Tax Planning Issues for 2017: 20 Ideas

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The proposed GOP Tax Cuts and Jobs Act (TCJA) is very far-reaching and sweeping in tax changes. While there is no way to predict where it will go, there are some planning moves that people can consider before the end of 2017. Here's a short-list of planning opportunities (and possible pitfalls):

Charity

The TCJA raises the standard deduction, so going forward taxpayers will need more itemized deductions to receive the tax benefit of excess deductions, including charity.

If you itemize:

1. Make additional contributions before year-end – consider pulling 2018's donations into this year instead. Every additional dollar is likely saved at your current rate, which is most likely to be lower next year.

2. Donate appreciated property like stocks or mutual funds. A high stock market like the one we are currently experiencing provides an additional opportunity. Giving appreciated investments avoids capital gains tax and possibly the additional net investment income tax and allows a fair market value deduction. There is a limitation of 50% of your Adjusted Gross Income (AGI), but you can carry-over the unused portion to future years (when the limitation goes up to 60% of AGI). If you are considering gifting mutual funds, do so before the funds declare their capital gains and dividends. You'll save taxes by not recognizing that income as well.

3. Use a Donor Advised Fund (DAF) or Community Foundation (CF) to max out contributions if you are unsure of where to contribute. If you give $50,000 to a DAF, you deduct it all now, but can designate your charities over time. You can even invest the undonated portion of your DAF so there is more to donate in the future.

4. Clean out your closet and your garage, and give the extra stuff to charity. Ask the charity for a receipt and keep a thorough list of what you donated, including values. Use garage sale or thrift store prices to assign fair market values to the items you donate. You could use a valuation program like ItsDeductible to figure out the value (itsdeductible.com).

5. If you have a sizeable donation in mind, look at a remainder or lead trust. A remainder trust allows you actually donate property upon your death, but receive a deduction now. Plus, you may receive income for a period of time, including your lifetime. A lead trust lets you give income to the charity now, receive an income tax deduction now and leave the money to heirs on your death. The deduction is based on an interest rate, which is low right now. This makes the contribution value high. Charitable trusts are also sometimes used as asset-protection devices.

If you are 70½ or older and have an IRA:

6. Consider a Qualified Charitable Distribution (QCD). With a QCD, you donate a portion of or all of your IRA Required Minimum Distribution (RMD) to a qualified charity. The donated amount is not included in your taxable income. In addition, it lowers your income for certain 'floors' like social security benefit taxation and Medicare Part B and D premiums. QCDs are a very tax-efficient way to make charitable donations.

If you want to make donation large enough to shift you into a lower tax bracket and you have an IRA:

7. Consider a Roth conversion charity offset. This is where you have a charitable contribution and then do a Roth conversion to offset the deduction. If you make a donation of appreciated stock to your DAF (say $50,000) pushing you into a lower tax bracket, you might convert enough of your IRA into a Roth, pay taxes on the conversion and use up some or all of the charitable contribution. The Roth grows tax-free, and is not subject to Required Minimum Distributions at age 70½. Recognize that the TCJA, as currently written, restricts Roth recharacterization.

Downside to charitable gifts: If you were going to make a donation anyway, there are very few downsides to any of the above strategies.

Medical

The TCJA eliminates medical deductions. For 2017, you can deduct medical expenses if you itemize and if they exceed 10% of AGI. This includes health insurance (including long-term care premiums), prescription medicine, doctors, dentists, and medical travel and nursing home costs (generally). The deduction does not include over-the-counter medicines, toiletries, cosmetics or most cosmetic surgeries.

8. If you are able to deduct medical expenses, try to 'lump' additional expense into 2017. This might include dental work, medicine and drugs (stock up), contact lenses, hearing aids, and eye surgery (like LASIK). If you pay with your credit card, you can deduct the expense when you incur the charge, not when you actually pay the credit card bill.

Downside to medical: If you were going to incur the cost anyway, then there are few downsides to the strategy.

Taxes

The TCJA restricts property tax deductions and eliminates the deduction for state and local income taxes and sales taxes.

If you itemize:

9. Consider paying an additional estimate for State income taxes or, if you already have a state estimate, consider paying the 4th Quarter estimate before 12/31/17.

10. Consider paying your winter property taxes due in 2018 before 12/31/17.

Downside to state taxes: If you are subject to Alternative Minimum Tax (AMT), you do not get a benefit from deductions for state and local taxes.

Employee Business Expense

The TCJA eliminates the deduction for employee business expenses, like teacher supplies, salesperson expenses, office-in-home, and union dues. It also eliminates the deductibility of tax return preparation fees. You can currently only deduct such expenses if they exceed 2% of AGI.

If you itemize and your expenses exceed or are close to 2% of AGI:

11. 'Lump' the expenses to maximize them. Buy supplies, purchase any additional equipment you may need, pay for journal subscriptions in 2017. You may want to pre-pay your tax return preparation fee for your individual return. Note, if you have a rental or a business, the tax return preparation cost for the rental activities or business is deductible.

Downside to employee business expense: If you were going to incur the cost anyway, then there are few downsides to the strategy. Another downside: If you are subject to AMT, you are not entitled a benefit for employee business expenses.

Tuition and Student Loan Interest

The current law allows a deduction of up to $2,500 for student loan interest and $4,000 for tuition paid (each subject to different income limitations). The tuition deduction is coordinated with other education credits in a complicated fashion. The TCJA eliminates the deduction for student loan interest and consolidates the education credits. The tuition deduction expired at the end of 2016, hasn't been renewed for 2017 and is not part of the TCJA.

If you pay student loan interest and have income less than $80,000 (Single) or $165,000 (Married filing joint), and you have less than $2,500 of interest paid this year:

12. Make sure you pay any payments right up to year-end to maximize the interest.

If you pay tuition and have income less than $80,000 (Single) or $160,000 (Married filing jointly), and you have less than $4,000 of tuition paid this year:

13. Pay any unpaid tuition up to the $4,000 or prepay for next semester.

Coverdell Educational Savings Accounts (which allow a $2,000 nondeductible contribution and tax-free accumulation) are repealed. If you want to fund tuition tax-free and have income less than $110,000 (Single) or $220,000 (Married filing jointly), and you have less than $4,000 of tuition paid this year:

14. Consider contributing to the Coverdell, or a 529 plan, which in Michigan would be the MESP. Remember contributions to the MESP are deductible up to $10,000 (joint) or $5,000 (single) from Michigan taxes if the contribution is made before 12/31/17. The TCJA allows for up to $10,000 of pre-college educational expenses to be paid from a 529 plan, enhancing their appeal as educational savings vehicles.

Interest on Certain Savings Bonds

Current law allows the interest on US saving bonds redeemed and used to pay for higher education costs to be excluded from income. If you have qualified college costs and income (in this case MAGI) less than $93,150 (Single) or $147,250 (Married filing jointly), and qualifying US saving bonds:

15. Consider cashing in the savings bonds to pay for college to convert the income from taxable to non-taxable.

Downside to tuition, student loan interest, Coverdell or savings bond strategy: If you were going to incur the cost anyway, then there are few downsides to the strategy. Note for Michigan residents, MESP has an advantage over Coverdell in state income tax deductibility.

Executive Compensation

Current law generally allows executives to defer a portion of their compensation (usually bonuses) in the form of deferred compensation. The TCJA has a special transition rule for presently deferred compensation that it must be taken into income by 2026 (or the year it vests, if later). Future deferred compensation is effectively eliminated.

If you are an executive with a deferred compensation arrangement and have an opportunity to defer any income for 2017:

16. Take advantage of deferred compensation, and definitely review your agreements to avoid future unintended consequences.

Downside to maximizing deferred compensation: You may be in a higher tax bracket when it becomes taxable in the future.

Sale of Principal Residence

Under current law you can exclude gains up to $500,000 (married filing joint) or $250,000 (single) on the sale of your principal residence. You must have occupied the property as your principal residence for two out of the five most recent years. There is currently no income limitation, and you can use the exemption every two years. The TCJA changes the occupying restriction to five out of eight years, and adds an income limitation of $500,000 ($250,000 for single filers). The new rule would only allow you to use the exemption once every five years.

If you are selling your principal residence and you have lived in it for more than two and less than five years, or if you have income over $500,000 ($250,000 single):

17. Try to do anything possible to close before 12/31/17.

Downside to maximizing home sale rule: You might rush the sale by lowering the price and the law doesn't pass or is modified.

Electric Vehicle

There is currently a credit for plug-in electric vehicles up to $7,500. The credit is repealed after 2017.

If you are planning to buy an electric vehicle within a year:

18. Consider buying it before 12/31/2017 to receive the credit (also look at state credits).

Downside to electric vehicle credit: You might rush to buy an electric vehicle before you were intending to and the law doesn't pass.

Business Expensing

Under current law, a business can deduct up to $500,000 of capital business property (called Section 179 property) directly from income. The TCJA pretty much allows full expensing of qualifying property on an unlimited basis, and increases the Section 179 limit to $5 million, with a phase-out at $20 million for small businesses. If passed, the provisions would be effective immediately (so they would be partially retroactive to 9/27/17). For business owners in higher tax brackets, these expense deductions can be useful to lower taxes, especially for business owners with income less than $1 million ($500,000 if single).

If you own a business and have need for business equipment that is qualifying property:

19. Consider taking advantage of full expensing. Pending the passage of the law, you may want to stay within the current Section 179 limits.

Downside to business expensing: If you were going to incur the cost anyway, then there are few downsides to the strategy. You may be in a higher bracket next year, or the law may not pass (hence the stick with the current rule until a law is signed).

Like-Kind Exchanges

Under current law, property used in a trade or business or held for investment may be exchanged on a tax-deferred basis. In other words, if you trade in a business truck for another truck, you are not required to recognize a current gain on the traded-in truck (it is deferred until you dispose of the new truck). This applies to real estate as well. For example, you can swap an apartment building for an office building and potentially postpone the gain recognition. The TCJA restricts like-kind exchanges to real property.

If you own a business, have equipment with a gain and are thinking about replacing that equipment by trading it in for new equipment:

20. Complete qualifying like-kind exchanges in 2017.

Downside to like-kind: Assuming you were going to trade the property anyway, and there is a gain, your risk is that you would be a in a lower bracket in the future year when you did the exchange. The proposed full expensing rules make like-kind exchanges of non-real estate less attractive.

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