2017-2018
TAX PLANNING GUIDE

YEAR-ROUND STRATEGIES TO MAKE THE TAX LAWS WORK FOR YOU

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Possible tax law changes on the horizon

With Donald Trump in the White House and Republicans maintaining a majority in Congress comes the possibility of some dramatic changes in tax law. For example:

- Individuals could see changes to their tax rates and breaks and the elimination of certain taxes.
- On the business front, corporate tax reform could affect not only C corporations but other entity types as well. This would likely mean lower rates but fewer deductions and credits.
- Affordable Care Act (ACA) "repeal and replace" legislation could also affect taxes for both individuals and businesses. Certain taxes associated with the ACA could be repealed, while some health-care-related breaks might be enhanced.

As of the writing of this guide, however, these and other prospective tax law changes are still uncertain. Legislation might be signed into law later this year, but likely with many provisions not going into effect until 2018 or later. That doesn't mean there wouldn't be an impact on 2017 tax planning. There could be major incentives to defer income to 2018 and accelerate deductions into 2017.

What does this mean for you and your tax strategies? In your 2017 planning, you'll need to follow current tax law with an eye on what could happen in the future and be ready to act quickly if changes should warrant it. This guide provides an overview of some key tax provisions you need to be aware of and offers a variety of strategies for minimizing your taxes, as the tax environment now stands. Your tax advisor will be a key resource in the coming year; stay in touch with him or her to learn about the latest tax law developments and how they might affect your tax strategies for 2017.

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How you time your income and deductions matters

Usually it makes tax sense to accelerate as many deductible expenses as you can into the current tax year and defer income to the next year to the extent possible. This can reduce current-year tax, deferring tax to future years. In some cases it may even permanently lock in tax savings. But there are also situations where this strategy could be costly. To time income and deductions to your tax advantage, you must consider the potential impact on your particular situation.

Alternative minimum tax

Before timing income and deductions, consider the AMT — a separate tax system that limits some deductions and disallows others, such as:

- State and local income tax deductions,
- Property tax deductions, and
- Miscellaneous itemized deductions subject to the 2% of adjusted gross income (AGI) floor, including investment advisory fees and unreimbursed employee business expenses.

It also treats certain income items differently, such as incentive stock option exercises. You must pay the AMT if your AMT liability exceeds your regular tax liability. See Chart 6 on page 16 for AMT rates and exemptions, and work with your tax advisor to project whether you could be subject to the AMT this year or next. You may be able to time income and deductions to avoid the AMT, or at least reduce its impact.

Home-related breaks

Consider both deductions and exclusions:

Property tax deduction. Before paying your bill early to accelerate this itemized deduction into 2017, review your AMT situation. If you're subject to the AMT this year, the deduction won't save you tax.

Mortgage interest deduction. You generally can deduct interest on up to a combined total of $1 million of mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your *principal* residence also may be deductible.

Home equity debt interest deduction. Interest on home equity debt used for any purpose (debt limit of $100,000) may be deductible. So consider using a home equity loan or line of credit to pay off credit cards or auto loans, for which interest isn't deductible and rates may be higher. ***Warning:*** If home equity debt isn't used for home improvements, the interest isn't deductible for AMT purposes.

Mortgage insurance premium deduction. This break expired on Dec. 31, 2016, but it could be extended. Check with your tax advisor for the latest information.

Home office deduction. If your use of a home office is for your employer's benefit and it's the only use of the space, you generally can deduct a portion of your mortgage interest, property taxes, insurance, utilities and certain other expenses, and the depreciation allocable to the space. Or you may use the IRS's simplified method for calculating the deduction. For employees, home office expenses are a miscellaneous itemized deduction, and you'll enjoy a tax benefit only if these expenses plus your other miscellaneous itemized expenses exceed 2% of your AGI. (If you're self-employed, see page 11.)

Rental income exclusion. If you rent out all or a portion of your principal residence or second home for less than 15 days, you don't have to report the income. But expenses directly associated with the rental, such as advertising and cleaning, won't be deductible.

Home sale gain exclusion. When you sell your principal residence, you can exclude up to $250,000 ($500,000 for married couples filing jointly) of gain if you meet certain tests. ***Warning:*** Gain that's allocable to a period of "nonqualified" use generally isn't excludable.

Loss deduction. If you sell your home at a loss and part of your home is rented out or used exclusively for your business, the loss attributable to that portion may be deductible.

Debt forgiveness exclusion. This break for homeowners who received debt forgiveness in a foreclosure, short sale or mortgage workout for a principal residence expired on Dec. 31, 2016, but it could be extended. Check with your tax advisor for the latest information.

Energy-related breaks. A wide variety of breaks designed to encourage energy efficiency and conservation expired on Dec. 31, 2016. Ask your tax advisor for the latest information on whether any have been extended.

Charitable donations

Donations to qualified charities are generally fully deductible for both regular tax and AMT purposes, and they may be the easiest deductible expense to time to your tax advantage. For large donations, discuss with your tax advisor which assets to give and the best ways to give them. For example:

Appreciated publicly traded stock. If you've held it more than one year, it can make one of the best charitable gifts because you can deduct the current fair market value and avoid the capital gains tax you'd pay if you sold the property. ***Warning:*** Such donations are subject to tighter deduction limits. Excess contributions can be carried forward for up to five years.

CRTs. For a given term, a charitable remainder trust pays an amount to you annually (some of which generally is taxable). At the term's end, the CRT's remaining assets pass to one or more charities. When you fund the CRT, you receive an income tax deduction. If you contribute appreciated assets, you also can minimize and defer capital gains tax. You can name someone other than yourself as income beneficiary or fund the CRT at your death, but the tax consequences will be different.

Tax-advantaged saving for health care

You may be able to save taxes by contributing to one of these accounts:

HSA. If you're covered by a qualified high-deductible health plan, you can contribute pretax income to an employer-sponsored Health Savings Account — or make deductible contributions to an HSA you set up yourself — up to $3,400 for self-only coverage and $6,750 for family coverage for 2017. Plus, if you're age 55 or older, you may contribute an additional $1,000. HSAs can bear interest or be invested, growing tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year.

FSA. You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit — not to exceed $2,600 in 2017. The plan pays or reimburses you for qualified medical expenses. What you don't use by the plan year's end, you generally lose — though your plan might allow you to roll over up to $500 to the next year. Or it might give you a 2½-month grace period to incur expenses to use up the previous year's contribution. If you have an HSA, your FSA is limited to funding certain "permitted" expenses.

WHAT'S NEW!

Tax law uncertainty complicates timing strategies

Determining the right timing strategies in 2017 is especially challenging because changes that might be signed into law later this year could potentially affect both your income tax rate and what you can deduct — probably not for 2017 but for 2018, which would impact 2017 planning.

While rates may go down for many taxpayers, they could go up for some people. And itemized deductions could be subject to new caps, or some deductions might be eliminated. In addition, the alternative minimum tax (AMT) might be repealed. Finally, Affordable Care Act repeal and replace legislation could affect health-care-related tax breaks. Consult your tax advisor for the latest information on these and other developments that may affect your timing strategies this year.

Medical expense deduction

If medical expenses not paid via tax-advantaged accounts or reimbursable by insurance exceed 10% of your AGI, you can deduct the excess amount. Beginning in 2017, this floor also applies to taxpayers age 65 and older. (Previously, they could enjoy a 7.5% floor for regular tax purposes but were subject to the 10% floor for AMT purposes.) Eligible expenses may include:

- Health insurance premiums,
- Long-term-care insurance premiums (limits apply),
- Medical and dental services, and
- Prescription drugs.

Mileage driven for health care purposes also can be deducted — at 17 cents per mile for 2017.

Consider bunching nonurgent medical procedures (and any other services and purchases whose timing you can control without negatively affecting your or your family's health) into one year to exceed the 10% floor. If one spouse has high medical expenses and a relatively lower AGI, filing separately may allow that spouse to exceed the AGI floor and deduct some medical expenses that wouldn't be deductible if the couple filed jointly.

Sales tax deduction

The break allows you to take an itemized deduction for state and local *sales* taxes in lieu of state and local *income* taxes. The deduction is valuable to those who reside in states with no or low income tax, and it also can benefit taxpayers in other states who purchase a major item, such as a car or boat.

Limit on itemized deductions

If your AGI exceeds the applicable threshold, certain deductions are reduced by 3% of the AGI amount that exceeds the threshold (not to exceed 80% of otherwise allowable deductions). For 2017, the thresholds are $261,500 (single), $287,650 (head of household), $313,800 (married filing jointly) and $156,900 (married filing separately).

If your AGI is close to the threshold, AGI-reduction strategies (such as contributing to a retirement plan or HSA) may allow you to stay under it. If that's not possible, consider the reduced tax benefit of the affected deductions before implementing strategies to accelerate or defer deductible expenses. The limitation doesn't apply, however, to deductions for medical expenses, investment interest, or casualty, theft or wagering losses. ❖

Parent or student? Here are some breaks for you

Raising children and helping them pursue their educational goals — or pursuing your own — can be highly rewarding. But it also can be expensive. Fortunately, a variety of tax breaks can offset some of the costs. And changes might be signed into law that would enhance some of these breaks. (Check with your tax advisor for the latest information.)

Child and adoption credits

Tax credits reduce your tax bill dollar-for-dollar, so make sure you're taking every credit you're entitled to. For each child under age 17 at the end of the year, you may be able to claim a $1,000 child credit. If you adopt in 2017, you may qualify for an adoption credit — or for an income exclusion under an employer adoption assistance program. Both are up to $13,570 per eligible child. ***Warning:*** These credits phase out for higher-income taxpayers. (See Chart 1.)

Child care expenses

A couple of tax breaks can help you offset child care costs:

Tax credit. For children under age 13 or other qualifying dependents, you may be eligible for a credit for a percentage of your dependent care expenses. Eligible expenses are limited to $3,000 for one dependent and $6,000 for two or more. Income-based limits reduce the credit percentage but don't phase it out altogether. (See Chart 1.)

FSA. You can contribute up to $5,000 pretax to an employer-sponsored child and dependent care Flexible Spending Account. The plan pays or reimburses you for these expenses.

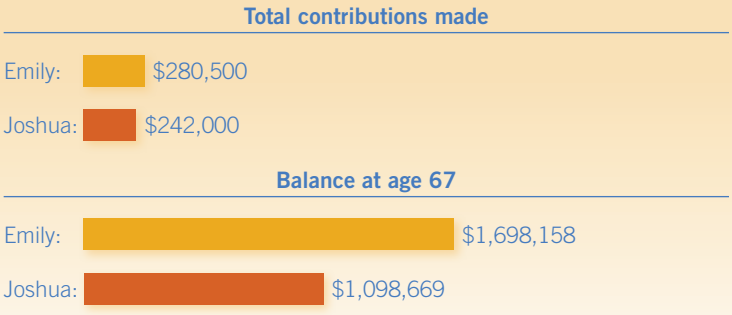
IRAs for teens

IRAs can be perfect for teenagers because they likely will have many years to let their accounts grow tax-deferred or tax-free. The 2017 contribution limit is the lesser of $5,500 or 100% of earned income. A teen's *traditional* IRA contributions typically are deductible, but distributions will be taxed. *Roth* IRA contributions aren't deductible, but qualified distributions will be tax-free. Choosing a Roth IRA is typically a no-brainer if a teen doesn't earn income that exceeds the standard deduction ($6,350 for 2017 for single taxpayers), because he or she will likely gain no benefit from the ability to deduct a traditional IRA contribution. Even above that amount, the teen probably is taxed at a very low rate, so the Roth will typically still be the better answer.

Case Study I

It's never too early to save for retirement

Roth IRAs can be perfect for teenagers — just look at how much difference starting contributions early can make: Both Emily and Joshua contribute $5,500 per year to their Roth IRAs through age 66. But Emily starts contributing when she gets her first job at age 16, while Joshua waits until age 23, after he's graduated from college and started his career. Emily's additional $38,500 of early contributions results in a nest egg at full retirement age of 67 that's nearly $600,000 larger!



Note: *This example is for illustrative purposes only and isn't a guarantee of future results. The figures presume $5,500 is contributed at the end of each year over the ages shown and a 6% rate of return. See page 12 for more information on Roth IRA contribution rules.*

If your children or grandchildren don't want to invest their hard-earned money, consider *giving* them up to the amount they're eligible to contribute. But keep the gift tax in mind. (See page 14.)

If they don't have earned income and you own a business, consider hiring them. As the business owner, you can deduct their pay, and other tax benefits may apply. ***Warning:*** The children must be paid in line with what you'd pay non-family employees for the same work.

"Kiddie tax"

The "kiddie tax" generally applies to children under age 19 and to full-time students under age 24 (unless the students provide more than half of their own support from earned income). For children subject to the tax, any unearned income beyond $2,100 (for 2017) is taxed at their parents' marginal rate, assuming it's higher. Keep this in mind before transferring income-generating assets to them.

529 plans

If you're saving for college, consider a Section 529 plan. You can choose a prepaid tuition plan to secure current tuition rates or a tax-advantaged savings plan to fund college expenses:

- Although contributions aren't deductible for federal purposes, any growth is tax-deferred. (Some states do offer breaks for contributing.)
- Distributions used to pay qualified expenses (such as tuition, mandatory fees, books, supplies, computer equipment, software, Internet service and, generally, room and board) are income-tax-free for federal purposes and typically for state purposes as well, thus making the tax deferral a permanent savings.
- The plans usually offer high contribution limits, and there are no income limits for contributing.
- There's generally no beneficiary age limit for contributions or distributions.
- You can control the account, even after the child is of legal age.
- You can make tax-free rollovers to another qualifying family member.
- A special break for 529 plans allows you to front-load five years' worth of annual gift tax exclusions and make up to a $70,000 contribution (or $140,000 if you split the gift with your spouse).

CHART 1

Are you eligible for these 2017 tax breaks?

Tax break[1]	Modified adjusted gross income phaseout range	
	Single filer	Joint filer
Child credit[2]	$ 75,000 – $ 95,000	$110,000 – $130,000
Adoption credit	$203,540 – $243,540	$203,540 – $243,540
Child or dependent care credit[3]	$ 15,000 – $ 43,000	$ 15,000 – $ 43,000
ESA contribution	$ 95,000 – $110,000	$190,000 – $220,000
American Opportunity credit	$ 80,000 – $ 90,000	$160,000 – $180,000
Lifetime Learning credit	$ 56,000 – $ 66,000	$112,000 – $132,000
Student loan interest deduction	$ 65,000 – $ 80,000	$135,000 – $165,000

[1] These tax breaks might be affected by tax law changes. Check with your tax advisor for the latest information.

[2] Assumes one child. The phaseout end is higher for families with more than one eligible child.

[3] The phaseout is based on AGI rather than MAGI. The credit doesn't phase out altogether, but the minimum credit percentage of 20% applies to AGIs above $43,000.

The biggest downsides may be that your investment options — and when you can change them — are limited.

ESAs

Coverdell Education Savings Accounts are similar to 529 savings plans in that contributions aren't deductible for federal purposes, but plan assets can grow tax-deferred and distributions used to pay qualified education expenses are income-tax-free. One of the biggest ESA advantages is that tax-free distributions aren't limited to college expenses; they also can fund elementary and secondary school costs. ESAs are worth considering if you want to fund such expenses or would like to have direct control over how and where your contributions are invested.

But the $2,000 contribution limit is low, and it's phased out based on income. (See Chart 1.) Amounts left in an ESA when the beneficiary turns age 30 generally must be distributed within 30 days, and any earnings may be subject to tax and a 10% penalty.

Education credits and deductions

If you have children in college now, are currently in school yourself or are paying off student loans, you may be eligible for a credit or deduction:

American Opportunity credit. The tax break covers 100% of the first $2,000 of tuition and related expenses and 25% of the next $2,000 of expenses. The maximum credit, *per student*, is $2,500 per year for the first four years of postsecondary education.

Lifetime Learning credit. If you're paying postsecondary education expenses beyond the first four years, you may benefit from the Lifetime Learning credit (up to $2,000 *per tax return*).

Tuition and fees deduction. This expired on Dec. 31, 2016, but could be extended. Consult your tax advisor for the latest information.

Student loan interest deduction. If you're paying off student loans, you may be able to deduct the interest. The limit is $2,500 *per tax return*.

Warning: Income-based phaseouts apply to these breaks. (See Chart 1.) If your income is too high for you to qualify, your child might be eligible. But if your dependent child claims the credit, you must forgo your dependency exemption for him or her (and the child can't take the exemption).

ABLE accounts

Achieving a Better Life Experience accounts offer a tax-advantaged way to fund qualified disability expenses for a beneficiary who became blind or disabled before age 26. For federal purposes, tax treatment is similar to that of Section 529 college savings plans. ❖

Tax planning for investments involves many considerations

You need to understand the potential tax consequences of buying, holding and selling a particular investment. However, you shouldn't let tax considerations propel your investment decisions. Instead, as you buy and sell investments, consider not only tax implications but also your investment goals, time horizon, risk tolerance, factors related to the investment itself, and fees and charges that apply to buying and selling securities.

Capital gains tax and timing

Although time, not timing, is generally the key to long-term investment success, timing can have a dramatic impact on the tax consequences of investment activities. Your long-term capital gains rate might be as much as 20 percentage points lower than your ordinary-income rate. The long-term gains rate applies to investments held for more than 12 months. The applicable rate depends on your income level and the type of asset you've sold. (See Chart 2.)

Holding on to an investment until you've owned it more than a year may help substantially cut tax on any gain. Here are some other tax-saving strategies related to timing:

Use unrealized losses to absorb gains. To determine capital gains tax liability, realized capital gains are netted against any realized capital losses. Both long- and short-term gains and losses can offset one another. If you've cashed in some big gains during the year and want to reduce your 2017 tax liability, before year end look for unrealized losses in your portfolio and consider selling them to offset your gains.

Avoid wash sales. If you want to achieve a tax loss with minimal change in your portfolio's asset allocation, keep in mind the wash sale rule. It prevents you from taking a loss on a security if you buy a substantially identical security (or an option to buy such a security) within 30 days before or after you sell the security that created the loss. You can then recognize the loss only when you sell the replacement security.

Fortunately, there are ways to avoid triggering the wash sale rule and still achieve your goals. For example, you can immediately buy securities of a different company in the same industry or shares in a mutual fund that holds securities much like the ones you sold. Or, you can wait 31 days to repurchase the same security. Alternatively, before selling the security, you can purchase additional shares equal to the number you want to sell at a loss, and then wait 31 days to sell the original portion.

Swap your bonds. With a bond swap, you sell a bond, take a loss and then immediately buy another bond of similar quality and duration from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical. Thus, you achieve a tax loss with virtually no change in economic position.

Mind your mutual funds. Mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you more tax dollars because of the lower long-term rates.

Case Study II

Mutual fund capital gains distributions: A taxable event

Farah purchases 200 shares of an equity mutual fund on Dec. 1, 2017, at $100 per share, for a total investment of $20,000. The next week, the fund makes a capital gains distribution of $15 per share. Farah ends up with capital gains of $3,000, reportable on her 2017 return. It doesn't matter whether the actual value of the shares has increased or even decreased since Farah purchased them, or whether she reinvests the proceeds back into the same fund.

Why? The distribution itself is a taxable event. If capital gains distributions from the mutual fund are reinvested in the fund, the distribution itself doesn't change Farah's value in the fund. It simply increases the number of shares she owns, yet now at a lower per-share value.

CHART 2

What's the maximum capital gains tax rate?

Assets held	2017[1, 2]
12 months or less (*short term*)	Taxpayer's ordinary-income tax rate
More than 12 months (*long term*)	
■ 39.6% ordinary-income tax bracket	20%
■ 25%, 28%, 33% or 35% ordinary-income tax bracket	15%
■ 10% or 15% ordinary-income tax bracket	0%
Some key exceptions	
Long-term gain on collectibles, such as artwork and antiques	28%
Long-term gain attributable to certain recapture of prior depreciation on real property	25%

[1] In addition, the 3.8% NIIT applies to net investment income to the extent that modified adjusted gross income (MAGI) exceeds $200,000 (singles and heads of households), $250,000 (married filing jointly) or $125,000 (married filing separately).

[2] These tax rates might be affected by tax law changes.

Also pay attention to earnings reinvestments. Unless you or your investment advisor increases your basis accordingly, you may report more gain than required when you sell the fund. Brokerage firms are required to track (and report to the IRS) your cost basis in mutual funds acquired during the tax year.

Finally, beware of buying equity mutual fund shares late in the year. Such funds often declare a large capital gains distribution at year end. If you own the shares on the distribution's record date, you'll be taxed on the full distribution amount even if it includes significant gains realized by the fund *before* you owned the shares. (See Case Study II.)

See if a loved one qualifies for the 0% rate. The 0% rate applies to long-term gain that would be taxed at 10% or 15% based on the taxpayer's ordinary-income rate. If you have adult children in one of these tax brackets, consider transferring appreciated assets to them so they can sell the assets and enjoy the 0% rate. This strategy can be even more powerful if you'd be subject to the 3.8% NIIT and/or the 20% long-term capital gains rate if you sold the assets.

Warning: If the child will be under age 24 on Dec. 31, first make sure he or she won't be subject to the "kiddie tax." (See page 5.) Also, consider any gift tax consequences. (See page 14.)

Loss carryovers

If net losses exceed net gains, you can deduct only $3,000 ($1,500 for married taxpayers filing separately) of the net losses per year against other income (such as wages, self-employment and business income, dividends and interest).

You can carry forward excess losses until death. Loss carryovers can be a powerful tax-saving tool in future years if you have a large investment portfolio, real estate holdings or a closely held business that might generate substantial future capital gains.

Finally, remember that capital gains distributions from mutual funds can also absorb capital losses.

Beyond gains and losses

With some types of investments, you'll have more tax consequences to consider than just gains and losses:

Dividend-producing investments. Qualified dividends are taxed at the favorable long-term capital gains tax rate rather than at your higher ordinary-income tax rate.

Interest-producing investments. Interest income generally is taxed at ordinary-income rates. So stocks that pay qualified dividends may be more attractive tax-wise than other income investments, such as CDs and taxable bonds. But nontax issues must be considered as well, such as investment risk, rate of return and diversification.

Bonds. These also produce interest income, but the tax treatment varies:

- Interest on U.S. government bonds is taxable on federal returns but exempt by law on state and local returns.
- Interest on state and local government bonds is excludable on federal returns. If the bonds were issued in your home state, interest also may be excludable on your state return.
- Tax-exempt interest from certain private-activity municipal bonds can trigger or increase the AMT (see page 2) in some situations.
- Corporate bond interest is fully taxable for federal and state purposes.
- Bonds (except U.S. savings bonds) with original issue discount build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay this interest annually — and you must pay tax on it.

Stock options. Before exercising (or postponing exercise of) options or selling stock purchased via an exercise, consult your tax advisor about the complicated rules that may trigger regular tax or AMT liability.

3.8% NIIT

Taxpayers with modified adjusted gross income (MAGI) over $200,000 per year ($250,000 if married filing jointly and $125,000 if married filing separately) may owe the net investment income tax, in addition to other taxes already discussed here. The NIIT equals 3.8% of the lesser of your net investment income or the amount by which your MAGI exceeds the applicable threshold. Net investment income can include capital gains, dividends, interest and other investment-related income (but not self-rental income from an active trade or business). Keep in mind that the NIIT might be repealed or reduced. Check with your tax advisor for the latest information.

Many of the strategies that can help you save or defer income tax on your investments can also help you avoid or defer NIIT liability. And because the threshold for the NIIT is based on MAGI, strategies that reduce your MAGI could also help you avoid or reduce NIIT liability. ❖

Businesses: Ready to tackle 2017's planning challenges?

Running a profitable business isn't easy. You have to operate efficiently, market aggressively and respond swiftly to competitive and financial challenges. And without proper planning, taxes may drag down your bottom line more than they should. This year, tax law uncertainty makes planning even more challenging: Lower rates for both corporations and flow-through entities have been proposed, along with replacement of the depreciation system with immediate deductions but elimination of many other breaks. No matter what happens, work with your tax advisor to implement a robust tax plan — one that will net you the best tax result.

Projecting income

Projecting your business's income for this year and next can allow you to time income and deductions to your advantage. It's generally — but not always — better to defer tax, so consider:

Deferring income to next year. If your business uses the cash method of accounting, you can defer billing for products or services at year end. If you use the accrual method, you can delay shipping products or delivering services.

Accelerating deductible expenses into the current year. If you're a cash-basis taxpayer, you may pay business expenses by Dec. 31, so you can deduct them this year rather than next. Both cash- and accrual-basis taxpayers can charge expenses on a credit card and deduct them in the year charged, regardless of when the credit card bill is paid.

Warning: Don't let tax considerations get in the way of sound business decisions. For example, the negative impact of these strategies on your cash flow might not be worth the potential tax benefit.

Taking the opposite approach. If it's likely you'll be in a higher tax bracket next year, accelerating income and deferring deductible expenses may save you more tax over the two-year period.

Depreciation

For assets with a useful life of more than one year, you generally must depreciate the cost over a period of years. In most cases, the Modified Accelerated Cost Recovery System (MACRS) will be preferable to other methods because you'll get larger deductions in the early years of an asset's life.

But if you make more than 40% of the year's asset purchases in the last quarter, you could be subject to the typically less favorable midquarter convention. Careful planning can help you maximize depreciation deductions in the year of purchase.

Other depreciation-related breaks and strategies may be available:

Section 179 expensing election. This allows you to deduct (rather than depreciate over a number of years) the cost of purchasing eligible new or used assets, such as equipment, furniture, off-the-shelf computer software, and leasehold-improvement, restaurant and retail-improvement property. The expensing limit for 2017 is $510,000 — and the break begins to phase out dollar-for-dollar when total asset acquisitions for the tax year exceed $2.03 million. (These amounts are annually adjusted for inflation.) You can claim the election only to offset net income from a "trade or business," not to reduce it below zero to create a loss.

50% bonus depreciation. This additional first-year depreciation for qualified assets has been extended through 2019. However, it's scheduled to drop to 40% for 2018 and 30% for 2019.

Qualified assets include *new* tangible property with a recovery period of 20 years or less (such as office furniture and equipment), off-the-shelf computer software, water utility property and qualified improvement property.

Accelerated depreciation. This break allows a shortened recovery period of 15 years — rather than 39 years — for qualified leasehold-improvement, restaurant and retail-improvement property.

Tangible property repair safe harbors. A business that has made repairs to tangible property, such as buildings, machinery, equipment and vehicles, can expense those costs and take an immediate deduction. But costs incurred to acquire, produce or *improve* tangible property generally must be depreciated. Distinguishing between repairs and improvements can be difficult, but IRS safe harbors can help: 1) the routine

maintenance safe harbor, 2) the small business safe harbor, or 3) the de minimis safe harbor. The rules are complex, so contact your tax advisor for details.

Cost segregation study. If you've recently purchased or built a building or are remodeling existing space, consider a cost segregation study. It identifies property components that can be depreciated much faster, increasing your current deductions. Typical assets that qualify include decorative fixtures, security equipment, parking lots and landscaping.

Vehicle-related deductions

Business-related vehicle expenses can be deducted using the mileage-rate method (53.5 cents per mile driven in 2017) or the actual-cost method (total out-of-pocket expenses for fuel, insurance, repairs and other vehicle expenses, plus depreciation).

Purchases of *new or used* vehicles may be eligible for Sec. 179 expensing. However, many rules and limits apply. For example, the normal Sec. 179 expensing limit generally applies to vehicles with a gross vehicle weight rating of more than 14,000 pounds. A $25,000 limit applies to vehicles (typically SUVs) rated at more than 6,000 pounds but no more than 14,000 pounds.

Vehicles rated at 6,000 pounds or less are subject to the passenger automobile limits. For autos placed in service in 2017, the first-year depreciation limit is $3,160. The amount that may be deducted under the combination of MACRS depreciation and Sec. 179 for the first year is limited under the luxury auto rules to $11,160.

In addition, if a vehicle is used for business and personal purposes, the associated expenses, including depreciation, must be allocated between deductible business use and nondeductible personal use. The depreciation limit is reduced if the business use is less than 100%. If business use is 50% or less, you can't use Sec. 179 expensing or the accelerated regular MACRS; you must use the straight-line method.

Section 199 deduction

The Section 199 deduction, also called the "manufacturers' deduction" or "domestic production activities deduction," is 9% of the lesser of qualified production activities income or taxable income. The deduction is also limited to 50% of W-2 wages paid by the taxpayer that are allocable to domestic production gross receipts.

The deduction is available to traditional manufacturers and to businesses engaged in activities such as construction, engineering, architecture, computer software production and agricultural processing. It isn't allowed in determining net self-employment earnings and generally can't reduce net income below zero. But it can be used against the AMT.

Employee benefits

Offering a variety of benefits not only can help you attract and retain the best employees, but also may save tax:

Qualified deferred compensation plans. These include pension, profit-sharing, SEP and 401(k) plans, as well as SIMPLEs. You take a tax deduction for your contributions to employees' accounts. (For information on the benefits to employees, see page 12.) Certain small employers may also be eligible for a credit when setting up a plan. (See page 10.)

Case Study III

Be cautious when deducting meal, entertainment, auto and travel expenses

Paul regularly claimed business deductions for meal, entertainment, vehicle and travel expenses as well as employee reimbursements of such expenses. He had heard that these deductions might draw IRS attention. So he consulted his tax advisor to learn what he could do to help ensure his deductions pass muster with the IRS. Here's what his advisor suggested:

Keep detailed, accurate records. You generally must have receipts, canceled checks or bills that show amounts and dates. In addition, there are other rules for specific expenses. For example, you must record the business purpose of entertainment expenses, as well as the names of those you entertained and their business relationship to you. If you reimburse employees for expenses, make sure they comply with these rules.

Be timely in your recordkeeping. Don't create expense or mileage logs at year end or wait until you receive an IRS deficiency notice. Record the details in a log or diary at the time of the event or soon after. Require employees to submit monthly expense reports.

Respect the fine line between personal and business expenses. For example, you can't deduct expenses for a spouse on a business trip unless he or she is employed by the company and there's a bona fide business reason for his or her presence.

HSAs and FSAs. If you provide employees with a qualified high-deductible health plan (HDHP), you can also offer them Health Savings Accounts. Regardless of the type of health insurance you provide, you can offer Flexible Spending Accounts for health care. (See page 3.) If you have employees who incur day care expenses, consider offering FSAs for child and dependent care. (See page 4.)

HRAs. A Health Reimbursement Account reimburses an employee for medical expenses up to a maximum dollar amount. Unlike an HSA, no HDHP is required. Unlike an FSA, any unused portion can be carried forward to the next year. But only the employer can contribute to an HRA.

Fringe benefits. Some fringe benefits aren't included in employee income. Yet the employer can still receive a deduction for the portion, if any, of the benefit it pays and typically avoid payroll tax as well. Examples of such benefits are employee discounts, group term-life insurance (up to $50,000 annually per person), parking (up to $255 per month for 2017), mass transit / van pooling (also up to $255 per month) and health insurance.

You might even be penalized for *not* offering health insurance. The play-or-pay provision of the Affordable Care Act (ACA) can in some cases impose a penalty on "large" employers if they don't offer full-time employees "minimum essential coverage" or if the coverage offered is "unaffordable" or doesn't provide "minimum value."

The IRS has issued detailed guidance on what these terms mean and how employers can determine whether they're a "large" employer and, if so, whether they're offering sufficient coverage to avoid the risk of penalties. However, as of this writing it's uncertain whether these penalties will be enforced, given the Executive Order issued earlier this year for federal agencies to "exercise all authority and discretion available to them" to minimize the ACA's impact. Plus, ACA repeal and replace legislation might eliminate the provision. Check with your tax advisor for the latest information.

NOLs

A net operating loss occurs when a C corporation's operating expenses and other deductions for the year exceed its revenues. Generally, an NOL may be carried back two years to generate a refund. Any loss not absorbed is carried forward up to 20 years to offset income.

Carrying back an NOL may provide a needed influx of cash. But you can elect to forgo the carryback if carrying the entire loss forward may be more beneficial. This might be the case if you expect your income to increase substantially compared to the prior two years or tax rates to go up.

Tax credits

Tax credits reduce tax liability dollar-for-dollar, making them particularly beneficial:

Research credit. The research credit (often called the "research and development" credit) gives businesses an incentive to step up their investments in research.

Businesses with $50 million or less in gross receipts may be able to claim the credit against AMT liability. And certain start-ups (in general, those with less than $5 million in gross receipts) that haven't yet incurred any income tax liability can use the credit against their payroll tax.

While the credit is complicated to compute, the tax savings can prove significant.

Work Opportunity credit. This credit is designed to encourage hiring from certain disadvantaged groups, such as certain veterans, ex-felons, individuals who've been unemployed for 27 weeks or more and food stamp recipients.

The size of the credit depends on the hired person's target group, the wages paid to that person and the number of hours that person worked during the first year of employment. The maximum credit that can be earned for each member of a target group is generally $2,400 per adult employee. But the credit can be higher for members of certain target groups, up to as much as $9,600 for certain veterans.

Employers aren't subject to a limit on the number of eligible individuals they can hire. That is, if there are 10 individuals that qualify, the credit can be 10 times the listed amount.

Bear in mind that you must obtain certification that an employee is a target group member from the appropriate State Workforce Agency before you can claim the credit. The certification generally must be requested within 28 days after the employee begins work.

New Markets credit. This gives investors who make "qualified equity investments" in certain low-income communities a 39% credit over a seven-year period. Certified Community Development Entities (CDEs) determine which projects get funded — often construction or rehabilitation real estate projects in "distressed" communities, using data from the 2006–2010 American Community Survey. Flexible financing is provided to the developers and business owners. The credit is scheduled to expire on Dec. 31, 2019.

Retirement plan credit. Small employers (generally those with 100 or fewer employees) that create a retirement plan may be eligible for a $500 credit per year for three years. The credit is limited to 50% of qualified startup costs.

Small-business health care credit. The maximum credit is 50% of group health coverage premiums paid by the employer, provided it contributes at least 50% of the total premium or of a benchmark premium. For 2017, the full credit is available for employers with 10 or fewer full-time equivalent employees (FTEs) and average annual wages of less than $26,200 per employee. Partial credits are available on a sliding scale to businesses with fewer than 25 FTEs and average annual wages of less than $52,400. ***Warning:*** To qualify for the credit, online enrollment in the Small Business Health Options Program (SHOP) generally is required. In addition, the credit can be taken for only two years, and they must be consecutive. (Credits taken before 2014 don't count, however.)

Empowerment Zones. Empowerment Zones are certain urban and rural areas where employers and other taxpayers qualify for special tax incentives, including a 20% credit for "qualified zone wages" up to $15,000, for a maximum credit of $3,000. This tax incentive expired on Dec. 31, 2016, but Congress could extend it. Check with your tax advisor for the latest information.

Business structure

Income taxation and owner liability are the main factors that differentiate one business structure from another. (See Chart 3 to compare the tax treatments.) Many businesses choose entities that combine flow-through taxation with limited liability, namely limited liability companies (LLCs) and S corporations. Lower corporate rates and more favorable taxation of income from flow-through entities have been proposed.

The top individual rate is higher (39.6%) than the top corporate rate (generally 35%), which might affect business structure decisions. For tax or other reasons, a structure change may be beneficial in certain situations, but there also may be unwelcome tax consequences.

Some tax differences between structures may provide tax planning opportunities, such as differences related to salary vs. distributions/dividends:

S corporations. Only income that shareholder-employees receive as salary is subject to employment taxes and, if applicable, the ACA's additional 0.9% Medicare tax, which generally applies to taxpayers with earned income exceeding the same thresholds as those for the NIIT. (See page 7.) To reduce these taxes, you may want to keep your salary relatively — but not unreasonably — low and increase your distributions of company income, because distributions generally aren't taxed at the corporate level or subject to the 0.9% Medicare tax or the 3.8% NIIT.

C corporations. Only income that shareholder-employees receive as salary is subject to employment taxes and, if applicable, the 0.9% Medicare tax. Nevertheless, you may prefer to take more income as salary (which is deductible at the corporate level) as opposed to dividends (which aren't deductible at the corporate level, yet are still taxed at the shareholder level and could be subject to the 3.8% NIIT) if the overall tax paid by both the corporation and you would be less.

Warning: The IRS is cracking down on misclassification of corporate payments to shareholder-employees, so tread carefully.

CHART 3

Income tax differences[1] based on business structure

Flow-through entity or sole proprietorship	C corporation
One level of taxation: The business's income flows through to the owner(s).	Two levels of taxation: The business is taxed on income, and then shareholders are taxed on any dividends they receive.
Losses flow through to the owner(s).	Losses remain at the corporate level.
The top individual tax rate is 39.6%.	The top corporate tax rate is generally 35%[2], and the top rate on qualified dividends is 20%.

[1] Lower corporate rates and more favorable taxation of income from flow-through entities have been proposed.

[2] See Chart 6 on page 16 for exceptions.

Sale or acquisition

Whether you're selling your business or acquiring another company, the tax consequences can have a major impact on the transaction's success or failure.

Consider installment sales, for example. A taxable sale might be structured as an installment sale if the buyer lacks sufficient cash or pays a contingent amount based on the business's performance. An installment sale also may make sense if the seller wishes to spread the gain over a number of years — which could be especially beneficial if it would allow the seller to stay under the thresholds for triggering the 3.8% NIIT or the 20% long-term capital gains rate. But an installment sale can backfire on the seller. For example:

- Depreciation recapture must be reported as gain in the year of sale, no matter how much cash the seller receives.
- If tax rates increase, the overall tax could wind up being more.

With a corporation, a key consideration is whether the deal should be structured as an asset sale or a stock sale. If a stock sale is chosen, another important question is whether it should be a tax-deferred transfer or a taxable sale.

Of course, tax consequences are only one of many important considerations when planning a sale or acquisition.

The self-employed

If you're self-employed, you can deduct 100% of health insurance costs for yourself, your spouse and your dependents. This above-the-line deduction is limited to your net self-employment income. You also can take an above-the-line deduction for contributions to a retirement plan (see page 12) and, if you're eligible, an HSA (see page 3) for yourself.

You pay both the employee and employer portions of employment taxes on your self-employment income. The employer portion (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible above the line.

And you may be able to deduct home office expenses (see page 2) from your self-employment income. ❖

Make golden decisions about your golden years

Planning for your retirement means making a series of financial decisions that will have an impact on your golden years: Should you invest in a traditional tax-deferred plan, a Roth plan that offers tax-free distributions, or both? If you opt for a Roth plan, which of the several options available is right for you? Also, when should you start withdrawing from your retirement savings, and in what amounts? Whether you're just starting to think about retirement planning, are retired already or are somewhere in between, addressing the questions relevant to your current situation will help ensure your golden years are truly golden.

401(k)s and other employer plans

Contributing to a traditional employer-sponsored defined contribution plan is usually a good first step:

- Contributions are typically pretax, reducing your taxable income.
- Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions.
- Your employer may match some or all of your contributions.

Chart 4 shows the 2017 employee contribution limits. Because of tax-deferred compounding, increasing your contributions sooner rather than later can have a significant impact on the size of your nest egg at retirement. Employees age 50 or older can also make "catch-up" contributions, however. So if you didn't contribute much when you were younger, this may allow you to partially make up for lost time.

If your employer offers a match, at *minimum* contribute the amount necessary to get the maximum match so you don't miss out on that "free" money.

CHART 4

Retirement plan contribution limits for 2017

	Regular contribution	Catch-up contribution[1]
Traditional and Roth IRAs	$ 5,500	$ 1,000
401(k)s, 403(b)s, 457s and SARSEPs[2]	$ 18,000	$ 6,000
SIMPLEs	$ 12,500	$ 3,000

[1] For taxpayers age 50 or older by the end of the tax year.

[2] Includes Roth versions where applicable.

***Note:** Other factors may further limit your maximum contribution.*

More tax-deferred options

In certain situations, other tax-deferred saving options may be available:

You're a business owner or self-employed. You may be able to set up a plan that allows you to make much larger contributions than you could make to an employer-sponsored plan as an employee. You might not have to make 2017 contributions, or even set up the plan, before year end. SEP plans, for example, generally may be set up as late as the due date (including extensions) of your business's income tax return for that year.

Your employer doesn't offer a retirement plan. Consider a traditional IRA. You can likely deduct your contributions, though your deduction may be limited if your spouse participates in an employer-sponsored plan. You can make 2017 contributions until the April 2018 income-tax-return-filing deadline for individuals. Your annual contribution limit (see Chart 4) is reduced by any Roth IRA contributions you make for the year.

Roth alternatives

A potential downside of tax-deferred saving is that you'll have to pay taxes when you make withdrawals at retirement. Roth plans, however, allow tax-free distributions; the tradeoff is that contributions to these plans don't reduce your current-year taxable income:

Roth IRAs. An income-based phaseout may reduce or eliminate your ability to contribute. But estate planning advantages are an added benefit: Unlike

other retirement plans, Roth IRAs don't require you to take distributions during your lifetime, so you can let the entire balance grow tax-free over your lifetime for the benefit of your heirs.

Roth conversions. If you have a traditional IRA, consider whether you might benefit from converting some or all of it to a Roth IRA. A conversion can allow you to turn tax-*deferred* future growth into tax-*free* growth and take advantage of a Roth IRA's estate planning benefits. There's no income-based limit on who can convert to a Roth IRA. But the converted amount is taxable in the year of the conversion.

Whether a conversion makes sense depends on factors such as:

- Your age,
- Whether the conversion would push you into a higher income tax bracket or trigger the 3.8% NIIT (see page 7),
- Whether you can afford to pay the tax on the conversion,
- Your tax bracket now and expected tax bracket in retirement, and
- Whether you'll need the IRA funds in retirement.

"Back door" Roth IRAs. If the income-based phaseout prevents you from making Roth IRA contributions and you *don't* have a traditional IRA, consider setting up a traditional account and making a nondeductible contribution to it. You can then immediately convert the traditional account to a Roth account with minimal tax impact.

Roth 401(k), Roth 403(b), and Roth 457 plans. Employers may offer one of these in addition to the traditional, tax-deferred version. You may make some or all of your contributions to the Roth plan, but any employer match will be made to the traditional plan. No income-based phaseout applies, so even high-income taxpayers can contribute.

Early withdrawals

Early withdrawals from retirement plans should be a last resort. With a few exceptions, distributions before age 59½ are subject to a 10% penalty on top of any income tax that ordinarily would be due on a withdrawal. Additionally, you'll lose the potential tax-deferred future growth on the withdrawn amount.

Case Study IV

Avoiding retirement plan pitfalls when leaving a job

Lauren and Megan both change jobs in 2017 and decide to roll over funds from their traditional 401(k) plans with their former employers to traditional IRAs so that they'll have more investment choices. Each has a balance of $100,000. Lauren requests a direct rollover from her old plan to her IRA. Because she never personally receives the funds, she owes no income tax or penalties.

Megan, however, doesn't request a direct rollover. Instead, she receives a lump-sum check. Much to her surprise, the check is for only $80,000, because her employer withheld 20% for federal income taxes. After consulting with her tax advisor, she learns that she needs to make an indirect rollover to her IRA within 60 days to avoid tax and potential penalties. (She may be able to receive a refund of the $20,000 withheld when she files her 2017 tax return, depending on her overall tax liability for the year.)

She also learns that if she doesn't roll over the gross amount of $100,000 — which will require her to make up for the withheld amount with other funds — she'll be subject to income tax on the $20,000 difference. And, because she's under age 59½, she'll also owe the 10% early withdrawal penalty.

If you must make an early withdrawal and you have a Roth account, consider withdrawing from that. You can withdraw up to your contribution amount without incurring taxes or penalties. Another option: If your employer-sponsored plan allows it, take a plan loan. You'll have to pay it back with interest and make regular principal payments, but you won't be subject to current taxes or penalties.

Early distribution rules also become important if you change jobs or retire. See Case Study IV.

Required minimum distributions

In the year in which you reach age 70½, you must begin to take annual required minimum distributions (RMDs) from your IRAs (except Roth IRAs) and, generally, from your defined contribution plans. If you don't comply, you can owe a penalty equal to 50% of the amount you should have withdrawn but didn't. (An RMD deferral is allowed for the initial year, but you'll have to take two RMDs the next year.) You can avoid the RMD rule for a non-IRA Roth plan by rolling the funds into a Roth IRA.

Waiting to take distributions until age 70½ generally is advantageous because of tax-deferred compounding. But a distribution (or larger distribution) in a year your tax bracket is low may save tax. Be sure, however, to consider the lost future tax-deferred growth and, if applicable, whether the distribution could: 1) cause Social Security payments to become taxable, 2) increase income-based Medicare premiums and prescription drug charges, or 3) affect tax breaks with income-based limits.

If you've inherited a retirement plan, consult your tax advisor about the distribution rules that apply to you.

IRA donations to charity

Taxpayers age 70½ or older are allowed to make direct contributions from their IRA to qualified charitable organizations up to $100,000 per tax year. A charitable deduction can't be claimed for the contributions. But the amounts aren't deemed taxable income and can be used to satisfy an IRA owner's RMD.

To take advantage of the exclusion from income for IRA contributions to charities on your 2017 tax return, you'll need to arrange a direct transfer by the IRA trustee to an eligible charity by Dec. 31, 2017. Donor-advised funds and supporting organizations aren't eligible recipients. ❖

Estate planning: Uncertainty in the air

As difficult as it is, accumulating wealth is only the first step to providing a financially secure future for your family. You also need to develop a comprehensive estate plan. The earlier you begin, the more options you'll have to grow and transfer your wealth in a way that minimizes taxes and leaves the legacy you desire. But uncertainty is in the air this year; repeals of the estate, gift and generation-skipping transfer (GST) taxes have been proposed. If those changes are signed into law, these rules and strategies may no longer be applicable. Consult with your tax advisor for the latest information.

Estate tax

The estate tax rate remains at 40%. The estate tax exemption has increased to $5.49 million for 2017 (see Chart 5), and it's currently scheduled to continue to be adjusted annually for inflation.

To avoid unintended consequences, review your estate plan in light of the changing exemption. A review will allow you to make the most of available exemptions and ensure your assets will be distributed according to your wishes.

Gift tax

The gift tax continues to follow the estate tax exemption and rate. (See Chart 5.) Any gift tax exemption used during life reduces the estate tax exemption available at death. Using up some of your exemption during life can be tax-smart, depending on your situation and goals.

You also can exclude certain gifts of up to $14,000 per recipient each year ($28,000 per recipient if your spouse elects to split the gift with you or you're giving community property) without depleting any of your gift and estate tax exemption. This is the same as the 2016 amount. (The exclusion is adjusted for inflation annually, but it increases only in $1,000 increments, so it typically goes up only every few years. It might go up again for 2018.)

Warning: You need to use your 2017 exclusion by Dec. 31. The exclusion doesn't carry over from year to year. For example, if you don't make an annual exclusion gift to your granddaughter this year, you can't add $14,000 to your 2018 exclusion to make a $28,000 tax-free gift to her next year.

CHART 5

Transfer tax exemptions and rates[1]

Year	Estate tax exemption[2]	Gift tax exemption	GST tax exemption	Estate, gift and GST tax rate
2016	$ 5.45 million	$ 5.45 million	$ 5.45 million	40%
2017	$ 5.49 million	$ 5.49 million	$ 5.49 million	40%
Future years	Indexed for inflation	Indexed for inflation	Indexed for inflation	40%

[1] Repeals of the estate, gift and GST taxes have been proposed.

[2] Less any gift tax exemption already used during life.

GST tax

The GST tax generally applies to transfers (both during your lifetime and at death) made to people more than one generation below you, such as your grandchildren. This is in addition to any gift or estate tax due. The GST tax continues to follow the estate tax exemption and rate. (See Chart 5.)

The GST tax exemption can be a valuable tax-saving tool for taxpayers with large estates whose children also have — or may eventually have — large estates. With proper planning, they can use the exemption to make transfers to grandchildren and avoid any tax at their children's generation.

State taxes

A federal estate tax deduction is available for state estate taxes paid. Keep in mind that some states impose estate tax at a lower threshold than the federal government does.

To avoid unexpected tax liability or other unintended consequences, it's critical to consider state law. Consult a tax advisor familiar with the law of your particular state.

Exemption portability

If one spouse dies and part (or all) of his or her estate tax exemption is unused at his or her death, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption.

Warning: Portability is available only for the most recently deceased spouse. It doesn't apply to the GST tax exemption and isn't recognized by many states.

And it must be elected on an estate tax return for the deceased spouse — even if no tax is due.

The portability election will provide flexibility if proper planning hasn't been done before the first spouse's death. But portability doesn't protect future growth on assets from estate tax like applying the exemption to a credit shelter trust does. Trusts offer other benefits as well, such as creditor protection, remarriage protection, GST tax planning and state estate tax benefits.

So married couples should still consider marital and credit shelter trusts — and transferring assets to each other to the extent necessary to fully fund them at the first death. Transfers to a spouse (during life or at death) are tax-free under the marital deduction, assuming he or she is a U.S. citizen.

Tax-smart giving

Giving away assets now will help reduce the size of your taxable estate. Here are some strategies for tax-smart giving:

Choose gifts wisely. Consider both estate and income tax consequences and the economic aspects of any gifts you'd like to make:

- To minimize *estate tax*, gift property with the greatest future appreciation potential.
- To minimize *your beneficiary's income tax*, gift property that hasn't appreciated significantly while you've owned it.
- To minimize *your own income tax*, don't gift property that's declined in value. Instead, consider selling the property so you can take the tax loss and then gifting the sale proceeds.

Plan gifts to grandchildren carefully. Annual exclusion gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers. For gifts to a grandchild that don't qualify for the exclusion to be tax-free, you generally must apply both your GST tax exemption and your gift tax exemption.

Gift interests in your business or an FLP. If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts. So, for example, if the combined discount is 30%, in 2017 you can gift an ownership interest equal to as much as $20,000 tax-free because the discounted value doesn't exceed the $14,000 annual exclusion.

Another way to potentially benefit from valuation discounts is to set up a family limited partnership. You fund the FLP with assets such as public or private stock and real estate, and then gift limited partnership interests. ***Warning:*** The IRS may challenge valuation discounts; a professional, independent valuation is recommended. The IRS also scrutinizes FLPs, so be sure to properly set up and operate yours.

Pay tuition and medical expenses. You may pay these expenses without the payment being treated as a taxable gift to the student or patient, as long as the payment is made directly to the provider.

Make gifts to charity. Donations to qualified charities aren't subject to gift tax and may provide an income tax deduction. (See page 3.)

Trusts

Trusts can provide significant tax savings while preserving some control over what happens to the transferred assets. You may want to consider these:

- A *credit shelter (or bypass) trust* helps married couples minimize estate tax and provides additional benefits.
- A *qualified terminable interest property (QTIP) trust* can benefit first a surviving spouse and then children from a prior marriage.
- A *qualified personal residence trust (QPRT)* allows you to give your home to your children today — removing it from your taxable estate at a reduced gift tax cost (provided you survive the trust's term) — while you retain the right to live in it for a certain period.
- A *grantor-retained annuity trust (GRAT)* works on the same principle as a QPRT but allows you to transfer other assets; you receive payments back from the trust for a certain period.

Finally, a GST — or "dynasty" — trust can help you leverage both your gift and GST tax exemptions, and it can be an excellent way to potentially lock in the currently high exemptions while removing future appreciation from your estate.

Insurance

Along with protecting your family's financial future, life insurance can be used to pay estate taxes, equalize assets passing to children who aren't involved in a family business, or pass leveraged funds to heirs free of estate tax. Proceeds are generally income-tax-free to the beneficiary. And with proper planning, you can ensure proceeds are excluded from your taxable estate. ❖

Case Study V

Why annual exclusion gifts can be a powerful tax-saver

In 2017, Angela and Phil combine their $14,000 annual exclusions so that their three children and their children's spouses, along with their six grandchildren, each receive $28,000. The result is that $336,000 is removed from the couple's estates free of taxes.

If the same amounts were transferred to the recipients upon Angela's or Phil's death instead — and no estate or GST tax exemption were available — the tax hit, at the current 40% rate, would be $134,400 in federal estate taxes and $67,200 in GST taxes. So the annual exclusion gifts could potentially save the family $201,600 in taxes. If they maximize their annual exclusion gifts each year, just think about how much tax they could save!

CHART 6

2017 individual income tax rate schedules[1]

Tax rate	Regular tax brackets			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
10%	$ 0 – $ 9,325	$ 0 – $ 13,350	$ 0 – $ 18,650	$ 0 – $ 9,325
15%	$ 9,326 – $ 37,950	$ 13,351 – $ 50,800	$ 18,651 – $ 75,900	$ 9,326 – $ 37,950
25%	$ 37,951 – $ 91,900	$ 50,801 – $ 131,200	$ 75,901 – $ 153,100	$ 37,951 – $ 76,550
28%	$ 91,901 – $ 191,650	$ 131,201 – $ 212,500	$ 153,101 – $ 233,350	$ 76,551 – $ 116,675
33%	$ 191,651 – $ 416,700	$ 212,501 – $ 416,700	$ 233,351 – $ 416,700	$ 116,676 – $ 208,350
35%	$ 416,701 – $ 418,400	$ 416,701 – $ 444,550	$ 416,701 – $ 470,700	$ 208,351 – $ 235,350
39.6%	Over $ 418,400	Over $ 444,550	Over $ 470,700	Over $ 235,350
Tax rate	**AMT brackets**			
	Single	**Head of household**	**Married filing jointly or surviving spouse**	**Married filing separately**
26%	$ 0 – $ 187,800	$ 0 – $ 187,800	$ 0 – $ 187,800	$ 0 – $ 93,900
28%	Over $ 187,800	Over $ 187,800	Over $ 187,800	Over $ 93,900
	AMT exemptions			
	Single	**Head of household**	**Married filing jointly or surviving spouse**	**Married filing separately**
Amount	$ 54,300	$ 54,300	$ 84,500	$ 42,250
Phaseout[2]	$ 120,700 – $ 337,900	$ 120,700 – $ 337,900	$ 160,900 – $ 498,900	$ 80,450 – $ 249,450

[1] These tax rates might be affected by tax law changes.

[2] The AMT income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.

***Note:** Consult your tax advisor for AMT rates and exemptions for children subject to the "kiddie tax."*

CHART 7

2017 corporate income tax rate schedule[1]

Tax rate	Tax brackets
15%	$ 0 – $ 50,000
25%	$ 50,001 – $ 75,000
34%	$ 75,001 – $ 100,000
39%	$ 100,001 – $ 335,000
34%	$ 335,001 – $ 10,000,000
35%	$ 10,000,001 – $ 15,000,000
38%	$ 15,000,001 – $ 18,333,333
35%	Over $ 18,333,333

[1] These tax rates might be affected by tax law changes.

***Note:** Qualified personal service corporations are taxed at a flat 35% rate.*

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