**Wellspring Group CPAs, PLLC**
Year-End Tax Update 2017
www.wellspringgroup.net

Every tax year presents uncertainty and 2017 certainly has not disappointed! With President Trump in office, we are looking at a potential tax code overhaul, perhaps the most sweeping since the Tax Reform Act of 1986. On November 2nd a tax bill was introduced into the House of Representatives with a modified bill introduced by the Senate on November 9th. The bills propose cuts to personal and corporate income tax rates, would condense the number of tax brackets, and eliminate certain itemized deductions. It remains unclear whether any of the bills tax reform plans will be enacted for the 2018 tax year.

**BEFORE THE END OF 2017:** The ordinary income tax rates remain the same as in the last few years. The 10, 15, 25, 28, 33, and 35 percent tax rates remain in effect for middle and lower income taxpayers, and the 39.6% income tax bracket kicks in with income at $470,701 for married filing jointly (MFJ) and $418,401 for unmarried individuals. If there are no major changes as the result of tax reform in 2017, these tax brackets will adjust upwards for inflation ($480,051 MFJ and $426,701 single). For taxpayers in the top bracket, the tax rate for long term capital gains and qualified dividends remains at 20%. As was the case last year, since trusts and estates are subject to the highest tax rate at a comparatively low income level ($12,501 in 2017 and $12,701 in 2018), increasing distributions to beneficiaries may be advisable since the beneficiary would likely pay less tax on the income than the trust would. Distributions during the first 65 days of 2018 are eligible to be treated as a 2017 distribution for tax purposes.

Limitations on certain itemized deductions and the personal exemptions continue for 2017. The limitation reduces otherwise allowable itemized deductions by 3% of the taxpayer's adjusted gross income ("AGI") over the threshold amount, with a maximum reduction of 80%. The threshold levels for 2017 are $313,800 for joint filers and $261,500 for single filers. Investment expenses and charitable contributions are among those that are subject to the limitation. Personal exemptions start to phase out at the same thresholds. Unlike itemized deductions, the phase out of personal exemptions has no maximum and may be reduced to zero.

The U.S. Treasury Department has announced the withdrawal of the proposed regulations under Internal Revenue Code Section 2704 which imposed restrictions on transfers of an interest in property for estate, gift and generation-skipping transfer taxes. The proposed regulations were aimed at closing loopholes used to generate artificial valuation discounts thereby reducing the value of property for gift and estate tax purposes. The proposed regulations were deemed to provide an unworkable approach to artificial valuation discounts.

The life-time exclusion for estate and gift tax purpose is $5.49 million per individual in 2017 and $5.6 million in 2018. Amounts in excess of the exclusion will remain taxable at 40%. The tax bills propose a gradual repeal of the Federal estate tax which may or may not happen. Even though federal exclusion limits remain high, it is important to consider the impact of Washington state estate tax. The exclusion for Washington state purposes is significantly lower ($2,129,000 in 2017) and there is a graduated tax rate starting at 10% with a maximum of 20%.

The annual gift exclusion for 2017 remains unchanged at $14,000 per donee ($28,000 per donee for a married couple). In 2018, the annual exclusion is $15,000 per donee ($30,000 per donee for a married couple). Payments made directly to an institution for tuition and medical expenses do not count toward the $14,000 annual exclusion. Large gifts can still be made to 529 plans for young taxpayers since the gift amount can be taken equally over 5 years. Since taxpayers in the 10% or 15% tax brackets still pay a capital gain rate of 0%, in appropriate circumstances, consideration should be given to transferring appreciated capital assets to those in the 10% or 15% tax brackets and having them realize the gains.

**HOUSE/SENATE TAX BILL:** After several months of discussions on the prospects of tax reform, two versions of a tax bill have been introduced in the House of Representatives and Senate**.** Here are some of the key proposed provisions at the current time:

- The standard deduction increases almost by double to $12,200 for single filers and $24,400 for married taxpayers filing jointly (MFJ). The current additional standard deduction of $1,550 for single filers ($1,250 for MFJ) who are blind or over 65 is eliminated.
- Personal exemption to be eliminated (Currently, $4,050 per person, subject to phase-out).
- Increase in child tax credit, a portion of which may be refundable. In addition, current phase-out amounts will increase, making the credit available for more people to qualify (Currently, $75,000 for single and $110,000 for married couple filing jointly).
- Repeal Alternative Minimum Tax (AMT).

- Eliminate certain itemized deductions. Deductions for state and local income taxes and medical expenses would be eliminated and a cap placed on deductible real estate taxes.
- Gradually repeal the estate tax and the generation-skipping transfer tax (GST).
- Reduction in top corporate tax rate to 20% from current 35%.

It remains to be seen which, if any, of the bills provisions will be enacted into law.

**REMINDERS:** The 3.8% net investment income (NII) tax is still here for 2017 and applies to individuals, estates, and trusts that have NII and modified adjusted gross income above set threshold amounts. The NII thresholds for individuals have not been indexed for inflation and remain the same for 2017. The threshold for a married couple filing jointly is $250,000; $200,000 for single filers. NII includes interest, dividends, capital gains, rents/royalties, and passive pass-through trade or business income reduced by properly allocable investment expenses. Tax-exempt income, self-employment income, and distributions from tax-deferred retirement plans are specifically excluded from NII. The additional Medicare tax of 0.9% will continue to be imposed on wages and self-employment income for couples who have earned income exceeding $250,000; $200,000 for single individuals.

Senate Republicans have shelved their plans to repeal the Affordable Care Act. Until further notice, minimum essential health coverage remains required for all U.S. citizens and legal residents (with limited exceptions). If you or a family member opted to forgo coverage, a penalty will be due with your tax return unless you qualify for an exception. In addition, the IRS has announced that they will not accept electronically filed tax returns on which taxpayers do not address the status of their health insurance coverage. Insurance companies and employers will be required to report the insurance coverage provided to a policy holder on a Form 1095, which will be used to report minimum essential coverage on individual returns.

Health Saving Accounts (HSA) and the Flexible Spending Accounts (FSA) continue to be great tools to reduce income, if eligible. The 2017 HSA contribution limit is $3,400 ($3,450 in 2018) for a single person and $6,750 ($6,900 in 2018) for a family (an extra $1,000 is allowed for those 55 and older). FSAs and similar pre-tax medical deduction arrangements are capped at $2,600 for 2017 and $2,650 for 2018.

A self-employed person can potentially contribute 25% of their self-employment earnings up to $54,000 into a retirement plan for 2017 and $55,000 for 2018. The annual IRA contribution limit remains at $5,500 for 2017 and 2018, with a $1,000 catch-up amount for individuals 50 years or older. Your deduction may be limited if you are covered by a retirement plan at work or your income exceeds certain levels. The maximum contribution to a 401(k) is $18,000 ($24,000 for those 50 or older) in 2017 and $18,500 ($24,500 for those 50 or older) in 2018. Taxpayers ineligible for Roth IRA contributions may make a non-deductible Traditional IRA contribution and then roll it into a Roth on the same day with no tax impact.

**EQUIFAX DATA BREACH:** It is likely that you're one of the 143 million American consumers whose personal data was compromised in a massive cybersecurity breach at Equifax. The data includes, names, social security numbers, birth dates, addresses and driver's license numbers. There are steps to protect your financial information.

1) Place a <u>fraud alert</u> on your credit report with any one of the three major credit bureaus. They must notify the other two bureaus. Fraud alert is free and when activated, creditors are encouraged to take certain steps to protect you.
2) Place a <u>security freeze</u> on credit reports by contacting the three credit bureaus individually. A freeze prevents potential creditors from accessing credit reports, making it difficult for hackers to open a new account in your name. Fees vary by state and credit agency.
3) Equifax is offering a complimentary one year membership in TrustedID Premier to those who may have been affected. This membership provides credit monitoring and identity theft protection services.

**WATCH OUT FOR FRAUD:** Identity theft continues to be prevalent and new brazen tactics are being employed by fraudsters. Please be advised, the IRS is required to send you correspondence through the U.S. Postal Service. You should never share personal, social security or financial information with someone purporting to be from the IRS via an email or phone call. If you receive such a call or email, please inform us so that we can advise you accordingly.

**DONOR ADVISED FUND:** As we move into a season of giving, a Donor-Advised Fund (DAF) is an attractive charitable giving vehicle that offers streamlined administration and, if privacy is a concern, your donations can remain anonymous. Contributions made to the DAF are tax deductible immediately regardless of when the funds are actually paid to a charity. If distributions are being deferred until later, your contributions are invested with the potential to grow tax free, providing even more impact for charities.