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Special Issue

Comprehensive Year-End Tax Planning

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Comprehensive Year-End Tax Planning

With Donald Trump's victory and with the Republicans retaining control of the House and Senate, Trump's tax proposals actually have a chance of becoming law. These include eliminating of the 35% and 39.6% tax brackets and replacing them with a 33% highest marginal tax rate. In addition, he would eliminate the "marriage penalty" that taxes married wage earners higher than unmarried co-habitants, the Alternative Minimum Tax, the 3.8% surtax on investment income, the 0.9% surtax on wages, and the estate tax. With this in mind, some of the recommendations below that deal with the timing of income and deductions will favor claiming deductions in 2016 and delaying income recognition until 2017 - though there are no guarantees that tax reform will pass in 2017. Remember, the goal is to **minimize** our tax bill for **both** 2016 and 2017. Here are some ideas:

1. **Maximize Retirement Plan Contributions If A Plan Works For You**: This is the single best tax shelter available. The long-term tax advantages (deductible contributions and decades of tax deferral) will overwhelm the costs (staff contributions and administration) where the doctor(s) and family members on the payroll get at least 65% of the annual contributions. However, we would use 70% as the threshold before we would draft the plan documents for a new client, since having a plan is not hassle-free. In other words, we recommend starting a plan if the key people get at least 70% of the contribution. We would amend a current plan to implement a better allocation formula, if possible, or else eliminate or scale back contributions if the key people's percentage drops below 65%. If the key people can receive at least 70%, and if the money that would have been contributed is being taken home, taxed, and saved anyway, then we strongly recommend maximizing plan contributions. A new plan must be established by December 31, 2016 in order to make a 2016 contribution. If interested in setting up a new qualified plan, call our office for information.

2. **Shifting Business Income And Expenses Between 2016 and 2017**: In general, we will cut our 2016 taxes by accelerating deductions into 2016 and deferring income until next year. This means delaying year-end billings into 2017 and pre-paying up to 12 months of expenses in advance. These include lease payments on vehicles, office rent, and business and malpractice insurance. If we expect to be in a higher tax bracket in 2017, we'd do the opposite – accelerate income (i.e., speed up billings) and delay deductions to 2017. But, with Trump's tax reform now a legitimate possibility, this may make 2016 a higher tax year than 2017. If so, then we will want to accelerate as many deductions as possible into 2016

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where they will carry more weight and delay income recognition until 2017 when the income may be taxed at lower rates.

3. **If You Itemize Deductions, You Have Flexibility to Time Some of the 2017 Expenses for 2016**: For example, state and local income taxes. Mailing your estimated payment due in January by year-end 2016 makes the payment deductible this year. Mortgage interest is another. If you make the January 2017 mortgage payment in December, the interest is deductible in 2016. Charitable contributions planned for 2017 can be made at the end of 2016 if they are charged on a credit card or the check is mailed by December 31st. In addition, your accountant can give you a preliminary estimate to see if you will be ensnared by the alternative minimum tax (AMT). If so, then you will **not** want to prepay certain expenses that are non-deductible for purposes of the AMT, such as real estate and state income taxes. Instead, claim them in 2017, when it's possible that the AMT will be repealed.

4. **To Mitigate the Impact of the 3.8% Tax on Investment Income and the New 0.9% Medicare Tax, Strive to Lower W-2 Income and Boost S Corporation Dividends**: Set compensation at the max that can be taken into account for retirement plan contribution purposes (this year $265,000) and take the rest as dividend distributions. If you own your office building then keep rent payments high. Under Regulation 1.469-2(f)(6), this is non-passive income which is excluded from the 3.8% tax. Also, if you are subject to the 3.8% Obamacare surtax on investment income and you can control the timing of the receipt of your investment income (e.g., capital gains from the sale of appreciated stock), then time the receipt of income for 2017 when Obamacare is likely to be repealed.

5. **If Incorporated, Use Extra Payroll Withholdings To Make Up Personal Tax Prepayment Shortfalls**: That's better than increasing quarterly estimates. Withheld taxes are counted for calculating the under-payment penalty as if they were pre-paid evenly throughout the year. If you need to catch up, you can go so far as to allocate your entire pay to payroll taxes and drop your take-home pay to zero.

6. **Put Your Spouse On The Practice Payroll If You Want Any Chance To Deduct His Or Her Business Travel Costs (And It Might Also Help Your Retirement Plan Funding)**: Your spouse must be a bona fide practice employee to deduct his or her business travel costs. Even a modest salary will suffice. If your spouse could receive a retirement plan contribution of at least 12.4% of his or her pay (which is your added Social Security tax cost from raising your spouse's pay), without increasing staff contributions, then set your spouse's pay as high as reasonably justified – even while incurring extra Social Security payroll taxes. If your spouse is not yet on the payroll, then start now. Getting the spouse in the plan immediately in order to earn a 2016 contribution may require a plan amendment that accelerates the plan's eligibility rules. But, it is worth doing if the relaxed entry rules won't bring other part-time employees into the plan.

7. **Finalize Roth IRA Planning**: 2016 IRA contributions technically aren't due until April 15, 2017. However, a 2016 Roth IRA conversion must be made by Dec. 31, 2016. If you think you'll be in a low tax bracket this year, then convert only so much that it takes you to the top of the income threshold for that bracket but no higher. If you will have a "cream in the coffee" problem (i.e., some or most of what you think should be a tax-free conversion will be taxable due to the existence of other IRA accounts) then transfer the pre-tax IRA dollars to your qualified retirement plan **now** and then convert the after-tax contributions to the Roth IRA.

8. **Fund HSAs By Year-End**: The deadline is April 15, 2017, but we prefer it be done by year-end. The 2016 limits are $3,350 for a single and $6,750 for a family. Each spouse can contribute an additional $1,000 if they are at least 55, for a total family HSA contribution of up to $8,750. (If both spouses want to make the added $1,000 contributions they must each have separate accounts). If possible, pay for medical expenses out of your checking account (and not the HSA) so as not to stifle the HSA's long-term tax-free growth.

9. **Convert Non-Deductible Interest To Deductible Interest**: Interest on consumer loans is not deductible. Interest on up to $100,000 of a home mortgage loan is deductible -- regardless of what the proceeds are used for. That means you could use a home equity loan to finance up to $100,000 of big-ticket consumer purchases (non-

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business car, child's education expenses, etc.) and deduct the interest.

10. **<u>Make Charitable Contributions With Appreciated Long-Term Securities Instead Of Cash</u>**: You get a charitable contribution for the full fair market value and the long-term capital gain is ignored (the security must be held for more than one year). If you want to retain the stock, use the cash you would have given to the charity to replace the contributed shares. That way you end up with the same number of shares, but the new shares have a higher cost and thus a lower capital gain when you eventually sell them. The charity will help you with the details. This is well worth the little effort involved for gifts above, say, $2,000. Never donate stock which has dropped in value. You will lose the capital loss. Sell the stock, take the capital loss, and then make a cash donation.

11. **<u>If You Turned 70-1/2 In 2016, Start "Required Minimum Distributions" From Your Retirement Plans And IRAs</u>**: For the year you turn 70-1/2, there is a grace period -- you can wait until April 1 of next year to make this year's distribution -- but then you would get two distributions in 2017. Normally, two distributions in the second year could push you into a higher tax bracket. But, if the highest income tax rate falls to 33% in 2017, then it might have paid to delay the 2016 RMD into 2017. If we expect to be in the 39.6% bracket both this year and next, then we would delay the 2016 distribution into early 2017, in the hopes potential tax relief. <u>Discuss this with your CPA</u> who can advise you based on anticipated levels of taxable income and RMDs in both 2016 and 2017.

<u>The rule permitting charitable contributions of required minimum distributions from IRAs (but not plans) has been made permanent</u>. The benefit of moving the money directly to the charity is that it doesn't first hit your income and raise your AGI. A higher AGI limits itemized deductions and raises Medicare Part B and D premiums. If you are eligible (over 70-1/2) we prefer this method of charitable giving over the gifting of appreciated securities. You'd retain the appreciated securities in your taxable accounts where your heirs will get a stepped-up basis when they ultimately inherit them.

12. **<u>Make Gifts To Children Well Before December 31</u>**: If reducing your estate makes sense <u>and if it will help, not hurt, your child</u>, then make gifts down to the next generation. You can give up to $14,000 per year to as many people as you choose without any negative gift or estate tax consequences. If you want to give more than $14,000 to any person, your spouse can join you by electing to have 1/2 of your gifts attributable to him or her. That allows annual gifts of up to $28,000 per recipient without eating into your lifetime estate tax exemption. If your gifts to any recipient in a year exceed $14,000, you must file a simple gift tax return (Form 709) by the due date of your 1040 personal tax return, including extensions.

13. **<u>Tuition And Medical Costs Paid To The School Or Health Care Provider Do Not Count Toward The $14,000 Annual Gift Limit</u>**: If you pay a child's or grandchild's tuition <u>directly to</u> the school, the payments are exempt from gift tax and do not count against the annual exclusion amount. The same rule applies to the child's or grandchild's medical bills paid <u>directly to</u> the provider.

14. **<u>If You Are Selling Stocks or Bonds at a Gain to Pay a Child's Graduate School Costs, Give the Securities to the Child Instead</u>**: The recipient of a gift takes over the gift-giver's tax cost and holding period. The securities can then be sold in the child's name and the gains will be taxed at the child's lower capital gains rate. And, because of the child's lower income, the child will not be subject to the additional 3.8% on investment income if sold in 2016. The child would then use the greater after-tax proceeds to pay school costs directly. The harsh Kiddie Tax now taxes students <u>under age 24</u> at the <u>parents' higher rates</u>, so this won't work with younger children. In 2016, the adult child will have a capital gains tax rate of zero if the child is not otherwise hitting the 25% income tax bracket (AGI no higher than $37,650 if single and $75,300 if married). The gifts can also be made to recent grads to help them pay down college loans.

15. **<u>Offset Capital Gains With Capital Losses</u>**: Capital losses first offset capital gains for the year and any excess losses can then be used to offset up to $3,000 of ordinary income. Losses above that get carried forward to offset future years' gains plus $3,000 of ordinary income per year until the loss is used up. If, for example, you sold your practice you would likely have a large capital gain from the sale of personal goodwill, some of this gain can be sheltered by capital losses. If you want to continue owning the investment, the "wash sale" rule <u>disallows</u> a loss

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deduction if you buy the same securities within 30 days before or after the loss sale.

16. **If Your Securities Sales To Date Show A Net Loss, Sell Others At A Gain To Absorb The Available Capital Loss**: Let's say your securities sales to date this year give you a net overall loss of $15,000. Only $3,000 of this is deductible against ordinary income. Sell enough securities to generate a $12,000 gain. There is no "wash sale" rule on gains so you could immediately buy back the same securities you just sold at a gain and get a stepped-up cost basis.

17. **The $500,000 Section 179 Deduction is Now Permanent and 50% Bonus Depreciation Remains in Effect for 2016 and 2017**: This is an excellent time to make needed equipment upgrades.

18. **Buying A Business Vehicle**: SUVs with gross vehicle weight ratings over 6,000 pounds that are bought new are eligible for up to $25,000 of first-year Section 179 expensing plus 50% bonus depreciation. Used heavy SUVs get the up to $25,000 first year depreciation under Section 179, but no bonus depreciation, and the remainder of the cost is depreciated over the first five years. Cars and light trucks are not eligible for Section 179, but have a different bonus depreciation rule. If bought new they get an additional $8,000 of first year depreciation. Large pick-up trucks get the best deal. The entire cost can be expensed under Section 179 if the GVWR is over 6,000 pounds and the cargo bed is at least six feet long and not accessible from the cab. To find the vehicle's GVWR, check the certification form glued on the edge of the driver's door or car frame.

19. **You May Qualify For 0% Long-Term Capital Gains And Dividends**: If you are in the 10% or 15% income tax bracket, dividends and long-term capital gains (where the holding period is more than one year) are tax-free until they would otherwise push you into the 25% bracket (i.e., if these were instead short-term gains they are subject to the higher ordinary income rates.) For 2016, the 25% bracket starts above $75,300 of taxable income on joint returns and $37,650 on individual returns.

20. **Use Your Credit Card For Last Minute Deductions**: If you charge it on your credit card on December 31, it's a 2016 deduction even though the credit card bill isn't paid until 2017. If you are accelerating income and postponing expenses, wait until January to charge it.

21. **Don't Make A Big Mutual Fund Purchase Before Its Year-End Taxable Distribution To Shareholders**: To be sure, call the mutual fund to find out the distribution "record" date, and buy the fund afterwards. Getting a taxable distribution on shares you didn't own when the gain was earned, is like missing the party but getting the hangover.

22. **Bunch Medical Expenses**: The old 7.5%-of-income deduction threshold is now 10% (however, it remains 7.5% if either spouse is age 65 or older until the end of 2016). Bunch into one year as many medical costs as possible. (This is especially true for seniors who still have access to the lower 7.5% threshold in 2016.) For example (your orthodontist will love this) pay the entire fee up front for your child's braces. If you support a dependent by providing more than 50% of their support, you can deduct their medical costs (including long-term care insurance) you pay directly. That applies even if you cannot claim a personal exemption because your income is too high or the person (say, a parent) has income of $4,050 or more. By paying the dependent's medical bills, your money does double duty - it counts toward meeting the 50% support test and towards meeting your 10% medical deduction threshold.

23. **It Works The Same Way If You Make A Dependent's Charitable Contributions**: Let's say you are supplying more than 50% of your widowed mother's support but you cannot claim her as a dependent due to her income. If she wants to use your money to give to charity, then you should make the contribution directly. When you pay for her, you get the charitable deduction (which is worth more in your higher bracket) and it will count in calculating your support.

24. **Act Quickly to Take Advantage of Expiring Energy Tax Credits**: Last year's tax law changes extended the energy efficiency tax credit through 2016. The credit is 10% of the costs with a maximum of $500 and covers home improvements like energy efficient windows, doors, roofs and insulation. This does not apply to the 30% credit for residential solar systems which continues through 2019 and then phases out and ends after 2021.

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