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CCH® Federal Tax Perspectives: 2017 Year-End Planning

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CCH® FEDERAL TAX PERSPECTIVES: 2017 Year-End Tax Planning

Year-end 2017 presents more than its share of both traditional and unique tax planning opportunities for a broad cross-section of taxpayers. One of the major challenges this year involves the uncertainty that will remain, likely into late November/early December, over pending tax reform legislation. This includes uncertainty about rate cuts, additional/repealed deductions and credits, and more, for individuals and businesses. Overlaid onto this prospective "game-changer" legislation is whether some or all provisions that may make it to the finish line will be retroactive to 2017, or only effective starting January 1, 2018, or later if phase-in schedules are used. Effective strategies in response to any of these "tax reform" priorities involve close monitoring of the proposed tax bill as it moves through negotiations within the various Congressional tax committees and Trump administration officials, with year-end planning action-steps ready to go based upon alternative legislative outcomes.

Eleventh-hour decisions with tax planning , as well as with all year-end planning involve:

1. The assessment of what's new, either in the tax law or your personal or business situation. IRS guidance over the past several years has also created new rules, with new pitfalls and opportunities to be addressed.
2. A projection of what income and deductions, as well as resulting tax liability, would amount to if no additional steps were taken. Often helpful is a look at last year's tax return, and last year's year-end strategies, against a projection of what this year's return is shaping up to look like.
3. The application of traditional year-end planning techniques to defer or accelerate income, deductions and credits based upon these assessments and projections.

In short, year-end tax planning for 2017 is multifaceted. It should consider tax savings from a number of different directions.

In addition to the possible changes that may be made through tax reform, an analysis of variables for 2017 year-end planning should include consideration of:

- How changes in personal and financial circumstances—marriage, divorce, children, and change in employment or even investment success or setbacks—should be reflected within 2017 year-end strategies.
- How tax law rule changes made over the past year by the IRS, the Treasury Department and the courts should be integrated into specific 2017 year-end considerations. This strategy-focused review of 2017 events includes, among other developments critical to year-end transactions:
  - Recent run-ups in the stock market and how they may impact tax liability of net capital gains;
  - Growing interest by the IRS in the responsibilities and liabilities of participants within the "sharing" and "gig" economies;
  - Hurricane disaster relief both through legislation and IRS compliance relief;
  - Changing responsibilities of individuals and employers under revised rules implementing the Affordable Care Act;
  - Payroll tax credit option for small start-up companies otherwise unable to make full use of the research tax credit;
  - Changing schedules for business tax incentives that have been temporarily renewed while others have been allowed to sunset;
  - "Repair reg" elections to be made for the 2017 tax year; and
  - The impact of recent Treasury Department regulations, including a reset by the Trump Administration of certain rules affecting debt/equity issues, foreign income reporting, recourse partnership liabilities, and estate tax valuation issues, among others.
- How inflation adjustments that are required by the Tax Code annually can impact certain decisions at year-end 2017.
- How timing rules, both time-tested and new, can determine when income or a deduction is considered locked into a particular tax year within a variety of personal and business situations.
- How legislative and political forces in 2018, still unknown, might impact strategies at year-end 2018.
- And finally, as previously emphasized, how a review, now, of traditional year-end techniques, such as balancing income and deductions between the current and upcoming year through acceleration and deferral techniques, may be applied at year-end 2017, irrespective of how circumstances develop between now and then.

PLANNING FOR INDIVIDUALS

Income Tax Rates

One of the most significant factors in tax planning for individuals is their tax bracket. In 2017 and 2018 (under current law as of press time), there are seven tax brackets for individuals (10%, 15%, 25%, 28%, 33%, 35%, and 39.6%). The income level at which these seven tax brackets rates apply depends on taxpayers' filing status and are adjusted annually for inflation. For example, the top tax bracket of 39.6 percent begins at the following taxable income levels:

39.6% Top Tax Rate Bracket Starts at:

Filing Status	2017	2018
Married filing jointly and surviving spouse	$470,700	$480,050
Heads of households	$444,550	$453,350
Unmarried individuals	$418,400	$426,700
Married filing separately	$235,350	$240,025

STRATEGY. The most direct control taxpayers have over their tax bracket rests in their ability to control the timing of income and deductible expenses. For example, taxpayers who expect to be in a higher tax bracket in 2018 should consider accelerating income into 2017 and deferring deductions until 2018. Conversely, taxpayers who expect to be in a lower tax bracket in 2018 should consider deferring income to 2018 and accelerating deductions into 2017.

COMMENT. The existing tax rate brackets may be short lived if Congress and the Trump administration can enact tax reform legislation. President Trump and GOP leaders have proposed a three-bracket structure: 12%, 25% and 35%. The income level at which these brackets would apply could also change dramatically with additional changes in the standard deduction amounts. These changes could present tax planning opportunities for taxpayers depending on when any proposed rate changes go into effect. Especially if new rates are not made effective until 2018, 2017 year-end strategies should utilize enhanced techniques that defer income into 2018 and accelerate deductions and credits into 2017, to balance projected tax liabilities between 2017 and 2018.

STRATEGY. Because the highest rate for estates and trusts starts at a relatively low level of taxable income ($12,500 in 2017 and $12,700 in 2018 (with low levels also likely under any tax reform)), executors and trustees should consider making distributions to beneficiaries before year end, which generally will pass that amount of taxable income through to those beneficiaries and escape tax at the comparatively high estate/trust level.

Investments

Taxpayers holding investments, whether in the form of securities, real estate, collectibles, or other assets, often have an opportunity to reduce their overall tax bill by some strategic buying or selling (or exchanging in the case of "like-kind property") toward the end of the year. Balancing tax considerations with other factors is part of the challenge in dealing with investments, including: the ordinary income tax rates, the net investment income tax rate, the capital gain rates, and the alternative minimum tax (AMT).

STRATEGY. Year-end planning should start with data collection and a review of prior year returns. This includes losses or other carryovers, estimated tax installments, and items that were unusual. Conversations about next year should include review of any plans for significant purchases or dispositions, as well as any possible life cycle plans.

STRATEGY. When making investment decisions, economic factors in the market should take priority over tax considerations. Taxpayers should not hold assets simply to avoid paying tax on any gain. Similarly, taxpayers should not sell assets just to take a tax loss if the asset will likely rise in value. Only after the economic factors are considered, should taxpayers consider the tax consequences.

Net Investment Income (NII) Tax

In addition to regular income tax liability, many individuals may be surprised to learn that they may be subject to an additional 3.8 percent tax on net investment income (NII). Recent run ups in the financial markets over the past several years, combined with the fact that the income thresholds for the NII tax are not adjusted for inflation, have increased the need to implement strategies that can avoid or minimize this tax.

STRATEGY. The NII tax is not required to be withheld from any payment of income made to individuals. As a result, taxpayers may want to adjust any income tax-withholding or estimated tax payments to avoid penalties for underpayment of the NII tax.

The NII tax equals 3.8 percent of the lesser of the individual's (1) net investment income for the year, or (2) modified adjusted gross income (MAGI) for the year over a threshold amount. The threshold amount is equal to: $250,000 MAGI in the case of joint returns or a surviving spouse; $125,000 in the case of a married taxpayer filing a separate return, and $200,000 in any other case. As noted before, these threshold amounts are not indexed for inflation. They therefore capture more and more taxpayers each year regardless of their income tax bracket.

STRATEGY. If possible, keeping income below the thresholds is an avenue to explore. Spreading income out over a number of years or offsetting the income with above-the-line deductions are possible approaches. For example, taxpayers may want to shift wages and investments into retirement accounts if possible. Increasing retirement plan contributions will reduce income to help stay below the MAGI thresholds.

COMMENT. NII encompasses more than interest, dividends, and capital gains from investments. It also includes income from a business in which the taxpayer is a passive participant. Rental income may also be considered NII unless earned by a real estate professional. Such passive investments may be grouped in certain cases.

COMMENT. Repeal of the NII tax has not been proposed at press time to become part of any year-end tax reform legislation. Because it was enacted as part of the Affordable Care Act, it may be difficult (but not impossible) to include its repeal in any of the budget/revenue projections needed within the tax reform framework.

Additional Medicare Tax

The NII tax is separate and distinct from the additional Medicare tax. An employee's share of the Medicare tax on wages is increased by an additional 0.9 percent on wages in excess of certain threshold amounts. Similarly, the Medicare rate on self-employment income is increased by an additional 0.9 percent on self-employment income in excess of the threshold amounts.

These threshold amounts are identical to those use for the NII tax and are not adjusted for inflation. The thresholds are: $200,000 for single individuals (and heads of household); $250,000 for married couples filing a joint return; and $125,000 for married individuals filing separate returns.

STRATEGY. Employers are only required to withhold the additional 0.9 percent Medicare tax if it pays wages exceeding the threshold amounts. If total wages exceed the threshold amounts, taxpayers will be liable for the additional tax without it being withheld from wages. This may occur because taxpayers receive wages from more than one employer or taxpayers are married filing jointly. Employees who anticipate liability for additional Medicare tax may request that their employer(s) take out an additional amount of income tax withholding. Employees who anticipate liability for additional Medicare tax may request that their employer(s) take out an additional amount of income tax withholding. Similarly, self-employed individuals will need to increase the amount of any estimated tax payments to account for liability for the additional Medicare tax.

Capital Gains and Dividends

As an economic incentive for individuals to save and invest, gains from the sale of capital assets held for at least one year unless offset by losses, as well qualified dividends received during the year, may be taxed at rates lower than ordinary income tax rates. The tax rate on long-term capital gains and qualified dividends for individuals is 20 percent, 15, percent, or 0 percent depending on their income tax bracket.

Income Tax Bracket	Capital Gains Rate
39.6%	20 percent
35%	15 percent
33%	15 percent
28%	15 percent
25%	15 percent
15%	0 percent
10%	0 percent

STRATEGY. When dealing with capital gains, the greatest flexibility taxpayers have comes from their ability to decide when to sell assets.

For example, taxpayers may know they will be in a higher income tax bracket in 2018 that would subject them to a higher capital gains rate. As a result, they could sell investments in 2017 to generate long-term capital gains to take advantage of a lower capital gains rate. In other words, spreading the recognition of income between multiple years may help minimize the total amount of tax paid in those years.

STRATEGY. The zero percent capital gains rate creates a planning opportunity, particularly within intra-family situations. Appreciated property may be gifted to a low-bracket individual, with the gain on a subsequent sale then taxed at a zero rate to the extent that gain on top of other income does not exceed the top of the 15 percent bracket. Certain restrictions must be respected, however, including not contravening the kiddie tax rules, not exceeding the annual gift tax exclusion, and not being setting up a structured transaction in which the sale after the gift has been prearranged.

COMMENT. The existing tax rate brackets for individuals may be short lived if Congress and the Trump administration can enact tax reform legislation. Some proposals have called for reducing the number of tax brackets for individuals down to only three or four. Any changes in the income tax brackets would also affect the tax on capital gains and qualified dividends. At press time, there are no known proposals to reduce the capital gains tax rates themselves, but the reduction of income tax brackets could alter which capital gains rate applies to which taxpayers.

Most types of nonbusiness property used for personal or investment reasons, such as stocks and bonds, are capital assets. As noted above, to receive the lower tax rate on capital gains, taxpayers must hold these investments for more than one year. The gain from the sale of capital assets held for one year or less are ‘short-term’ capital gains are taxed at ordinary income tax rates. In addition, the long-term capital gain rates do not apply to all types of capital assets. A 28 percent rate applies to long-term gains from collectible and small business stock, while a 25 percent rate applies to unrecaptured Code Sec. 1250 gain realized on the sale of depreciable real property.

COMMENT. Capital gains from the sale of property not used in an active business as subject to the 3.8 percent NII tax. This means this income may potentially be subject to a top rate of 39.6 percent if the gains are short-term capital gains and even higher at 43.4 percent if the NII tax applies.

STRATEGY. Generally, holding capital assets for more than 12 months before taxable disposition to avoid short-term capital gain status is advisable, unless sufficient loss offsets have been recognized, or market conditions indicate otherwise.

Capital losses. Generally, taxpayers must offset their capital gains with capital losses before applying the tax rates. Thus, cashing out stock and bonds with a built-in loss can be a simple means of providing a loss to be taken against income. If capital losses exceed capital gains for the year, individuals are only allowed to deduct up to $3,000 of the losses, whether net long-term or short-term capital gain against ordinary income. Any capital losses above $3,000 must be carried over and deducted in succeeding years.

STRATEGY. As a result of the netting of capital gains and losses, taxpayers have an opportunity to minimize their tax liability by timing when the gains and losses occur. For example, taxpayer could sell capital gain property before the end of the year if they have already realized capital gain losses during the year. Also, if allowable deductions for the year will exceed income, taxpayers should try to avoid realizing any additional capital losses during the year as they would be worthless or have to be carried over to the next year.

Taxpayers may want to recognize capital losses for tax purposes on stock or securities without completely abandoning their investment. One technique for maintaining the investment is to sell the stock or security at a loss, and then buy reacquire the same stock or security. The 'wash sale' rules, however, prevent taxpayers from claiming any loss from these types of transactions if they acquire substantially identical stock or securities within 30 days before or after the sale.

STRATEGY. The wash sale rule can be avoided by simply waiting 31 days before purchasing substantially identical stock or securities. Even if taxpayers violate the time limits of the wash sale rule, the disallowed loss is not lost. Instead, the loss is added to cost of the new stock or securities acquired. Plus, the holding period of the new stock or securities includes the time taxpayers held the stock or securities sold for a loss.

Alternative Minimum Tax

Just when most middle income and high-income individuals think they have maximized their tax savings by shifting income and deductions, they

may find that they are subject to the alternative minimum tax (AMT). The AMT tax ensures taxpayers pay a minimum level of tax if they attempt to claim too many tax breaks by adjusting or disregarding those tax breaks to produce AMT income.

COMMENT. At press time, Congress and the Trump administration are working to enact tax reform legislation. The tax reform "framework" released by the President Trump and the GOP in late September called for the repeal of both the individual and corporate AMT. It is unclear whether this could actually happen, however, because of the revenue loss that would repeal. Even if legislation modified or eliminated the AMT, there remain numerous unanswered questions such as: would it be eliminated immediately or over a number of years; or would it simply be modified so it didn't affect as many middle-income taxpayers

A certain amount of AMT income is exempt from the AMT depending on filing status. Any AMT income in excess of the exemption amount is taxed in 2017 at rate of 26 percent on the first $187,800 ($93,900 if married filing separately), plus 28 percent of AMTI exceeding the threshold amount.

STRATEGY. For 2017, the exemption amount is: $84,500 for married individuals filing jointly and surviving spouses; $54,300 for single individuals and heads of households; and $42,250 for married individuals filing separate returns. The exemption amounts are phased out or reduced if taxpayers AMT income exceeds: $160,900 for married individuals filing jointly and surviving spouses; $120,700 for single individuals and heads of households; and $80,450 for married individuals filing separate returns..

STRATEGY. Taxpayers who tend to be borderline candidates for the AMT each year, will need to be careful of bunching deductions into one year so as not to lose their value. Certain itemized deduction, such as state and local taxes and miscellaneous itemized deductions, do not reduce AMT income. As a result, taxpayers should attempt to shift some of those deductions from years in which they are liable for the AMT to one in which they are not.

COMMENT. Manipulating certain income and deductions in an attempt to reduce regular tax or AMT liability may in fact increase either liability because of differences in the income and deductions allowed for regular tax and AMT purposes. Taxpayers whose regular

and AMT liabilities that tend to be equal from year to year, may want to maintain this sort of stability. If income and deductions are not so evenly spaced year to year, taxpayers will want to make careful planning to minimize both regular tax and AMT liabilities.

Itemized Deduction and Personal Exemption Phaseouts

In lieu of claiming a standard deduction, taxpayers may claim itemized deduction of certain personal expenses paid during the year, such as medical expenses, taxes, mortgage interest, and charitable contributions. The total amount of itemized deductions allowed is phased out or reduced if AGI exceeds a threshold amount. The phaseout sometimes referred to as the "Pease" limitation (named for the member of Congress who sponsored the original legislation).

COMMENT. The phaseout reduces the total amount of taxpayer's otherwise allowable itemized deductions by three percent of the amount by which the taxpayer's AGI exceeds an applicable threshold. However, the amount of itemized deductions is not reduced by more than 80 percent; but enough to try to avoid through year-end planning, if possible. Certain items, such as medical expenses, investment interest, and casualty or theft losses, are excluded.

For 2017, the income threshold is: $313,800 for married individuals filing jointly and surviving spouses; $287,650 for heads of households; $261,500 for unmarried individuals; and $156,900 for married individuals filing separate returns. For 2018, the income threshold is: $320,000 for married individuals filing jointly and surviving spouses; $293,350 for heads of households; $266,700 for unmarried individuals; and $160,000 for married individuals filing separate returns.

STRATEGY. Individuals who may be affected by the Pease limitation may want to explore the value of either accelerating or deferring itemized deductions if possible to avoid or lessen its impact. Similarly, individuals might consider accelerating or postponing gifts to charity or state income or property tax payments to raise change the level of their itemized deductions.

COMMENT. At press time, Congress and the Trump administration are working to enact tax reform legislation. One possible outcome is an increase in the standard deduction to $24,000 for married taxpayers and $12,000 for single filers. In a trade-off for these higher amounts, and in a bid for "tax simplification" only charitable contri-

butions and mortgage interest would survive as itemized deductions and no personal exemptions would be allowed. Taxpayers should continue to monitor these proposals as end-year 2017 approaches.

In addition to claiming itemized deductions for personal expenses, taxpayers under current law are allowed a personal exemption for themselves, spouses if married filing jointly, and any dependents claimed on their return. The total amount of personal and dependency exemptions allowed is phased out or reduced if AGI exceeds a threshold amount. The threshold amounts for the personal exemption phaseout (PEP) are the same as the threshold amounts for the Pease limitation.

Personal Exemption Amounts before PEP reduction:

2018	2017
$4,150	$4,050

COMMENT. Under the phaseout for personal and dependency exemption, the total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each $2,500, or portion thereof (two percent for each $1,250 for married couples filing separate returns) by which the taxpayer's AGI exceeds the applicable threshold level.

COMMENT. At press time, the Trump/GOP framework for tax reform would repeal the personal exemptions for dependents while increasing the Child Tax Credit. That framework in effect would roll the personal exemptions for taxpayers and spouses into a higher standard deduction.

Other Income Caps on Benefits

Monitoring AGI at year end can also pay dividends in qualifying for a number of other tax benefits. Often tax savings can be realized by lowering income in one year at the expense of realizing a bit more in the other. The following table lists other tax benefits that get phased out or reduced depending taxpayers AGI and the level for 2017 and 2018 that the phaseout begins. In year-end planning to take advantages of the year-to-year differences, taxpayers should keep a close eye on tax reform legislation that may change phase-out levels (and the underlying tax benefits) for either 2018, or 2017 and 2018.

	2017	2018
Savings Bond Interest Exclusion		
Married filing jointly	$117,250	$199,550
Single, head of household	$78,150	$79,700
Lifetime Learning Credit		
Married filing jointly	$112,000	$114,000
Single, head of household	$56,000	$57,000
American Opportunity Credit		
Married filing jointly	$160,000	$160,000
Single, head of household	$80,000	$80,000
Student Loan Interest Deduction		
Starting AGI phaseout		
Married filing jointly	$135,000	$135,000
Single, head of household	$65,000	$65,000
Adoption credit		
All filers	$203,540	$207,580
Maximum Roth IRA Contributions		
Married filing jointly	$186,000	$189,000
Single, head of household	$118,000	$120,000
Maximum IRA contributions for individuals covered by a retirement plan		
Married filing jointly	$99,000	$101,000
Single, head of household	$62,000	$63,000
Married filing jointly (only one spouse covered)	$186,000	$189,000

Life Events

The biggest variable for many taxpayers impacting their year-end tax planning are likely to be life events such as marriage, divorce birth or adoption of a child, a new job or the loss of a job, and retirement. These life events may result in a change in filing status and a variety of tax benefits that will affect tax liability. The possibility of significant changes and/or significant or unusual items of income or loss should also be part of a year-end tax strategy. Additionally, taxpayers need to take a look into the future and predict, if possible, any events that could trigger significant income, losses, or deductions.

Marriage. Marital status (single, married or divorced) for the entire tax year is determined on December 31st, unless the taxpayer's spouse dies during the tax year. In that case, marital status is determined as of the date of the spouse's death, and the spouses may be considered married for the tax year and are eligible to file a joint return, unless the surviving spouse remarries during that same year. Because of varying income tax brackets depending upon filing status, a marriage penalty or a marriage benefit may result for any particular couple.

> **STRATEGY.** As a general rule, if each partner has income approximately in the same amount of the other, they will pay more in combined tax filing a married, joint return rather than as two single individuals. Accelerating or postponing marriage or divorce at year end might be considered based upon this difference in tax brackets.

For purposes of filing status, divorce and separation have the following affects:

- An individual who as of the last day of the tax year is legally separated from a spouse under a decree of divorce or separate maintenance is not considered married for that entire year for purposes of filing status.
- An interlocutory decree of divorce does not end a marriage until the decree becomes final.
- A couple living under a separation agreement, but without any court decree, is married.
- A legal separation requires more than a physical separation order, an order of alimony *pendente lite* or other temporary support order.
- A decree of separate maintenance does not render an individual unmarried unless the court order effects a legal separation under local law.
- However, a divorce decree that is in the process of being appealed, and a divorce decree against which there is a motion to vacate pending at the close of the tax year, have been held sufficient to terminate married status for tax purposes.

Same-sex marriage. A marriage of same-sex individuals that is validly entered into in any state or a foreign country is recognized for federal tax purposes. Specifically, a marriage of two individuals is recognized for federal tax purposes if the marriage is recognized by the state, possession, or territory of the United States in which the marriage is entered into, regardless of the married couple's place of domicile. Similarly, two individuals entering

into a relationship denominated as marriage under the laws of a foreign jurisdiction are married for federal tax purposes if the relationship would be recognized as marriage under the laws of at least one state, possession, or territory of the United States.

COMMENT. A marriage for federal tax purposes does not include registered domestic partnerships, civil unions, or other similar relationships recognized under state law that are not denominated as a marriage under that state's law. Thus, while some states have extended the rights and responsibilities of marriage to couples in these relationships, these states also retain marriage as a separate legal relationship. As a result, individuals in a registered domestic partnerships or similar relationship may not file a federal return using the filing status of married filing jointly or married filing separately.

Dependents. Taxpayers may claim an exemption deduction for each dependent they claim on their tax return. Generally, a dependent is someone who is a qualifying child or qualifying relative of the taxpayer. The amount of each exemption is $4,050 for 2017 and $4,150 for 2018. A qualifying child who is born or dies during a particular tax year is considered a qualifying child of the taxpayer for that entire tax year and the exemption amount other than by the AGI limits on the deduction.

COMMENT. The definition of who is a dependent applies for other purposes besides the dependency exemption. However, all of these benefits have cut-off ages that are keyed to the year a dependent turns a certain age any time before the close of the tax year: under 19 (or incapacitated), or under 24 (if a student) for the dependency exemption, under age 17 (or incapacitated) for the child credit, under age 13 (or incapacitated) for the child care credit.

"Kiddie" tax. The "kiddie tax" limits the tax advantages of shifting income to children, but it does not eliminate them. Under the "kiddie tax," the net unearned income of certain children (under 18 by the end of the tax year, except under 24 if a full-time student) that exceeds an inflation-adjusted threshold is taxed at the higher of the child's or the parent's marginal rate.

Even if the kiddie tax does apply, the child's regular tax liability must also be computed, with the child paying whichever tax is higher. The tax on a child who is subject to the kiddie tax is the greater of the tax on all of the child's income without regard to the special rules for net unearned income,

or the sum of the tax on the child's total income reduced by net unearned income, plus the child's share of the allocable parental tax.

The "kiddie tax" applies if:

- the child is required to file a tax return;
- the child does not file a joint return for the tax year;
- the child's investment income is more than $2,100 for 2017 (same for 2018);
- either parent of the child is alive at the end of the year; and
- the child is:
  - under the age of 18 at the end of the tax year;
  - under the age of 19 at the end of the tax year and does not provide more than half of his or her own support with earned income; or
  - under the age of 24 at the end of the tax year, a full-time student, and does not provide more than half of his or her own support with earned income.

The kiddie tax applies to the child's net unearned income, which is the portion of the child's AGI for the tax year that is not attributable to earned income. This amount is further reduced by the limitation on the dependent standard deduction amount ($1,050 for 2017 and 2018) and by the greater of either $1,050 in 2017 and 2018 or the child's itemized deductions relating to the production of the unearned income.

2017 Tax Law Changes Impacting Individuals

The tax law changes year to year and with it taxpayers are faced with opportunities and pitfalls that need particular attention before the end of the year. In many cases, these changes are accounted for based on a tax-year period. Once the current tax year is over, however, there often is no going back for a "do-over" for a missed opportunity or to correct a costly mistake. Year-end 2017 is no exception to this rule. Here's a rundown of some tax incentives that were previously temporary but have been made permanent and may impact year-end planning.

American Opportunity Tax Credit. The American Opportunity tax credit may be used to help pay the cost of the first four years of secondary education attended on at least a half-time basis. The credit amount is equal to 100 percent of the first $2,000 of qualified tuition and related expenses, plus 25 percent of the next $2,000 of qualified tuition and related expenses. Up to 40 percent of the credit amount is refundable should the taxpayer's tax liability be insufficient.

STRATEGY. Keeping an eye on income flow through the end of the year may be essential for those close to the MAGI" cut-off for use of the AOTC. The credit amount phases out ratably for taxpayers with MAGI between $80,000 and $90,000 (between $160,000 and $180,000, if married filing jointly).

STRATEGY: The AOTC is generally allowed only for payments of qualified tuition and related expenses for an academic period beginning in the same tax year as the year the payment is actually made. However, if qualified expenses are paid during one tax year for an academic period that begins during the first three months of the following tax year, the academic period is treated as beginning during the tax year in which the expenses were paid. As a result, a taxpayer who pays qualified tuition and related expenses to a college in December 2017 for the semester beginning in 2018, may claim an education credit for tax year 2017.

CAUTION. An individual must possess a valid Form 1098-T, Tuition Statement, from the school to whom the qualified expenses were paid to claim the AOTC. To prevent improper and fraudulent claims due to the refundable nature of a portion of the AOTC, additional criteria must be satisfied to be able to claim the credit, and a due diligence requirement has been added.

Teachers' classroom expense deduction. Eligible educators (i.e., teachers, administrators and others) may claim an above-the-line deduction (as an adjustment to gross income) for education, classroom-related unreimbursed expenses, rather than as a miscellaneous itemized deduction. The deduction is also available for the unreimbursed costs of the eligible educator's participation in professional development courses that are related to the curriculum in which or the students for which the educator provides instruction. The deduction is limited to set dollar amount each year, adjusted for inflation ($250 for 2017 and 2018). Expenses that exceed the dollar limit can only been claimed as an itemized miscellaneous deduction, to subject to a two-percent AGI floor.

To qualify as an eligible educator for the deduction, the taxpayer must be a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide hired for at least 900 hours during a school year in a school that provides elementary or secondary education as determined under state law.

COMMENT. As with any business expense deduction, receipts are essential. These receipts must not only show purchase within the

tax year, but also that the items were used for a qualified purpose. The IRS might also ask for proof of meeting the 900 hour school year requirement.

State and local sales tax deduction. Individuals may claim an itemized deduction for state and local general sales taxes in lieu of state and local income taxes. Although primarily a benefit to individuals living in states without an income tax, it may also be claimed by all individuals, especially depending upon the sales tax on some "big ticket" purchases.

STRATEGY. Taxpayers generally use IRS tables based upon federal income levels and number of dependents to determine the deduction. Taxpayers who use the tables may also deduct actual sales tax paid on big-ticket items such as a motor vehicle or boat. For those taxpayers who wish to itemize their sales tax to claim more than the table amounts, they must provide adequate substantiation, including purchase within the tax year for which it is claimed. A taxpayer planning the purchase of big-ticket items near year end might want to accelerate or delay a purchase into 2017 and 2018 as their tax situation warrants.

CAUTION. The permanence of any itemized deduction for state and local taxes may be short lived. At press time, there are proposals in Congress to abolish the deduction for any state and local taxes, including income taxes, property taxes and sales taxes to help pay for reductions in the tax rates for individuals and businesses. Thus, the time to act in claiming the deduction may be in 2017 before the deduction is taken away.

Charitable IRA Distributions. Individuals aged 70½ or older may exclude from gross income distributions of up to $100,000 from a traditional or Roth IRA ($100,000 for each spouse if married filing jointly) which are directly donated to a charitable organization. The exclusion is taken in lieu of recognizing income and taking an itemized charitable deduction. As a bonus, however, a qualified charitable distribution counts toward satisfying a taxpayer's required minimum distribution (RMD) for the year from a traditional IRA.

PLANNING TIP. The taxpayer needs the same kind of written acknowledgment from the charitable institution that would be needed to claim a charitable deduction. Also, the same timing rules apply, so that the transfer to the charity must be completed by December 31, 2017, to treat the exclusion as taking place in 2017.

> **CAUTION.** The entire distribution must otherwise be allowable as a charitable deduction (disregarding any percentage limitation) to be excluded from gross income. For example, if the contribution would be reduced for any reason (e.g., a benefit received in exchange or substantiation problems), the exclusion is not available for any part of the qualified charitable distribution.

100-percent gain exclusion on qualified small business stock. Noncorporate taxpayers may exclude 100 percent of the gain from the sale or exchange of qualified small business stock acquired after September 27, 2010, and held for five years.

> **PLANNING TIP.** Because of the various changes to the percentage of the exclusion, a taxpayer in connection with a sale in 2017 must not only meet the five-year holding requirement, but also be aware of the date the qualified small business stock was acquired. For example, if a taxpayer acquired the stock after February 17, 2009, and before September 28, 2010, only 25 percent of the gain will be subject to tax and 75 percent of the gain excluded.

Conservation contributions benefits. Increased deduction limits and enhanced carryforward rules are available for charitable contributions of real property for conservation purposes (qualified conservation contributions). Specific provisions also encourage both individual and corporate farmers and ranchers to make qualified conservation contributions. Under these rules, the deduction percentage limits are raised and enhanced carryforward rules apply for qualified conservation contributions of real property.

> **STRATEGY:** Particularly relevant to year end planning is the enhanced percentage limits allowed when measuring these deductions against the donor's contribution base. For an individual, the amount of a deduction for charitable contributions of appreciated capital gain real property is limited to a percentage of the donor's contribution base. The limit is generally either 20 percent or 30 percent of the donor's contribution base depending on the type of charitable organization receiving the donation. If the taxpayer's contributions in any tax year exceed the applicable percentage limit, the excess may be carried forward for up to five years.

Residential solar energy property. Individuals may claim a tax credit for qualified solar electric property and qualified solar water heating property

installed on or in their home through December 31, 2021. The credit is 30 percent of the cost of the eligible property placed in service in 2017 through 2019, and decreases generally to 22 percent of the property placed in service in 2021.

CAUTION. The residential energy efficient property credit only applies to qualified solar property placed in service after 2016. Prior to 2017, the credit applied to other property including qualified fuel cell plants, qualified small wind energy property, and qualified geothermal heat pump. The credit is no longer available for these types of property after 2016.

Tax Provisions Expired at End of 2016

The PATH Act renewed several extenders related to individuals, for two years through 2016. At press time, there is discussion on Capitol Hill regarding whether to pass an extenders bill to cover these provisions. However, with federal budgets growing ever tighter, approving another round of extensions for this group remains speculative, especially if they are to be made retroactive to January 1, 2017.

Nonbusiness energy property credit. Individuals could have claimed a tax credit for qualified nonbusiness energy property installed on their home, such as residential exterior doors and windows, insulation, heat pumps, furnaces, central air conditioners, and water heaters, placed in service before January 1, 2017. The property must meet certain energy conservation criteria to be eligible for the credit.

STRATEGY. If this extenders provision is renewed again by Congress, attention to the deadline is important: equipment must be placed in service, rather than merely purchased, on or before the end of the tax year to claim it during that year.

COMMENT. The credit is generally 10 percent of the cost of the qualified property, but there is a $500 maximum lifetime limit. In addition there is $200 limit for exterior windows and skylights reduced by any credit claimed in a previous year, a $50 limit for any advanced main air circulating fan, a $150 limit for any qualified furnace or boiler, and a $300 limit for any other item.

Fuel cell motor vehicle credit. A tax credit was available for a new qualified fuel cell motor vehicle purchased before January 1, 2017, and

placed in service during the tax year. A qualified fuel cell motor vehicle was a motor vehicle that is propelled by power derived from one or more cells that convert chemical energy directly into electricity by combining oxygen with hydrogen fuel that is stored on board the vehicle and may or may not require reformation before use.

The amount of the new qualified fuel cell motor vehicle credit was determined the based on the vehicle's gross vehicle weight rating and fuel efficiency. The credit ranged from $4,000 to $40,000, based on weight.

> **STRATEGY.** Only commercially available vehicles made by a manufacturer qualified; any homemade variation did not. Examples of qualified fuel cell vehicles are the Hyundai Tucson and Toyota Mirai.

Electric motorcycles credit. Taxpayers could claim a tax credit for qualified two-wheeled plug-in electric vehicles (i.e., electric motorcycles) acquired before January 1, 2017, and placed in service during the tax year. The credit was equal to 10 percent of the cost of each qualified plug-in electric vehicle with a maximum credit per vehicle of $2,500.

Mortgage insurance premium deduction. Qualified mortgage insurance premiums could be claimed by individuals as part of their itemized deduction of home mortgage interest if paid or accrued before January 1, 2017, and not properly allocable to a period after December 31, 2016. However, for every $1,000 by which the taxpayer's AGI exceeded $100,000, the amount of premiums treated as mortgage interest was reduced by 10 percent (every $500 in excess of $50,000 for married individuals filing separately).

> **STRATEGY.** If Congress does extend this tax benefit for premiums paid or accrued in 2017, then it would be important for taxpayers to pay the premiums before the end of the year to be assured of the deduction.

Tuition and fees deduction. Taxpayers were able to claim an above-the-line deduction in calculating their AGI for qualified tuition and related expenses paid before January 1, 2017.

> **STRATEGY.** If Congress extends this deduction against, the timing of payments by year-end 2017 may be particularly critical to taking this deduction. However, there is some flexibility regarding the deductibility of tuition paid before a semester begins. As with the American Opportunity tax credit, the deduction is allowed for ex-

penses paid during a tax year, in connection with an academic term beginning during the year or the first three months of the next year.

The maximum amount of the tuition and fees deduction was $4,000 for an individual whose AGI for the tax year did not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose AGI did not exceed $80,000 ($160,000 in the case of a joint return). No deduction was allowed for an individual whose AGI exceeds these thresholds, a married individual filing a separate return, or an individual with respect to whom a dependency exemption may be claimed by another taxpayer. A taxpayer cannot claim the tuition and fees deduction if he or she, or any other person, claims an education credit such as the American Opportunity tax credit in the same tax year with respect to the same student. This is because qualified expenses are defined the same as for purposes of the credit.

CAUTION. An individual must possess a valid Form 1098-T, Tuition Statement, from the school to whom the qualified expenses were paid to claim the tuition and fees deduction.

Exclusion for discharge of debt on principal residence. Individuals could have excluded from gross income a limited amount of debt discharged on a qualified principal residence. The qualified debt had to discharged before January 1, 2017, or was subject to an arrangement that was entered into and evidenced in writing before January 1, 2017. The aggregate amount that could be excluded was limited to $2 million, or $1 million in the case of a married individuals filing separate returns.

STRATEGY. Generally, homeowners must include in gross income the amount of mortgage discharged or otherwise forgiven on their home. If Congress were to extend the exclusion of income from the discharge a qualified mortgage after 2016, then homeowners underwater on the mortgage have a planning opportunity. They may want to negotiate with their lender to a discharge a portion before the end of year to take advantage of the exclusion.

STRATEGY. To exclude discharged debt under this exclusion, the lender was required issue the appropriate Form 1099-C, for the particular tax year desired. In other words, the lender needed to be onboard that no further collection activities would take place. Qualification for the exclusion in effect is not a unilateral decision

made by the homeowner. The IRS encouraged homeowner to work out the disagreement with the lender and have the lender issue a corrected Form 1099-C.

STRATEGY. Another route to avoid income recognition from debt forgiveness is through use of the insolvency exclusion. If a taxpayer's net worth is negative at the time of the debt forgiveness—that is, the fair market value of assets is less than liabilities immediately before the discharge.

Other 2017 Deadlines and Changes

Additional IRS guidance, regulations, and case law released so far in 2017 also impact on year-end tax planning. Some of these 2017 developments include:

Charitable contribution substantiation. In response to concerns from some in Congress and the nonprofit community, the IRS withdrew proposed regulations (NPRM REG-138344-13) providing an optional reporting procedure for donees to substantiate certain charitable contributions of $250 or more. That proposed method of information reporting would have included the donor's name, address, and taxpayer identification number/Social Security number ("Donee Report"). Many charitable organizations expressed concerns about the information reporting requirements, particularly Social Security Numbers from donors.

STRATEGY. Charitable contributions are deductible only if they are verified in accordance with the applicable substantiation requirements. Cash donations must be substantiated with bank records of written communication from the donee. Charitable contributions of $250 or more must be substantiated by contemporaneous written acknowledgment from the donee organization. For qualified vehicles valued at more than $500, the writing must include the sale proceeds amount. Contributions of property must be documented by a statement from the donee. Appraisal is required for contributions of property in excess of $5,000. A penalty applies to an underpayment of tax attributable to a substantial valuation overstatement.

Relief for late rollovers. The IRS unveiled a new self-certification procedure for taxpayers who inadvertently miss the 60-day time limit for certain retirement plan distribution rollovers Distributions to plan participants must be rolled over, i.e., deposited, into another qualified retirement account (usually an IRA) within 60 days.

> **COMMENT.** The procedure eliminates the costs associated with requesting a private letter ruling for the 60-day waiver. It is generally effective August 24, 2016; further, the IRS may grant a waiver during an examination of the taxpayer's income tax return of any year. The procedure does not rubber-stamp any excuse; it must be reasonable and subject to IRS verification.

Per taxpayer mortgage deduction. The IRS announced its acquiescence in *Voss, 2015-2 USTC ¶50,427*. In Voss, the Ninth Circuit Court of Appeals, reversing the Tax Court, had found that when multiple unmarried taxpayers co-own a qualifying residence, the debt limit provisions under Code Sec. 163(h)(3) apply per taxpayer and not per residence. So, rather than sharing the $1.1 million mortgage debt limit to which each taxpayer is subject, whether single or married, joint filers, then two, unmarried taxpayers sharing the same residence and same mortgage debt are effectively allowed a combined $2.2 million limit.

> **COMMENT.** The Ninth Circuit court reasoned that, because the statute expressly provides that married individuals filing separate returns are entitled to deduct interest on up to $550,000 of home debt each, Congress implied that unmarried co-owners filing separate returns are entitled to deduct interest on up to $1.1 million of home debt each. It is up to Congress to revise the law.

Hurricane disaster relief. In response to the hardships being faced by victims of Hurricanes Harvey, Irma and Maria, Congress passed and President Trump signed into law the Disaster Relief Act of 2017. In addition to the administrative relief already provided by the IRS, the new law, among other things:

- eliminates the current law requirements in the disaster areas that uncompensated personal casualty losses exceed 10 percent of adjusted gross income to qualify for deduction;
- eliminates the current law requirement that taxpayers itemize deductions to access this tax relief;
- provides an exception to the 10-percent early retirement plan withdrawal penalty for qualified hurricane relief distributions;
- allows for the re-contribution of retirement plan withdrawals for home purchases cancelled due to eligible disasters;
- provides flexibility for loans from retirement plans for qualified hurricane relief;

- temporarily suspends limitations on charitable contribution deductions associated with qualified hurricane relief made before December 31, 2017;
- provides a tax credit for 40 percent of wages (up to $6,000 per employee) paid by a disaster-affected employer to each employee from a core disaster area; and
- allows taxpayers to refer to earned income from the immediately preceding year for purposes of determining the Earned Income Tax Credit and Child Tax Credit for the 2017 tax year.

At the same time, the IRS announced a number of relief measures including the postponement of certain tax filing and payment deadlines before January 1, 2018, for taxpayers in designated disaster areas, as well as the easing the rules on loans and hardship distributions from retirement plans. The IRS will also not assert that cash payments made from an employer's leave donation program to charitable organizations to assist Hurricane victims should be included in employees' gross income or wages. Leave donation programs allow employees to elect to forgo vacation, sick or personnel leave in exchange for cash payments an employer makes to a qualified charitable organization (Notice 2017-48; Notice 2017-52).

STRATEGY. Taxpayers are also reminded that they can help themselves by keeping a duplicate set of key documents, including tax returns, financial statements, and insurance policies in a safe place. Paper documents should also be scanned into an electronic format as they can easily be stored online. The IRS also recommended that taxpayers photograph or videotape the contents of their primary residences, vacation home, and other locations where valuables may be located. Photographs and videos may help a taxpayer show the fair market value of valuables for insurance and casualty loss claims.

Charitable contribution substantiation. Courts has offered various opinions on how strictly taxpayers must meet the substantiation requirements for claiming various charitable contributions depending on the type of donation. In one case, the Tax Court held that failure to strictly follow the substantiation rules for donations of aircraft precluded a taxpayer from claiming a deduction. The taxpayer's evidence of the donation did not satisfy the requirements for a contemporaneous written acknowledgment (*Izen*, 148 TC No. 5).

STRATEGY. Charitable contributions are deductible only if they are verified in accordance with the applicable substantiation require-

ments. Cash donations must be substantiated with bank records of written communication from the donee. Charitable contributions of $250 or more must be substantiated by contemporaneous written acknowledgment from the donee organization. For qualified vehicles valued at more than $500, the writing must include the sale proceeds amount. Contributions of property must be documented by a statement from the donee. Appraisal is required for contributions of property in excess of $5,000. A penalty applies to an underpayment of tax attributable to a substantial valuation overstatement.

On the other hand, various courts held that substantiation requirements for a charitable contribution of conservation easements may be satisfied by the deed of the easement and a separate contemporaneous written acknowledgment from the done organization was not necessary. The courts found the deeds to *de facto* written acknowledgments since they contained all the required information necessary for the contribution (*310 Retail, LLC*, TC Memo 2017-164; RP Golf, LLC, Dec. 59,215(M), TC Memo 2012-282).

Offers in compromise. The IRS has updated its policy covering offer in compromise (OIC) applications received on or after March 27, 2017. The application will returned without further consideration in instances where the taxpayer has not filed all required tax returns. The application fee will be returned and any required initial payment submitted with the OIC will be applied to outstanding tax debt.

COMMENT. Being in compliance with current tax obligations as a prerequisite for having an OIC considered also includes adequate withholding and/or estimated tax payments.

Applicable Federal Rates. The IRS publishes applicable federal rates (AFRs) each month for various purposes under the Internal Revenue Code. The rates have slowly been rising throughout 2017 and are expected to continue to rise into 2018. Since the AFRs closely reflect general interest rates through the economy, their continue rise into 2018 are either a tax planning opportunity or the closing of certain tax advantages. As general interest rates continue to rise, taxpayers should plan accordingly.

Life Cycle Changes Important to Year-End Strategies

In addition to changes in the tax law, year-end tax strategies should also consider personal circumstances that changed during 2017 as well as what may change in 2018. These "life cycle" changes include:

- Change in filing status: marriage, divorce, death or head of household changes
- Birth of a child
- Child no longer young enough for child credit
- Child who has outgrown the "kiddie" tax
- Casualty losses
- Changes in medical expenses
- Moving/relocation
- College and other tuition expenses
- Employment changes
- Retirement
- Personal bankruptcy
- Large inheritance
- Business successes or failures

PLANNING FOR RETIREMENT

Taxpayers may want to take a look at a number of different provisions in anticipation of retirement, at the point of retirement, or after retirement. Many of these provisions have opportunities and deadlines associated with the concept of taxable year.

Employer plans. Active employees should consider making contributions to an employer-sponsored plan, using elective salary deferrals, particularly if an employer will match the contribution. These plans include 401(k) plans, 403(b) tax sheltered annuities, and 457 state, local and tax-exempt plans. For 2017, the elective salary deferral limit for these plans is the lesser of $18,000 or 100 percent of compensation. Those at least 50 years old at year end are allowed an additional $6,500 contribution on top of the $18,000 maximum. Unlike plans unaffiliated with employers, such as traditional individual retirement accounts (IRAs) that may accept contributions for the 2017 tax year until the April 15, 2018 filing date, contributions to 401(k) plans have a hard-stop at December 31st each year.

IRAs. Employees and other taxpayers should also consider making contributions to individual retirement accounts (IRAs), whether traditional or Roth IRAs. Contributions to traditional IRAs may be deductible, but payouts of deductible contributions (and earnings) will be taxable. Contributions to a Roth IRA are not deductible, but payouts of qualifying contributions and earnings will not be taxable. Contributions to a traditional IRA can be made up the filing deadline (without extensions) for 2017 returns.

Minimum distribution requirements. Most retirement arrangements (other than Roth IRAs) require that participants begin to take annual payments of benefits in the year they turn age 70 1/2. While distributions generally must be made at the end of the calendar year, distributions for the first year can be delayed until April 1 of the succeeding year. However, the possible disadvantage of the latter approach is that the participant will receive two distributions in first year of payments (a delayed payment for the first year and the required payment for the second year).

PLANNING NOTE. The prospects for tax reform legislation impacting retirement planning at year-end 2017 remains uncertain at press time. A "Framework for Tax Reform," released by President Trump and GOP leaders in late September, states that those tax benefits that encourage retirement security will be retained. It goes on to say that "Tax reform will aim to maintain or raise retirement plan participation of workers and the resources available for retirement." On the other hand, this "Framework" also recommends doing away with all personal exemptions, which presumably includes the additional exemption for those over 65 years of age.

Roth conversions/ reconversions

A traditional IRA may be converted to a Roth IRA. As with rollovers to traditional IRAs, the 10-percent additional tax on early distributions does not apply; however, unlike rollovers to traditional IRAs the amount converted is taxable in the year of conversion.

STRATEGY. A key advantage of a traditional IRA for taxpayers who anticipate being in a lower tax bracket during their retirement years is that the deduction is taken in their high-earning years when they are in a high tax bracket, and the distributions are made in low-income years when their tax bracket is lower. That consideration would not apply for higher wealth individuals whose income will remain in a high tax bracket. In addition, traditional IRAs force

such individuals to take required minimum distributions that they do not need and which (and unlike their dividend or capital gains income) are taxed at ordinary rates. Conversions may make sense for these kinds of taxpayers if they can afford the immediate tax. A common strategy for such taxpayers is at "tax filing time" each year, to convert in amounts that "fill up" a lower tax bracket before the next bracket level is reached.

Timing. Any amount converted to a Roth IRA is includible in gross income as a distribution for the tax year in which the amount is distributed or transferred from the traditional IRA. When a rollover spans two tax years, the taxable amounts from the traditional IRA are included in gross income in the year in which the amounts are withdrawn from the traditional IRA.

STRATEGY. Converting when IRA asset prices are depressed makes sense if the taxpayer anticipates recovery because the taxpayer will have to pay less tax for each asset converted. Note that if a taxpayer converts and then IRA asset prices suddenly drop, the taxpayer is left with a large tax bill with little to show for it. Fortunately, there is an option for such situations.

Recharacterizations. A recharacterization allows a taxpayer to undo conversion to a Roth IRA by asking the Roth IRA trustee to transfer the amount back to a traditional IRA. As long as the recharacterization is done by the due date of the taxpayer's return, including extensions, the taxpayer can ignore the conversion. This means that a taxpayer has until October 15 of the following year to recharacterize. Note that the taxpayer does not have to request an extension or file after April 15 to take advantage of the October 15 deadline.

Year-end reconversions. Once a Roth IRA has been recharacterized back to a (new) traditional IRA, the (new) traditional IRA can be (re)converted to a Roth IRA, provided the taxpayer meets the eligibility requirements in the reconversion year.

An individual who converts an amount from a traditional IRA to a Roth IRA during any tax year and then transfers that amount back to a traditional IRA by means of a recharacterization may not reconvert that amount from the traditional IRA to a Roth IRA before the beginning of the tax year following the tax year in which the amount was converted to a Roth IRA or, if later, the end of the 30-day period beginning on the day on which the IRA owner transfers the amount from the Roth IRA back to a traditional IRA by means

of a recharacterization (regardless of whether the recharacterization occurs during the tax year in which the amount was converted to a Roth IRA or the following tax year).

EXAMPLE. On March 1, 2017, Maria converts an amount from her traditional IRA to a Roth IRA. On July 1, 2017, she transfers the funds back to a traditional IRA by means of a recharacterization. Maria must wait until January 1, 2018, to convert back to the Roth IRA. Note that if Maria had completed the recharacterization on December 20, 2017, she would have to wait until January 20, 2018, to reconvert.

Self-Directed IRAs

A self-directed IRA may own a newly created entity (typically an LLC), managed by the IRA owner, which makes investments using IRA funds without violating the prohibited transaction rules. These arrangements typically give the IRA owner "checkbook control" over the IRA funds, and allow the owner to make nontraditional investments, including investments in real estate, private business entities, precious metals, etc.

A self-directed IRA that is a member/owner of an LLC is a tax exempt entity that may have unrelated business taxable income (UBTI) and as such must report on Form 990-T, Exempt Organization Business Income Tax Return. For an IRA (and retirement plans generally), the due date is the 15th day of the fourth month after the tax year (for other tax exempts, it is the 5th month).

STRATEGY. IRA LLCs are commonly used for real estate investments and enterprises since income from real estate is generally excluded from UBTI.

Owners of an exporting entity might set up an Interest Charge Domestic International Sales Corporation (IC-DISC) to which the exporting entity pays commissions. The commissions are not subject to federal income tax at the IC-DISC level. The IC-DISC shareholders pay tax upon the receipt of a distribution, deemed or actual. If the IC-DISC shareholder is a tax-exempt entity, such as a qualified pension plan or IRA, that shareholder is treated as receiving unrelated business taxable income (UBTI).

COMMENT. A Roth IRA is preferable to a traditional IRA for this purpose since income is tax free rather than merely deferring tax. Typically, an IRA is used to directly own the IC-DISC, or own shares in a C corporation that owns the IC-DISC.

CAUTION. There is some tension in the law over whether the form-over-substance doctrine disallows this type of arrangements. In *Summa Holdings v. Commissioner*, the IRS took the position that it does, and the Tax Court agreed. However, on appeal the Sixth Circuit Court of Appeals held that it does not as long as it follows the tax code. The Sixth Circuit's *Summa* decision is the law in Ohio, Michigan, Kentucky and Tennessee. The IRS has not, however, indicated that it plans to acquiesce to this ruling for other states.

MyRAs

A "myRA" is a Roth IRA that invests in a new United States Treasury retirement savings bond, which will not lose money. The Treasury Department has announced that it is winding down the myRA program after a review revealed that the program was not cost effective. The Treasury Department will notify participants in the myRA program of the changes, including information on moving their myRA savings to another Roth IRA. Participants are encouraged to visit www.myRA.gov for additional information or to call myRA customer support with any questions.

Employer Retirement Plans

The deadline for an employer to set up a qualified retirement plan (including a 401(k) plan) for a year by the end of the tax year. For SIMPLE plans, the plan must be set up between January 1 and October 1 (except for a new employers that come into existence after October 1). An employer can be set up a SEP plan any time before the due date of the employer's tax return for that year (including extensions).

Employer contributions to a plan can be made as late as the due date for the employer's tax return (including extensions) for that year.

Due to regulatory changes made in 2016, employers with qualified plans may amend their plans to allow bi-furcated distributions to allow participants to direct a portions of a distribution to different destinations for distributions with annuity starting dates in plan years beginning on or after January 1, 2017, or, if the taxpayer elects, to earlier periods. The IRS has provided model language for such amendments.

AFFORDABLE CARE ACT—INDIVIDUALS

The ACA imposes new requirements on individuals and tightens or eliminates some tax incentives. Year-end planning for individuals with regards to

the ACA may generally be more prospective than retrospective but there are some year-end moves that may be valuable, particularly with health-related expenditures.

The Trump administration has attempted multiple times to repeal and replace ACA. However, at this time, ACA remains the law of the land. Future legislative and/or administrative changes could substantially alter the requirements currently in place. It may also limit the ability to take medical expenses as an itemized deduction.

Minimum Essential Coverage

Unless exempt, the ACA requires that all individuals carry minimum essential coverage or make a shared responsibility payment. To satisfy the ACA's minimum essential coverage requirement, plans must meet a number of criteria. These include coverage of essential health benefits, coverage of inpatient hospital and physician services, coverage for newborns, women's health services, and more. Plans generally must pay at least 60 percent of the total cost of medical services for a standard population.

STRATEGY. Individuals with health insurance coverage should review the checklist of coverage that satisfies the ACA's minimum essential coverage requirements. Minimum essential coverage designated by statute or regulations includes the following:

- Employer-sponsored coverage (including Consolidated Omnibus Budget Reconciliation Act (COBRA) coverage and retiree coverage)
- Coverage purchased in the individual market, including a qualified health plan offered by the Health Insurance Marketplace
- Medicare Part A coverage and Medicare Advantage (MA) plans
- Most Medicaid coverage
- Children's Health Insurance Program (CHIP) coverage
- Certain types of veterans health coverage administered by the Veterans Administration
- TRICARE
- Coverage provided to Peace Corps volunteers
- Coverage under the Nonappropriated Fund Health Benefit Program
- Refugee Medical Assistance supported by the Administration for Children and Families
- Self-funded health coverage offered to students by universities for

plan or policy years that begin on or before Dec. 31, 2014 (for later plan or policy years, sponsors of these programs may apply to HHS to be recognized as minimum essential coverage)
- State high risk pool coverage established on or before November 26, 2014 in any state

Excepted Benefits

Coverage that provides only limited benefits is not minimum essential coverage. These "excepted benefits" (also known as "excepted coverage") includes coverage consisting solely stand-alone vision care or dental care; workers' compensation; and accident or disability coverage. Individuals enrolled in a plan consisting solely of excepted benefits still must obtain minimum essential coverage to satisfy the ACA's individual shared responsibility requirement.

Exemptions

Individuals without minimum essential coverage are liable for an individual shared responsibility payment. However, before making that payment, individuals should ascertain if they are exempt from the ACA's minimum essential coverage requirement. A number of exemptions are available to qualified individuals:

- Religious conscience exemption
- Hardship exemption
- Exemption for members of federally-recognized Native American nations
- Exemption for members of a health care sharing ministry
- Exemption for incarcerated individuals
- Short coverage gap exemption
- Exemption for individuals not lawfully present in the U.S.

STRATEGY. Individuals who experienced a gap in health insurance coverage in 2017 should determine if they qualify for the exemption for a short-term gap in coverage. Generally, a gap in coverage that lasts less than three months qualifies as a short coverage gap. If an individual has more than one short coverage gap during a year, the short coverage gap exemption only applies to the first gap.

STRATEGY. Under IRS regulations, individuals are treated as having minimum essential coverage for a month as long as the individual has coverage for at least one day during that month.

COMMENT. Individuals claiming an exemption from the requirement to carry minimum essential health coverage file Form 8965 Health Coverage Exemptions with their federal income tax return. Form 8965 identifies the types of exemptions and whether an exemption may be granted by the Marketplace, claimed on the individual's income tax return or both.

Hardship exemptions. The IRS has identified the hardship exemptions that may be claimed on a return without obtaining Marketplace certification. If an individual is not required to file an income tax return, he or she is exempt from the individual shared responsibility requirement and need not file Form 8965 to claim a coverage exemption.

STRATEGY. The circumstances that may qualify for a hardship exemption from the individual shared responsibility requirement are broad. The U.S. Department of Health and Human Services (HHS) has identified some circumstances that may qualify for a hardship exemption:

- The taxpayer experienced a fire, flood, or other natural or human-caused disaster that caused substantial damage to his or property
- The taxpayer filed for bankruptcy protection in the last six months
- The taxpayer had medical expenses he or she could not pay in the last 24 months that resulted in substantial debt
- The taxpayer experienced unexpected increases in necessary expenses due to caring for an ill, disabled, or aging family member
- The taxpayer was determined ineligible for Medicaid because his or her state did not expand eligibility for Medicaid under the ACA
- The taxpayer's individual insurance plan was cancelled and the taxpayer believes other Marketplace plans are unaffordable
- The taxpayer was homeless
- The taxpayer was evicted in the past six months or was facing eviction or foreclosure
- The taxpayer received a shut-off notice from a utility company
- The taxpayer recently experienced domestic violence
- The taxpayer recently experienced the death of a close family member

Individual Shared Responsibility Payment

For 2017, the individual shared responsibility payment is the greater of two percent of household income that is above the tax return filing threshold

for the individual's filing status or the individual's flat dollar amount, which is $695 per adult and $347.50 per child, limited to a family maximum of $2,085, but capped at the cost of the national average premium for a bronze level health plan available through the Marketplace in 2017. For 2017, the monthly national average premium for qualified health plans that have a bronze level of coverage and are offered through the Marketplace is $272 per individual and $1,360 for a shared responsibility family with five or more members.

STRATEGY. Open enrollment for coverage through the Health Insurance Marketplace runs for a limited period of time (November 1 through December 15, 2017 for the 2018 plan year). However, some qualifying life events may make an individual eligible for a special enrollment period. These requirements are linked to qualifying life events which include marriage or divorce, having a baby, adopting a child or placing a child for adoption or foster care, change of residence, gaining citizenship, leaving incarceration, or losing job-based coverage. An individual who experiences a complex situation may also qualify for special enrollment. These include exceptional circumstances, such as where the individual faced a serious medical condition or natural disaster that kept the individual from enrolling in the Marketplace during open enrollment. Additionally, individuals whose COBRA coverage is exhausted may be eligible for special enrollment. Some qualifying life events may require pre-enrollment verification of eligibility.

Code Sec. 36B Premium Assistance Tax Credit

Individuals who obtain health insurance coverage through the Health Insurance Marketplace may be eligible for the Code Sec. 36B premium assistance tax credit. The credit is designed to offset the cost of coverage and is payable in advance to insurers. Individuals who receive advance payments of the Code Sec. 36B credit must reconcile their payments using Form 8962, Premium Tax Credit, which are filed with their federal income tax return. Eligibility for the Code Sec. 36B credit is determined, among other criteria, by the relationship of the taxpayer's household income to the federal poverty level (FPL).

COMMENT. According to HHS, the average monthly Code Sec. 36B credit for 2016 was $290 and reduced a consumer's premium by 73 percent.

STRATEGY. Any life event may impact an individual's eligibility for the Code Sec. 36B premium assistance tax credit. These include changes in income; marriage or divorce; birth or adoption of a child; moving out of the area served by the current Marketplace plan; starting a job with health insurance; and gaining or losing your eligibility for other health care coverage. Notifying the Marketplace about changes in circumstances allows the Marketplace to update the information used to determine an individual's expected amount of the credit.

Federal Poverty Line. Generally, a taxpayer's household income for the tax year must be not more than 400 percent of the federal poverty line (FPL) to be eligible for the Code Sec. 36B credit. Under the PPACA, eligibility for a certain year is based on the most recently published set of poverty guidelines at the time of the first day of the annual open enrollment period. Eligibility for the Code Sec. 36B credit for 2018 is based on the 2017 FPL.

STRATEGY. Individuals who obtain coverage through the Health Insurance Marketplace should not overlook the credit as available only to lower-income individuals. Because the credit reaches 400 percent of the FPL, significant numbers of individuals may be eligible. For 2017, for residents of one of the 48 contiguous states or Washington, D.C., the following illustrates when household income would be between 100 percent and 400 percent of the federal poverty line: $12,060 (100%) up to $48,240 (400%) for one individual; $16,240 (100%) up to $64,960 (400%) for a family of two; $24,600 (100%) up to $98,400 (400%) for a family of four.

COMMENT. If an individual is enrolled in a plan that offers only excepted benefits, enrollment in that plan does not preclude claiming the Code Sec. 36B credit for minimum essential coverage, if eligible, through the Health Insurance Marketplace. Excepted benefits ("excepted coverage") is not treated as minimum essential coverage under the ACA.

Medical Expense Deduction

Taxpayers who itemized deductions (for regular tax purposes) may claim a deduction for qualified unreimbursed medical expenses to the extent those expenses exceed 10 percent of adjusted gross income (AGI). The AMT threshold for itemized deductions is 10 percent.

STRATEGY. For deductions by cash-basis taxpayers in general, including for purposes of the medical expense deduction, a deduction is permitted only in the year in which payment for services rendered is actually made. Under this general rule, payment by credit card constitutes payment in the year the charge is made, as opposed to the year in which the credit card statement is paid. Prepayment of medical expenses prior to the year in which services are rendered, however, generally does not accelerate the deduction, absent some legitimate payment-in-advance requirement of the service provider.

COMMENT. At the time this material was prepared, the House had approved legislation *(Halt Tax Increases on the Middle Class and Seniors Act, HR 3590)* to repeal this provision of the ACA and return the medical expense deduction to its pre-ACA parameters. The Senate had not acted on the bill as of the time this material was prepared.

Health Flexible Spending Arrangements

Contributions to health flexible spending arrangements (health FSAs) are capped under the ACA at $2,500 (indexed for inflation). Any salary reductions in excess of the cap subject an employee to tax on distributions from the health FSA. For 2017, the cap is $2,600; for 2018, the cap is projected to rise to $2,650.

STRATEGY. Before year-end 2017, if they have not already done so, individuals need to modify their budgeted expenses to reflect the health FSA contribution maximum.

STRATEGY. Use-it-or-lose-it rules for health FSAs allow cafeteria plans to provide for a 2½ month grace period after the current year to incur expenses and request reimbursement. However, plans are not required to offer this grace period so participants should check before year-end whether a grace period applies to them. Also relevant to year-end is the requirement that an election as to the amount contributed to an FSA be made before the tax year to which it will apply. Additionally, IRS regulations allow employers to amend their plans to permit employees to carry over up to $500 in unused health FSA balances to the following plan year. The amounts carried over do not apply against the annual limitation. However, a plan cannot provide for both a grace period and relief from the use-it-or-lose-it rule. Both the grace period and relief from the use-it-or-lose-it rule are optional for plans.

STRATEGY. Qualified medical expenses for purposes of reimbursements from health FSAs include amounts paid for medicine or a drug only if the medicine is a prescribed drug or is insulin. A prescribed drug qualifies whether or not it is otherwise available without a prescription. A valid prescription is one written by anyone authorized under applicable state law to do so. However, equipment such as crutches, bandages, blood-sugar test kits, eyeglasses and contact lens are reimbursable without a prescription. Year-end planning should include exhausting any unused health FSA dollars if possible with qualifying over the counter purchases (if no need for prescription medicines is contemplated before year-end).

COMMENT. This general ban on reimbursement of over-the-counter drugs also applies to Health Reimbursement Accounts (HRAs), Health Savings Accounts (HSAs), and Archer Medical Savings Accounts (Archer MSAs).

PLANNING FOR BUSINESSES

Businesses seeking to maximize tax benefits through 2017 year-end tax planning may want to consider several general strategies, such as use of traditional timing techniques for delaying income recognition and accelerating deductions as well as strategies tailored for their particular business. For the 2017 tax year, taxpayers have relative clarity with respect to available credits and deductions. With the exception of a handful of industry specific tax credits and deductions that expired at the end of 2016, most temporary credits and deductions were permanently extended by the Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113) (PATH Act). A few others were extended for 5-years through 2019. Far less clear, is the possibility of the enactment of Tax Reform legislation by year's end. The final scope of such legislation if enacted remains unknown. At a minimum, Tax Reform legislation is expected to result in a reduction of corporate and individual tax rates. However, whether such reductions would apply to 2017 as well as to 2018 is uncertain.

Business Credits and Deductions

Many business-related tax credits and deductions that were scheduled to expire after 2015, were permanently extended by the PATH. Others were only extended one year and will not be available for the 2017 filing season unless extender legislation is enacted. A few were extended for a five-year period.

Business-related benefits made permanent by the PATH Act:

- ***15-year recovery period for leasehold improvement, restaurant, and retail improvement property.*** The 15-year recovery period for qualified leasehold improvement property, qualified restaurant buildings and improvements, and qualified retail improvement property is now permanent (Code Sec. 168(e)(3)(E)).
- ***Section 179.*** The $500,000 section 179 expense allowance, which was scheduled for reduction to a mere $25,000, was made permanent with adjustments for inflation. For tax years beginning in 2017, the inflation-adjusted dollar limitation is $510,000. The $510,000 dollar limitation amount is reduced dollar-for-dollar by the amount of qualifying section 179 property placed in service in 2017 in excess of $2,030,000. Under this phase-out rule, the $510,000 dollar limit is completely phased out if the taxpayer places $2,540,000 of section 179 property in service in 2017. Projections for 2018 have the dollar limitation set at $520,000, with the starting point for phaseout reached at $2,070,000.
- ***Research credit.*** The research credit is permanent and is augmented with an election for start-up businesses to claim a credit against payroll taxes in place of the research credit otherwise allowable (Code Sec. 41). Businesses with no more than $50 million in gross receipts are now also allowed to claim the research credit against alternative minimum tax liability (Code Sec. 38(c)(4)).
- ***Recognition period for S corporation's BIG.*** The reduction from five years to ten years of the recognition period for the tax imposed on the built-in gain (BIG) of a C corporation than converts to an S corporation is now permanent. The BIG tax is imposed on sales of appreciated property by the S corporation during the recognition period (Code Sec. 1374(d)(7)).

  PLANNING NOTE. The BIG tax can be triggered by downsizing or other business survival decisions, including the disposal of unused assets to raise needed cash. Consequently, the relief provided by the permanent extension of this tax benefit is valuable for small family or privately-owned businesses.

- ***Shareholder's basis reduction for S corporation's charitable donations.*** The rule providing that the decrease in a shareholder's basis in the stock of an S corporation due to the corporation's charitable contribution deduction is equal to the shareholder's pro rata share of the adjusted basis of the contributed property (rather than the fair market value of the contribution) is made permanent (Code Sec. 1367(a)(2)).

- ***Differential wage credit for activated military reservists.*** The employer tax credit for differential wage payments made by any employer regardless of size to qualified employees on active military duty is made permanent (Code Sec. 45P). The credit is equal to 20 percent of the first $20,000 in wage payments made to an employee on active duty.
- ***Qualified small business stock.*** The 100-percent gain exclusion on qualified small business stock held for more than 5 years is permanent (Code Sec. 1202).
- ***Enhanced deduction for charitable contributions of food inventory.*** The enhanced deduction for charitable contributions of food inventory from any trade or business of a corporate or noncorporate taxpayer is permanent (Code Sec. 170(e)(3)(C)).

  COMMENT. For taxpayers other than C corporations, the total deduction for donations of food inventory during the tax year is limited to a maximum of 15 percent of the taxpayer's net income from all trades and businesses from which the contributions are made during the tax year. For a C corporation, the contributions are limited to 15 percent of the corporation's taxable income.

Business-related benefits with future expiration date

The PATH Act extended several business-related provisions for five-years beginning with the 2015 tax year, with the expectation that general tax reform will consider a more permanent fate.

- ***Bonus depreciation.*** Property placed in service in 2017 is eligible for bonus depreciation at a 50 percent rate. The rate is reduced to 40% in 2018 and 30% in 2019. Bonus depreciation expires after 2019 (Code Sec. 168(k)).
- ***Long-term accounting method relief.*** The rule allowing the percentage of completion under the long-term contract method of accounting to be computed without regard to bonus depreciation claimed on MACRS property with a recovery period of 7 years or less is extended for five years to property placed in service through December 31, 2019 (Code Sec. 460(c)(6)).
- ***Work opportunity credit.*** The work opportunity credit is extended through December 31, 2019 (Code Sec. 51). In general, employers get a 40 percent credit on the first $6,000 of wages paid to a targeted group member, for a maximum credit of $2,400.

Business-related benefits allowed to expire at the end of 2016:

- ***Film, TV, theatrical production expenses.*** The expense election for qualified film and television productions and live theatrical productions expires effective for productions commencing after 2016 (Code Sec. 181).
- ***Indian reservation property depreciation.*** The shorter MACRS recovery periods that apply to property placed in service on an Indian reservation expire effective for property placed in service after 2016. Taxpayers are now permitted to make an election out of the longer depreciation periods by attaching a statement to their income tax return (Code Sec. 168(j)).
- ***Indian employment credit.*** A nonrefundable credit was available to employers for certain wages and health insurance costs paid or incurred in a tax year beginning before January 1, 2017, for qualified full- or part-time employees, or their spouses, who are enrolled members of an Indian tribe (Code Sec. 45A).
- ***Race horse depreciation.*** A 3-year recovery period applies to race horses placed in service through 2016 regardless of age. After 2016, race horses that are two years or younger when placed in service are 7-year MACRS property. Race horses that are three years or older will continue to qualify as 3-year property (Code Sec. 168(e)(3)(A)).
- ***Empowerment zone designations.*** Empowerment zone designations expire after December 31, 2016. Thus, various tax benefits for investments in an empowerment zone, such as a 20 percent wage credit and $35,000 increase in the section 179 expense allowance, are not available in 2017 (Code Sec. 1391(d)).
- ***Energy efficient commercial buildings.*** The deduction for energy efficient commercial building property expires effective for property placed in service after 2016. The deduction is generally claimed by the owner of the building and relates to improvements to interior lighting systems, heating, cooling, ventilation, or hot water systems; or the building envelope (Code Sec. 179D).
- ***Energy efficient home credit.*** Eligible contractors who build an energy-efficient home acquired by a person for use as a residence before January 1, 2017, can claim an income tax credit of up to $2,000 (Code Sec. 45L).
- ***Mine safety equipment expense election.*** The election to expense 50 percent of the cost of advanced mine safety equipment expires effective for property placed in service after 2016 (Code Sec. 179E).
- ***Additional depreciation for biofuel plant property.*** The 50-percent additional depreciation allowance for second generation biofuel plant property expires effective for property placed in service after 2016 (Code Sec. 168(l)).

Code Sec. 179 Expensing and Bonus Depreciation

Section 179. The PATH Act permanently set the Code Sec. 179 expensing dollar limit at $500,000 and the investment limit at $2 million. Both limits are indexed for inflation. In tax years beginning in 2017 the dollar limit is $510,000 and the investment limit is $2,030,000. Projected amounts for 2018 are $520,000 and $2,070,000 respectively.

> **PLANNING NOTE.** The Trump/GOP framework for tax reform that was released in late September proposes to allow businesses to immediately expense the full cost of new investments in depreciable assets other than structures made after September 27, 2017, for at least five years. This incentive as initially proposed apparently would apply to businesses, large and small, with no phase out structure. It therefore would replace both Section 179 and bonus depreciation. This initial proposal, as with others, will be subject to negotiation and refinement.

Tangible property depreciable under MACRS, acquired by purchase, and predominantly (more than 50%) used in the active conduct of a trade or business qualifies as Section 179 property. Off-the-shelf computer software and portable air conditioning and heating units (not used in residential rental units other than hotels and motels) may be expensed (Rev. Proc. 2017-33).

Generally, only section 1245 property qualifies for expensing. An important exception treats qualified real property as eligible for section 179 expensing if a taxpayer attaches an election statement to its return. Qualified real property consists of qualified leasehold improvement property, retail improvement property, and restaurant buildings and improvements that qualify for a 15-year depreciation period under MACRS.

> **STRATEGY.** Prior the end of the tax year, determine whether the taxpayer has any remaining portion of the overall $510,000 limitation available after any phase-out required by the investment limitation.

For 2017, under the investment limitation, no expense deduction may be claimed once $2,540,000 of section 179 property is placed in service. If the election to treat qualified real property as section 179 property is made, all qualified real property placed in service in 2017 is counted toward the investment limitation. Caution is advised in making this election, since it could easily cause the investment limitation to wipe out the ability to claim a section 179 deduction on other types of qualifying property. Another issue to consider before purchasing additional section 179 property before the end of the year is whether the taxpayer will have enough taxable income from

the active conduct of its trades or businesses in 2017 to apply against the amount elected to be expensed under section 179.

> **COMMENT.** Under section 179, the expense election amount may only offset taxable income derived from trades or businesses which a taxpayer actively conducts and any excess is carried forward. Bonus depreciation on the other hand offsets all types of income and can generate a net operating loss that can be carried back two years.

Amended return elections. A taxpayer may make, change, or revoke a Code Sec. 179 election on a timely-filed amended return (Code Sec. 179(c)(2)). Generally an amended return must be filed within 3 years from the date the original return was filed. A return that is filed prior to the regular non-extended due date is considered filed on the due date. A return filed before an extended due date is considered filed on the date of filing. For example, the time for making, changing, or revoking a section 179 election for an individual 2014 calendar-year return filed on or before April 15, 2015, is April 15, 2018.

Bonus Depreciation. Bonus depreciation applies to property placed in service through 2019 (Code Sec. 168(k)). The bonus rate is 50 percent for property placed in service in 2017 but decreases to 40 percent for property placed in service in 2018 and to 30 percent in 2019. Unless extender legislation is enacted the bonus deduction expires after 2019.

Depreciation on property which qualifies for bonus depreciation is not subject to an AMT adjustment even if the taxpayer elects out of bonus depreciation (Rev. Proc. 2017-33). Prior to 2016, AMT adjustments on depreciation claimed on qualifying property were waived only if bonus depreciation was actually claimed. An election out of bonus depreciation could inadvertently trigger an AMT liability.

Beginning in 2016, the bonus allowance for improvements made under a lease to the interior of nonresidential real property (the "qualified leasehold improvement" category of qualifying property) was replaced with a much broader category which allows bonus depreciation for improvements to the interior of nonresidential real property whether or not made pursuant to a lease (the "qualified improvement property" category).

> **STRATEGY.** IRS guidance illustrated that the improvement could be made any time (e.g., a few days) after the nonresidential real property was considered placed in service (Rev. Proc. 2017-33). This means that taxpayers can intentionally delay making leasehold improve-

ments, etc., on a new building until after it is placed in service in order to get the bonus deduction.

Farmers may file a statement with their return to elect to accelerate the 50 percent bonus deduction to the tax year that certain crop bearing trees, vines, and plants are planted or grafted. Normally such property would qualify for bonus depreciation in the first year of commercial productivity.

Corporate election to claim unused AMT credits. In 2017, corporations, regardless of size, may continue to elect to claim unused alternative minimum tax (AMT) credits in lieu of bonus depreciation (Code Sec. 168(k)(4)). If the election is made, the corporation must forgo bonus depreciation on all qualifying bonus depreciation property placed in service in the election year and must depreciate the bonus depreciation property using the MACRS straight-line method.

The credit is equal to 20 percent of the difference between first-year depreciation computed by claiming bonus depreciation and first-year depreciation computed if bonus depreciation is not claimed but may be subject to a limitation.

PLANNING NOTE. The credit is refundable. Thus, a corporation may receive a payment for the credit amount even though it has no tax liability for the tax year the election to forgo bonus depreciation is made.

Differences between bonus depreciation and Section 179. Many times there are no advantages between the expense deduction under Code Sec. 179 and bonus depreciation. For example, both deductions are allowed in full for AMT purposes and neither a short tax year nor the date that the qualifying property is placed in service affect the amount of the deduction. However, certain important distinctions do exist.

- Used and new Code Sec. 1245 property qualify for the Code Sec. 179 expense allowance without regard to the recovery period. Only new property with a MACRS recovery period of 20 years or less qualifies for bonus depreciation. Except for "qualified real property," section 1250 property does not qualify for expensing under Section 179. Bonus depreciation applies to both section 1245 and 1250 property, such as a section 1250 land improvement.

COMMENT: Taxpayers should maximize their overall bonus deductions by first expensing property which does not qualify for bonus

depreciation, for example, used property. In addition, property with the longest recovery period should be expensed before property with shorter recovery periods.

- The Section 179 allowance is subject to the section 1245 recapture rules whether claimed on section 1245 property or section 1250 property (e.g., section 1250 "qualified real property"). Thus, the section 179 allowance may be recaptured as ordinary income to the extent of gain. The bonus allowance is subject to section 1245 recapture if claimed on section 1245 property and is treated as an accelerated depreciation deduction under the section 1250 recapture rules when claimed on section 1250 property (e.g., section 1250 land improvements and qualified improvement property). Under section 1250, the difference between the bonus deduction and straight-line deduction that could have been claimed through the recapture year is subject to ordinary income recapture to the extent of gain.
- The Code Sec. 179 allowance may only be claimed on property that is used more than 50 percent in a trade or business. Even if this threshold is satisfied, investment/production of income may not be taken into account in determining the Code Sec. 179 allowance. The bonus depreciation allowance applies to eligible property whether it is used for trade or business purposes or investment/production of income purposes. The percentage of business use of the bonus property is not relevant unless the property is a listed property, such as a passenger automobile, in which case the bonus depreciation may not be claimed if business use is 50 percent or less or, if previously claimed, must be recaptured when business use falls to 50 percent or less.
- The Code Sec. 179 expensing allowance may not be claimed by estates and trusts and certain noncorporate lessors. This rule does not apply to the bonus depreciation.
- Acquisitions from related parties do not qualify under Code Sec. 179. The bonus depreciation may be claimed on eligible assets purchased from a related party.

STRATEGY. The MACRS mid-quarter convention (rather than the half-year convention) only applies if more than 40 percent of the basis of depreciable property is placed in service in the last quarter of the tax year (Code Sec. 168(d)(3)). Since basis for this purpose does not include amounts expensed under section 179 a taxpayer may be able to expense property in the fourth quarter to avoid the mid-quarter convention or expense property in the first three quarters

in order to trigger the mid-quarter convention. Under the half-year convention a taxpayer claims one-half of a full year's depreciation allowance in the placed-in-service year. The mid-quarter convention allows depreciation on an asset from the beginning of the tax year through the mid-point of the quarter in which the asset was placed in service. The mid-quarter convention produces a larger first-year depreciation deduction than the half-year convention on assets placed in service in the first two quarters of the tax year.

Repair Regulations

In 2013, the IRS issued final tangible property regulations (a.k.a., the "repair regs") on accounting for costs to acquire, repair and improve tangible property (TD 9636). The repair regs impact virtually all asset-based businesses by providing the rules for distinguishing between capital expenditures and deductible repairs or other types of deductible expenses. While taxpayers were expected to file change in accounting methods using the automatic consent procedure to retroactively comply with the repair regs for their first tax year beginning in 2014, taxpayers who are not yet subject to a capitalization audit may continue to file these accounting method changes using the automatic consent procedure described in Sec. 11.08 of Rev. Proc. 2017-30.

CAUTION. Sec. 11.08 was revised to provide that the automatic consent procedure may not be used if the taxpayer is changing from capitalizing to deducting repair and maintenance costs and the taxpayer also received a Code Sec. 1603 grant for energy property in lieu of tax credits in connection with the costs. Taxpayers must also use the advance consent procedure if a tax credit (e.g., rehabilitation credit) was claimed on the previously capitalized amount.

COMMENT. The IRS wants to carefully review and approve these accounting method changes using the advance consent procedure of Rev. Proc. 2015-13 to ensure that a taxpayer is not receiving a double tax benefit with respect to grants and credits claimed on capitalized amounts that the taxpayer now wants to deduct by filing the accounting method change.

In preparing 2017 income tax returns, practitioners need to be aware of several key elections under the repair regs that must be made on an annual basis on a timely filed (including extensions) return.

Building improvements safe harbor for small taxpayers. A taxpayer with $10 million or less in average annual gross receipts in the three preceding tax years may elect not to capitalize improvements on a building, condominium, or cooperative that has an unadjusted basis (generally cost) of $1 million or less if the total amount paid or incurred for repairs, maintenance, *and* improvements for the tax year of the election does not exceed the lesser of (1) $10,000 or (2) two percent of the unadjusted basis of the building (Reg. §1.263(a)-3(h)).

Election to capitalize repairs. Taxpayers can elect to capitalize their repair and maintenance expenses (Reg. §1.263(a)-3(n)). The election applies to all amounts paid for repair and maintenance to tangible property that the taxpayer treats as capital expenditures on its books and records for the tax year covered by the election. The election is intended to reduce uncertainty in applying subjective capitalization and repair standards and to reduce administrative burdens for taxpayers that capitalize their repair and maintenance expenses for financial accounting purposes.

De minimis safe harbor election. The repair elections include a *de minimis* expensing safe harbor that allows taxpayers to annually elect to deduct the cost of materials and supplies and units of property produced or acquired subject to a per-item dollar limit (Reg. §1.263(a)-1(f)). Beginning in 2016, Notice 2015-82 increased the de minimis safe harbor limit under the repair regs from $500 to $2,500 for taxpayers without an applicable financial statement (AFS). An AFS is an audited financial statement or other types of specified statements with similar reliability. Practitioners should ensure that the accounting policy of their non-AFS clients applies the higher limit and that the higher limit is in effect as of the beginning of the tax year in which it will apply (e.g., January 1, 2017 for the 2017 calendar year or January 1, 2018 for the 2018 calendar year).

PLANNING TIP. The use of the de minimis safe harbor requires an expensing policy be in place as of the first day of the tax year in which the de minimis safe harbor will be used. For a taxpayer without an AFS the policy does not need to be written but it should be communicated to employees and faithfully executed. A written policy for non-AFS taxpayers may be advisable to avoid any possible issues with the IRS. Note that the per-item deduction limit may exceed $2,500 but only items costing $2,500 or less receive safe harbor protection.

Partial disposition election. A taxpayer that replaced a major component of a building (e.g., a roof) or other property in 2017 that is depreciable under

MACRS may elect to claim a retirement loss on the undepreciated basis of the component by making a partial disposition election (Reg. §1.168(i)-8). The election is made by claiming the loss on Form 4797.

> **CAUTION.** If the election to claim a loss is made a taxpayer must capitalize any related expenses that might otherwise be considered a currently deductible repair expense. If an entire roof is replaced, the replacement costs are capitalized. Therefore, the election in this situation would not cause any adverse consequence. On the other hand, if a portion of the roof is replaced, this is probably a repair expense. If the election is made, however, the repair costs must be capitalized.

Business Use of Vehicles

Several year-end strategies involving both business expense deductions for vehicles and the fringe-benefit use of vehicles by employees involve an awareness of certain rates and dollar caps that change annually. Changes affecting 2017 include:

Standard mileage rate. Employers and employees arrive at the value of the fringe benefit provided in a particular calendar year by multiplying the standard mileage rate for the year by the total number of miles the vehicle is driven by the employee for personal purposes. The standard business mileage allowance rate for 2017 is 53.5 cents-per-mile (down from 54 cents-per-mile for 2016). Mileage rates for 2018 are expected to be released by February 2018.

Depreciation limits. The IRS releases the inflation-adjusted limitations on depreciation deductions for business-use passenger automobiles, light trucks, and vans around February of each year. Code Sec. 280F(a) imposes dollar limitations on the depreciation deduction for the year the taxpayer places the vehicle in service in its business, and for each succeeding year. The section 179 deduction and bonus deduction are treated as depreciation for this purpose.

The maximum depreciation limits under Code Sec. 280F for passenger automobiles first placed in service during the 2017 calendar year are:

- $3,160 for the first tax year ($11,160 if bonus depreciation is claimed);
- $5,100 for the second tax year;
- $3,050 for the third tax year; and
- $1,875 for each succeeding tax year.

The maximum depreciation limits under Code Sec. 280F for trucks and vans first placed in service during the 2017 calendar year are:

- $3,560 for the first tax year ($11,560 if bonus depreciation is claimed);
- $5,700 for the second tax year;
- $3,450 for the third tax year; and
- $2,075 for each succeeding tax year.

COMMENT. In 2017, the lower first-year cap in the chart above is increased by $8,000 if bonus depreciation is claimed. The increase will be reduced to $6,400 for vehicles placed in service in 2018 and to $4,800 for passenger automobiles placed in service in 2019. These decreases correspond to the scheduled decreases in the bonus depreciation rate from 50 percent to 40 percent in 2018 and to 30 percent in 2019.

$25,000 expensing limitation. Sport utility vehicles (SUVs) and pickup trucks with a gross vehicle weight rating (GVWR) in excess of 6,000 pounds are exempt from the luxury vehicle depreciation caps. However, a $25,000 limit on Code Sec. 179 expensing applies to SUVs and pick-up trucks with a bed length of less than six feet if the vehicle is not subject to the annual depreciation caps because of its weight. The $25,000 limit also applies to passenger vans in excess of 6,000 pounds GVW that seat fewer than ten persons behind the driver's seat. This rule prevents a taxpayer expensing the entire cost of these vehicles in the year of purchase.

Partnership Audit Rules

The *Bipartisan Budget Act of 2015* (Budget Act) repealed the TEFRA unified partnership audit rules and replaces them with streamlined procedures. The Budget Act delayed the effective date of the new audit rules for returns filed for partnership tax years beginning after 2017. However, subject to certain exceptions, partnerships may choose to apply the new rules to any partnership tax year beginning after November 2, 2015. In June, the IRS released a comprehensive set of proposed regulations interpreting the Code provisions under the new centralized audit regime (NPRM REG-136118-15), and more proposed regulations are expected before year's end.

COMMENT. Current tax reform proposals may impact the number of partnership audits for post-2017 tax years. The "Framework for Tax Reform" released by the Trump Administration and GOP leaders in late September would limit the maximum tax rate applied to the busi-

> ness income of small and family-owned businesses conducted as sole proprietorships, partnerships and S corporations to 25 percent. That same proposal, however, warns that "the framework contemplates that the committees will adopt measures to prevent the recharacterization of personal income into business income to prevent wealthy individuals from avoiding the top personal tax rate." Enforcement of those measures would likely result in an uptick in audits of partnerships as well as other passthrough entities, whether under the new partnership audit rules or under small-partnership procedures.

Under the new audit regime, Code Sections 6221 and 6225 provide a general rule that adjustments to partnership income, gain, loss, deduction or credit are determined at the partnership level, and that any additional tax, referred to as the imputed underpayment, will be collected from the partnership. Under new Code Section 6226, a partnership may instead elect to "push out" any partnership adjustments to partners who were partners during the year under review. Partnerships with 100 or fewer partners may elect out of the partnership-level audit rules.

> **COMMENT.** This change affects the manner in which the IRS will audit a partnership return and its partners. It does not affect year-end tax strategies, except perhaps to the extent that an aggressive year-end technique may be audited differently, and any imputed underpayment will be reported differently. Indirectly, however, partnerships should consider year-end 2017 a good time to redraft partnership agreements to cover tax responsibilities and liabilities in anticipation of the IRS' audit of any post-2017 tax year under the new partnership audit regime.

The IRS issued temporary and proposed regulations that provide the time, form, and manner of election for a partnership to opt into the new partnership audit regime prior to 2018 (T.D. 9780, NPRM REG-105005-16). The election to opt-in generally must be made when the IRS first notifies the partnership in writing—through a notice of selection for examination—that it has selected a partnership return (for an eligible tax year) for examination. A partnership makes the election, using Form 7036, within 30 days of receiving the notice of selection for examination. The election-in, once made, cannot be revoked unless the IRS consents.

At a public IRS hearing in September, an American Institute of CPAs (AICPA) representative voiced concern over the fact that, in a major change from the TEFRA procedures, under the new regime, the default mechanism requires

the partnership to pay any additional tax due. This, said the AICPA representative, would result in significant administrative and accounting complexities.

Earlier this year, the AICPA sent a letter to Treasury Secretary Steven Mnuchin and IRS Commissioner John Koskinen asking that the Treasury and IRS work with Congress to enact legislation that would delay the regime's effective date for one year until December 31, 2018. According to the AICPA, it is unlikely that all procedures and guidance necessary for taxpayers to make important decisions under the new regime will be established before the end of the year.

LB&I Issue-Based Compliance Campaigns

The IRS Large Business & International division has rolled out 13 new audit campaigns in nine different practice areas: five focus on a particular subject matter; four are geographically based. This initiative moves the LB&I division in the direction of issue-based examinations, focusing agency resources to drive specific compliance in particular areas, and is a fundamental change in the way the division selects workflow. The campaign process, however, is not expected to change the examination process.

LB&I has said that five of the initial 13 campaigns would use "soft letters," to be sent when a taxpayer has taken a position contrary to the position traditionally taken by the IRS, or when the IRS cannot determine a taxpayer's position from the return. The soft letter provides an explanation of the IRS's position and asks the taxpayer to confirm his or her own position based on the facts and circumstances. The letter also gives taxpayers an opportunity to correct or amend returns.

The 13 campaigns identify the following areas of concern:

- Code Sec. 48C energy credit
- Offshore voluntary disclosure program declines and withdrawals
- Code Sec. 199 domestic production activities deductions
- Micro-captive insurance
- Related-party transactions
- Deferred variable annuity reserves and life insurance reserves
- Basket transactions
- Completed contract method of accounting
- TEFRA linkage plan strategy
- S corporation losses claimed in excess of basis
- Repatriation
- Form 1120-F Nonfiler
- Inbound distributor

Gig Economy

Approximately 2.5 million taxpayers are now earning income each month in the "gig" economy, also commonly referred to as the "sharing" or "on-demand" economy. Participation continues to swell and is expected to double by 2020. In recognition of the increasing importance of the gig economy, the IRS opened a "Sharing Economy Tax Center" this year on its website which provides guidance to gig economy participants on their tax obligations.

The IRS website covers information reporting, estimated tax payments, employment taxes, recordkeeping, and gig-related business expense deductions, such as deductions for homes that are rented, automobiles used for business, and home offices. In addition, rules for determining employee v. independent contractor status are explained.

> **COMMENT.** The gig or sharing economy involves the use on-line platforms and mobile phone apps (usually owned by a third-party business) to arrange transactions that generate revenue from a taxpayer's assets, such as cars and homes or from services such as home repair, computer maintenance, household chores, child care, and food or merchandise delivery. The sharing economy is often used to connect workers and businesses for short-term work or even to obtain cash for business start-ups or personal needs through "crowdfunding."
>
> Income received for inventoried goods and services provided through the gig economy is nearly always taxable to the recipient. In the case of crowdfunding, amounts received are generally taxable income unless the cash received is a bone fide gift or, in the case of a business, the cash received is a contribution in exchange for an equity interest in the enterprise (Information Letter 2016-0036).

Independent contractor or employee? Most persons providing services in gig economy activities are independent contractors. Therefore, the person paying for the services or acting as the middleman connecting the customer and service provider and collecting payment is not required to withhold income taxes, withhold and pay social security and Medicare taxes, or pay unemployment tax. Instead, the independent contractor is required to report and pay self-employment tax and may need to make estimated tax payments in addition to the "normal" filing of an annual federal income tax return.

> **COMMENT.** Independent contractors can file a Schedule C to claim business deductions. Business deductions of employees can only be

claimed as a miscellaneous itemized deduction to the extent in excess of 2 percent of adjusted gross income.

Whether a worker is an employee or an independent contractor depends on a number of factors that fall into three categories: behavioral control, financial control and the type of relationship between the worker and the service recipient (IRS Fact Sheet 2017-9, Jul. 21, 2017)

An employer that incorrectly classifies a gig service provider as an independent contractor may be liable for employment taxes. However, certain measures may be taken both before and after classification takes place:

- An employer who is unsure of how to classify its workers can file, without charge, a Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding;
- An employer that has a reasonable basis for classifying its workers as independent contractors may be entitled to special relief under section 530 of the *Revenue Act of 1978*; and
- An employer may enter the IRS's Voluntary Classification Settlement Program that provides an opportunity to reclassify workers as employees for future tax periods, with partial relief from federal employment taxes.

Workers who believe an employer improperly classified them as independent contractors may use Form 8919, Uncollected Social Security and Medicare Tax on Wages, to figure and report the employee's share of uncollected social security and Medicare taxes.

Information reporting. Information reporting on Form 1099-K (first required in 2012) is a key method used by the IRS to verify that gig economy income is included in a recipient's taxable income.

Form 1099-K is used to report payments received by persons through reportable payment card transactions such as debit, credit, or stored-value cards (e.g., Master and Visa Cards) and through third-party processors who use their online platforms or mobiles apps to facilitate payments (e.g., PayPal, Amazon, UBER, Kickstarter). In the case of payment card transactions, Form 1099-K is issued to persons for whom more than $600 is paid. The filing threshold is much higher for third-party processors as this information return only needs to be provided if the gross amount processed was over $20,000 and there were more than 200 individual transactions. Nevertheless, many third-party processors, such as UBER, provide 1099-Ks even if the filing thresholds are not met.

CAUTION. To avoid reporting the same taxable income twice, taxpayers should review their sales records to determine whether any amounts reported on a Form 1099-K were also separately reported on a 1099-MISC. Form 1099-K is now used to report certain payments by a business to independent contractors that were previously reported on 1099-MISC but should now only be reported by the payment card or third-party processor on Form 1099-K. Some businesses, however, continue to unnecessarily file Form 1099-MISC.

Examples of individuals who may receive Form 1099-K include persons compensated via PayPal, Etsy, AirBnb, and Ebay merchants, and Uber and LYFT drivers.

Regulatory Resets

Executive Order (EO 13789) issued on *April 21, 2017* by President Trump required the Treasury Department to review all regulations issued on or after January 1, 2016, that: (1) impose an undue financial burden on U.S. taxpayers; (2) add undue complexity to the Federal tax laws; or (3) exceed the statutory authority of the IRS.

In its initial report (Notice 2017-38), Treasury reported that it would propose reforms to the following regulations, which could include repeal, in a final report to the White House:

- Proposed Regulations under Section 103 on Definition of Political Subdivision (REG-129067-15).
- Temporary Regulations under Section 337(d) on Certain Transfers of Property to Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs) (TD 9770).
- Final Regulations under Section 367 on the Treatment of Certain Transfers of Property to Foreign Corporations (TD 9803). These regulations eliminate the favorable tax treatment of outbound transfers of foreign goodwill and going concern value in certain nonrecognition transactions described in Code Sec. 367 and narrow the scope of the active trade or business exception of Code Sec. 367(a)(3).
- Final and Temporary Regulations under Section 385 on the Treatment of Certain Interests in Corporations as Stock or Indebtedness (TD 9790) establish threshold documentation requirements that must be satisfied for certain related-party interests in a corporation to be treated as debt, and that treat as stock certain related-party instruments that otherwise would be treated as debt (TD 9790).

- Temporary Regulations under Section 752 on Liabilities Recognized as Recourse Partnership Liabilities (TD 9778).
- Final Regulations under Section 987 on Income and Currency Gain or Loss With Respect to a Section 987 Qualified Business Unit (TD 9794).
- Proposed Regulations under Section 2704 on Restrictions on Liquidation of an Interest for Estate, Gift and Generation-Skipping Transfer Taxes (REG-163113-02). concerning the treatment of certain lapsing rights and restrictions on liquidations in determining the value of transferred interests
- Final Regulations under Section 7602 on the Participation of a Person Described in Section 6103(n) in a Summons Interview (TD 9778).

COMMENT. Treasury explained that it "considered the degree to which the regulation at issue imposed compliance costs or resulted in tax liabilities that exceed the minimum required to achieve the relevant statutory objectives." To assess "undue complexity," Treasury "considered the extent to which the regulation at issue imposed new substantive, computational, or other requirements not required to achieve the relevant statutory objectives, or introduced rules that added uncertainty for taxpayers."

As of press time, the IRS has not released its final report specifying the specific actions it will take with respect to these regulations.

Implementation delay for documentation regulations under Section 385. The Treasury Department and the IRS have announced a one-year delay, until January 1, 2019, to the implementation of the so-called Documentation Regulations (Reg. §1.385-2) under the controversial Section 385 debt-equity regulations (Notice 2017-36). The delay recognizes the difficulties many corporations are having in setting up a reporting structure in time, as well as the possibility that the regulations themselves may change in response to Executive Order 13789's mandate on the review of unnecessary or cumbersome regulations.

The initial purpose of the regulations was to prevent corporate inversions by way of earning-stripping techniques that reclassify as equity certain debt structured to benefit from interest deductions. The regulations, however, cover much more and, in the process, required a broad cross-section of corporations to comply with relatively complex Documentation Regulations, which some say is overkill. Controversy over the Section 385 regs not only surrounds documentation requirements but also, among others, so-called "funding rules" that would convert to equity any debt issued for the principal

purpose of funding a specified transaction, as well as bifurcation rules that were "reserved" for future consideration.

Tax Reform on the Horizon

President Trump ran on a platform of consolidating and reducing individual tax rates. The Trump/GOP "framework for tax reform," released in late September, would reduce the maximum corporate rate to 20 percent, eliminating the federal estate tax and the alternative minimum tax (AMT), as well as limit the maximum tax rate applied to the business income of small and family-owned businesses conducted as sole proprietorships, partnerships and S corporations to 25 percent.

The President also proposed ending unspecified deductions and credits to offset lost revenue from the tax cuts.

> **COMMENT.** A campaign proposal to impose a controversial border adjustment tax is no longer part of the President's plan and is not likely to be part of any Tax Reform package. Under a tax system implementing a border adjustment, U.S. businesses generally would no longer be effectively permitted a deduction based on the cost of imports. Additionally, those businesses would no longer be taxed on income received from exports.

No legislative language has been revealed at press time. It is unclear if tax reform will happen before the end of 2017, and if so, whether the law changes will be temporary or permanent and whether they will be prospective or retroactive.

Administration's Proposed Tax Changes for Business:

- Reduction in maximum corporate tax rate to 20 percent in conjunction with the elimination of unspecified tax breaks intended to prevent most businesses from gaining an effective rate lower than 20 percent
- Repeal of alternative minimum tax
- Repeal of the estate tax
- A one-time tax benefit for repatriated profits
- Targeted limitations on the deduction for net interest expense
- Targeted repeal of carried interest rule

Pass-thru entity taxation. The administration supports a proposal that would apply the 25 percent corporate rate to pass-thru entities, although the details remain unknown. Owners of S corporations, partnerships, and sole

proprietors currently pay tax on pass-thru income at the individual level, with the highest rate topping out at 39.6 percent. That top income tax rate would be reduced to 35 percent under the administration's "framework for tax reform" proposal.

> **COMMENT.** The most likely component of any tax reform legislation will be a tax cut for corporations and, possibly, owners of pass-thru entities. In addition, tax cuts in individual rates seem likely. These cuts may only begin to apply in 2018. Consequently, if cash flow considerations allow, the deferral of income to 2018 where possible will likely be a winning strategy. For example, cash-basis taxpayers can defer income into 2018 by billing for products and services performed in 2017 in 2018. Accrual basis taxpayers can achieve the same result by delaying the delivery of products and the provision of services until 2018.

Territorial tax regime. The President's plan would also move to a territorial tax regime under which U.S. companies would only be subject to tax on U.S. related income.

> **COMMENT.** A territorial tax system for businesses would allow businesses to repatriate newly earned overseas profits without additional taxation.

Carried interest. Although not specifically mentioned in the President's written outline, repeal of the carried interest rule, which provides capital gains tax rates on income received by investment fund managers in exchange for services appears targeted for elimination. Some carried-interest tax breaks, however, may be retained for funds that invest in a way that creates a significant number jobs.

Energy incentives. Current law provides for many energy tax incentives for businesses (and individuals). The President's tax proposal does not specifically address energy tax incentives.

Significant New Developments

Additional IRS guidance released so far in 2017 also impacts year-end tax planning. Some of these 2017 developments include:

Updated automatic change of accounting method procedure. All accounting method changes that may be made without advance IRS consent

(i.e., automatic consent methods) are listed and explained in a single revenue procedure. Rev. Proc. 2017-30, which supersedes Rev. Proc. 2016-29, is the most recently issued procedure. It generally applies to accounting method changes filed on or after April 19, 2017, for a year of change ending on or after August 31, 2016.

COMMENT. Taxpayers requesting IRS consent to change their method of accounting under either the automatic or advance consent procedures must use the current version of Form 3115 which was last revised in December 2015.

Payroll tax credit for small businesses. The IRS issued guidance in early 2017 explaining how a qualifying small business may elect to claim the payroll tax credit of up to $250,000 in lieu of the research credit (Notice 2017-23). This election is useful to a business with no income tax liability against which to claim the research credit. The business must have less than $5 million of gross receipts in the election year and must not have had gross receipts in any tax year that precedes the five-tax-year period that ends with the tax year of the election.

The election is made on Section D of Form 6765, Credit for Increasing Research Activities attached to a timely filed (including extensions) 2017 income tax return.

APPROACHING DEADLINE. Significantly, the guidance contains a transition rule which allows a taxpayer that did not make the election on its return for a tax year beginning after December 31, 2015 to make the election on an amended return filed on or before December 31, 2017. The taxpayer must attach Form 6765 to the amended return and either write "FILED PURSUANT TO NOTICE 2017-23" on the top of the Form 6765 or attach a statement to the Form 6765 that the late election is being made pursuant to Notice 2017-23. A taxpayer claiming the credit on an amended return claims the payroll tax credit on its employment tax return for the quarter beginning after the date the taxpayer filed the amended return.

If the election is timely made, Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities, is used to determine the amount of the payroll tax credit claimed on the applicable payroll tax return (generally, Form 941). Form 8974 is attached to the payroll tax return.

The IRS has clarified that the amount of credit claimed on a Form 941 may be taken into account in determining the amount of withholding to deposit for the quarter for which the Form 941 is filed. The credit reduces

the first payroll payment otherwise due for the quarter and each subsequent payment in the quarter until it is used up. Any unused credit at the end of the quarter is similarly applied toward deposits otherwise due in the next quarter (AM-2017-003, September 1, 2017).

> **CAUTION.** The payroll credit cannot be claimed unless the election was timely made on Form 6765.

> **COMMENT.** For 2017, employers pay Social Security tax of 6.2 percent on up to $127,200 of each employee's wages. A qualifying small business may not use the payroll credit against the employee-portion of Social Security taxes. The credit also may not be used against Medicare taxes.

Safe harbor for determining qualified research expenditures. A Directive from the Large Business & International ("LB&I") Division allows examiners to accept as sufficient evidence of a taxpayer's qualified research expenditures (QREs) for purposes of the research credit, the ASC 730 Financial Statement R&D for the credit year with certain adjustments. The directive only applies to LB&I taxpayers (i.e. taxpayers with assets equal to or greater than $10,000,000) who follow U.S. GAAP to prepare their certified audited financial statements. The amount of the currently expensed ASC 730 Financial Statement R&D must be shown as a separate line item on the income statement included in the certified audited financial statements or as a separately stated note to the certified audited financial statements. A taxpayer may claim QRE's in excess of its Adjusted ASC 730 Financial Statement R&D amount but those amounts do not receive protection under the Directive. The Directive applies only to original returns timely filed (including extensions) on or after September 11, 2017 (LB&I Directive, September 11, 2017).

> **COMMENT.** The Directive provides qualifying taxpayers with an efficient way to determine a minimum amount of tax QRE's that will not be challenged in an IRS audit.

Public utility normalization safe harbor. A public utility is subject to investment tax credit recapture and denied accelerated depreciation under MACRS if it fails to comply with a normalization method of accounting that takes the tax benefits of the ITC and accelerated depreciation into account in setting rates over the regulatory life of its property. The IRS has issued a safe harbor that allows utilities to correct inadvertent or unintentional compliance with the normalization rules in order to avoid recapture of tax benefits. (Rev. Proc. 2017-47).

COMMENT. This safe harbor will eliminate the necessity of filing expensive and time consuming letter ruling requests to make these corrections

Away from home meal expenses ruled fully deductible as fringe benefit. Mandatory pre-game meals eaten in a hotel prior to away games by professional hockey players and staff were considered *de minimis* fringe benefits and, therefore, not subject to the otherwise applicable 50 percent deduction limitation (*Jacobs,* 148 TC No. 24, Dec. 60,947). For purposes of the de minimis fringe rules (Reg. §1.132-7(a)(2) and (a)(3))) the hotel was an employer facility because it was leased to the employer during the employees' stay and the meal facilities were considered operated by the employer via its contract with the hotel. The hotel was considered the employer's business premises during the employees' stay and the meals satisfied the operating-cost test because they were provided for the convenience of the employer.

COMMENT. The *Jacobs* case is the first to address the application of the *de minimis* fringe benefit rule to meals provided "on the road." Other professional teams and even other types of businesses may be able to fit within the narrow parameters of the fringe benefit rule as somewhat liberally interpreted by the Tax Court. Keep in mind that the IRS is likely to file an appeal of the Tax Court's decision in an effort to stymie the extension of this fringe benefit rule.

AFFORDABLE CARE ACT—BUSINESSES

Despite Congressional attempts to repeal the Affordable Care Act, the basic structure of the ACA for businesses, both large and small, generally remains intact. If an employer is an applicable large employer (ALE) based on the previous year's employee head-count, employer shared responsibility provisions and the employer information reporting provisions are triggered. The complex rules for ALEs are beyond the scope of this book. Small businesses, however, are not unaffected by the ACA and should take the ACA into account in year-end planning. Some incentives in the ACA could help maximize tax savings for small businesses.

Contraceptive Coverage

It has been widely reported that the Trump Administration intends to change the Obama Administration's contraceptive coverage regulations that require employer health plans to provide such coverage. Under the change

under consideration, no employer of any size that has a moral objection to providing any particular kind of contraceptive coverage or any contraceptive coverage at all would be under an obligation to do so. They could pursue the Obama Administration's religious employer accommodation if they wanted, but they would be under no obligation to do so. They could simply cease providing coverage.

Health Reimbursement Arrangements

Many small businesses have traditionally provided a health benefit to their employees through a health reimbursement arrangement (HRA). An HRA is an arrangement funded solely by an employer and that reimburses an employee for medical care expenses up to a maximum dollar amount for a coverage period. In Rev. Rul. 61-146, the IRS determined that if an employer reimburses an employee's substantiated premiums for non-employer sponsored hospital and medical insurance, the payments are excluded from the employee's gross income. The exclusion also applies if the employer pays the premiums directly to the insurer.

Following passage of the ACA, the IRS released Notice 2013-54, which described these arrangements as employer payment plans. Therefore, they are considered to be group health plans subject to the ACA's market reforms, including the prohibition on annual limits for essential health benefits and the requirement to provide certain preventive care without cost sharing. Failure to comply with the ACA's market reforms triggers excise taxes under Code Sec. 4980D. The excise tax reaches $100 per affected individual per day.

COMMENT. The IRS provided transition relief (Notice 2015-17) from the excise taxes to qualified small employers but the relief expired after June 30, 2015. Notice 2015-17 covered 2014 and up to July 1, 2015. With the passage of the 21st Century Cures Act, Congress retroactively extended this transition relief through plan years that begin as late as December 31, 2016.

COMMENT. A plan with fewer than two participants who are current employees (a "one-employee health plan") is exempt from the ACA market reforms.

COMMENT. At the time this book was prepared, the House had approved legislation (the Small Business Health Care Relief Act, HR 5447) to provide permanent relief for qualified small employers. Under the legislation, small employers (employers with less than 50-full-time and full-time equivalent employees) would be able to have stand-alone HRAs and reimburse expenses without violating the ACA's market

reforms and triggering penalties for employers. The Senate had not acted on HR 5447 as of the time this book was prepared.

STRATEGY. The excise tax under Code Sec. 4980D is a self-assessed tax. Employers will report the tax when they file their returns.

Qualified Small Employer Health Reimbursement Arrangements

Congress not only provided an extension of relief for reimbursement plans, it also provided an alternative for employers called the Qualified Small Employer Health Reimbursement Arrangements (QSEHRAs). QSEHRAs can be adopted for any plan year beginning after December 31, 2016. Like earlier transition relief, only employers that had fewer than 50 full-time employees the previous year can qualify.

There are additional requirements, however, including the following:

- An employer that has a group health plan for some of its employees must end that plan if it wants to adopt a QSEHRA;
- The employer must establish a "permitted benefit" amount, which is subject to an annual maximum ($4,950 for self-only coverage, $10,000 for family coverage); and
- The employer must be the sole source for funding—employee salary reduction contributions are not allowed.

There are also requirements on the employee starting with having to maintain minimum essential coverage or lose the exclusion for employer provided health coverage. In addition, the premium tax credit is available only if the coverage is not affordable with QSEHRA benefits, and in the case it is available the amount of the credit is reduced by the QSEHRA benefit.

There are a number of administrative requirements:

- The employer must require and maintain documentation substantiating documentation regarding employee minimum essential coverage and employee medical expenses
- The employer must provide written notices to employees 90 days before the beginning of the plan year and is subject to a penalty if it fails to do so (transition relief applies for 2017 until further guidance is issued).
- Each employee's permitted benefit is reported on Form W-2.

A QSE HRA must treat all employees the same, but variations in permitted benefits are allowed as long as they reflect the variation in the price of an insurance policy in the relevant individual health insurance market based on:

- The age of the eligible employee (and, in the case of an arrangement which covers medical expenses of the eligible employee's family members, the age of such family members); or
- The number of family members of the eligible employee the medical expenses of which are covered under such arrangement.

Small Business Health Care Tax Credit

Small employers with no more than 25 full-time equivalent employees may qualify for a special tax credit to help offset the cost of health insurance for their employees. The employer must pay average annual wages of no more than $50,000 per employee (indexed for inflation). The employer also must pay premiums on behalf of employees enrolled in a health plan offered through the Small Business Health Options Program (SHOP) Marketplace or qualify for an exception.

SHOP coverage. SHOP is open to small employers with up to 50 full-time equivalent employees (some states may make SHOP available to employers with up to 100 qualified employees).

STRATEGY. The small employer tax credit may be carried back or forward. Small businesses that do not owe tax, may take advantage of the credit in a prior year or a future year, if eligible.

COMMENT. Wellness programs (discussed below) generally are not taken into account in calculating the credit.

Wellness Programs

Creation of a wellness program could generate tax benefits to the small employer as well as health benefits to employees. Generally, the expenses of an employer-provided wellness program for employees are deductible as a business expense under Code Sec. 162.

COMMENT. IRS regulations divide wellness programs into participatory wellness programs and health-contingent wellness programs. The regulations further divide health-contingent programs into activity-only programs and outcome-based programs. The regula-

tions also describe the reasonable alternatives that wellness programs must offer to avoid violating health plan nondiscrimination rules.

Participatory programs. Participatory programs either do not provide a reward or do not include any condition for obtaining a reward based on a standard related to a health factor. Examples of participatory programs include:

- Reimbursement for all or part of the cost of a fitness membership;
- A diagnostic testing program that rewards participation, and does not base any reward on test outcomes;
- A program that reimburses costs of participating, or provides a reward for participating, in a smoking cessation program, regardless of whether the employee quits smoking; and
- A program that rewards employees who complete a health risk assessment, without requiring any further action.

Health-contingent programs. A health-contingent wellness program requires an individual to satisfy a standard related to a health factor, to obtain a reward. The maximum permissible reward under a health-contingent program is 30 percent of the cost of coverage (50 percent if the additional amount is for programs designed to prevent or reduce tobacco use).

There are specific requirements for health contingent programs:

- Individuals must have an opportunity to qualify for the reward at least once a year.
- The total reward cannot exceed the specified limits.
- The program must be reasonably designed to promote health or prevent disease.
- Programs must be available to all similarly-situated individuals. For both types of health-contingent programs, a reasonable alternative standard (or a waiver) must be made available to any individual for whom it is unreasonably difficult, due to a medical condition, to satisfy the standard.
- The plan must disclose the availability of alternatives to qualify for the reward (or a waiver).

COMMENT. For activity-only programs, individuals must perform an activity to obtain a reward, but they do not have to attain a specific health outcome. Under an outcome-based program, an individual must attain or maintain a specific health outcome, such as not smoking or attaining certain test results. For individuals who do not

meet the specific health outcome, the program may offer compliance with an educational program or activity to achieve the same reward.

Information Reporting

Under Code Sec. 6055, every provider of "minimum essential coverage" must report coverage information by filing an information return with the IRS and furnishing a statement to individuals. Code Sec. 6056 requires applicable large employers (ALEs) to file information returns with the IRS, and provide statements to their full-time employees about the health insurance coverage the employer offered.

COMMENT. Employer reporting under Code Sec. 6056 (and insurer reporting under Code Sec. 6055) is needed for the administration of Code Sec. 4980H (employer shared responsibility requirements) and the Code Sec. 36B premium assistance tax credit.

COMMENT. An ALE with respect to a calendar year is an employer that employed an average of at least 50 full-time employees (or combination of full-time and part-time employees that equals at least 50) on business days during the preceding year. For purposes of determining whether an employer is an applicable large employer, full-time employees and full-time equivalent employees are taken into account. An employee is a full-time employee if he or she works on average at least 30 hours a week. A part-time employee is an employee whom the employer reasonably expects to be employed on average less than 30 hours of service per week.

COMMENT. An hour of service is each hour for which payment is made or due to an employee. For non-hourly employees, hours of service can be accounted for in a similar manner; by using a days-worked equivalency where the employee is credited with eight hours of service for each day for which the employee would be credited with at least one hour of service; or by using a weeks-worked equivalency where the employee is credited for 40 hours of service for each week for which the employee would be credited with at least one hour of service.

Forms. The IRS has developed Forms 1094-B, Transmittal of Health Coverage Information Returns; 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns; 1095-B, Health Coverage; and 1095-C, Employer-Provided Health Insurance Offer and

Coverage. The format for this information reporting is generally similar to other information reporting with which many employers are familiar.

The IRS has explained that providers are not required to report the following minimum essential coverage that is supplemental to other minimum essential coverage:

- Coverage that supplements a government-sponsored program, such as Medicare or TRICARE supplemental coverage; or
- Coverage of an individual in more than one plan or program provided by the same plan sponsor (the plan sponsor is required to report only one type of minimum essential coverage).

Coverage is not provided by the same plan sponsor if it is not reported by the same reporting entity. An insured group health plan and a self-insured health reimbursement arrangement (HRA) covering the employees of the same employer are not supplemental, the IRS explained.

STRATEGY. Some small employers may potentially have more of a burden. If a small employer has a fully insured plan, the insurer will report information on Forms 1094-B and 1095-B, and the small employer has no reporting requirement. If, in addition to having a fully insured plan, the small employer has an HRA that results in a self-insured plan that triggers a reporting requirement, the small employer will also have to file Forms 1094-B and 1095-B.

COMMENT. The deadline for filing Forms 1094-B and 1095-B, and Forms 1094-C and 1095-C is February 28 if filing on paper and March 31 if filing electronically. An automatic 30-day extension is available by completing Form 8809 and filing it with the IRS on or before the due date for the Form 1094-B and 1095-B. Because March 31, 2018, falls on a Saturday, the due date for electronic filing is April 2, 2018.

The IRS encourages, but not require, health insurance issuers and carriers to report coverage in catastrophic health plans enrolled in through the Marketplace for months in 2017.

ACA Excise Tax Moratoriums Set to Expire

Medical device tax. The ACA imposes a tax equal to 2.3 percent of the sale price on the sale of any taxable medical device by the manufacturer, producer, or importer such device (effective for sales after December 31, 2012). The

Consolidated Appropriations Act, 2016 (P. L. 114-113) suspended the medical device excise tax for a period of two years. The suspension is effective for sales on or after January 1, 2016 and before January 1, 2018. Barring further action by Congress, the medical device tax will commence on sales beginning on January 1, 2018.

> **COMMENT.** The medical device excise tax does not apply to eyeglasses, contact lenses, hearing aids, or any other medical device determined by the IRS to be of a type that is generally purchased by the general public at retail for individual use. This is known as the "retail exemption."

Health insurance coverage tax. The ACA imposes an annual fee on providers of health insurance for U.S. health risks. There is a moratorium on the fee for 2017. Under the moratorium, no fee will be due in fee year 2017 based on the 2016 data year. The moratorium does not affect the filing requirement and payment of fees for 2016. Form 8963 (Rev. February 2016) must be filed by April 18, 2016. The 2017 moratorium has no effect on the filing obligation or fee amount for the 2018 fee year and the aggregate fee for 2018 remains at $14.3 billion.

> **COMMENT.** If Congress does nothing, this fee will spring back for 2018 and thus directly increase the cost of health insurance coverage.

Branded Prescription Drug Fee

The IRS issued final regulations defining "controlled group" for purposes of the branded prescription drug fee. The final regulations affect manufacturers or importers of certain branded prescription drugs. The final regulations are effective July 24, 2017.

GENERAL & SPECIFIC TIMING RULES

Year-end tax planning, especially if done "at the eleventh hour," requires some understanding of the timing rules: when income becomes taxable and when it may be deferred; and, likewise, when a deduction or credit is realized and when it may be deferred into next year or beyond.

The current uncertainty in tax law complicates timing strategies for 2017. Due to that uncertainty, taxpayers must be nimble and be prepared to implement timing strategies based on tax legislation adopted this year.

It is likely that most tax legislation, if and when approved, would not be effective until 2018. However, the law changes would still impact year-end planning since strategies designed to straddle the 2017 and 2018 tax years would remain in play.

Income Acceleration/Deferral

Taxpayers using the cash method basis of accounting can defer or accelerate income using a variety of strategies. These may include:

Sell appreciated assets. It is probable that the capital gains rate will not decrease. Especially if a taxpayer has losses that may cover these gains, realizing some investment gains may make sense. Identical appreciated securities may be sold and repurchased. Their cost basis would be reset with, at worst, a downside of some accelerated tax liability. The "wash sale" rule only applies to losses.

Receive bonuses before January. If an employer goes against custom and pays a bonus in the year of service (2017) rather than up to 2 ½ months into 2018 to get the same deduction, the employees can take the bonus into income in 2017.

Sell outstanding installment contracts. Income on a sale reported under the installment method is realized pro-rata over the years in which the installment payments are made. To accelerate income realization, the taxpayer simply sells the remainder of the installment contract to a third party for a lump sum.

Redeem U.S. Savings Bonds. For cash-basis taxpayers, interest on series E, EE and I bonds is generally taxed at the earliest of disposition, redemption or final maturity of the bond (however, the taxpayer can elect to report the interest as it accrues).

Accelerate debt forgiveness income. Determination of the time of debt forgiveness requires a practical assessment of the facts and circumstances relating to the likelihood of payment. Convincing the lender to issue a Form 1099-C, Cancellation of Debt, for the 2017 tax year, should also form part of the process. Note that beginning in 2017, the 36-month nonpayment testing period no longer applies. The exclusion related to mortgage debt on a principal residence also expired at the end of 2016, unless it is extended by Congress.

Avoid mandatory like-kind exchange treatment. Taxpayers may also avoid tax deferred, like-kind exchanges by taking steps to disqualify the transaction from Code Sec 1031 treatment. Such steps might include delaying identification of replacement property, transferring cash to an intermediary, or switching to a sale-and-reinvestment arrangement.

Self-employed year-end receipts. Self-employed taxpayers can defer income by waiting to send year-end bills until 2018. However, merely delaying the deposit of a bill payment does not delay the income.

Deduction Acceleration/Deferral

A cash basis taxpayer generally deducts an expense in the year it is paid, although prepayment of an expense generally will not accelerate a deduction. There are exceptions.

Year-end payments. It is not necessary to pay cash to make a payment with the goal of attaining a deduction or other tax benefit for 2017. Taxpayers can write a check or can charge an item by credit card and treat these actions as payments. It does not matter, for example, when the recipient receives a check mailed by the payor, when a bank honors the check, or when the taxpayer pays the credit card bill, as long as done or delivered "in due course."

The same treatment applies for a gift (up to $14,000 for 2017)– sending a check is treated as a payment and will qualify for the current year gift tax exclusion. Of course, proving postmarks or other evidence of transfer may be difficult from a practical perspective, making such eleventh-hour transfers to be avoided if possible.

This treatment also applies to charitable contributions. However, for contributions of $250 or more, the taxpayer must substantiate the contribution by a contemporaneous written acknowledgment of the contribution by the done. Separate contributions of less than $250 each are not aggregated to determine whether a donor has reached the $250 threshold in a tax year.

Package payment. An agreement for services or other deliverables that require full upfront payment may gain a full, immediate deduction, depending upon the circumstances (for example, payment up front for an orthodontia program as a medical expense deduction). However, a pledge made to a charity in advance of actual payment on the other hand is never deductible.

Bunching strategies. Certain items are deductible only to the extent they exceed a floor. For example, aggregate miscellaneous itemized deductions are deductible only to the extent they exceed two percent of the taxpayer's adjusted gross income (AG)), and medical expenses are deductible only to the extent they exceed 10 percent of the taxpayer's AGI. In addition, a taxpayer should generally avoid claiming these and other itemized deductions when they amount to less than the applicable standard deduction. Thus, year-end and new-year tax planning should consider ways to bunch such expenditures in a single year, so that particular deductions exceed their applicable floors and the taxpayer's total itemized deductions exceed the standard deduction.

For example, a taxpayer who incurs significant medical expenses in the current year, and has major dental work scheduled for January of the following year, should consider having the dental work done (and paid for) in December of the current year. Conversely, if few expenses have been incurred and/or AGI is high so that, even with bunching, the floor would not be exceeded or would only be exceeded slightly, the taxpayer should avoid late year-end expenditures and push them into the following year, when bunching might produce more benefits.

Tuition prepayment. Payments made in 2017 for tuition for an academic period beginning in 2017 or during the first three months of 2018 qualifies for an education credit taken in 2017.

Estimated state taxes. Although the deadline is generally not until January 16, 2018, payment of fourth quarter state and local estimated taxes made in 2017 is deductible for 2017. In certain cases, real estate taxes may also be prepaid.

HSA contributions. An individual who is an eligible individual during the last month of a tax year is treated as having been an eligible individual during every month during the tax year for purposes of computing the contribution limit. Thus, such an individual may make contributions for months before he or she was enrolled in a high deductible health plan. For the months the individual is treated as an eligible individual solely by reason of this rule, he or she is treated as having been enrolled in the same high deductible health plan in which he was enrolled during the last month of the tax year. This rule also applies to catch-up contributions. Therefore, an individual who enrolls on December 1, 2017, may make the maximum contribution to his or her HSA for 2017 ($3,400 for individuals and $6,750 for families).

Capital losses. Generating year-end capital losses could provide an additional $3,000 tax deduction. Capital losses are deductible only to the extent of capital gains, but individuals and other non-corporate taxpayers may also deduct $3,000 ($1,500 for married individuals filing separate returns) of the excess of their aggregate capital losses (either long term or short term) over aggregate capital gains (either long term or short term) against ordinary income. The amount of any remaining capital loss that is not deductible is rolled over to the following year

Home mortgage interest deductions. Generally, the interest paid on a January mortgage payment accrued in December. Technically, the interest payment is deductible in December. Note that the recipient's cooperation is frequently required to coordinate tax information reporting. Thus, a January 2018 mortgage payment that is accelerated into late December 2017 must be substantiated on the homeowner's 2017 Form 1098, Mortgage Interest Statement, or it will likely be flagged by the IRS.

> **CAUTION.** The economic substance doctrine applies to all transactions. Even if a transaction is in formal compliance with tax law, the IRS and eventually the courts may look at the economic substance of the transaction to determine what is and what is not income or loss.

Traditional Year-End Planning Techniques

Traditional year-end planning techniques include:

Income Acceleration:

(*for postponement to 2018, delay the following actions:*)

- Sell outstanding installment contracts
- Receive bonuses before January
- Sell appreciated assets
- Redeem U.S. Savings Bonds
- Declare special dividend
- Complete Roth conversions
- Accelerate debt forgiveness income
- Maximize retirement distributions
- Accelerate billing and collections
- Avoid mandatory like-kind exchange treatment
- Take corporate liquidation distributions in 2017

Deductions/Credit Acceleration:

(for deferral, take contrary actions:)

- Bunch itemized deductions into 2017/Standard deduction into 2018
- Don't delay bill payments until 2018
- Pay last state estimated tax installment in 2017
- Don't delay economic performance
- Watch AGI limitations on deductions/credits
- Watch net investment interest restrictions
- Match passive activity income and losses

FILING DEADLINE CHANGES

Due to changes in the tax laws and other events, some deadlines have been changing. Although the 2018 tax filing season will be the second year in which the new filing tax deadlines apply, planning at year-end 2017 is still important and should include marshalling the paperwork and scheduling necessary to meet these deadlines. With information returns now due so early in 2018, preparing for them in December is a wise strategy. There have also been some tax deadline changes as a result of some natural disasters that have recently occurred.

Tax Laws and Regulations

Congress made significant revisions to the due dates of many important and common returns in the 2015 Transportation Act and the PATH Act. These changes affected Form 1065, U.S. Return of Partnership Income; Form 1120, U.S. Corporation Income Tax Return; FinCEN Report 114, Report of Foreign Bank and Financial Accounts (known as the FBAR), and more. Filing and other compliance deadlines were given a delayed start by the *Surface Transportation and Veterans Health Care Choice Improvement Act of 2015* (P.L. 114-41). The delayed was intended to give taxpayers time to prepare for some fairly significant deadlines. There were also major changes to certain automatic filing extensions and due dates.

The IRS recently issued final, temporary and proposed regulations that address the new due dates and extensions of time to file for various tax returns and information returns to reflect recent statutory changes now in place. Affected forms include Form W-2 (series, except Form W-2G), Form W-3, Form 990 (series), Form 1099-MISC, Form 1041, Form 1041-A, Form 1065, Form 1120 (series), Form 4720, Form 5227, Form 6069, Form 8804, or Form 8870.

STRATEGY. Lawmakers intended to better align return deadlines with the deadlines for information returns, as well as with the workflow of return preparers during the regular filing season and the extended filing season. The change affecting the FBAR, for example, aligns FBAR filings with Form 1040, U.S. Individual Income Tax Return, filings.

Due Dates and Extensions

Form W-2. The amended due date for filing Form W-2 series wage and tax statements (but not Form W-2G, Certain Gambling Winnings), the related Form W-3 transmittal form, and Form 1099-MISC, Miscellaneous Income (if nonemployee compensation is being reported), is January 31 of the calendar year following the calendar year for which the information is being reported, regardless of whether the returns are filed on paper or electronically.

Partnership Form 1065. Specifically, the due dates for the filing of Form 1065 by partnerships and the filing of Form 1120-S by S corporations are codified, but in doing so, the due date (without extension) for filing of Form 1065 is modified so that both Form 1065 and Form 1120-S will be due on or before the 15th day of the third month following the close of the tax year. For the 2017 tax year, the due date is March 15, 2018 for calendar-year taxpayers)

COMMENT. The change in the due date for partnership returns to March 15 will enable partners who are individuals to receive their Schedule K-1 in time to report the information on their Form 1040 (like individuals who are S corporation shareholders). Without this change, many more individuals who are partners would be forced to file a six-month extension to file their Form 1040.

CAUTION. Partnerships should make sure they take note of this March 15 due date to avoid a late filing penalty. So many partnerships missed the March 15 deadline in 2017, assuming that their deadline remained at April 15, that the IRS issued a grace period until April 15 before failure-to-file penalties would be imposed. The IRS emphasized, however, that this was a one-time only grace period and that no accommodation would be given for 2017 year returns filed in 2018.

C Corporation Form 1120. Generally applicable to returns for tax years beginning after December 31, 2015, the due date (without extension) for the filing of Form 1120 by C corporations is changed from the 15th day of the third month after the close of the tax year (March 15 for calendar-year taxpayers) to the 15th day of the fourth month following the close of the tax year (April 15 for calendar-year taxpayers). However, a special rule provides that for C corporations with fiscal years ending on June 30, the changes don't begin to apply until returns due for tax years beginning after December 31, 2025. Therefore, June 30 fiscal-year corporations retain a filing deadline of September 15th until returns for tax years starting in 2026.

Related C Corporation deadlines. The change in the due date of a C corporation's return affects other Code provisions keyed to that due date, involving:

- charitable contributions (Code Sec. 170(a)(2)(B)),
- the penalty for underpayment of estimated taxes (Code Sec. 6425(a)(1)),
- accumulated earnings tax (Code Sec. 563(a)),
- personal holding company tax (Code Sec. 563(b)),
- alternative tonnage tax on qualified shipping activities (Code Sec. 1354(d)(1)(B)(i)), and
- the extension of time for payment of tax attributable to recovery of foreign expropriation losses.

In the case of the penalty for underpayment of estimated taxes, the change does not affect the period of underpayment of an S corporation, since that due date was merely codified by the new law and remains the same as the existing deadline (15th day of the third month) (Code Sec. 6655(g)(4)(E)).

Filing extension periods. In addition to modifying some initial filing deadlines, the new law changes the deadlines on certain filing extensions:

C Corporations. The six-month automatic extension currently provided by Reg. §1.6081-3(a) to C corporations filing Form 1120 is codified (Code Sec. 6081(b), as amended). Code Sec. 6081(b) provides an automatic three-month extension, but Reg. §1.6081-3(a) essentially extends it to six-months if Form 7004 is filed and other requirements are met. This change to Code Sec. 6081(b) under the new law applies to returns for tax years beginning after December 31, 2015, but contains an important twist that impacts calendar year corporations.

A special rule provides that in the case of any calendar-year C corporation beginning before January 1, 2026, the maximum extension allowed is five months, not six months. Further, in the case of a C corporation with a fiscal year ending on June 30 and beginning before January 1, 2026, the maximum extension allowed is seven months (Code Sec. 6081(b), as amended by the 2015 Surface Transportation Act).

Other extensions. The regulations reflect the law changes regarding automatic filing extensions (using Form 7004 or other extension form) and due dates for tax years beginning after December 31, 2015, as follows:

- a maximum six-month extension (currently five months) for partnerships filing Form 1065 (ending on September 15 for calendar-year taxpayers;
- a maximum five-and-a-half month extension (currently five months) for trusts filing Form 1041 (ending on September 30 for calendar-year taxpayers);
- a maximum three-and-a-half month extension (same as before) for employee benefit plans filing Form 5500 (series) (ending on November 15 for calendar-year taxpayers);
- a maximum six-month extension (currently three months) for tax-exempt organizations filing Form 990 (series) (ending on November 15 for calendar-year taxpayers);
- a maximum six-month extension (currently three months) for tax-exempt organizations filing Form 4720 beginning on the due date for filing the return (without regard to any extensions);

- a maximum six-month extension (currently three months) for split-interest trusts filing Form 5227 beginning on the due date for filing the return (without regard to any extensions);
- a maximum six-month extension (currently three months) for coal-mine operators filing Form 6069 beginning on the due date for filing the return (without regard to any extensions);
- a maximum six-month extension (currently three months) for charitable organizations or remainder trusts filing Form 8870 beginning on the due date for filing the return (without regard to any extensions);
- a due date of the 15th day of the third month after the close of a trust's tax year for trusts filing Form 3520-A (with a maximum six-month extension (same as before)); and
- a due date of April 15 for calendar-year filers of Form 3520 with a maximum extension of six months ending on October 15.

FBARs. The due date going forward for filers of FBAR (FinCEN Report 114) has shifted from June 30 to April 15, applicable for FBARs for tax years beginning after December 31, 2015 – therefore, the next FBAR for most individuals will be due April 17, 2017 (since April 15 falls on a Saturday). The new law also provides that any penalty for failure to timely request or file an extension may be waived for taxpayers required to file Report 114 for the first time. The IRS is also given authority to modify regulations to provide for a maximum extension of six months ending on October 15.

COMMENT. Treasury's Financial Crimes Enforcement Network (FinCEN) again postponed the Report of Foreign Bank and Financial Accounts (FBAR) (FinCEN Form 1114) filing deadline for certain individuals with signature authority over but no financial interest in one or more foreign financial accounts (FinCEN Notice 2016x-1). The filing due date is postponed to April 15, 2018, for individuals whose filing due date for reporting signature authority had been previously extended.

Extensions Due to Disasters

The IRS can extend the time for filing returns, paying taxes, and claiming refunds for up to one year for persons affected by a federally declared disaster.

Hurricane Harvey and Irma

Victims of Hurricane Harvey that took place beginning on August 23, 2017 in parts of Texas and those affected by Hurricane Irma that took place

beginning on September 4, 2017 in parts of Florida, in parts of the Commonwealth of Puerto Rico and all of Georgia beginning on September 5, 2017, may qualify for tax relief from the Internal Revenue Service.

The declaration of these areas as Federal Disaster Areas permits the IRS to postpone certain deadlines for taxpayers who reside or have a business in the disaster areas. For instance, certain deadlines falling on or after August 23, 2017 and before January 31, 2018, are granted additional time to file through January 31, 2018. This includes taxpayers who had a valid extension to file their 2016 return that was due to run out on October 16, 2017. It also includes the quarterly estimated income tax payments originally due on September 15, 2017 and January 16, 2018, and the quarterly payroll and excise tax returns normally due on October 31, 2017. In addition, penalties on payroll and excise tax deposits due on or after August 23, 2017, and before September 7, 2017, will be abated as long as the deposits were made by September 7, 2017.

Under section 7508A, the IRS gives affected taxpayers until January 31, 2018, to file most tax returns (including individual, corporate, and estate and trust income tax returns; partnership returns, S corporation returns, and trust returns; estate, gift, and generation-skipping transfer tax returns; and employment and certain excise tax returns), that have either an original or extended due date occurring on or after August 23, 2017, and before January 31, 2018. Affected taxpayers that have an estimated income tax payment originally due on or after August 23, 2017, and before January 31, 2018, will not be subject to penalties for failure to pay estimated tax installments as long as such payments are paid on or before January 31, 2018. The IRS also gives affected taxpayers until January 31, 2018 to perform other time-sensitive actions described in Reg. §301.7508A-1(c)(1) and Rev. Proc. 2007-56, 2007-34 I.R.B. 388 (Aug. 20, 2007), that are due to be performed on or after August 23, 2017, and before January 31, 2018.

Re: Year-End Tax Planning – Individuals

Dear Client:

Year-end 2017 is shaping up as an important deadline to have tax strategies in place to take advantage of certain opportunities before they sunset along with the close of the tax year on December 31, 2017. A major challenge this year, of course, involves the uncertainty that will remain, likely into late November/ early December, over pending tax reform legislation. This includes uncertainty about rate cuts, certain deductions, and much more. Effective strategies in response to any of these "tax reform" priorities involve close monitoring of any proposed tax bill as it moves through negotiations within the various Congressional tax committees and Trump administration officials, with year-end action steps ready to go based upon alternative legislative outcomes.

Although year-end 2017 may be unique because of possible tax reform, planning during the final weeks and months of this year involves much more –both in terms of traditional year-end strategies and strategies developed in response to developments that have taken place since last year. Here are some points to consider:

Data gathering. Year-end planning should start with data collection and a review of prior year returns. This includes losses or other carryovers, estimated tax installments, and items that were unusual. Conversations about next year should include discussions of any plans for significant purchases or dispositions, as well as any possible life cycle events.

Income tax rates. One of the most significant factors in tax planning for individuals is their tax bracket. The most direct control taxpayers have over their tax bracket rests in their ability to control the timing of income and deductible expenses. For example, taxpayers who expect to be in a lower tax bracket in 2018 should consider deferring income to 2018 and accelerating deductions into 2017. Also relevant are "tax reform" proposals that may compress tax brackets and lower tax rates. These changes could present year-end tax planning opportunities for taxpayers depending on when any proposed rate changes go into effect.

Investments. Taxpayers holding investments, whether in the form of securities, real estate, collectibles, or other assets, often have an opportunity to reduce their overall tax bill by some strategic buying, selling, or exchanging for like-kind property toward the end of the year. Balancing tax considerations with other factors is part of the challenge in dealing with investments, including: the ordinary income tax rates, the net investment income tax rate, the capital gain rates, and the alternative minimum tax (AMT).

Income caps on benefits. Monitoring adjusted gross income (AGI) at year-end can also pay dividends in qualifying for a number of tax benefits. Often tax savings can be realized by lowering income in one year at the expense of realizing a bit more in another year.

Life events. The biggest variables for many taxpayers impacting their year-end tax planning surrounds life events such as marriage, divorce, birth or adoption of a child, a new job or the loss of a job, and retirement. These life events may, for instance, result in a change in filing status that will affect tax liability. The possibility of significant changes and/or significant or unusual items of income or loss should also be part of a year-end tax strategy. Additionally, taxpayers need to take a look into the future and predict, if possible, any events that could trigger significant income, losses, or deductions.

2017 tax law changes. In addition to possible changes for the 2018 tax year, and more remotely for 2017, that may be part of recent "tax reform" efforts, other tax law changes by the IRS and the courts that have taken place during 2017 are worth a look in mapping out year-end strategies.

- ***Charitable contribution substantiation.*** In response to concerns from some in Congress and the nonprofit community, the IRS withdrew proposed regulations that would have required more stringent reporting procedure for charitable contributions of $250 or more. In general, however, courts have offered various opinions during 2017 on how strictly taxpayers must meet the substantiation requirements for claiming various charitable contributions depending on the type of donation.
- ***Relief for late rollovers.*** The IRS unveiled a new self-certification procedure for taxpayers who inadvertently miss the 60-day time limit for certain retirement plan distribution rollovers.
- ***Per taxpayer mortgage deduction.*** The IRS announced that it would not contest a Ninth Circuit Court of Appeals defeat that found that multiple unmarried taxpayers co-owning a qualifying residence can double the normal $1.1 million mortgage debt limit for interest deduction purposes.
- ***Hurricane disaster relief.*** For victims of Hurricanes Harvey, Irma and Maria in 2017, a variety of tax relief measures are now available, through a special Disaster Relief Act of 2017 and numerous IRS measures to extend compliance deadlines and other requirements.
- ***Offers in compromise.*** The IRS has updated its policy covering offer in compromise (OIC) applications received on or after March 27, 2017.
- ***Interest rates.*** Interest rates have slowly been rising throughout 2017 and are expected to continue to rise into 2018, which points to various tax planning opportunities or the closing of certain tax advantages.

Timing rules. Timing, and the skilled use of timing rules to accelerate and defer certain income or deductions, is the linchpin of year-end tax planning. For example, timing year-end bonuses or year-end tax payments, or timing sales of investment properties to maximize capital gains benefits should be considered. So, too, sometimes fairly sophisticated "like-kind exchange," "installment sale" or "placed in service" rules for business or investment properties come into play. In other situations, however, implementation of more basic concepts are just as useful. For example, taxpayers can write a check or can charge an item by credit card and treat these actions as payments. It often does not matter for tax purposes when the recipient receives a check mailed by the payor, when a bank honors the check, or when the taxpayer pays the credit card bill, as long as done or delivered "in due course."

Please feel free to call our offices if you have any questions about how year-end tax planning might help you save taxes. Our tax laws operate largely within the confines of "the taxable year." Once 2017 is over, tax savings that are specific to this year may be gone forever.

Sincerely yours,

Wolters Kluwer

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