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November 2017

To Our Clients and Friends:

As we get closer to the end of yet another year, it's time to assess your tax situation and implement tax saving strategies. This has been an interesting year in Washington. Republicans in Congress are currently working on separate plans to overhaul the U.S. tax code with a goal of passing a final tax bill before the end of the year. Democrats are united in opposing the tax proposals, so passage will be challenging. We can't predict which proposals will survive to a final bill, but the effective date of most apply to 2018.

Despite the current uncertainties, keeping the line on your taxable income is more important than ever. Absent any last-minute legislation, the top federal income tax rate for 2017 remains at 39.6%, but higher-income individuals can 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.

Before we get to specific suggestions, here are two important considerations to keep in mind.

1. Effective tax planning requires considering both this year and next year—at least. Without a multiyear outlook, you can't be sure maneuvers intended to save taxes on your 2017 return won't backfire and cost additional money in the future. Uncertainty with the recent tax proposals which would significantly affect 2018 taxes make those decisions more difficult.
2. Be on the alert for the Alternative Minimum Tax (AMT). Although the tax proposals include the repeal of AMT, it is still on the books and needs to be considered in all of your planning because what may be a great move for regular tax purposes may create or increase an AMT problem. There's a good chance you'll be hit with AMT if you deduct a significant amount of state and local taxes, claim multiple dependents, exercise incentive stock options, or recognize a large capital gain this year.

This letter presents some planning ideas to consider while there is still time to act before the year-end. Some of the ideas may apply to you, some to family members, and others to your business.

Consider Deferring Income and Accelerating Deductions

Due to the time value of money, it's better to pay taxes later rather than sooner (assuming your tax rates won't be appreciably higher next year). Therefore, strategies that defer income from the current year to later years and those that move deductions from later years into the current year are always popular. These time-honored strategies could be particularly effective this year if tax reform with lower tax rates is enacted but doesn't take effect until next year.

Accelerate Itemized Deductions in 2017. If you currently take advantage of itemized deductions, you may want to accelerate next year's deductions into this year. First, you'll get the benefit of the additional tax deductions this year. Furthermore, if tax reform is enacted and effective next year, not only may your tax rate be lower next year, thereby reducing your tax savings from the deductions, but some of these deductions could be limited, eliminated, or rendered useless by an increased standard deduction.

For example, you might consider pursuing elective medical procedures if you think total medical expenses will exceed 10% of your adjusted gross income or paying property taxes and/or state income taxes early. But, watch out for the AMT, as these taxes are not deductible for AMT purposes. Increasing charitable contributions you make this year is also a good idea. Consider taking the following measures:

- Make charitable contributions you would normally make in early 2018 at the end of 2017. Note that donations charged to a credit card are deductible in the year charged, not when payment is made on the card. Thus, charging donations to your credit card before year-end enables you to increase your 2017 charitable donations deduction even if you're temporarily short on cash.

- Make a gift to a donor-advised fund. These funds essentially allow you to obtain an immediate charitable contribution deduction for setting aside funds that will be used for future charitable donations. With these arrangements, which are available through a number of major mutual fund companies, as well as universities and community foundations, you contribute money or securities to an account established in your name. You then choose among investment options and, on your own timetable, recommend grants to charities of your choice. The minimum for establishing a donor-advised fund is often $10,000 or more. These funds can make sense if you want to obtain a tax deduction now but take your time in determining or making payments to the recipient charity or charities. They can also be a way to establish a family philanthropic legacy without incurring the administrative costs and headaches of establishing a private foundation.

- Make charitable gifts of appreciated stock. If you have appreciated stock that you've held more than a year and you plan to make significant charitable contributions before year-end, keep your cash and donate the stock (or mutual fund shares) instead. You'll avoid paying tax on the appreciation but will still be able to deduct the donated property's full value. If you want to maintain a position in the donated securities, you can immediately buy back a like number of shares. (This idea works especially well with no-load mutual funds because there are no transaction fees involved.)

  However, if the stock is now worth less than when you acquired it, sell the stock, take a loss, and then give the cash to the charity. If you give the stock to the charity, your charitable deduction will equal the stock's current depressed value, and no capital loss will be available. Also if you sell the stock at a loss, you can't immediately buy it back as this will trigger wash sale rules. This means your loss won't be deductible but, instead, will be added to the basis in the new shares.

- If you expect to owe state and local income taxes when you file your return next year, consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2017 if you won't be subject to alternative minimum tax (AMT) in 2017. Pulling state and local tax deductions into 2017 would be especially beneficial if Congress eliminates such deductions beginning next year.

Defer Income until 2018. There are various ways to defer income until the following tax 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. Of course, before deferring income, you must assess the risk of doing so. You might also consider prepaying a reasonable amount of deductible business expenses such as office supplies and repairs and maintenance before the end of this year. Setting up a retirement plan and/or making additional deductible retirement plan contributions for the year is another idea.

- If you're a participant in a 401(k) plan and have not already maxed out your elective contributions to the plan this year, consider increasing contributions through the year-end. Depending on your employer's plan, you may be able to contribute 100% of your compensation up to $18,000 ($24,000 if you are age 50 or older).

- For sales of property, consider an installment sale that shifts part of the gain to later years when the installment payments are received.

- For the sale of a personal residence or former principal residence, be aware that both tax proposals extend the length of time you must own and use a residence to qualify for the $250,000 gain exclusion ($500,000 if married filing a joint return) from two years to five years. If passed, the proposal is effective for sales after 12/31/17. If you are otherwise planning to take advantage of this gain exclusion and have lived in the home less than five years, accelerating that sale into 2017 may be worthwhile.

Tax-Smart Strategies for Your Business

Ramp Up Investments in Equipment, Software, and Certain Real Property. If you have plans to buy a business computer, office furniture, equipment, vehicle, or other tangible business property or to make certain improvements to real property, you might consider doing so before year-end to capitalize on the following tax breaks:

- *Section 179 Deduction.* For 2017, the maximum Section 179 deduction is $510,000 (assuming property purchases for the year don't exceed $2,030,000). Therefore, 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.

  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. Also, you might want to consider delaying purchases in excess of $510,000 until next year as it is possible that next year's expensing allowance could be even more generous. Please contact us if either of these situations applies to your operation.

- *First-Year Bonus Depreciation.* Above and beyond the Section 179 deduction, your business also can 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 of those years. Please contact us for details on the interaction between asset additions and NOLs. The bonus depreciation rate is scheduled to drop to 40% for property placed in service in 2018. Be aware that part of the new tax proposals increases the rate to 100% for property acquired after 9/27/17 and extends application to purchases of qualifying used property.

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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. If you're age 50 or older as of year-end and your business has no employees, a solo 401(k) can allow for a contribution of up to $60,000.

Evaluate Inventory for Damaged or Obsolete Items. Inventory is normally valued for tax purposes at cost or the lower of cost or market value. Regardless of which of these methods is used, the end-of-the-year inventory should be reviewed to detect obsolete or damaged items. The carrying cost of any such items may be written down to their probable selling price (net of selling expenses). To claim a deduction for a write-down of obsolete inventory, you are not required to scrap the item. However, in a period ending not later than 30 days after the inventory date, the item must be actually offered for sale at the price to which the inventory is reduced.

Check for Domestic Production Activities Deduction. If your business qualifies for the Domestic Production Activities Deduction (DPAD) for its 2017 tax year, consider whether the 50% of W-2 wages limitation on that deduction applies. If it does, consider ways to increase 2017 W-2 income, e.g., by bonuses to owner-shareholders whose compensation is allocable to domestic production gross receipts. Note that the limitation applies to amounts paid with respect to employment in calendar year 2017, even if the business has a fiscal year. Keep in mind that the DPAD won't be available next year under the tax reform plan currently before Congress.

Check Your Partnership and S Corporation Stock Basis. If you own an interest in a partnership or S corporation, your ability to deduct any losses it passes through is limited to your basis. Although any unused loss can be carried forward indefinitely, the time value of money diminishes the usefulness of these suspended deductions. Thus, if you expect the partnership or S corporation to generate a loss this year and you lack sufficient basis to claim a full deduction, you may want to make a capital contribution (or in the case of an S corporation, loan it additional funds) before year-end.

Note: The Bipartisan Budget Act of 2015 (BBA) established a new audit regime for partnerships that will go into effect in 2018. The BBA regime creates new roles and responsibilities for partners. To avoid future disagreements, it is recommended that partnership agreements be reviewed by competent legal counsel and revised as needed.

Consider Disposing of a Passive Activity. To reduce 2017 taxable income, consider disposing of a passive activity in 2017 if doing so will allow you to deduct suspended passive activity losses.

Employ Your Child. If you are self-employed, don't miss the opportunity to employ your child before the end of the year. 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 the standard deduction. There can also be payroll tax savings since wages paid by a sole proprietor to their children age 17 and younger are exempt from both social security and 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, particulary with 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 must be reasonable given the child's age and work skills. Second, if the child is in college, or is entering soon, having too much earned income can have a detrimental impact on the student's need-based financial aid eligibility.

Making the Most of Year-End Investment Moves

Depending on your taxable income, the 2017 federal income tax rates on long-term capital gains and qualified dividends are 0%, 15%, and 20%, with the maximum 20% rate affecting taxpayers with taxable income above $418,400 for single taxpayers, $470,700 for married joint-filing couples, and $444,550 for heads of households. High-income individuals can also be hit by the 3.8% NIIT, which can result in a marginal long-term capital gains/qualified dividend tax rate as high as 23.8%. Still, that is substantially lower than the top regular tax rate of 39.6% (43.4% if the NIIT applies).

Holding on Longer Can Lower Your Taxes. If you hold appreciated securities in taxable accounts, owning them for at least one year and a day is necessary to qualify for the preferential long-term capital gains tax rates. In contrast, short-term gains are taxed at your regular rate, which can be as high as 39.6% (43.4%, if the NIIT applies).

Sell the Right Shares. Generally, when you sell stock or mutual fund shares, the shares you purchased first are considered sold first, which is good news if you are trying to qualify for the long-term capital gain rate. But, there may be situations where you're better off selling shares that have been held a year or less rather than those held longer. Selling recently purchased shares at little or no gain (because you purchased them at a higher price) may be better than selling shares held for more than one year if that sale would produce a significant gain. Whenever you want to sell shares other than those you purchased first, you must properly notify your broker as to the specific shares you want sold.

Harvest Capital Losses. Biting the bullet and selling some loser securities (currently worth less than you paid for them) before year-end can 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. 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 high-taxed ordinary income ($1,500 if you're married and file separately). Any excess net capital loss is carried forward to next year.

Secure a Deduction for Nearly Worthless Securities. If you own any securities that are all but worthless with little hope of recovery, you might consider selling them before the end of the year so you can capitalize on the loss this year. You can deduct a loss on worthless securities only if you can prove the investment is completely worthless. Thus, a deduction is not available as long as you own the security and it has any value at all. Total worthlessness can be very difficult to establish with any certainty. To avoid the issue, it may be easier just to sell the security if it has any marketable value. As long as the sale is not to a family member, this allows you to claim a loss for the difference between your tax basis and the proceeds (subject to the normal rules for capital losses and the wash sale rules restricting the recognition of loss if the security is repurchased within 30 days before or after the sale).

Year-End Moves for Seniors Age $70^{1}/_{2}$ Plus

Make Charitable Donations from Your IRA. IRA owners and beneficiaries who have reached age $70^{1}/_{2}$ are permitted to make cash donations totaling up to $100,000 per individual IRA owner per year—$200,000 per year maximum on a joint return if both spouses make QCDs of $100,000—to IRS-approved public charities directly out of their IRAs. These so-called *Qualified Charitable Distributions,* or QCDs, are federal-income-tax-free to you, but you get no itemized charitable write-off on your Form 1040. That's okay because the tax-free treatment of QCDs equates to an immediate 100% federal income tax deduction without having to worry about restrictions that can delay itemized charitable write-offs. It also reduces your AGI. QCDs have other tax advantages, too. Contact us if you want to hear about them. Be careful—to qualify for this special tax break, the funds must be *transferred directly* from your IRA to the charity.

Take Your Required Retirement Distributions. Individuals with retirement accounts must generally take withdrawals based on the size of their account and their age every year after they reach age $70^{1}/_{2}$. Failure to take a required withdrawal can result in a penalty of 50% of the amount not withdrawn. There's good news though—QCDs discussed above count as payouts for purposes of the required distribution rules. This means, you can donate all or part of your 2017 required distribution (up to the $100,000 per individual IRA owner limit on QCDs) and convert taxable required distributions into tax-free QCDs.

Also, if you turned age $70^{1}/_{2}$ in 2017, you can delay your 2017 required distribution until April 1, 2018. However, waiting until 2018 will result in two distributions in 2018—the amount required for 2017 plus the amount required for 2018. While deferring income is normally a sound tax strategy, here it results in bunching income into 2018. Thus, think twice before delaying your 2017 distribution to 2018—bunching income into 2018 might throw you into a higher tax bracket or have a detrimental impact on your tax deductions.

Ideas for the Office

Maximize Contributions to 401(k) Plans. If you have a 401(k) plan at work, it's just about time to tell your company how much you want to set aside on a tax-free basis for next year. Contribute as much as you can stand, especially if your employer makes matching contributions. You give up "free money" when you fail to participate to the max for the match.

Adjust Your Federal Income Tax Withholding. If it looks like you are going to owe income taxes for 2017, consider bumping up the federal income taxes withheld from your paychecks now through the end of the year. When you file your return, you will have to pay any taxes due less the amount paid in and/or withheld. However, as long as your total tax payments (estimated payments plus withholdings) equal at least 90% of your 2017 liability or, if smaller, 100% of your 2016 liability (110% if your 2016 adjusted gross income exceeded $150,000; $75,000 for married individuals who filed separate returns), penalties will be minimized, if not eliminated.

Review Your Health Insurance Costs and Coverage

Make Sure You Have Adequate Health Insurance Coverage. If you and your family don't have adequate medical coverage (referred to as minimum essential coverage), you may be subject to a penalty. Although there has been talk about repealing this penalty, it is still on the books and needs to be considered. Medical insurance provided by your employer or through an individual plan purchased through a state insurance marketplace generally qualifies as adequate coverage. The penalty amount varies based on the

number of uninsured members of your household and your household income. If you have three or more uninsured household members, the penalty could be $2,085 or more for 2017.

Take Advantage of Flexible Spending Accounts (FSAs). If your company has a healthcare and/or dependent care FSA, before year-end you must specify how much of your 2018 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying dependent care costs. Watch out, though, FSAs are “use-it-or-lose-it” accounts—you don’t want to set aside more than what you’ll likely have in qualifying expenses for the year.

If you currently have a healthcare FSA, make sure you drain it by incurring eligible expenses before the deadline for this year. Otherwise, you’ll lose the remaining balance. It’s not that hard to drum some things up: new glasses or contacts, dental work you’ve been putting off, or prescriptions that can be filled early.

Consider a Health Savings Account (HSA). If you are enrolled in a high-deductible health plan and don’t have any other coverage, you may be eligible to make pre-tax or tax-deductible contributions to an HSA of up to $6,750 for a family coverage or $3,400 for individual coverage—plus an extra $1,000 if you will be 55 or older by the end of 2017. Distributions from the HSA will be tax free as long as the funds are used to pay unreimbursed qualified medical expenses. Furthermore, there’s no time limit on when you can use your contributions to cover expenses. Unlike a healthcare FSA, amounts remaining in the HSA at the end of the year can be carried over indefinitely.

Affected by Natural Disasters

If you were affected by Hurricanes Harvey, Irma, or Maria, or the Wine Country fires, keep in mind that you may be entitled to special tax relief under recently passed legislation, such as relaxed casualty loss rules, temporary reduced assessment for property taxes, and eased access to your retirement funds. In addition, qualifying charitable contributions related to relief efforts are not subject to the usual charitable deduction limitations.

If your business was affected by the natural disasters in a federally-declared disaster area, it may be entitled to an employee retention credit for eligible employees.

Don’t Overlook Estate Planning

Currently, the unified federal gift and estate tax exemption for 2017 is $5.49 million, and the federal estate tax rate is 40%. The 2017 annual gift exclusion per donee is $14,000 but this increases to $15,000 in 2018. The new tax proposals being debated by Congress has provisions that increase the estate and gift exemption and may ultimately repeal the federal estate tax. 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

Through careful planning, it’s possible your 2017 tax liability can still be significantly reduced, but don’t delay. The longer you wait, the less likely it is that you’ll be able to achieve a meaningful reduction. The ideas discussed in this letter are a good way to get you started with year-end planning, but they’re no substitute for personalized professional assistance. Please don’t hesitate to call us with questions or for additional strategies on reducing your tax bill. We’d be glad to set up a planning meeting or assist you in any other way that we can.

Sincerely,

JHS CPAs, LLP