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CAPITOL ASSETS

America's Real Estate & Mortgage Update

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2017 YEAR-END TAX PLANNING GUIDE

If the administration and congressional leaders are able to follow through on their plans, we are in for major tax reform soon. How soon? That is a good question. Maybe very soon.

Reform would already be on the books had the original timetable been followed, but now leaders are looking to get it done before the end of the year. If that difficult schedule (there are some thorny must-pass bills that will take precedence) can't be followed, then it will certainly be a priority early in 2018.

House leaders have now put together a detailed reform plan, but all the intracacies may not yet be known and it shouldn't be assumed that what we do know will ultimately pass without some changes. What do we know so far? See the broad strokes of the plan on page 4.

An earlier reform framework mostly addressed the easiest part of reform: tax cuts. Agreeing on so-called loopholes to close in order to reduce the cost to the Treasury is the more difficult task and the provisions singled out have strong defenders. The path of tax reform is always contentious and could be more protracted than originally anticipated. Taxpayers will want to pay close attention to developments while it is in progress.

As for right now, with so much unresolved for 2018 and beyond, the best you can do is to take advantage of the opportunities available for minimizing your tax liability ***this*** year. Then keep an eye out for tax reform developments.

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For the most comprehensive planning, a professional who is wise in all the technical details of the tax code can help provide the most thorough review of options and strategies available.

Key numbers to know for 2017 and 2018

Over 50 key tax numbers are indexed for inflation. The index rise for 2018's cost-of-living increase for tax provisions is larger than either of the last two years. Howver, if a reform bill is passed, some of these levels will be changed.

Absent legislation, standard deductions will see small increases for 2018, rising $300 to $13,000 for married couples and

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$150, to $6,350 for single persons. Single heads of household would get a $200 standard deduction increase in 2018, to $9,350. The personal exemption will climb $100, to $4,150 for 2018.

Taxpayers in higher tax brackets lose a portion of their itemized deductions and personal exemptions once they exceeded a certain threshold, which is adjusted for inflation. For 2017, married taxpayers start to lose a percentage of their itemized deductions and personal exemptions at $313,800. In 2018, that level will be $320,000. For singles, the levels are $261,500 in 2017 and $266,700 in 2018.

Starting Your Year-end Tax Planning

One of the first steps in year-end tax planning is to figure out if you have income or deductions that can either be accelerated into the current tax year or delayed until the following year and to see whether doing either would benefit you.

This is especially true if managing your income and deductions will make you an itemizer in one year and a standard deduction filer in the other. Understand, the uncertainty surrounding tax reform will make that particularly difficult this year. All we can do is to go on what the current tax code states and be ready to pivot as more reform details become known.

> ☛ **Alert:**
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> **INVESTMENT INCOME SURTAX REMAINS**
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> The Affordable Care Act, imposed a surtax of 3.8% on the net investment income of taxpayers whose adjusted gross income exceeds certain levels. That amount is $250,000 for joint filers and $200,000 for single individuals and heads of household. The failure to repeal the Act means the surtax remains in place for now. Even if a there is eventually a compromise on the Act be passed, the surtax might stay in place after all.

Knowing your marginal tax bracket (the rate at which each additional dollar of income is taxed) is a key to this. Looking at last year's tax return is usually a good way to predict this year's bracket

The threshold for the 39.6% bracket is $470,700 in adjusted gross income for married couples in 2017 and $480,050 in 2018. For singles, it is $418,400 in 2017 and $426,700 in 2017. New brackets would be set under a reform bill. Taxpayers in the highest bracket also pay a higher rate, 20%, on capital gains.

Typically, accelerating deductions to the current tax year, while deferring income to the following year, is the preferred move. The basic principal here is that a dollar saved in taxes today is worth more than a dollar saved next year, so long as you don't move to a higher tax bracket. That strategy should particularly hold for 2017 & 2018 if reform legislation lowers tax rates or raises bracket thresholds, as expected.

A person returning to work after a layoff or illness or who was out of work (or out of business) for long enough during 2017 might want to accelerate income.

Some Tax Benefits and Their 2017 Phaseouts

	Married Couple	Single
Deductible IRAs (max. $5,500)[1,2]	$99,000-$119,000	$62,000-$72,000
$1,000/per child credit	$110,000-$130,000	$75,000-$95,000
Student loan int. ded. (max. $2,500)	$135,000-$165,000	$65,000-$80,000
American Opportunity credit (max. $2,500)[4]	$160,000-$180,000	$80,000-$90,000
Roth IRA contribution (max. $5,500)[2]	$186,000-$196,000	$118,000-$133,000
Coverdell Education Accts (max. $2,000)[3]	$190,000-$220,000	$95,000-$110,000

[1] If covered by a retirement plan [2] $5,500 is the general limit. If 50 or older, add $1,000.
[3] Per beneficiary [4] Per student Note: Some phaseouts are based on "Modified Adjusted Gross Income"

The value of tax planning is especially clear in view of the thresholds for tax breaks that have income phaseouts. By shifting income or accelerating or deferring deductions, you might be able to take advantage of them in either 2017 or 2018, when, without planning, they could be unavailable in both years.

The chart above shows some of the thresholds to be aware of when planning. The first figure shows where the benefit of that provision begins to be lost. By the time the second figure in the range is reached, the tax benefit is lost completely.

Accelerating or delaying deductions and income can help you qualify for these tax benefits, but too many of the wrong deductions (investment interest, certain tax-exempt bonds, high state and local income, sales tax and property taxes) or exemptions (for a portion of the value of incentive stock options, for instance) can bring on the AMT.

> ☛ **Alert:**
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> **PAY CLOSE ATTENTION TO CHARITY DEDUCTION RULES**
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> Taxpayers who make a charitable deduction of $250 or more must have a written acknowledgement from the charity with details about the gift before their tax return is due. The IRS is strictly interpreting this, and is a warning to closely follow all charitable contribution rules.
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> Even taxpayers who could provide other proof for their gifts have been denied a deduction if they didn't have the letter in hand and on time. Needed in the letter is the amount and nature of the gift and whether any goods or services were provided in return.

Alternative minimum tax levels rise.

Many people have been hoping to see the tricky alternative minimum tax be eliminated. That hasn't happened quite yet, but it is now indexed for inflation and full use of nonrefundable credits is permitted.

The AMT exemption for 2017 is $84,500 for joint filers and $54,30 for singles and heads of household. For 2018, it will be $86,200 for joint filers and $55,400 for singles.

So long as the AMT exists, if you have a lot of the deductions that may make you subject to the AMT, you *absolutely* must see a tax advisor for assistance. That said, elimination of the AMT is in the sights of tax reformers.

Postpone or Accelerate Income & Deductions

Self-employed persons might be able to postpone billings to delay customer payments until the following year. To accelerate income, self-employeds could aggressively pursue receivables or offer discounts for early payment. Delaying or speeding up payments to suppliers or for other expenses can also be used to tweak the bottom line, especially with lower rates in sight.

Employees have less flexibility, but they might have an option to receive some income, say a year-end bonus, before or after the new year. Other types of compensation, such as sales commissions, also have some potential to be shifted.

Taxpayers have a little more control over their deductions. If you make estimated state or local tax payments, you probably have the choice of making your year-end payment either before or after the new year. Making a tax year 2017 state tax payment in December would get a deduction for this year, while paying in January would move the deduction to 2018. The latter is potentially a risky move, given the threat that the deduction for state and local taxes could be eliminated.

Manage Capital Gains & Losses

One important aspect of year-end tax planning is to look for capital losses to offset gains you may have had during the year (called tax-loss harvesting), especially short-term gains (on property held for less than a year), which are taxable at regular income tax rates.

No changes in capital gains taxation is mentioned in the tax reform outline, but that doesn't mean it couldn't happen. Investors should keep a close eye on reform developments.

Taxpayers should always take exceptional care with late-year mutual fund purchases in order to avoid year-end distributions in taxable accounts. Call the fund or check the fund's website before making any big year-end purchase of fund shares for a taxable account (nontaxable retirement account purchases are okay) that could land you a distribution of dividends or capital gains taxable in 2017. Such distributions would lower the tax basis of those shares, of course.

If you have losses that exceed your gains, they are deductible up to $3,000 against other income, but the excess can be carried forward to future years, as many as it takes to offset them, either with gains or income. Don't forget about any losses from previous years that you can carry forward. Losses will be less valuable if tax reform lowers rates for 2018.

If possible, short-term losses should be used to offset short-term gains, which are taxed at regular income tax rates, rather than wasting them on capital gains (gains on investments that have been held for a year or more). Capital gains for those in the highest tax bracket are now generally taxed at a maximum of 20% for most types of property. The capital gains tax rate is zero for taxpayers in the lowest two brackets and 15% for taxpayers in all other brackets short of the top one.

Be aware of "wash sale" rules that say you can't take a loss deduction if you purchase a "substantially identical" security 30 days before or after the sale. Switching to a similar, but not identical, security might even be an opportunity to find a better-performing investment. Losses from financial investments can also be used to offset gains from sales of art, antiques and other collectibles (such as metal ETFs), that are taxed at 28%.

Make Charitable Contributions

Charitable giving must be strictly documented. Deductions for contributions of cash, check or any other monetary gift require that the donor can show a bank record or a written communication from the charity indicating the amount of the contribution, date it was made and name of the charity.

Capital gain property can be donated to a charity and a deduction taken for the appreciated value. If you have property that would register a loss if sold, you should sell it first and then give the proceeds to charity.

Deductions for contributions of appreciated property, including real estate, are generally limited to 30% of the adjusted gross income of the donor, but currently can be carried forward for five years.

Taxpayers can make contributions but defer the decision about how they are to be distributed until later on by using a donor-advised gift account.

> ☛ **Tip:**
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> ### VETTING CHARITIES ONLINE
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> When you make a charitable donation, you may wonder how your money will be used. Charities have been filing a Form 990 with the IRS that gives more detailed information and it is available to the public.
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> Online sources for info on charities include **guidestar.org, charitynagivator.org** and **give.org** can help you figure out where to put your contribution dollars to their very best use.
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> Check with the IRS regarding less well-known charities. Charities can lose their tax-exempt status and donations would no longer be deductible.

The contribution gets a tax deduction in the year that it is made (another especially big opportunity for 2017), while the assets can be invested until they are disbursed. Donor-advised funds require initial gifts of as little as $5,000, but generally charge annual fees for administering the fund. Some will accept contributions of appreciated securities.

Special rules apply to contributions of used vehicles to charity. If the vehicle is worth more than $500, and the charity sells the vehicle, the donor will generally get a deduction for the gross proceeds received by the charity.

However, if the charity makes a "significant intervening use" of the vehicle, or sells it at a price below market value to a needy individual in direct furtherance of the charity's purpose, then a deduction can be taken for fair market value.

REFORM PROPOSAL: THE FIRST LOOK

Out of the gate, we did not see details from the White House or congressional leaders on exactly what they wanted tax reform to look like. But in early November, we are now seeing some details of the House's initial version.

For individuals, the plan calls for the current seven tax brackets to be consolidated into four brackets, with rates of 12%, 25%, 35% and 39.6%. Indexing the brackets to inflation will continue, but the indexing mechanism would be changed, in all likelihood one that will somewhat reduce inflation adjustments.

The standard deduction would be increased to $12,000 for singles and $24,000 for married couples, a move that is expected to reduce the number of itemizers from about 30% of filers to around 5%.

Most of those switching to the newly increased standard deductions will probably be homeowners. The deduction maximum for mortgage interest will be retained as is for current homeowners, but reduced for new purchasers. Deductions for state and local taxes would end, but up to $10,000 in property taxes could still be deducted.

The additional standard deduction and personal exemptions would be eliminated. The personal exemption for dependents would be replaced with an expanded child tax credit, raising the current $1,000 per child credit to $1,600 and adding a $300 credit for a non-child dependent.

To help pay for the standard deduction, the plan calls for elimination of "special interest" deductions. Deductions for medical expenses, casualty losses, alimony payments, moving expenses and student loan interest are currently on the table.

The plan would retain the deduction for charitable contributions. Notably, 401(k) pre-tax contribution maximums are also untouched. The proposal would eliminate the alternative minimum tax. and doubles the estate tax exclusion, while terminating it entirely in 2024.

Finally, the proposal would change the current requirements for homeowners to take advantage of the $500,000 (couples)/$250,000 (singles) capital gain exclusion on the sale of a principal resident. Owners would have to have maintained the home as a principal residence for 5 years of the preceding 8 years, instead of the current 2 years out of 5.

REAL ESTATE TAX ISSUES & Tax REFORM

Real estate is the subject of a number of tax issues that may be affected in tax reform.

***Would be modified*: The mortgage interest deduction.**
Currently, interest on total (any number of homes) acquisition debt of up to $1 million is deductible for itemizers. Interest on up to $100,000 in home equity debt is also deductible.

The tax proposal would reduce the interest deduction to debt of up to $500,000 for a married couple and $250,000 for single individuals, if they are new purchasers, but continued at $1 million for current homeowners. The deduction would be limited to interest on a principal residence only.

A purchaser eligible for the old limit would include those who entered into a contract before November 2 to close before January 1. Understand, such effective dates often have a way of getting changed as reform efforts progress.

***Perennial opportunity remains:* Flex your mortgage payment.**
So long as a deduction for mortgage interest is allowed, this will present a perennial planning opportunity. Understand, your mortgage payment for January 2018 actually reflects interest accrued for December 2017. As a consequence, if you make the payment in December, the interest will be deductible this year.

Interest is deducted in the year that the mortgage servicer records the payment, so send your January remittance early enough to see that it gets recorded before the end of the year if you want the deduction for 2017. This is a tool you can use every year to choose in what year to take a sizeable deduction.

***Renewal in jeopardy*: The mortgage insurance deduction.**
Homeowners who have benefited (or hope to benefit) from a provision that allowed mortgage insurance premiums to be treated as a deductible item, like interest, face uncertainty. The provision was extended through 2016, but needs a renewal for 2017 and was not included in the reform plan. The deduction has many supporters and could still be revived.

The deduction has applied to mortgage insurance premiums paid or accrued, including for prepaid MI, on acquisition (not on refinancing) debt. The deduction phased out for taxpayers (both single and married filing joint returns) with adjustable gross incomes over $100,000.

***Outlook uncertain*: The 14-day rules for owners/investors.**
There are special rules for homeowners who rent their residence and investors who use their rental properties. If you rent your home out for fewer than 15 days, you don't have to report the rent as income (you can't deduct any expenses as rental expenses, though).

Similarly, if you make personal use of a rental property (including a vacation home), but not for more than 14 days a year, you can still take depreciation and deduct rental expenses. Generally, "personal use" includes use by family members, by someone who allows you to use their property in exchange or anyone to whom you don't rent at a fair price.

Though not addressed yet, these two special carve-outs for real estate could still be at risk as tax reformers start looking for additional money-raising changes.