2017

DMJ & Co., PLLC presents Year-End Tax Planning

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2017 Year-End Tax Planning

Thank you!

2017 marks the 68th year of DMJ's service to its clients. We remain humbled by the support and faith that this represents from you, our trusted client. What began as a simple one-room office in Greensboro, North Carolina in 1949 has grown to more than 75 professionals in the Triad, Triangle, and Sandhills. We serve clients throughout the state and beyond.

While our offices are physically located in North Carolina, we assist clients with tax reporting matters in practically every jurisdiction in the country, as well as many foreign countries. Where we do not have the first-hand contacts and experience, we rely on associate firms through our CPAmerica association, both nationwide and worldwide. We bring you the access, knowledge, and experience of much larger firms while providing you with the customized service and familiar faces you know and trust.

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This is our annual year-end tax planning letter. Feel free to share this letter with others that may find it of interest. If this letter was shared with you, and you would like to receive your own copy in the future, please connect with us at contact@dmj.com to be included in future mailings.

Tax reform on the horizon?

While the talk of proposed tax reform legislation is the "buzz" of Washington, we do not know what provisions might pass and when they might become effective. What we know will be featured on the www.dmj.com page titled "Insights" soon after it is released. Stay tuned!

The GOP has a very tight majority in the Senate, which was too slim to repeal the Affordable Care Act. Any tax reform proposal will face a similar fate unless virtually 100% of the Republicans in the Senate support it, or the leadership and Administration reach "across the aisle" on a more broad-based bill to garner Democratic support.

If tax reform comes as advertised, we could see lower tax rates coupled with fewer deductible items in coming years. In this situation, it would be wise to defer income into the future to benefit from lower tax rates, and accelerate deductions into the current year in case they are not allowed in the future. But if you are expecting higher income next year, or a less advantageous filing status, it may prove beneficial to actually accelerate income.

Keep an eye on the specific deductions at risk in the tax reform discussion. For some, it may be better to get some benefit now, versus no benefit in the future. These deductions could include medical deductions, state and local income taxes, personal property taxes, and miscellaneous business and investment expenses.

Similarly, if you believe that the repeal of the Affordable Care Act (a/k/a "Obamacare") is inevitable, you may want to delay triggering investment income to avoid paying the 3.8% tax on net investment income, which was included in the Affordable Care Act.

Tax law changes in the future make it worthwhile for you to stay informed so you can minimize taxes or at least avoid missteps that could complicate your life. Make sure that you receive our email blasts on tax matters. Sign up by sending your information to contact@dmj.com or visit www.dmj.com.

Outside of proposed tax reform, little in terms of tax legislation or significant regulations has changed in the last year.

General tax environment

The IRS continues to send out computer-generated notices based on computer-based document-matching processes. Since IRS notices generated in this way are sometimes incorrect, you should consult with us about the appropriate response. Never ignore an IRS notice – it will not go away. Deal with it promptly to reduce any penalties and interest that may accrue.

Meanwhile, the IRS has made progress on its identity theft war, with less identity theft fraud seen for 2016 tax filings than in recent years.

IRS adjusts tax provisions for inflation

Continued low interest rates result in small inflation indexes of key tax amounts. For 2017, the personal and dependency exemptions are unchanged at $4,050. The standard deductions for all filing statuses received an increase of $150 to $300 above the 2016 amounts.

Taxpayers who have a health savings account (HSA) under a high-deductible health plan (HDHP) have a contribution limit this year of $6,750 for a family, unchanged from 2016. The single contribution limit is increased to $3,400, compared to $3,350 in 2016. To be considered an HDHP, out-of-pocket maximums of $6,550 per individual and $13,100 for a family apply. These amounts are unchanged from 2016 and minimum deductibles of $1,300 per individual and $2,600 for a family remain for both 2017 and 2016.

The future of the estate tax is one point of debate in the broader tax reform discussion. For 2017, the estate tax exemption is $5.49 million, an increase of $40,000 over 2016. The exemption will increase by another $110,000 in 2018. Together, a married couple can pass a 2017 estate valued at $10.98 million to their heirs without paying federal estate tax because of the portability provision. This transfer amount is reduced during life by taxable gift tax transactions, so your total estate tax exemption could be less if taxable gifts have occurred in the past.

The annual gift tax exclusion remains at $14,000 per recipient in 2017 ($28,000 if married and using a gift-splitting election, or if each spouse uses separate funds). By maximizing the use of these gifts annually, taxpayers can transfer significant wealth out of their estate without using any of their lifetime estate exemption. This annual exclusion moves to $15,000 per recipient for 2018, in case additional gifts early next year are planned.

Retirement plan rules

A good tax strategy is to participate in your employer's 401(k) plan. You may elect to contribute up to $18,000 for 2017 before taxes, and the additional catch-up contribution for employees who are age 50 and above is $6,000. Refer to your employer's plan to confirm that the catch-up contribution is permitted. These increased contribution limits also apply to 403(b) plans and most 457 plans. These amounts are unchanged from 2016, although in 2018, the $18,000 becomes $18,500.

Some 401(k) plans allow you to make an after-tax Roth contribution, which will not reduce your current taxable income. However, you generally will not owe tax when this contribution, plus any earnings, are withdrawn in retirement.

> Note that for those who fully maximize their 401(k) contributions, electing to defer as a Roth contribution is a way to make additional contributions, economically speaking, as you are not only contributing the maximum 401(k) contribution, but you are also contributing the tax on that contribution by forgoing the deduction.
>
> [redacted]

The IRA contribution limit was not raised in 2017. It is still $5,500, with an additional $1,000 catch-up contribution allowed for people 50 years of age or older. SIMPLE plan amounts also have not changed.

You and your spouse must have earned income to contribute to either a traditional or a Roth IRA. Only taxpayers with modified AGI below certain thresholds are permitted to contribute to a Roth IRA. If a workplace retirement plan covers you or your spouse, modified AGI also controls your ability to deduct your contribution to a traditional IRA.

There is no AGI limit on your or your spouse's deduction if you are not covered by an employer plan. If your modified AGI falls within the phase-out range, a partial contribution/deduction is still allowed.

If you would like to contribute to a Roth IRA, but your income exceeds the threshold, consider making a non-deductible contribution to a traditional IRA for 2017 by April 15, 2018, and then convert the regular IRA to a Roth IRA. Consult with your DMJ professional about the tax consequences of the conversion, especially if you have funds in other traditional IRAs, as this could dramatically change the tax impact.

Please do not forget that as of 2015, you may make only one IRA-to-IRA indirect rollover per year, which must be re-deposited within 60 days. This does not limit direct rollovers from trustee to trustee. Any attempted rollover after the first one will be treated as a withdrawal and taxed at regular rates – with potentially a 10 percent early withdrawal penalty. The attempted rollover will be subject to regular IRA contribution limits, meaning that, if the amount of funds in the account exceeds your contribution limit, it will be subject to a 6 percent excise tax.

When you reach age 70-1/2, you are required to begin taking required minimum distributions (RMDs) from your IRAs and other retirement accounts. Roth IRAs are not subject to this rule. We can assist with the computation of the minimum amount needed to withdraw. For the first year only (if you turn age 70-1/2 in 2017), you have a grace period to take the initial 2017 year withdrawal until April 1, 2018. Often this is not a good idea, because a second withdrawal for 2018 would still need to be done by December 31, 2018, resulting in two taxable retirement withdrawals subject to income tax in one year, potentially at higher tax rates.

For RMDs from retirement accounts that are inherited (including Roth IRAs), a completely different set of rules apply, and most taxpayers cannot wait until age 70-1/2. Consult with us if you are unsure of what action is required.

Remember also that the provision that allowed an individual who is at least 70-1/2 years old to make a qualified charitable distribution of up to $100,000 from an IRA directly to a charity has been made permanent. This distribution to charity can satisfy all or part of your RMD requirement. This is generally a good idea for taxpayers who (1) are subject to the RMD rules, and (2) have charitable commitments to satisfy. It's also a good plan where the taxpayers cannot itemize deductions, or receive little benefit from doing so, due to high standard deductions, the house is paid for, etc. It is arguably a better idea to first use long-term significantly appreciated stock for your charitable giving (discussed later in this letter), but a charitable IRA distribution is also a good idea.

In addition to the SIMPLE IRA shown in the table below, self-employed individuals can have a Simplified Employee Pension (SEP) plan. They may contribute as much as 25 percent of their net earnings from self-employment, not including contributions to themselves. The contribution limit is $54,000 in 2017 and $55,000 in 2018. The self-employed may set up a SEP plan as late as the due date, including extensions, of their 2017 income tax return.

An individual, or solo, 401(k) is another option for the self-employed. For 2017, a self-employed individual, as an employee, may defer up to $18,000 ($24,000 for age 50 or older) of annual compensation (unchanged from 2016). Acting as the employer, the individual may contribute 25 percent of net profits, including the deferred $18,000, up to a maximum contribution of $54,000.

Inflation Adjustments for 2017 Tax Provisions	
Standard Deduction	
Single or married filing separately	$6,350
Married filing jointly or surviving spouse	$12,700
Head of household	$9,350
Personal Exemption (unchanged)	$4,050
Health Savings Account Limitation	
Single	$3,400
Family	$6,750
401(k) Limitation (unchanged)	$18,000
Plus catch-up contribution for age 50 & over, if permitted by employer plan	$6,000

SIMPLE Plan Limitation (unchanged)	$12,500
Plus catch-up contribution for age 50 & over, if permitted by employer plan	$3,000
Estate Tax Exemption	$5,490,000
Foreign Earned Income Exclusion	$102,100

Make the most of long-term capital gains

- While avoiding or deferring tax may be your primary goal, to the extent there is income to report, the income of choice is long-term capital gain (more than one year holding period) thanks to the favorable tax rate available. Short-term capital gain is taxed at your ordinary income tax rate.
- If you hold a capital asset for more than one year before selling it, your capital gain is long-term. For most taxpayers, long-term capital gain is taxed at rates no higher than 15 percent. But taxpayers in the 10 percent to 15 percent ordinary income tax bracket have a long-term capital gains tax rate of 0 percent.
- Taxpayers whose income exceeds the thresholds set for the 39.6 percent ordinary tax rate are subject to a 20 percent rate on capital gain. The thresholds are $418,400 for singles; $470,700 for married couples filing jointly or for surviving spouses; $444,550 for heads of household; and $235,350 for married couples filing separately.
- If the long-term capital gains rates of 0, 15, or 20 percent are not complicated enough, keep in mind that special rates of 25 percent can apply to certain real estate, and 28 percent to certain collectibles. Also, gains on the sale of certain C corporations held for more than five years can qualify for a 0 percent rate if certain tests are met. Talk to your tax advisor before you assume which long-term capital gains rate would apply. In any event, the 3.8% tax on Net Investment Income could also apply in addition to these capital gains rates.
- Remember that you can use capital losses, including worthless securities and bad debts, to offset capital gains. If capital losses exceed capital gains during the year, you can offset ordinary income by up to $3,000 of your losses. Then you can carry forward any capital losses in excess of a net of $3,000 into the next tax year.
- You should be careful not to violate the "wash sale" rule by buying an asset nearly identical to the one you sold at a loss within 30 days before or after the sale. Otherwise, the wash sale rule will prevent you from claiming the loss immediately. While wash sale losses are deferred, wash sale gains are fully taxable. It is important to discuss the meaning of "nearly" or "substantially" identical assets with your tax advisor.

Charitable deduction depends on qualified organization

As most taxpayers are aware, federal tax law allows a deduction for contributions made to qualified IRS tax-exempt organizations. Before making such contributions, however, you should become familiar with some of the laws and limitations on contributions so you can maximize the tax benefit of the deduction.

The contribution must be made to a qualified IRS tax-exempt organization. The IRS maintains an online tool **(http://tinyurl.com/a72f74x)** that simplifies the search for organizations that meet the criteria.

It should be noted that churches are generally not on this list as they are automatically exempt. Also note that nonprofit status is granted by the state when the organization applies for its corporate charter as a nonprofit organization. Tax-exempt status is granted by the IRS upon application, after formative approval by the state.

The donor cannot exercise undue control over the contribution. For example, you cannot make a contribution to a church, specifying that the funds be used to pay the medical bills of a good friend. A contribution may be made to the church benevolent fund with an expressed preference that the funds be used to help your friend, but the request may not be a condition of the gift.

The contribution must be made by December 31 of that year. A check mailed with a December 31 postmark is acceptable. A credit card charge is deductible when charged, not when the credit card bill is paid. The organization cannot "hold the books open" for a few days after the end of the year and credit those contributions to the year just ended.

There are limitations on the amount of charitable contributions that you may deduct. For individuals, the limit is 50 percent of adjusted gross income (AGI) or 30 percent of AGI if the donation is capital gain property. Any excess may be carried over for up to five future years. Contributions may also be limited if the qualified organization is not considered by the IRS to be a 50 percent limit organization. This includes contributions to veterans' organizations, fraternal societies, nonprofit cemeteries, and certain private nonoperating foundations. Contributions made to these organizations are subject to a limit of 30 percent of AGI or 20 percent of AGI if the donation is capital gain. At the website listed above, the IRS indicates whether or not contributions to certain organizations are subject to these additional limitations.

Beyond the laws and limitations discussed above, some strategies may be employed to maximize the benefit of the deduction. If your itemized deductions are near the amount of the standard deduction, you may wish to bunch contributions in a year in which the standard deduction amount has been exceeded.

In addition, if your AGI exceeds a threshold amount, for example, $313,800 for married filing jointly, your charitable deduction amount will be phased out to not less than 80 percent of the contribution. If you have an unusually large income in a particular year, you may wish to defer your giving to another year to receive a greater net deduction.

It is a good strategy to keep a running list of your charitable contributions so you can be prepared to speed up or delay any contributions to maximize your deductions. Along this same line, keeping tabs on your total income for the year, in case you will be subject to the phase-out provisions, will enable you to plan properly.

If you plan to contribute appreciated capital gain property, you will achieve the maximum benefit if the property is long-term – property held for more than 12 months.

- You can normally deduct the fair market value of the contribution rather than the cost basis. If held for 12 months or less, the deduction is limited to the basis in the property.
- Even if you want to keep the investment, consider gifting the qualifying property and using your charitable cash to instead purchase a replacement investment. You would be made whole, with a new 12-month long-term holding period to meet, but you have increased your investment basis in the meantime.

Don't give securities that have depreciated, as your deduction is limited to the lower fair market value. You would be better to sell the security, take your loss, and contribute the net cash to charity.

While those over age 70-1/2 can direct IRA withdrawals to charity, which can work well, arguably the gift of appreciated stock is an even better idea since you get a full deduction without reporting the appreciation as income.

Before making such a contribution, you should ascertain that the property does qualify for deduction of the fair market value and is, in fact, appreciated property.

This overview provides some of the laws and strategies for deriving the maximum tax benefit from charitable contributions. Before making significant contributions, you would be wise to consult with us to assure that you are maximizing the benefit.

Timing income and expenses can be important tax reduction strategy

As you consider your tax plan, determine whether you are likely to be subject to the alternative minimum tax (AMT). The AMT's function is to level taxes when income – adjusted for certain preference items – exceeds certain exemptions, but the tax rate applied to that income falls below the AMT rate.

Before deciding to accelerate or defer income and prepay or delay deductible expenses, you need to gauge the possible effect of the AMT on these tax-planning strategies. Having a number of miscellaneous itemized deductions, personal exemptions, medical expenses, and state and local taxes can trigger AMT.

After analyzing your specific tax situation, if you anticipate that your income will be higher in 2018, you might benefit from accelerating income into 2017 and possibly postponing deductions, keeping the AMT threat in mind.

<table>
<tr><th colspan="5">2017 AMT Rates and Exemption Amounts</th></tr>
<tr><th colspan="2">AMT Income</th><th colspan="3">Rate</th></tr>
<tr><td colspan="2">$1-$187,800*</td><td colspan="3">26%</td></tr>
<tr><td colspan="2">Over $187,800*</td><td colspan="3">28%</td></tr>
<tr><th></th><th>Single</th><th>Head of Household</th><th>Married Filing Jointly and Surviving Spouses</th><th>Married Filing Separately</th></tr>
<tr><th>AMT Exemption Amount</th><td>$54,300</td><td>$54,300</td><td>$84,500</td><td>$42,250</td></tr>
<tr><th>Exemption Phase-out Begins</th><td>$120,700</td><td>$120,700</td><td>$160,900</td><td>$80,450</td></tr>
<tr><td colspan="5">*Note: Married taxpayers filing separate returns should substitute $93,900 for $187,800 in the rate table.</td></tr>
</table>

On the other hand, if you think you may be in a lower tax bracket in 2018, look for ways to defer some of your 2017 income. For example, you could delay into 2018:

- Collecting rents
- Receiving payments for services
- Accepting a year-end bonus
- Collecting business debts

And if you itemize deductions, consider prepaying some of your 2018 tax-deductible expenses in 2017.

Individuals usually account for taxes using the cash method. As a cash method taxpayer, you can deduct expenses when you pay them or charge them to your credit card. Expenses paid by credit card are considered paid in the year they are incurred, so this may be a way to accelerate deductions if you do not have the cash to do so.

In addition to charitable contributions discussed earlier, you should decide whether it would be beneficial for you to prepay the following expenses:

- **State and local income taxes** – You may prepay any state and local income taxes normally due on January 15, 2018, if you do not expect to be subject to the AMT in 2017. If you reside in a state with high income and property taxes, you are more likely to be subject to the AMT because state taxes are not deductible when computing AMT income.
- **Real estate taxes** – You can prepay in 2017 any real estate tax due early in 2018. But you should keep in mind how the AMT could affect both years when preparing to pay real estate taxes on your residence or other personal real estate. However, real estate tax on rental property is deductible and can be safely prepaid even if you are subject to the AMT.
- **Mortgage interest** – Your ability to deduct prepaid interest has limits. But, to the extent your January mortgage payment reflects interest accrued as of December 31, 2017, a payment before year end will secure the interest deduction in 2017. However, note that this technique really only works once. Deducting a 13th monthly payment in 2017 leaves you only 11 payments to deduct in 2018, thus you are forced to continue to prepay the next January payment just to keep 12 months of deductions in future years.

- **Margin interest** – If you bought securities on margin, any interest accrued as of December 31, 2017, will be deductible in 2017 only if you actually pay the interest by December 31 (subject to the investment interest limitation rules).
- **Miscellaneous itemized deductions** – You may deduct miscellaneous itemized deductions, like many deductions, only if you itemize your deductions and are not subject to the AMT. These deductions are different from other itemized deductions because the total amount of miscellaneous deductions must exceed 2 percent of your AGI to be deductible.
  - Taxpayers usually elect to itemize deductions only if total deductions exceed the standard deduction for the year. If itemized deductions are near the standard deduction amount, grouping these deductions in alternating years is often an effective tax-planning strategy.
  - Some expenses are deductible as itemized deductions only to the extent they exceed a specified percentage of your AGI.
  - Taxpayers with unreimbursed medical and dental expenses may deduct the amount in excess of 10 percent of AGI.
  - Also deductible are unreimbursed employee business expenses, tax return preparation fees, investment expenses, and certain other miscellaneous itemized deductions that together are in excess of 2 percent of AGI.
- **Total deductions** – The amount of itemized deductions you can claim on your 2017 tax return is reduced by 3 percent of the amount by which your AGI exceeds the threshold amount:

2017 AGI Threshold	Filing Status
$261,500	Single taxpayers
$313,800	Married couples filing jointly
$287,650	Heads of household
$156,900	Married taxpayers filing separately

Taxpayers cannot lose more than 80 percent of the itemized deductions subject to the phase-out. Deductions for medical expenses, investment interest, casualty and theft losses, and gambling losses are not subject to the limitation.

Stay on top of your tax payments

If you expect to be subject to an underpayment penalty for failure to pay your 2017 tax liability on a timely basis, consider increasing your withholding between now and the end of the year to reduce or eliminate the penalty. Increasing your final estimated tax deposit due January 15, 2018, may reduce the amount of the penalty, but is unlikely to eliminate it entirely.

Withholding, even if done on the last day of the tax year, is deemed withheld ratably throughout the tax year. For federal taxes, underpayment penalties can be avoided when total withholdings and estimated tax payments exceed the 2016 tax liability, or in the case of higher-income taxpayers, 110 percent of 2016 tax. For NC tax, the rule is the same except you can replace “110 percent of 2016 tax” with “100 percent.”

Employer questions and responsibilities abound

If you are a business owner, make sure that you receive a copy of our year-end letter that focuses on business issues. If you do not receive a copy by December 10th or so, please let us know at contact@dmj.com.

If you classify some of your workers as independent contractors who are actually employees, please note that the government continues to pursue these issues. Your business could be required to pay unpaid payroll taxes, interest, and penalties. It could also be obligated to pay for employee benefits that your company did not previously provide, as well as federal penalties.

The basic guidance is an "economic realities test." How much control does your company have over the way workers perform their jobs? For example:

- Do the workers in question determine how they accomplish their task, or do you closely supervise them?
- Do they have other clients, or do they work full-time for you?
- Do they receive payment for each job, or do you pay them on your schedule?
- Do they own their own equipment and facilities, or does your company provide equipment, supplies, and office space?

These and other considerations are important in determining a worker's status. If you have any questions, consult with your DMJ tax advisor about the proper classification of your workers to avoid additional taxes and penalties.

North Carolina Taxes

As most of our clients are NC residents, here are a few NC issues to consider.

Your NC personal income tax rate for 2017 will be 5.499%, a drop from 5.75% in 2016. The basic mechanics of the computation of taxable income will be similar to 2016. No significant changes for 2018 are known at this point.

The most significant change for 2017 in NC taxation is in the sales tax area, with further clarifications and changes in the taxation of repair, maintenance, and installation services. If you are in a business that provides these services, make sure that you are aware of your sales tax collection rules.

Conclusion

The U.S. Tax Code is incredibly complex and can change rapidly, even though it may sometimes seem to be moving along at a snail's pace. This complexity has given rise to more calls for simplification. For now, taxpayers must still live with the complexity and the changes, as simplification appears to be only a dream.

Although a majority of taxpayers have their taxes prepared by a professional, people are turning in larger numbers to self-prepared returns. Since the online program does the calculations, it seems to be an economical approach to preparing and filing taxes.

However, the program is no substitute for a qualified tax professional such as a CPA. Programs can calculate tax liability, but they cannot substitute for professional advice and guidance. With such complexity in the tax code, a CPA is better able to keep abreast of the changes and can prepare taxes in a manner that determines a taxpayer's minimum legal tax liability. But minimizing tax liability started last week, last month, last year. Tax planning is a constant in today's complex world. In closing, DMJ is committed to improving our connection with each client. We encourage you to stay in contact and learn more about our services and relevant news by following us at:

twitter.com/dmjandco

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Sincerely,

DMJ & Co., PLLC

Certified Public Accountants

The technical information in this newsletter is necessarily brief. No final conclusion on these topics should be drawn nor action taken without further review and consultation.