

TAX PLANNING LETTER

Midyear 2017

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Dear Clients and Friends,

Benjamin Franklin said nothing is certain except for death and taxes. This year he may be only half right.

That's because a dramatic tax overhaul is on the table in Washington for the first time in thirty years. If Congress and the White House are able to pass tax reform, we could see significant tax code changes that impact our overall tax burden.

But that's no easy task. The federal tax code is more than 1 million words long, making it longer than the combined works of William Shakespeare and about twice the length of *War and Peace*. Current proposals suggest big changes to the tax bracket structure, personal deduction exemptions, and child care credits. Tax breaks we've relied on in the past may change or disappear.

Or, the political process may jam up again and reform will grind to a halt. The outcome is far from certain.

What *is* certain is that while Washington debates, you need to have your tax situation reviewed to ensure you can be nimble, flexible, and prepared for when change comes. Contact our office to schedule your midyear tax review so we can help minimize your taxes in 2017 and beyond.

Hawkins Ash CPAs, LLP

Uncertain tax laws call for ‘small ball’ planning

In baseball everyone loves a dramatic home run. But a long time ago, teams found out they could beat a power-hitting opponent with a disciplined, methodical strategy that emphasized small gains and flexibility. By gradually getting players on base with modest base hits, they could eventually run up the score using this “small ball” strategy.

If ever there were a time when the principles of small ball could be used in your tax strategy, it’s now. The uncertainty surrounding tax reform in Washington makes it risky to make big moves in your tax strategy. It also means being locked in to old planning could hurt you if any of the major tax changes contemplated by lawmakers go through.

It’s time to stay nimble. It’s time to get on base with some small, but important steps. When tax reform gets done, you’ll need to be ready to hit the ground running and score. Here’s how:

Get flexible

Begin by looking at flexibility in your taxable income. If the tax system changes, you could find yourself on the wrong side of a new tax bracket structure or ineligible for an important deduction you’ve claimed in the past. Be prepared with strategies to lower your taxable income. This could include increasing your contributions to tax-deferred retirement plans. For consultants, it could mean deferred or expedited billing of clients at the end of the year.

Shift assets

Another technique to lower taxable income is to shift income-producing assets to family members with lower tax rates. Unearned income up to \$2,100 can be taxed at your child’s lower tax rate. But be careful, unearned income greater than this will be taxed at the parent’s tax rate rather than the child’s.

Offset gains

Offsetting capital gains with capital losses is another planning method. Selling losing stocks, for example, will allow you to deduct your capital loss against any realized gains from your portfolio. Also, any excess capital losses up to \$3,000 can be deducted against your regular income every year. Unused capital losses can be saved and “harvested” for deductions in future years. Having this option available to you will give your tax strategy extra adaptability in the face of change.

Charitable donations

Managing charitable donations is another useful strategy to react to tax law changes. You can donate appreciated stock you have owned for one year or more to charity and receive a deduction equal to its market value.

This not only avoids capital gains tax, it also increases your itemized deductions. If you are age 70½ or older, you can make a direct rollover to a qualified charity from your IRA of up to \$100,000 that could satisfy your required minimum distribution.

Beware of special tax assessments

It's important to keep your income flexible in order to avoid special tax assessments. A 0.9% Medicare surtax is charged on wages or self-employment income beginning at \$200,000 for single filers, and a 3.8% net investment income tax impacts the highest tax bracket. Any of these amounts and thresholds could change under coming legislation.

Remember the tried-and-true

Remember, there are some tried-and-true strategies that will likely remain viable in the face of any changes, such as:

- Maximizing your retirement plan contributions; contribute at least up to your employer's match.
- Making employer-sponsored retirement plan contributions before year-end, if you are a business owner.
- Reviewing your tax withholdings or estimated tax payments. Changes this year to your job, marital status, or dependents could affect your previous tax estimates.

Tax planning will be a challenge this year, so don't hesitate to schedule a midyear review. Knowing where you stand will keep you ahead of the game. □

Don't let taxes eat away the legacy you plan to leave

With federal estate taxes on the table for reform, now is a good time to review some estate planning principles and determine whether potential tax reform could impact the legacy you plan to leave to your heirs.

The basis challenge

While rescinding the estate tax altogether has been suggested, we can only speculate what might actually happen. Currently, when assets are inherited, the value is "stepped up," or readjusted to the fair market value at the time of the owner's death. One proposal of estate tax reform has suggested that stepped up basis would be replaced by carryover basis, which would carry your basis forward to your heirs. There is a big difference in the two methods of basis. With the step up in basis, if you leave your home to your children

You can give each recipient gifts of up to \$14,000 a year without paying a penny of gift tax.

and if they sell it relatively soon, they will likely face no income tax due on the sale. However, with the carryover basis, your children could owe capital gains tax on all the appreciation in market value since you've owned the home.

A state's estate view

Another challenge for your estate planning review during federal tax uncertainty is that states vary greatly when it comes to estate taxes. Some follow the federal laws, others have their own exemptions, and some have no tax at all. If you own assets in multiple states, understanding each state's laws will help you formulate your estate plan.

Gifts as a solution

One means of leaving a legacy is gifting before your death. You can leave gifts of up to \$14,000 per year per recipient without having to pay gift tax. If you gift as a married couple, you can double that amount. Under current law, transfers of property after your death are sheltered from the estate and gift tax up to 5.49 million.

Potential tax reform remains uncertain, so the best thing you can do now is ensure your plan meets your objectives using current laws, but remains flexible in the event estate laws change. Everyone's situation and asset mix is different, but we can help you stay ahead of tax reform and adjust your plan as needed. Call us; we're here to help. □



Succession planning – why it’s even more important this year

Tax reform is making its way through the halls of our nation’s capital and business owners should take note, especially if they are planning to retire in the not-too-distant future. Here are two ways proposed changes to the tax code might shape your company’s succession planning strategy.



1 Tax bracket changes

Proposals are in the works to reduce the number of individual tax brackets to three tiers from seven. The top rate may drop to 33% from 39.6%. This is significant because many small businesses are organized as subchapter S corporations, also known as “pass-throughs.” S corporations report profits, but the taxes are paid on the tax returns of the shareholders.

Because of this, if you’re planning to retire with a severance package, you might want to wait to collect that compensation until after tax reform has passed. Suppose you’re expecting a \$500,000 payout from the business. Under current tax rules, your income would be taxed at 39.6%. If you defer that compensation until 2018, your tax bill could be reduced by 6.6% (\$33,000). In some cases, the business might recognize a deduction in the current year at the higher rate, while the individual owner recognizes income in the next year at a lower rate.

Bottom line: Anticipating changes in the tax law can help you plan for

a smooth and economically sound transition. But it pays to sweat the details. In most cases, compensation arrangements should be amended for tumultuous tax years.

2 Expense projections and income

Whether you sell your business to a third party or maintain operations with existing employees, proposed changes to the tax law should be factored into your financial projections. Owners and

If tax reform becomes a reality and you defer compensation until 2018, your tax bill could be significantly reduced.

managers will want a clear understanding of the company’s expense projections. For example, if Congress enacts currently proposed revisions to capital investment rules, the cost of

doing business might fluctuate. One proposal suggests full expensing of new business investment in the year it’s made. If passed, a prolonged depreciation schedule could go away, and you may need to revise expense projections.

On the business income side of the ledger, changes to taxes on imports, exports, and money earned abroad are being reviewed. Under present law, American corporations pay U.S. tax on all profits, regardless of where the income is earned. Firms are allowed to defer those corporate taxes until the money earned overseas is returned or “repatriated.” Congress is currently considering a change to a territorial tax system. Under such a system, profits earned abroad would not be subject to U.S. taxes, but a one-time repatriation tax would be imposed on a company’s overseas profits.

Tax reform has the potential to enhance or sidetrack your company’s succession plans in many ways. Regardless of the outcome, you must remain flexible. For help crafting a solid succession plan that takes tax reform into account, please call. □