

WINTER 2017

## 2017 Year End Tax Planning Tips

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As we remind readers of some common year-end tax-reduction strategies, we find ourselves dealing with the prospect of upcoming major tax changes. At press-time, each of the House Ways and Means Committee and the Senate Finance Committee has released its proposals. Some significant differences exist. The content and timing of whatever emerges from the legislative process are unpredictable, but here are a few proposed changes that deserve your consideration before the end of the year:

**Charitable contributions.** Because tax rates may be lower after this year, greater tax benefits may be realized from contributions made this year. Also, the prospect of a much larger standard deduction next year may result in a higher tax benefit from this year's contributions than from next year's.

**Alimony.** The House proposal repeals the alimony deduction for divorce or separation agreements entered into after the end of this year. Couples in the process of divorcing should consider this possibility.

**Homesellers.** Proposed new rules would require that a residence be occupied as the principal residence for five out of the prior eight years rather than two out of the prior five years to qualify for favorable gain exclusion rules. The House proposal also phases out the long-standing gain exclusion for higher income homesellers. The prospect of these changes may put pressure on some sellers to close their home sales this year.

**Business income.** The proposals include favorable taxation of income of many businesses operated in pass-through entities or proprietorships. Personal service businesses, including professional service firms, would not qualify to use the favorable rules. For businesses that would qualify, deferring income and accelerating expenses, to the extent possible, may prove to be beneficial.

**State taxes.** Deductions for state income and property taxes are eliminated or restricted under the proposals. If you will not be in AMT in 2017, you may benefit from prepaying state taxes this year.

*Continued on page 2*



### TAX QUOTE

"Nearly every politician on both sides of the aisle claims to want to make the tax code simpler and fairer, but each time Congress takes up so-called tax reform, the result is the exact opposite."

– Former Senator Tom Coburn  
(from a compilation by Jeffrey L. Yablon,  
a tax attorney with Pillsbury Winthrop Shaw Pittman LLP in Washington)

## 2017 Year End Tax Planning Tips (continued)

When and if significant tax legislation is enacted, we will inform you of the more significant changes. Regardless of pending tax legislation, here are a few tax-saving ideas you may want to consider before year end:

**Capital gains and losses.** If you have realized net capital gains during 2017, consider realizing capital losses before the end of the year to offset the gains. Remember that net long-term losses can be used to offset net short-term capital gains which otherwise would be taxed as ordinary income. Also, be aware of the “wash sale” rules if you are inclined to reinvest in a security you sell at a loss.

**Section 179 and bonus depreciation.** Businesses should consider these tax breaks related to fixed asset acquisitions:

- *Section 179 depreciation deduction.* In 2017, individuals and business entities can elect to deduct up to \$510,000 of qualifying business property cost in the year the property is placed-in-service. The deduction is reduced dollar-for-dollar for qualifying property cost greater than \$2,030,000. This deduction is available only to the extent of positive business taxable income.
- *Special “bonus depreciation” allowance.* For 2017, an additional depreciation deduction is permitted for qualifying property in the year it is placed in service. This bonus depreciation is a deduction of 50% of the qualifying property's cost. This deduction can create or increase an existing business loss. The bonus depreciation deduction percentage currently is scheduled to drop to 40% for 2018.
- *Note:* Pending tax legislation would allow 100% expensing of the cost of tangible business property, other than most buildings, acquired and placed in service after September 27, 2017.

**Self-employed retirement plans.** If you have self-employment income and don't have a retirement plan in place to shelter any of it, you may qualify to use a Self-Employed Plan (SEP). A SEP contribution deduction is allowed for 2017, even if the SEP is created and funded at any time up to the due date, including extensions, of the 2017 income tax return in 2018. Depending on the amount of self-employment income, you could potentially fund (and deduct from taxable income) up to \$54,000 for the 2017 tax year.

**Required minimum distributions (RMDs).** Individuals with retirement plan accounts (employer qualified plans or IRAs) generally are required to take minimum annual distributions upon reaching age 70 ½. Steep penalties apply to noncompliance, and not all IRA custodians or plan sponsors actively communicate the applicability of the rules to account holders and plan participants. Please note that if you turned 70 ½ during 2017, you have until April 1, 2018 to receive your 2017 RMD. Future year RMDs must be received before the end of the year. If you wait until 2018 to receive your 2017 RMD, your 2018 RMD and the 2017 RMD received during 2018 will be included in 2018 taxable income.

**Annual gifting.** You may give your children and others up to \$14,000 each in 2017 without any gift tax consequences. This annual exclusion is calculated on a per donee basis and no carryover is allowed for the unused exclusion. Consider making year-end gifts to fully utilize this year's annual exclusion.

**S corporation and partnership losses.** If your S corporation will generate a tax loss this year, consider whether you have enough basis in the stock (or in loans you've made to the corporation) to take the full loss. If you don't, additional loans or equity investments should be considered. Similar considerations can arise in some situations with partnerships expecting tax losses.

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## Some Updated Amounts for 2018

**FICA base** — Annual compensation to which Social Security tax applies is \$128,700 for 2018 (up from \$127,200 for 2017).

**Social Security benefits** — Individuals who are drawing Social Security benefits prior to attaining full retirement age will begin to suffer reductions in payments if they have earned income exceeding \$17,040 in 2018 (up from \$16,920 in 2017).

**Adjustments for retirement accounts** — The maximum annual addition to a defined contribution plan is increased to \$55,000 for 2018 (up from \$54,000 for 2017). The maximum amounts that individuals can elect to contribute to employer-sponsored plans and IRAs for 2018, as shown below, are unchanged from 2017 with the exception of elective deferrals to other employer plans which increased to \$18,500 for 2018 (up from \$18,000 for 2017):

Year	IRAs		SIMPLE IRA Plans		Other Employer Plans	
	Annual Contribution	Catch-Up Contribution	Elective Deferral	Catch-Up Contribution	Elective Deferral	Catch-Up Contribution
2018	\$5,500	\$1,000	\$12,500	\$3,000	\$18,500	\$6,000

The maximum amount of compensation that can be considered as the base for retirement plan contributions is \$275,000 for 2018 (up from \$270,000 for 2017).

**Health savings accounts** — The limits on contribution deductions for 2018 are \$3,450 for self-only coverage (up \$50 from 2017) and \$6,900 for family coverage (up \$150 from 2017). The additional “catch-up” contribution allowable for those age 55 or older remains \$1,000.

**Health flexible spending arrangements** — The maximum voluntary employee salary reduction for employer-adopted FSAs (flexible spending arrangements) is \$2,650 for 2018 (up \$50 from 2017).

**Estate tax** — Federal estate and gift taxes apply to cumulative taxable transfers exceeding \$5,600,000 in 2018, up from \$5,490,000 in 2017.

**Gift taxes** — The annual exclusion for gifts per donee is increased to \$15,000 for 2018 (up from \$14,000 in 2017).

**Nanny tax** — Cash wages paid for domestic service in the employer’s home of less than \$2,100 are not subject to FICA in 2018 (up from \$2,000 in 2017).

Note: These updated amounts are subject to changes by Congress as it considers tax reform legislation at the time this newsletter is going to the printer.

## Pizza Operator Gets Burned

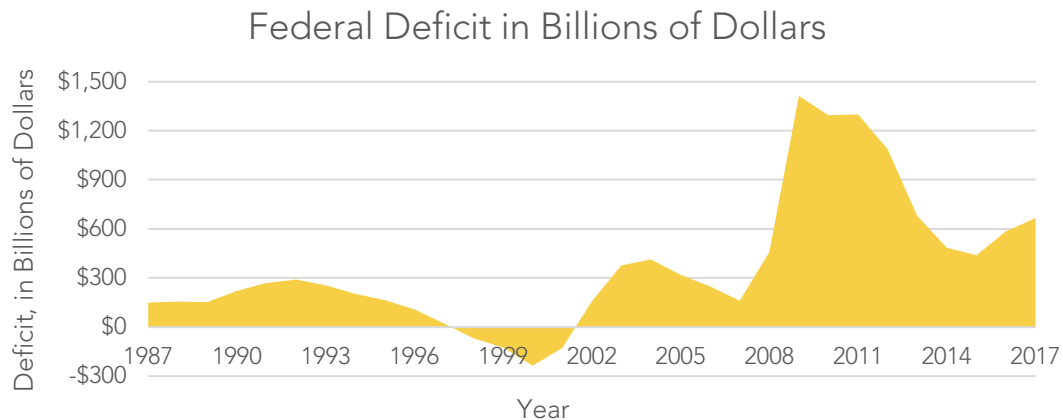
When Anthony Cowden, owner and operator of Tony’s Pizza House, put his business up for sale, two IRS undercover Criminal Investigation agents, posing as potential buyers, came to see him. To help get his price, Cowden told the agents that his records did not reflect the full value of his business, because he had been skimming cash sales and saving a lot of taxes.

Cowden apparently offered his customers discounts to pay in cash and pocketed, without reporting, this cash along with cash received from selling lottery tickets and from arcade games in his restaurant. The result: Cowden pled guilty to five counts of tax evasion.

## Federal Budget Deficit and Debt

After declining from 2011 to 2015, the federal deficit has increased the past two years (see Graph 1). The deficit for fiscal year ended September 30, 2017 was \$666 billion, the largest annual shortfall since 2013. Federal revenues covered only 83% of budget expenditures for the year. As the graph shows, deficits have exceeded \$400 billion in each of the last 10 years.

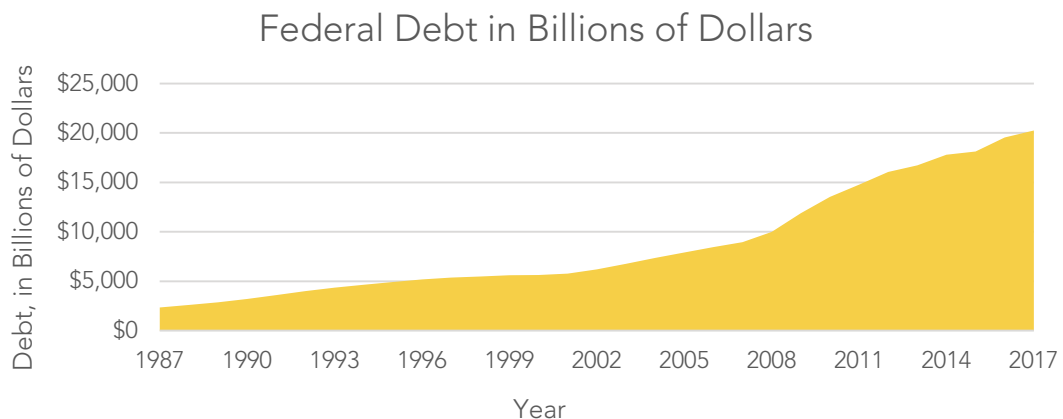
Graph 1



Budget deficits naturally lead to increased federal debt. At the end of fiscal 2017, federal debt was more than \$20 trillion, approximately \$62,000 per U.S. person. Federal debt includes debt held by the Federal Reserve Board, debt held by the federal government, and debt held by the public (including foreign governments). It does not include state and local debt, agency debt, or unfunded liabilities of entitlement programs, mainly Social Security and Medicare.

The debt has approximately doubled in the past 10 years from about \$10 trillion in 2008 to about \$20 trillion in 2017 (see Graph 2). The recession experienced during 2007 to 2009 played a major part in this increase. Expressed in terms of GDP, the debt has increased from 60% of GDP to over 100% of GDP in 10 years. Federal debt has been greater than 100% of GDP only twice since 1900. These high debt levels in relation to GDP occurred during World War II and as a result of financing bailouts and revenue shortfalls experienced during the last economic crisis.

Graph 2



## Some Things to Know About Social Security

"Is Social Security going broke?" This has been a common question in recent times. Every year the Trustees of the Federal Old-Age and Survivors Insurance (OASI) and Federal Disability Insurance (DI) Trust Funds address this question in an annual report projecting the ability of the Trust Funds to pay their obligations for the next 75 years. The 2017 report projects that the Trust Fund will be able to pay 100% of its scheduled benefits through 2033, when current reserves are depleted. From 2034 to 2091, the Trustees project that only 77% of scheduled amounts will be able to be paid. The projected shortfall results mainly from a large baby boomer generation reaching retirement age as generations with lower population growth rates have been and are entering the workforce.

Individuals with sufficient credits in the Social Security system are eligible to begin receiving Social Security payments at age 62, when benefits are 75% of full retirement age (FRA) benefits. FRA is between ages 66 and 67 depending on your year of birth. A person may delay receiving benefits until age 70 and receive 132% of FRA benefits. When you begin taking benefits can make a big difference is how much you receive.

Many factors need to be considered before deciding the best time to begin taking benefits:

- How long do you plan to work? Between age 62 and FRA, you are limited in the amount of income you can earn before having to pay back some of your Social Security benefits. In the context of this limitation, only earned income is considered. For 2018, the earnings limitation is \$17,040. One dollar of benefits is lost for every \$3 in

earnings above the limit. When you reach FRA, earnings no longer are limited.

- How long do you expect to live? Average life expectancy for a man age 65 currently is 84.3 years and for a woman age 65 is 86.6. Consider your current health and your family history of longevity to decide if average is reasonable in your case.
- What will you do with the benefits you receive? If you need the money to pay your living expenses, you have little choice, but if you will be investing them, consider the expected after tax return on your investments vs. deferring Social Security benefits.
- What is your marital status? The so-called "file-and-suspend" strategy no longer is available, but if you are married and both spouses were born on or before January 1, 1954, another strategy may be beneficial. Using this strategy, the lower earning spouse begins receiving his or her regular benefits at FRA, while the other spouse files only for the spousal benefit. Later, the second spouse switches to his or her own higher benefit, which in the meantime has grown.
- Do you believe Social Security benefits will be reduced during your lifetime?

No "one size fits all" answer exists for every situation. Individual circumstances should be taken into account. Let us know if we can assist in your consideration of what is best for you.

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## People News

### ***We welcome the following new team members:***

**Emily Collins**, who has earned credentials as a Professional in Human Resources (PHR) and Society for Human Resources Management – Certified Professional (SHRM-CP), joined us as a Human Resources Consultant. She has worked in HR roles with local, national, and international companies. She earned her Bachelor degree in Psychology from the University of Kentucky and Master degree in Industrial Relations and Human Resources from West Virginia University.

**Erica Horn**, a CPA and attorney, joined our Tax team in Lexington. She has over 20 years of experience as a tax professional with major regional law firms. Erica earned her Bachelor degree in Accounting from Transylvania University and a Juris Doctor in Law from the University of Kentucky.

**Jack Miller**, a CPA, joined our Tax team in Louisville. He has 40 years of tax experience in public accounting firms and

industry. Jack earned his Bachelor degree in Accounting from the University of Kentucky.

### ***We welcome the following team members who are starting their professional accounting careers with us:***

**Madison Embry** earned her Bachelor degree in Accounting and Master degree in Business Administration from Murray State University; **Stephanie Gray** earned her Bachelor degree in Accountancy from the University of Kentucky; and **Christina Westcroft** earned Bachelor degrees in Biomedical Engineering and Mathematics from Vanderbilt University, a Doctor of Pharmacy degree from the University of Kentucky, and most recently, her Master degree in Accounting from the University of Kentucky.

## People News, continued

*We recognize the following activities and accomplishments of our team members:*

**Patrick O'Brien** successfully completed all four sections of the CPA exam.

**Chad Luttrell** earned his CPA certification.

**Erica Horn** was selected as the recipient of the Kentucky Nonprofit Network's 2017 Outstanding Board Leadership Award. She also spoke on the upcoming changes to the auditing of partnerships by the IRS at the LLC Institute sponsored by the American Bar Association's Business Law Section.

**Faith Crump** spoke on a panel at Strong Women: Powerful Financial Strategies in Louisville.

**Jim Tencza, Lance Mann, Jason Miller, Elizabeth Woodward,** and **Nick Lynch** presented at Dean Dorton's annual Board Oversight and Risk Management Seminar.

**Jim Tencza** and **Elizabeth Woodward** presented an Ethics Annual Update at the Institute of Internal Auditors' Louisville Chapter meeting.

**Erica Horn, Natalie Schuler, Dave Sorrell, Dale Stratton, Melissa Hicks, David Angelucci, Doug Dean, David Smith,** and **Jen Shah** presented at Dean Dorton's Equine Tax & Accounting Update program at Keeneland.

**Lance Mann** and **Jason Miller** spoke on the topic "Is an Audit Necessary to Get a Grip on Your Organization's Financials?" at the Kentucky Nonprofit Network Leadership Forum.

**Jen Shah** participated on the accounting and legal panel at the Thoroughbred Owner Conference in California during Breeders' Cup week.

**Adam Shewmaker** participated in *Louisville Business First's* Healthcare Roundtable.

**Chris Anderson** and **David Angelucci** presented on succession planning at the KyCPA Business and Industry Conference.

**Matt Smith** spoke about financial best practices to dentistry professionals at an event hosted by iDENTity Dental Studio.

**Nick Lynch** presented on forensic accounting and using data analytics to prevent and detect fraud to accounting classes and to Beta Alpha Psi, an international honor organization for accounting students, at Kentucky State University and at Western Kentucky University.

**Elizabeth Woodward** participated on the "How to Recognize and Handle Ethical Dilemmas" panel at the AICPA Forensic and Valuation Services Conference in Las Vegas. In addition, she participated in a Facebook Live interview leading up to the panel, which appeared on AICPA's Facebook page.