Baiers & Associates pc
CPAs And Advisors

5106 Lovers Lane • Portage, MI 49002-1558

Phone: (269) 488-1700 **Fax: (269) 488-1701**
doug@baiersassociates.com www.baiersassociates.com

December 1, 2017

Dear Clients and Friends,

We thank both our new and returning clients as we value working with each of you. We strive to provide the best professional services to you in a timely manner. Thank you for giving us the opportunity to serve you and the confidence you have place in us.

Everyone has a unique tax situation and the general discussion in this letter may apply to your situation differently. Each of us can develop a year-end tax planning strategy that reflects his or her situation. We would like to help you attain your minimum legal tax liability. Our office can help you prepare such a strategy.

Potential New Tax Laws

Because Congress continues to wait until year-end to pass its tax legislation, it makes it very difficult for us to provide you with specific meaningful advice. This frustrates us beyond belief. However, the uncertain tax and legislative environment means that year-end tax planning may be more important than usual. So, we are left providing you with general ideas and thoughts as what is best to do. Both Houses of Congress have proposed tax legislation. Most analysts believe they will likely conference their differences with a law passed before year-end. By most accounts, it will be costly as it will substantially increase the deficit. It is anticipated that the changes will significantly change the tax landscape but most of the changes are not expected to take effect until 2018. Generally, the changes proposed favor lowering tax rates, increasing the standard deduction, eliminating personal exemptions, and limiting itemized deductions. If that turns out to be the case, traditional tax planning, which includes deferring income and accelerating deductions is at the forefront. If you believe that tax rates will be lower going forward, these traditional planning strategies will serve you well. You may wish to consider accelerating deductions into 2017 as they may be limited or not available in 2018. These could include state and local property and income taxes, medical expenses, charitable contributions, miscellaneous itemized deductions, and student loan interest. The proposals also eliminate alternative minimum tax (AMT). Those that will be subject to AMT in 2017 and not 2018 have a different planning strategy as noted below.

Traditional Year-End Considerations

A number of traditional year-end tax planning strategies may be helpful in maximizing tax savings, depending upon your overall tax situation anticipated for the rest of 2017 and estimated for 2018. These include:

1. Take full advantage of retirement plan deductions including 401(k) plan, IRA, and SEP contributions.
2. Donate to charity before the year end if you will itemize deductions. Remember, donations to individuals, social clubs, political groups, or foreign organizations are not deductible.
3. Donate non cash goods before year end. If the total is over $500 special reporting requirements are required (see our website for assistance with valuation of these items).
4. Accelerate payment of other itemized deductions.
    a. If a property tax payment is not due until early next year consider paying before year end (most escrow accounts do this for you).
    b. Make January state estimated tax payments in December.
    c. Making your January mortgage payment in December accelerates the mortgage interest deduction. Make it early enough so that your mortgage lender reports it in the 2017 Form 1098.
    d. If you have high medical and dental expenses, pay any bills before the end of the year. This only applies if your total medical expenses will be more than 10% of your adjusted gross income (the grandfathered 7.5% limit for those age 65 and older expired on December 31, 2016). If you have nursing home or assisted living costs, consider prepaying some of the 2018 amount as the medical expense deduction may be eliminated.
5. Payment by credit card of expenses including those items listed in items 2-4 above results in the deduction at the time of the credit card charge, not the later payment of the credit card bill.

6. For those that are close to the standard deduction amount ($12,700 for those married filing jointly, $6,350 for those single or married filing separately, or $9,350 for those head of household; also those over age 65 can add $1,250 each ($1,550 if single) to the amounts listed, consider bunching itemized deductions into 2017 (see items 2-4 above) and taking the standard deduction in 2018. This is especially true if many itemized deductions will be limited under the new tax law.
7. If you have capital gains, consider selling stocks that have lost money to offset capital gains if it is economically beneficial to do so.
8. Defer income (including bonuses, consulting income, and self-employment income) into the next year if possible. Especially if you anticipate being in a lower bracket in 2018.
9. Accelerate business deductions if you have net income.
10. Pay college tuition before year end if you have not reached the maximum allowed for deductions and credits.
11. Make sure you have taken any required minimum distributions (RMDs) from retirement plans if you are over 70½. The penalty is onerous.
12. If you believe a Roth IRA is better than a traditional IRA, consider Roth conversions.
13. Consider additional contributions to your Health Savings Account if you have a high deductible health plan. Married couples who both are over age 55 may each make an additional $1,000 contribution to their separate HSAs.
14. If you are subject to the Alternative Minimum Tax, accelerating certain deductions (for example property taxes and miscellaneous itemized deductions) will not reduce your overall tax liability, so there is no benefit in doing so. Because you will receive no benefit deduction in 2017, wait to pay them until 2018, as there may be a benefit under the new tax law.
15. If you have a gifting strategy, make sure all gifts are made before the year end. An individual can gift $14,000 tax free to each recipient annually. Note the annual limit increases to $15,000 in 2018.
16. **Consult us**. Many of these strategies can be complicated.
    a. Selling losing stocks may not be a good strategy depending upon numerous other factors. Some of these factors are your capital gains tax rate, expectations for the stock in the future, etc.
    b. If you expect to earn less next year, accelerating deductions and postponing income may not save you money depending upon your tax bracket and more.
    c. See number 10. Depending upon your income you may not qualify for education credits or deductions.
    d. See number 14. The Alternative Minimum Tax is a very tricky subject to say the least.

Identity Theft and IRS Issues

One of the most troubling issues regarding tax returns is the pervasive fraud that is happening with the filing of false tax returns and refunds issued. This is mostly done via identity theft and the thieves are becoming more sophisticated. The IRS, state taxing authorities, and software providers have joined to implement security procedures to make it more difficult to file fraudulent returns that has resulted in some success. You must protect your identity in all aspects of your life. Use of public Wi-Fi can significantly increase your risk. If you believe there is an issue with your returns or you believe you are a victim of identity theft, contact us or the IRS immediately. The IRS has implemented procedures to deal with this identity theft. However, it does take time for them to sort it out. **Remember, the IRS does not contact taxpayers by email or telephone. Emails and phone calls purportedly from the IRS are scams. If in doubt, contact us.** That being said, Congress has authorized collection agencies to contact taxpayers, which most of the time will be by phone. You are not required to provide them with any information.

If you receive correspondence from the IRS, please open it immediately and contact us. Don't put it aside. The requested response time can be anywhere from 10-30 days. Our experience is that many times the information that the IRS has obtained independently is incorrect. We can generally respond on your behalf with no additional tax due.

Affordable Care Act (ACA)

Taxpayers must report if they had minimum essential health coverage on their tax returns. For those that do not have this coverage, they may be liable for a shared responsibility payment and should carefully review the significant number of exemptions available, which cover many different circumstances. Penalty amounts for 2017 (are the same as 2016) is the greater of $695 per adult and $347.50 per child or 2.5% of income above the filing threshold. It is possible to project the amount of any payment. Our office can assist you in both understanding these complex ACA provisions and planning for their impact.

Capital Gains/Dividends, AMT, Net Investment Income Tax and More

The tax rate on net capital gain is no higher than 15% for most taxpayers. Net capital gain may be taxed at 0% for taxpayers in the 10% or 15% ordinary income tax brackets (taxable income less than $37,950 for single and married filing separately; $75,900 for married filing jointly or qualifying widow(er); and $50,800 for head of household). Consequently, taxpayers in this situation can sell stock at a gain and buy the same stock back immediately with no tax due as long as the gain does not push them into the higher tax bracket. However, a 20% rate on net capital gain applies to the extent that a taxpayer's taxable income exceeds the thresholds set for the 39.6% ordinary tax rate ($418,400 for single; $470,700 for married filing jointly or qualifying widow(er); $444,550 for head of household, and $235,350 for married filing separately). The 3.8% net investment income tax may also apply for some taxpayers.

Keep in mind the "wash sale rules" when reviewing year-end capital gains and dividends. Wash sales are sales of stock or securities in which losses are realized, but not recognized for tax purposes, because the seller acquires substantially identical stock or securities within 30 days before or after the sale. Nonrecognition, however, applies only to losses; gains are recognized in full.

The alternative minimum tax (AMT) requires personalized attention. If you previously have been subject to AMT, you may be this year as well or if you have a change in circumstances. No single factor automatically triggers AMT liability, but some common factors are personal exemptions and itemized deductions for taxes (including state and local income taxes, real estate taxes, and personal property taxes) and miscellaneous expenses. These are not deductible for AMT purposes.

For higher-income taxpayers, there is a phase-out of itemized deductions and personal exemptions beginning at the amounts shown. Taxpayers in this situation ($261,500 for singles, $313,800 for married couples, $287,650 for head of household, and $156,900 for married filing separately) may want to explore the value of deferring itemized deductions or reducing adjusted gross income.

The Net Investment Income Tax (NIIT) is a 3.8% tax that is applied to investment income (dividends, interest, rental income, etc.) and capital gains for earners above certain threshold amounts ($200,000 for single filers and $250,000 for married taxpayers filing jointly). Business income is not considered subject to the NIIT provided the individual business owner materially participates in the business. Perhaps there is planning here to avoid or mitigate the tax.

Other

Expired provisions: The following provisions expired 12/31/16 and have not yet been extended to 2017:

- Mortgage Insurance Premium Deduction
- Exclusion of Cancellation of Indebtedness on Principal Residence
- Higher Education Tuition and Fees Deduction
- Residential energy property expenditures

Life Events: Marriage, death of a spouse, the birth or adoption of a child, retirement, a new job, loss of a job, the purchase of a new residence, a change in filing status, and other life events impact year-end tax planning. Sometimes timing matters.

We urge everyone to review their IRA beneficiary forms to make sure that they are up-to-date. Please be aware that upon your death the IRA beneficiary form controls where the IRA goes, not your will or trust, so making sure these forms are accurate is essential. We have seen instances after death where the IRA funds went to the unintended divorced spouse or a non-deserving family member because these forms were not changed. The result was not the one intended by the deceased. In order to "stretch" your IRA payouts, your IRA needs to have a designated beneficiary. Beneficiary forms for other retirement plans and insurance policies should also be reviewed.

IRAs: There are strict restrictions on moving money between IRA accounts. Account-to-account transfers are unlimited. Taking distributions yourself and redepositing the funds (known as rollovers) can only be done once in a 12-month period no matter how many IRAs that you have.

Underpaid taxes: If you believe that you are underpaid in federal or state income taxes, consider increasing your withholdings for the rest of the year to avoid or lessen any potential underpayment penalties. If you are not subject to withholdings, increase your remaining estimated tax payments.

Michigan: There are no major changes in Michigan income tax this year.

Charitable deductions: As we head into the holiday giving season, please know that all cash donations to charity must be documented – no exceptions. You do not necessarily have to provide all supporting documents to us, but you must have them in your files. You are no longer allowed any write-offs for contributions of cash or other monetary gifts unless you retain either a bank record such as a canceled check, or a written statement from the charity. For donations of over $250, the canceled check is not enough – you must have the statement from the charity prior to the filing of your tax return.

Also, for clothing and household item donations to Goodwill and other charities, we need you to create an itemized list and value each item. This is the documentation the IRS requires. We can provide guidance on values (visit our website for assistance with these values). Items donated to charity must be in "good or better" condition.

Mileage Rates: The 2017 standard mileage rate for business miles is $.535 per mile. The medical and moving mileage rate for 2017 is $.17; for charitable miles it is $.14. The IRS requires good records to substantiate your mileage deductions. There is no substitute for a mileage log to prove business miles driven. The simplest log is to record your miles on your calendar or utilize a phone app.

Don't forget to include your charitable mileage in your tax information – including those trips to drop items at thrift stores. Do you volunteer at church, school, food pantry, thrift store, or a non-profit organization? Those miles are deductible as well. Medical miles to the doctor or pharmacy are also deductible, if you qualify for a medical deduction.

Office in home deduction: There are two methods to choose from. Under the simplified method, the taxpayer can deduct $5 per square foot annually for no more than 300 square feet for a maximum deduction of $1,500 under this method. You can still use the deduction under prior rules of tracking actual expenses if that method is more advantageous for you.

Taxpayers with children filing returns: In a rush to get their refunds, sometimes dependent children file their returns very early. In most cases, they should <u>not</u> claim the dependency exemption on their returns because they are not entitled to it and do not benefit from it. If the child does claim the exemption when filing first, the parents cannot claim the dependency exemption for the child (resulting in higher taxes to the parents) and cannot efile their returns (and get their refunds) until the child amends their return(s). This results in a delay of months before the parents can receive their refunds. Caution your children to wait to file their returns or prepare their returns correctly. It makes for a less stressful filing season.

Businesses: *Travel and entertainment* – make sure to document time, place, amount, business purpose, and who you met with for each expense. The IRS always reviews these expenses in an audit. *Inventory* – You must count the inventory once a year – as of December 31 if that is your year-end. It is an IRS requirement. *Assets* – Immediate write-off of assets less than $2,500 each. *Vehicles* – If you deduct actual vehicle expenses rather than the cents-per-mile method and you are contemplating the purchase of a vehicle before year-end, depending on the size of the vehicle, you may be able to deduct $25,000 in 2017.

Foreign Bank and Brokerage Accounts: This does <u>not</u> apply to foreign investments held in US brokerage accounts. If you have any foreign trust, bank and/or brokerage accounts with a combined value greater than $10,000 on **any day of the year**, or you hold specific foreign financial assets (excluding land) greater than $50,000 at the end of the tax year, you are required to report them. The IRS is hitting this hard, and the penalty for failure to file the form is up to $500,000. Also, be sure to tell us about any income generated by these accounts, even if you did not receive a 1099.

Social Security Earnings Statements: We recommend that every year or two you review the earnings that Social Security has on file for you. It is much easier to correct any errors now rather than many years later at retirement. Go to www.ssa.gov and set up an account. It will allow you to verify your earnings and get an estimate of your future benefits (and much more).

Conclusion

This letter is meant to summarize the most common tax law changes and planning items, but it cannot cover everything. If you are aware of a provision that affects you, please contact our office to discuss the effects on your personal tax and financial situation.

Sometimes tax planning involves avoiding surprises when taxes are due in April. If you have unusual transactions to report for 2017, give us a call soon so that we can make sure you are prepared and have done all you can in 2017 to help your tax situation.

Our 2017 tax organizer will arrive in January. Returning clients will receive a personalized organizer which will contain information from last year's return. We hope the organizer will make it easier to collect this year's information. New clients will receive a generic organizer for their use.

For more details about the year-end planning ideas we have discussed, and to review other strategies, please contact our office. Together, we can create a customized 2017 year-end tax strategy tailored to you.

In the meantime, have a wonderful Holiday Season! We look forward to hearing from you soon.

Very truly yours,

Doug and associates