRA ***must write the check to the charity by December 31, 2017.*** It may take the IRA custodian several days to complete all the necessary paper work to write the check. Consequently, you should alert the trustee that you want the check written to the charity ***well before December 31, 2017.***

Individuals Who Inherit IRAs And Qualified Retirement Plan Accounts May Defer Income By Delaying Distributions. If you are the beneficiary of an IRA or qualified plan account of someone who has died, you should consider the following options for deferring your RMDs (and thus postponing taxable income):

- **Planning For IRA Distributions After The Owner's Death.** If you are the beneficiary of an IRA or qualified plan account of someone that has died in 2017, there are certain time-sensitive planning techniques you should consider without delay. For example, if the decedent named multiple individual beneficiaries or included an estate or charity as a beneficiary, we may be able to rearrange the IRA beneficiaries for maximum tax deferral. The rules for rearranging IRA beneficiaries after the owner dies are tricky, and acting before certain deadlines pass is critical. ***If the owner died in 2017***, the best tax results can generally be achieved by making any necessary changes ***no later than December 31, 2017.*** If you need our assistance, we should review your situation as soon as possible.

- **Rollovers By Surviving Spouses.** If your spouse passed away during 2017 and named you beneficiary of an IRA or qualified plan account, there are certain things you should consider if you want to maximize tax deferral. For example, if your spouse was ***over age 70½*** and died ***during 2017,*** and you are ***over 59½***, you should consider rolling the deceased spouse's qualified plan or IRA amount into your name (as surviving spouse) ***on or before December 31, 2017.*** If you complete this rollover ***before 2018,*** then: **1)** If you are ***under age 70½***, you will not be required to take any *Required Minimum Distributions* (RMDs) until the tax year you reach age 70½, *or*
  2) If you ***are at least 70½***, your RMD for 2018 (and for future years) will be determined using the *Uniform Lifetime Distribution Table* that results in a smaller annual required payout. Therefore, ***converting the account into your name*** (as surviving spouse) on or ***before December 31, 2017,*** could substantially reduce the amount of your RMD for 2018 where the decedent was at least 70½. **Planning Alert!** If you (as surviving spouse) are not yet 59½, leaving the IRA or qualified plan account in the name of your deceased spouse may be the best option if you think that you will need to withdraw amounts from the retirement account before you reach age 59½. If your deceased spouse's account is transferred into your name and you take a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty.

TAKING ADVANTAGE OF DEDUCTIONS

If new tax legislation is enacted and reduces individual tax rates after 2017 as proposed, individuals would likely be subject to higher tax rates in 2017 than for 2018. Thus, accelerating deductions into 2017 may generate an even greater tax benefit than expected. **Planning Alert!** The tax reform proposals currently working their way through Congress would, if enacted, eliminate or place new limits on deductions after 2017 (e.g., proposals to eliminate or restrict the deduction for state and local taxes and medical expenses). Therefore, depending on future legislation, paying for a deductible item in 2017, rather than waiting until 2018, could have the added benefit of preserving a deduction that might not otherwise be available in 2018. If you think that you would benefit from accelerating 2018 deductions into 2017, you should consider the following:

<u>"Above-The-Line" Deductions Can Generate Multiple Tax Benefits.</u> So-called ***"above-the-line"*** deductions reduce both your "*adjusted gross income"* (AGI) and your *"modified adjusted gross income*" (MAGI), while ***"itemized"*** deductions (i.e., below-the-line deductions) do ***not*** reduce either AGI or MAGI. Deductions that reduce your AGI (or MAGI) can generate multiple tax benefits by: **1)** Reducing your taxable income and allowing you to be taxed in a lower tax bracket; **2)** Potentially freeing up other deductions (and tax credits) that phase out as your AGI (or MAGI) increases (e.g., itemized deductions, personal exemptions, IRA contributions, education credits, adoption credit, etc.); **3)** Potentially reducing your MAGI below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8 % NIIT only applies if MAGI exceeds $250,000 if married filing jointly; $200,000 if single); or **4)** Potentially reducing your household income to a level that allows you to qualify for a "refundable" Premium Tax Credit for health insurance purchased on a government Exchange.

If you think that you could benefit from accelerating ***"above-the-line"*** deductions into 2017, consider the following:

- **<u>Identifying "Above-The-Line" Deductions.</u>** ***"Above-the-line"*** deductions include deductions for IRA or Health Savings Account (HSA) contributions, health insurance premiums for self-employed individuals, qualified student loan interest, qualified moving expenses, qualifying alimony payments, and business expenses for a self-employed individual. **<u>Tax Tip.</u>** Unreimbursed *"employee"* business expenses are classified as *"miscellaneous itemized deductions"* and trigger two potential limitations: **1)** In the aggregate, these deductions are allowed only to the extent ***they exceed 2%*** of your AGI, and **2)** Any excess over the 2% threshold is included in *"itemized deductions"* and is subject to the 3% of AGI subtraction. However, if you arrange for your employer to reimburse you for your *"qualified"* employee business expenses under an ***"accountable reimbursement plan,"*** the reimbursement is excluded from your income (which essentially generates the equivalent of an *"above-the-line"* deduction). **Note!** We can help you establish a qualifying *accountable reimbursement plan* with your employer.

- **<u>Accelerating "Above-The-Line" Deductions.</u>** As a cash method taxpayer, you can generally accelerate a 2018 deduction into 2017 by *"paying"* it in 2017. *"Payment"* typically occurs in 2017 if a check is delivered to the post office, if your electronic payment is debited to your account, or if an item is charged on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express) in 2017. **Caution!** If you post-date the check to 2018 or if your check is rejected, no payment has been made in 2017. **<u>Planning Alert!</u>** The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payment are not deductible in 2017.

<u>Accelerating "Itemized" Deductions Into 2017.</u> As mentioned above, although ***"itemized"*** deductions (i.e., *below-the-line* deductions) do ***not*** reduce your AGI or MAGI, they still may provide valuable tax savings. Many of your *itemized deductions* are reduced in the aggregate once your AGI exceeds certain thresholds (e.g., for 2017 – $313,800 for joint returns; $261,500 if single). ***Itemized deductions*** generally include charitable contributions, state and local income taxes (or, alternatively state and local sales taxes), property taxes, medical expenses, unreimbursed employee travel expenses, home mortgage interest, and gambling losses (to the extent of gambling income). However, if your itemized deductions fail to exceed your *Standard Deduction* in most years, you are not receiving maximum benefit for your itemized deductions. You could possibly reduce your taxes over the long term by bunching the payment of your itemized deductions in alternate tax years. This may produce tax savings by allowing you to itemize deductions in the years when your expenses are bunched, and use the *Standard Deduction* in other years. **<u>Tax Tip.</u>** The easiest deductions to shift from 2018 to 2017 are *charitable contributions*, *state and local taxes*, and your January, 2018 home *mortgage interest payment*. For 2017, the standard deduction is $12,700 on a joint return and $6,350 for single individuals. If you are blind or age 65, you get an additional standard deduction of $1,250 if you're married ($1,550 if single).

- **<u>Pending Tax Reform Proposals Could Enhance The Benefits Of Accelerating Itemized Deductions Into 2017!</u>** As previously discussed, current tax reform proposals call for a significant increase in the *"Standard Deduction."* If this larger standard deduction is enacted and is effective in 2018, individuals who would itemize deductions for 2018 under current law, instead, may use the standard deduction for 2018. This would result in a loss of any benefit for items qualifying as an itemized deduction under current law that are paid in 2018. Therefore, if the increased standard deduction is enacted and is effective for 2018, these individuals could benefit by paying expenses qualifying as an itemized deduction before the end of 2017. Moreover, since the tax reform proposals would, if enacted, eliminate or place new limits on current itemized deductions (e.g., eliminate or restrict the deduction for state and local taxes and medical expenses), accelerating those deductions into 2017 could also have the benefit of preserving a deduction that might otherwise be lost in 2018.

<u>Pay Careful Attention To The Payment Of Your State And Local Income Taxes.</u> If you anticipate deducting your state and local income taxes, consider paying them (fourth quarter estimate and balance due for 2017) and any property taxes for 2017 ***prior to January 1, 2018*** if your tax rate for 2017 is higher than or the same as your projected 2018 tax rate. This will provide a deduction for 2017 (a year early) and possibly against income taxed at a higher rate. **<u>Planning Alert!</u>** Current tax reform proposals include the possibility of eliminating or limiting the itemized deduction for state and local taxes. Moreover, under current rules, state and local income and property taxes are not deductible for AMT purposes. Therefore, if you are subject to AMT for 2017, you will generally receive no benefit for these deductions. **<u>Caution!</u>** ***Please consult us before you overpay state or local income taxes!***

<u>Pending Tax Proposals That Could Impact Planning for AMT.</u> As mentioned above, certain itemized deductions are not allowed in computing your *"Alternative Minimum Tax"* (AMT), such as state and local taxes (including state income taxes) and unreimbursed employee business expenses. Congress is currently considering tax reform proposals that, if enacted, could eliminate the *"Alternative Minimum Tax"* (AMT) after 2017. Consequently, if the repeal of AMT is enacted and becomes effective in 2018, and the current deductions that are not allowed to reduce AMT in 2017 remain deductible for regular tax purposes in 2018, it could be to your advantage to delay payment of these items until 2018.

<u>TAX PLANNING FOR INVESTMENT INCOME (INCLUDING CAPITAL GAINS AND THE 3.8% NIIT)</u>

<u>Planning With The 3.8% Net Investment Income Tax (3.8% NIIT).</u> The ***Affordable Care Act*** (*ACA*) provides for a ***3.8% Net Investment Income Tax (3.8% NIIT)*** on the *net investment income* of higher-income individuals. This tax applies to individuals with modified adjusted gross income (MAGI) exceeding the following ***"thresholds"*: *$250,000*** for ***married filing jointly; $200,000*** if ***single;*** and ***$125,000*** if ***married filing separately.*** The 3.8% NIIT is imposed upon ***the <u>lesser of</u>*** an individual's: **1)** Modified adjusted gross income (MAGI) in excess of the ***threshold,*** or **2)** Net investment income. ***Trusts and estates*** are also subject to the ***3.8% NIIT*** on the ***lesser of*: 1)** The adjusted gross income of the trust or estate in excess of $12,500 (for 2017), or **2)** The undistributed net investment income of the trust or estate.

The 3.8% NIIT not only applies to traditional types of investment income (i.e., interest, dividends, annuities, royalties, and capital gains), it also applies to "business" income that is taxed to a "passive" owner (as discussed in more detail below) unless the "passive" income is subject to S/E taxes. If you believe that the 3.8% NIIT may apply to you, consider the following planning techniques:

- **<u>Roth IRAs (Including Roth IRA Conversions).</u>** Tax-free distributions from a Roth IRA are exempt from the 3.8% NIIT, and do not increase your MAGI (and, thus will not increase your exposure to the 3.8% tax).

Therefore, these tax-favored features should be factored into any analysis of whether you should contribute to a Roth IRA. However, if you are considering converting a traditional IRA into a Roth, the income triggered in the year of conversion would increase your MAGI and, therefore, may increase your exposure to the 3.8% NIIT on your *net investment income* (e.g., dividends, interest, capital gains). **Planning Alert!** If you want a Roth conversion to be ***effective for 2017,*** you must transfer the amount from the regular IRA to the Roth IRA ***no later than December 31, 2017*** (you do not have until the due date of your 2017 tax return). **Caution!** Whether you should convert your traditional IRA to a Roth IRA can be an exceedingly complicated issue, and the 3.8% NIIT is just one of many factors that you should consider. ***Please call our firm*** if you need help in deciding whether to convert to a Roth IRA.

- **"Passive" Income.** *"Net Investment Income*" for purposes of the 3.8% NIIT generally includes net income from a business activity if you are a *"passive"* owner (unless the income constitutes *self-employment* income that is subject to the 2.9% Medicare tax). You will generally be deemed a *"passive"* owner if you do not *"materially participate"* in the business as determined under the traditional *"passive activity loss"* rules. For example, under the *passive activity loss* rules, you may be a *"passive"* owner unless you spend more than 500 hours working in the business during the year or meet one of the other "material participation" tests. Furthermore, *rental income* is generally deemed to be "passive" income under the *passive activity loss* rules, regardless of how many hours you work in the rental activity. **Tax Tip.** In certain situations, real estate rentals may not be treated as "passive" income and could also be exempt from the 3.8% NIIT. For example, if you are a "qualified real estate professional," or you lease property to a business in which you "materially participate," the rental income may be exempt from the 3.8% NIIT. If you believe you may qualify for one of these rental real estate exemptions, or you otherwise believe you may have "passive" income from non-rental business activities, please contact our firm. We will gladly evaluate your situation to determine whether there are steps you could take before the end of 2017 to avoid "passive" income classification, and thus, reduce your exposure to the 3.8% NIIT.

Traditional Year-End Planning With Capital Gains And Losses. Generally, net capital gains (both short- term and long-term) are potentially subject to the 3.8% NIIT. This could result in an individual who is otherwise taxed at 39.6% on ordinary income paying tax on his or her ***net long-term capital gains*** at a ***23.8%*** rate (i.e., the maximum capital gains tax rate of 20% plus the 3.8% NIIT). In addition, this individual's ***net short-term capital gains*** could be taxed as high as ***43.4%*** (i.e., 39.6% plus 3.8%). Consequently, traditional planning strategies involving the timing of your year-end sales of stocks, bonds, or other securities are more important than ever. The following are time-tested, year-end tax planning ideas for sales of capital assets. **Planning Alert!** Always consider the ***economics of a sale or exchange first!***

- **Planning With Zero Percent Tax Rate For Capital Gains And Dividends.** Long-term capital gains and qualified dividends that would be taxed (if ordinary income) in the 15% or lower ordinary income tax bracket, are taxed at a zero percent rate. For 2017, taxable income up to $75,900 for joint returns ($37,950 if single) is taxed at the 15% rate, or below. **Tax Tip.** Taxpayers who have historically been in higher tax brackets but now find themselves between jobs, recently retired, or expecting to report higher-than-normal business deductions in 2017, may temporarily have income low enough to take advantage of the zero percent rate for 2017. If you are experiencing any of these situations, please call our firm and we will help you determine whether you can take advantage of this zero percent tax rate for long-term capital gains and qualified dividends.

- **Lower-Income Retirees.** The zero percent rate for long-term capital gains and qualified dividends is particularly important to lower-income retirees who rely largely on investment portfolios that generate dividends and long-term capital gains. Furthermore, gifts of appreciated securities to lower-income individuals who then sell the securities could reduce the tax on all or part of the gain from as high as 23.8% to as low as zero percent. **Caution!** If the lower-income individual is subject to the so-called *kiddie tax*, this planning technique will generally not work.

- **<u>Timing Your Capital Gains And Losses.</u>** If the value of some of your investments is less than your cost, it may be a good time to harvest some capital losses. For example, if you have already recognized capital gains in 2017, you should consider selling securities ***prior to January 1, 2018*** that would trigger a capital loss. These losses will be deductible on your 2017 return to the extent of your recognized capital gains, plus $3,000. **<u>Tax Tip.</u>** These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as the: $2,500 American Opportunity Tax Credit, $1,000 Child Credit, $13,570 Adoption Credit, etc. **<u>Planning Alert!</u>** If, within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the "wash sale" rules (although the disallowed loss will increase the basis of the acquired stock). **<u>Tax Tip.</u>** If you are afraid of missing an upswing in the market during this 60-day period, consider buying shares of a different company in the same sector. Also, there is *no* wash sale rule for *gains*. Thus, if you decide to sell stock at a gain in order to take advantage of a zero capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

<u>FINAL COMMENTS</u>

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this material should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

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