Year-end Tax Tips: 12/2017

7 year-end tax planning tips:

As we approach year end, it is important to proactively review your tax situation and consider potential tax-saving strategies. Given the potential for tax reform in 2018, year-end tax planning in 2017 may be more beneficial than ever. The biggest themes in the tax reform bill are likely to be lower marginal rates for most tax brackets and an increase in the size of the standard deduction. Which should lead to a lower tax rate in 2018 for most people and scaled-back or eliminated itemized deductions. Given the prospect of lower tax rates and less deductions, it may make more sense than ever to accelerate some deductions into 2017 and/or defer income till 2018. Here are seven year-end tax planning tips worth considering as year-end approaches.

1. **Maximize the use of tax-deductible retirement plan contributions.** One of the best ways to reduce taxable income is make pre-tax contributions to a company retirement plan, self-employed retirement account, or IRA. For 2017 the 401(k) annual contribution limit is now $18,000 and if you are age 50 or older you can contribute another $6,000 for a total of $24,000. While some retirement plans allow individuals to contribute more than $50,000. Traditional and ROTH IRA limits are $5,500 for 2017, if you are over age 50 you can contribute an additional $1,000. Keep in mind, if you have consulting income, you may be eligible to set up a self-employed retirement plan to shelter some of your consulting income.

2. **Remember to take required minimum distributions.** If you're age 70½ or older and have to take RMDs from your retirement accounts, you must do so before the end of the year; otherwise, you may have to pay a 50% tax on the amount not distributed. If you turned 70½ this year, you have until April 1st of next year to take your first RMD. However, if you wait until next year to start, you will have two distributions in the same year—which might bump you into a higher marginal tax bracket.

3. **Donate to charity.** Charitable giving can potentially be a great way to lower taxes, while also contributing to worthy causes. In the current bull market, donating appreciated securities (including stocks and mutual funds) instead of cash, may enable greater tax benefits as well as a larger contribution to your favorite charity. Contributing appreciated securities you have held for at least a year entitles you to a tax deduction and also helps you eliminate the capital gains tax. **Contributing appreciated assets to nonprofits is particularly easy through a donor-advised fund (DAF).** With a DAF, you can contribute your appreciated securities (or cash), be eligible for a tax deduction for this year for the full fair market value of the appreciated stock, select how the proceeds are invested for potential additional tax-free growth, and use the funds for future grants to your favorite nonprofits. **If you are over age 70 ½ and have an IRA, consider making a Qualified Charitable Distribution (QCD) directly from your IRA to the charity of your choice.** A QCD can be more beneficial than taking the money out of your IRA and will count towards your required minimum distribution. If you have questions about the benefits of a donor advised fund or making a QCD give us a call to discuss.

4. **Make annual or one-time gifts to family members.** Consider making annual gifts to your children, grandchildren, or other heirs up to the $14,000 ($28,000 per couple) annual exclusion

amount. If you have the financial means to afford additional gifts, consider transferring money in excess of the annual exclusion amount. While gifts above the annual exclusion amount are subject to gift tax, each individual is able to gift up to $5.49 million in excess of the annual exclusion (in 2017). Gifts not only reduce your estate's value, but can also reduce your family's income tax liability by shifting assets and the related income generated on those assets to family members who may be in a lower tax bracket. Note: A portion of the investment income for children under the age of 25 may be taxed at their parents' marginal tax rate, so consider sheltering gifts that will be used to pay for college expenses in a college savings plan (a.k.a. Section 529 Plan). Income earned inside a college savings plan is exempt from income tax if used to pay qualified educational expenses.

5. **Monitor your tax bracket and shift deductions into the year with the highest marginal tax rate.** If your income fluctuates and you may be in a lower tax bracket in the future, multiyear tax planning is important. Certain income and deductions (like business income receipts, business expenses, charitable donations, and portions of your state income tax and property tax payments) can be moved between tax years, allowing you to pick the year that you receive the greatest tax deduction. With tax reform likely in 2018 this may be a valuable year-end strategy.

6. **Consider a Roth-IRA or Roth-401(k) conversion.** Converting an IRA to a Roth-IRA, or a 401(k) to a Roth 401(k), can be an effective technique to minimize long-term taxes assessed on investment earnings. Though an upfront tax is due when an IRA or 401(k) is converted, none of the income earned inside a Roth vehicle is subject to income tax. A Roth vehicle can provide you and your family with decades of tax-free compounded earnings. A conversion is particularly effective if you can execute it in a low-income-tax-rate year.

7. **Invest tax-efficiently:**

    - **Hold investment assets more than a year before selling them so that the long-term capital gain rate will apply to the transaction.** There is still a large tax benefit for holding assets for longer than a year, as the top long-term capital gain rate is significantly lower than the top short-term capital gain rate. Generally taxes should not outweigh investment considerations so decisions to extend your holding period should include an assessment of any potential risk or return trade-offs that result.

    - **Place the interest-earning portion of your portfolio in your tax-deferred accounts.** With the top marginal tax rate being assessed on interest-bearing assets, the tax law favors holding these assets (taxable bonds, REITs, etc.) in tax-deferred accounts (like IRAs, 401(k) plans, 403(b) plans, etc.) where this income can be sheltered from tax until it is distributed.

- **At year end, sell positions with built-in losses to offset realized gains**. Proceeds can be placed in a comparable investment to maintain exposure to that type of investment. For example, if you sell an emerging-markets stock fund to take a loss, the proceeds can be invested in a comparable emerging-markets stock fund.

- **Consider holding tax-exempt bonds in lieu of taxable bonds for a portion of your bond portfolio.** Holding some taxable bonds can still be prudent to provide diversification, especially if these bonds can be held in a tax-deferred account like an IRA.

Final Thoughts

We welcome the opportunity to discuss these topics with you and help with your year-end planning. Keep in mind, the information provided is for illustration purposes only; it is not intended to be specific to any individual's personal circumstances. We suggest consulting with your tax advisor before implementing any of these tax planning techniques. As always we are willing to partner with your outside advisors to coordinate financial planning strategies that make the most sense for you and your family.

—AWM Investment Team (12/17)