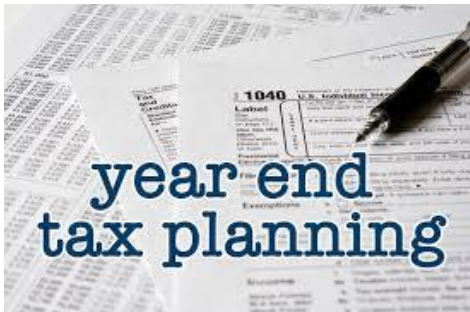
OEHLKE CPA, PLLC

2017 Year End Tax Planning Newsletter

TAX STRATEGIES THAT WILL CUT YOUR TAX BILL!

- Year end tax planning is always a good idea. Keep reading to find out which tax planning strategies you should use now to cut your tax bill.
- Tax rules regarding charitable contributions can be complex. Here's what you need to know.
- Pre-tax contribution details and limits that will help lower your taxable income.



GENERAL TAX PLANNING TIPS

General tax planning strategies for individuals this year include postponing income and accelerating deductions, as well as careful consideration of timing related investments, charitable gifts, and retirement planning. For example, taxpayers might consider using one or more of the following:

- Selling any investments on which you have a gain or loss this year.
- If you anticipate an increase in taxable income this year (2017) and are expecting a bonus at year-end, try to get it before December 31. Keep in mind, however, that contractual bonuses are different, in that they are typically not paid out until the first quarter of the following year. Therefore, any taxes owed on a contractual bonus would not be due until you file your 2018 tax return in 2019. Don't hesitate to call the office if you have any questions about this.
- Prepaying deductible expenses such as charitable contributions and medical expenses this year using a credit card. This strategy works because deductions may be taken based on when the expense was charged on the credit card, not when the bill was paid. Exercising this option is often but not always a taxable event; sale of the stock is almost always a taxable event.
- If your company grants stock options, you may want to exercise the option or sell stock acquired by exercise of an option this year if you think your tax bracket will be higher in 2018.
- If you're self-employed, send invoices or bills to clients or customers this year to be paid in full by the end of December.

"The hardest thing to understand in the world is the income tax." – Albert Einstein

CHARITABLE CONTRIBUTIONS

Property, as well as money, can be donated to a charity. You can generally take a deduction for the fair market value of the property. While you can also donate your services to charity, you may not deduct the value of these services. A donor may not claim a deduction for any contribution of cash, a check or other monetary gift unless the donor maintains a record of the contribution in the form of either a bank record (such as a cancelled check) or written communication from the charity (such as a receipt or a letter) showing the name of the charity, the date of the contribution, and the amount of the contribution.

Give the gift of cash. You can give a gift up to $14,000 to any one person free of gift tax. If you're married, you each can give a person up to $14,000 tax free — $28,000 in total. In most cases, the gift isn't complete until the recipient of a check cashes or deposits it. So, confirm the recipient does this by the end of the year.

Donate your RMD Tax-Free to Charity. A donation counts as your required minimum distribution, but doesn't increase your adjusted gross income. In the past, Congress generally waited until December every year to extend the law that allows people to make a tax-free donation of up to $100,000 from their IRA, leaving some to scramble to make the contribution before the RMD deadline. But Congress made the law permanent last year, so if you're 70½ or older, you can transfer your 2016 RMD to charity at any time. The donation counts as your required minimum distribution but doesn't increase your adjusted gross income, which can be particularly helpful if you don't itemize and can't deduct charitable contributions. Also, keeping some or all of your RMD out of your adjusted gross income could help you avoid the Medicare high-income surcharge or help make less of your Social Security benefits taxable. (You can't double-dip tax breaks and deduct the charitable contribution if you make the tax-free transfer to charity).

The money needs to be transferred directly from the IRA to the charity in order to be tax-free. If you withdraw it from the IRA first and then give it to the charity, you can deduct the gift as a charitable contribution (if you itemize), but the withdrawal will be included in your adjusted gross income.

Because the law is now permanent, IRA administrators are starting to simplify the process. Fidelity, for example, plans to introduce a new form in the next few weeks that makes it easy to transfer the money and make your wishes clear to the charity. You may also have the option of signing up for check-writing privileges from your IRA so that you can write the check directly from your account to the charity. That way, the charity will see who the contribution is from, and you can include specific directions as to which fund within the charity you'd like to support. Otherwise, the IRA administrator will cut a check and send it directly to the charity, but the charity won't necessarily be given clear information about whose account it is from or what the money is meant to support, says Jane Wilton, general counsel for the New York Community Trust.

If your IRA administrator doesn't offer check writing and instead transfers the money directly to the charity, Wilton recommends calling the charity in advance and giving them a heads up that it will be getting a check from your IRA. In addition to knowing who the donation is from, the charity can get your contact information to send you an acknowledgement for your tax records, and you can give the charity special instructions about which fund or program you're supporting. (Keep in mind that you can make the tax-free transfer from the IRA to a charity but not to a donor-advised fund).

REDUCE TAXABLE INCOME THROUGH PRE-TAX CONTRIBUTIONS

One of the best ways to reduce taxable income is through pre-tax contributions to a company retirement plan, self-employed retirement account or IRA. Traditional contribution limits are as follows for 2017 and 2018.

Plan Type	**Contribution Limits * 2017**	**Contribution Limits * 2018**
401(k)2, 403(b), TSP Elective Deferrals	$18,000	$18,500
Age 50+ Catch-up	$6,000	$6,000
Solo 401(k) & SEP IRA Plans	$54,000	$55,000
Simple Elective Deferrals	$12,500	$12,500
Age 50+ Catch-up	$3,000	$3,000
Traditional & ROTH IRAs **	$5,500	$5,500
Age 50+ Catch-up	$1,000	$1,000

** Income limitations apply.*
*** Contributions to Roth accounts don't reduce current year taxable income, but all future earnings and withdrawals are exempt from further taxation.*

ACCELERATING INCOME & DEDUCTIONS

Accelerating income into 2017 is an especially good idea for taxpayers who anticipate being in a higher tax bracket next year or whose earnings are close to threshold amounts ($200,000 for single filers and $250,000 for married filing jointly) that make them liable for additional Medicare Tax or Net Investment Income Tax (see below).

In cases where tax benefits are phased out over a certain adjusted gross income (AGI) amount, a strategy of accelerating income and deductions might allow you to claim larger deductions, credits, and other tax breaks for 2017, depending on your situation.

The latter benefits include Roth IRA contributions, conversions of regular IRAs to Roth IRAs, child tax credits, higher education tax credits and deductions for student loan interest.

Here are several examples of what a taxpayer might do to accelerate deductions:

- Pay a state estimated tax installment in December instead of at the January due date. However, make sure the payment is based on a reasonable estimate of your state tax.
- Pay your entire property tax bill, including installments due in year 2018, by year-end. This does not apply to mortgage escrow accounts.
- It may be beneficial to pay 2018 tuition in 2017 to take full advantage of the American Opportunity Tax Credit, an above-the-line deduction worth up to $2,500 per student to cover the cost of tuition, fees and course materials paid during the taxable year. Forty percent of the credit (up to $1,000) is refundable, which means you can get it even if you owe no tax.
- Try to bunch "threshold" expenses, such as medical expenses and miscellaneous itemized deductions. For example, you might pay medical bills and dues and subscriptions in whichever year they would do you the most tax good.

  Threshold expenses are deductible only to the extent they exceed a certain percentage of adjusted gross income (AGI). For example, to deduct medical and dental expenses these amounts must exceed 10 percent of AGI. By bunching these expenses into one year, rather than spreading them out over two years, you have a better chance of exceeding the thresholds, thereby maximizing your deduction.

ADDITIONAL MEDICARE TAX

Taxpayers whose income exceeds certain threshold amounts ($200,000 single filers and $250,000 married filing jointly) are liable for an additional Medicare tax of 0.9 percent on their tax returns, but may request that their employers withhold additional income tax from their pay to be applied against their tax liability when filing their 2017 tax return next April.

High net worth individuals should consider contributing to Roth IRAs and 401(k) because distributions are not subject to the Medicare Tax.

If you're a taxpayer close to the threshold for the Medicare Tax, it might make sense to switch Roth retirement contributions to a traditional IRA plan, thereby avoiding the 3.8 percent Net Investment Income Tax (NIIT) as well (more about the NIIT below).

ALTERNATIVE MINIMUM TAX

The Alternative Minimum Tax (AMT) exemption "patch," which was made permanent by the American Taxpayer Relief Act (ATRA) of 2012, is indexed for inflation and it's important not to overlook the effect of any year-end planning moves on the AMT for 2017 and 2018.

Items that may affect AMT include deductions for state property taxes and state income taxes, miscellaneous itemized deductions, and personal exemptions. Please call if you're not sure whether AMT applies to you.

Note: AMT exemption amounts for 2017 are as follows:

- $54,300 for single and head of household filers,
- $84,500 for married people filing jointly and for qualifying widows or widowers,
- $42,250 for married people filing separately.

INVESTMENT GAINS & LOSSES

This year, and in the coming years, investment decisions are likely to be more about managing capital gains than about minimizing taxes per se. For example, taxpayers below threshold amounts in 2017 might want to take gains; whereas taxpayers above threshold amounts might want to take losses.

If your tax bracket is either 10 or 15 percent (married couples making less than $75,900 or single filers making less than $37,950), then you might want to take advantage of the zero percent tax rate on qualified dividends and long-term capital gains. If you fall into the highest tax bracket (39.6 percent), the maximum tax rate on long-term capital gains is capped at 20 percent for tax years starting in 2013.

Minimize taxes on investments by judicious matching of gains and losses. Where appropriate, try to avoid short-term capital gains, which are usually taxed at a much higher tax rate than long-term gains--up to 39.6 percent in 2017 for high-income earners ($418,400 single filers, $470,700 married filing jointly).

Where feasible, reduce all capital gains and generate short-term capital losses up to $3,000. As a general rule, if you have a large capital gain this year, consider selling an investment on which you have an accumulated loss. Capital losses up to the amount of your capital gains plus $3,000 per year ($1,500 if married filing separately) can be claimed as a deduction against income.

Wash Sale Rule. After selling a securities investment to generate a capital loss, you can repurchase it after 30 days. This is known as the "Wash Rule Sale." If you buy it back within 30 days, the loss will be disallowed. Or you can immediately repurchase a similar (but not the same) investment, e.g., and ETF or another mutual fund with the same objectives as the one you sold.

Net Investment Income Tax (NIIT)

The Net Investment Income Tax, which went into effect in 2013, is a 3.8 percent tax that is applied to investment income such as long-term capital gains for earners above certain threshold amounts ($200,000 for single filers and $250,000 for married taxpayers filing jointly). Short-term capital gains are subject to ordinary income tax rates as well as the 3.8 percent NIIT. This information is something to think about as you plan your long-term investments. Business income is not considered subject to the NIIT provided the individual business owner materially participates in the business. Please call if you need assistance with any of your long term tax planning goals.

MUTUAL FUND INVESTMENTS

Before investing in a mutual fund, ask whether a dividend is paid at the end of the year or whether a dividend will be paid early in the next year but be deemed paid this year. The year-end dividend could make a substantial difference in the tax you pay.

> **Example:** You invest $20,000 in a mutual fund in 2017. You opt for automatic reinvestment of dividends, and in late December of 2017, the fund pays a $1,000 dividend on the shares you bought. The $1,000 is automatically reinvested.
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> **Result:** You must pay tax on the $1,000 dividend. You will have to take funds from another source to pay that tax because of the automatic reinvestment feature. The mutual fund's long-term capital gains pass through to you as capital gains dividends taxed at long-term rates, however long or short your holding period.
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> The mutual fund's distributions to you of dividends it receives generally qualify for the same tax relief as long-term capital gains. If the mutual fund passes through its short-term capital gains, these will be reported to you as "ordinary dividends" that don't qualify for relief.

Depending on your financial circumstances, it may or may not be a good idea to buy shares right before the fund goes ex-dividend. For instance, the distribution could be relatively small, with only minor tax consequences. Or the market could be moving up, with share prices expected to be higher after the ex-dividend date. To find out a fund's ex-dividend date, call the fund directly.

Please call if you'd like more information on how dividends paid out by mutual funds affect your taxes this year and next.

OTHER YEAR END MOVES

Retirement Plan Contributions. Maximize your retirement plan contributions. It doesn't actually need to be funded until you pay your taxes, but allowable contributions will be deductible on this year's return.If you are an employee and your employer has a 401(k), contribute the maximum amount ($18,000 for 2017), plus an additional catch-up contribution of $6,000 if age 50 or over, assuming the plan allows this and income restrictions don't apply.

If you are employed or self-employed with no retirement plan, you can make a deductible contribution of up to $5,500 a year to a traditional IRA (deduction is sometimes allowed even if you have a plan). Further, there is also an additional catch-up contribution of $1,000 if age 50 or over.

Health Savings Accounts. Consider setting up a health savings account (HSA). You can deduct contributions to the account, investment earnings are tax-deferred until withdrawn, and amounts you withdraw are tax-free when used to pay medical bills. In effect, medical expenses paid from the account are deductible from the first dollar (unlike the usual rule limiting such deductions to the amount of excess over 10 percent of AGI). For amounts withdrawn at age 65 or later that are not used for medical bills, the HSA functions much like an IRA.

To be eligible, you must have a high-deductible health plan (HDHP), and only such insurance, subject to numerous exceptions, and must not be enrolled in Medicare. For 2017, to qualify for the HSA, your minimum deductible in your HDHP must be at least $1,300 for single coverage or $2,600 for a family.

SUMMARY

These are just a few of the steps you might take. Please contact the Oehlke CPA, PLLC for assistance with implementing these and other year-end planning strategies that might be suitable to your particular situation. You can reach our office at 830.379.2991 or via email at brandon@oehlke-cpa.com for further tax planning assistance or to obtain the detailed version of this newsletter.