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Dear Clients and Friends:

Now that we have the results of the election, it is now time to plan for the future. With Republicans set to assume control of the White House and both houses of Congress in 2017, it is almost certain that we will see significant changes in federal tax laws next year. Given this almost certainty of significant change, it is especially important to consider year-end tax planning moves to help lower your income tax bill for 2016 and possibly position yourself for lower taxes in 2017.

Unfortunately, post-election, there still remain significant political, regulatory and economic uncertainties which will compound the planning challenges this year. Some of the more significant factors are:

- Both the Trump and House Republicans tax proposals would repeal the tax provisions in the Affordable Care Act, significantly lower tax rates on both individuals and businesses (to a maximum of 33%), eliminate the AMT, eliminate estate taxes (with a corresponding cap on the amount of stepped-up tax basis permitted for assets for large estates), lessen the relevance of itemized deductions, eliminate some business credits and deductions, and tighten the rules on business interest deductions. On the other hand, there are significant differences between the two proposals, especially in the area of new child and elder care tax breaks and tax changes for pass-through entities.

- In addition, even though one political party will control both the legislative and executive branches in 2017, we don't know how the political dynamics will actually play out. We don't know whether Congressional leaders and Mr. Trump's administration will collaborate as equal branches of government, or whether the balance of power will shift from one branch to the other. We don't know how the very sizable voting block of fiscal conservatives in Congress may respond as they consider the impact of various tax proposals on the federal deficit. We don't know whether the Republicans will attempt to pass tax legislation in the Senate under the legislative process called "reconciliation" which only requires a simple majority, or will instead give Democratic senators an opportunity to exercise greater influence by passing tax legislation through "regular process", which may lead to filibusters and a sixty-vote requirement to pass the legislation.

- Thus, even given the large overlap between the tax proposals advanced by the House Republicans and Mr. Trump, it is still hard to predict a lot of the specifics of 2017 tax legislation. Still, it seems highly likely that there will be legislation to consolidate tax brackets, to reduce tax rates, to eliminate personal exemptions, to eliminate or cap certain itemized deductions and to adopt some significant health care reform legislation. <u>When considering potential tax moves for the end of 2016, each taxpayer needs to consider their</u>

own unique situation, including their sources and amounts of income, available tax deductions and exposure to AMT, in this uncertain environment.

- Looking at the uncertainties built into our current tax laws, Congress has failed to act on a number of important tax breaks which will expire at the end of 2016. Some (but probably not all) of these expiring tax breaks will likely be extended, but Congress may not decide the fate of these expiring tax breaks until the very end of 2016 (or later). For individuals, these expiring tax breaks include: (i) the exclusion of income on the discharge of indebtedness on a principal residence, (ii) the treatment of mortgage insurance premiums as deductible qualified residence interest, (iii) the 7.5% of adjusted gross income floor beneath medical expense deductions for taxpayers age 65 or older, and (iv) the deduction for qualified tuition and related expenses. There are also a host of expiring energy provisions, including among them: the nonbusiness energy property credit, the residential energy property credit, the qualified fuel cell motor vehicle credit, the alternative fuel vehicle refueling property credit, the credit for 2-wheeled plug-in electric vehicles, the new energy efficient homes credit, and the hybrid solar lighting system property credit.

- Finally, there is significant regulatory uncertainty in the area of estate and gift tax planning. The Treasury has proposed draconian new regulations which would change the way that partial ownership interests in businesses, real estate and investment companies are valued for estate and gift tax purposes. Under current law, these partial ownership interests are valued at a discount to reflect the very real economic consequences arising from a partial ownership interest (the lack of control, marketability and liquidity, etc.). The proposed regulations would eliminate most, if not all, valuation discounts for partial interests, creating the potential for high-net-worth individuals to be hit with an estate or gift tax on assets at values substantially higher than the assets' true fair market value. The Treasury initially hoped to adopt these proposed regulations as early as January 1, 2017. However, this target date looks increasingly unlikely, as there has been substantial pushback by both tax professionals and Congress against these proposed regulations. More important, given the results of the election, Congressional pushback is likely to grow, and it is likely that the Trump administration will not support the Treasury's efforts to restrict valuation discounts. Thus, the risk that these proposed regulations will be formally adopted, in their current form or with revisions, appears to be deceasing. In addition, both Mr. Trump and House Republicans propose to end the estate tax, although the likelihood that this proposal will be implemented is highly uncertain. For the time being, high net-worth individuals (individuals with net-worth sufficiently high to face an estate tax at death) need to be aware of the Treasury's efforts to reduce the use of valuation discounts for partial interests in estate and gift tax planning. The smart move may be to sketch out preliminary plans for gifting, but wait to implement the plans until there is more clarity about the future of the estate and gift taxes and the Treasury's campaign against valuation discounts.

Taking these uncertainties into consideration, I have compiled a checklist of actions based on current tax rules which may help you save tax dollars for 2016 if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them. Please review the following list and contact me if you would like to discuss possible tax-saving moves which fit your particular situation:

Year-End Income Tax Planning Moves for Individuals:

- As always, higher-income earners have unique concerns to address when mapping out year-end plans. They must be wary of the 3.8% surtax on certain unearned income and the additional 0.9% Medicare (hospital insurance, or HI) tax. The unearned income surtax is 3.8% of the lesser of: (i) Net investment income (NII), or (ii) the excess of modified adjusted gross income (MAGI) over an unindexed threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case). As year-end nears, a taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on his estimated MAGI and NII for the year. Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, while other taxpayers should try to reduce MAGI other than NII, and other taxpayers will need to consider ways to minimize both NII and MAGI.

- The 0.9% additional Medicare tax also may require year-end planning to ensure that you have made the correct withholdings to avoid penalties. The additional Medicare tax applies to individuals for whom the sum of their wages received with respect to employment and their self-employment income is in excess of an unindexed threshold amount ($250,000 for joint filers, $125,000 for married couples filing separately, and $200,000 in any other case). Employers must withhold the additional Medicare tax from wages in excess of $200,000, regardless of the employee's filing status or other income. Self-employed persons must take it into account in figuring estimated tax. There could be situations where an employee may need to have more withheld toward the end of the year to cover the additional Medicare tax. For example, if an individual earns more than $200,000 through working for more than one employer during the year, there may be no withholding by either employer for the additional Medicare tax if wages from each employer don't exceed $200,000. Also, in determining whether they may need to make adjustments to avoid a penalty for underpayment of estimated tax, individuals also should be mindful that the additional Medicare tax may be over-withheld. This could occur, for example, where only one of two married spouses works and reaches the threshold for the employer to withhold, but the couple's combined income won't be high enough to actually cause the tax to be owed.

- Realize losses on stock, while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, then buy back the same securities at least 31 days later or buy similar securities in the same asset class.

- Postpone income until 2017 and accelerate deductions into 2016 to lower your 2016 tax bill. In addition to preparing for the most likely changes in 2017, this strategy may enable you to claim larger deductions, credits, and other tax breaks for 2016 that are phased out over varying levels of adjusted gross income (AGI). These include child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year (whether due to changes in tax laws or financial circumstances). Note, however, that in some cases, it may pay to actually accelerate income into 2016. For example, this may be the case where a person's marginal tax rate is much lower this year than it will be next year (even after taking proposed tax law changes into account).

- It may be advantageous to try to arrange with your employer to defer, until early 2017, a bonus that may be coming your way.

- Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2016 deductions even if you don't pay your credit card bill until after the end of the year.

- If you expect to owe state and local income taxes when you file your return next year, consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2016 if you won't be subject to alternative minimum tax (AMT) in 2016.

- You may be able to save taxes this year and next by applying a bunching strategy to "miscellaneous" itemized deductions, medical expenses and other itemized deductions.

- For 2016, the "floor" beneath medical expense deductions for those aged 65 or older is 7.5% of adjusted gross income (AGI). Unless Congress changes the rules, this floor will rise to 10% of AGI next year. Taxpayers age 65 or older who can claim itemized deductions this year, but won't be able to next year because of the higher floor, should consider accelerating discretionary or elective medical procedures or expenses (e.g., dental implants or expensive eyewear).

- When considering the acceleration of deductions into 2016, consider the effect of any year-end planning moves on the AMT for 2016. This is especially true for 2016, given the proposals to eliminate the AMT in 2017. Many tax deductions allowed for purposes of calculating regular taxes are disallowed for AMT purposes. These include the deduction for state and local property taxes on your residence, state income taxes, miscellaneous itemized deductions, and personal exemption deductions. Other deductions, such as for medical expenses of a taxpayer who is at least age 65 or whose spouse is at least 65 as of the close of the tax year, are calculated in a more restrictive way for AMT purposes than for regular tax purposes. If you are subject to the AMT for 2016, or suspect you might be, these types of deductions should not be accelerated.

- Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retirement plan). RMDs from IRAs must begin by April 1 of the year following the year you reach age 70- 1/2. That start date also applies to company plans, but non-5% company owners who continue working may defer RMDs until April 1 following the year they retire. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. Although RMDs must begin no later than April 1 following the year in which the IRA owner attains age 70- 1/2, the first distribution calendar year is the year in which the IRA owner attains age 70- 1/2. Thus, if you turn age 70- 1/2 in 2016, you can delay the first required distribution to 2017, but if you do, you will have to take a double distribution in 2017 — the amount required for 2016 plus the amount required for 2017. Think twice before delaying 2016 distributions to 2017, as bunching income into 2017 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2017 if you will be in a substantially lower bracket in 2017.

- If you are eligible to convert a traditional IRA to a Roth IRA, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA. Keep in mind, however, that such a conversion will increase your AGI for 2016. You may be better off by delaying a conversion until 2017 if you will be in a substantially lower bracket in 2017.

- If you converted assets in a traditional IRA to a Roth IRA earlier in the year and the assets in the Roth IRA account declined in value, you could wind up paying a higher tax than is necessary if you leave things as is. You can back out of the transaction by re-characterizing the conversion—that is, by transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA via a trustee-to-trustee transfer. You can later reconvert to a Roth IRA.

- Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year.

- If you become eligible in or before December of 2016 to make health savings account (HSA) contributions, you can make a full year's worth of deductible HSA contributions for 2016.

- If you are thinking of installing energy saving improvements to your home, such as certain high-efficiency insulation materials, do so before the close of 2016. You may qualify for a "nonbusiness energy property credit" that won't be available after this year, unless Congress reinstates it.

Year-End and Early 2017 Estate and Gift Tax Planning Moves for Individuals:

- Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and/or estate taxes. The exclusion applies to gifts of up to $14,000 made in 2016 and 2017 to each of an unlimited number of individuals. You can't carry over unused exclusions from one year to the next. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

- As discussed on page 2 above, if you are a high net-worth individual (an individual with a net-worth sufficiently high to face an estate tax at death) who owns a business, real estate ventures or other investment entities, you should consider the potential impact of the Treasury's proposed regulations that may eliminate or reduce available valuation discounts. Again, the smart move may be to sketch out preliminary plans for gifting, but wait to implement the plans until there is more clarity about the future of the estate and gift taxes and valuation discounts.

Year-End Planning Moves for Trusts and Estates:

- Fiduciaries for irrevocable trusts and estates should consider whether to make income distributions to beneficiaries to minimize income taxes. Under federal income tax laws, irrevocable trusts and estate pay income tax at a highly-compressed tax schedule and (for 2016) reaches the top marginal income tax rates of 39.6% once taxable income exceeds $12,400. In addition, irrevocable trusts and estates pay capital gains tax at the top rate of 20%, and further pay the additional Medicare surcharge tax of 3.8% on "unearned income" (e.g., dividends, interest, royalties, and rents) once taxable income exceeds $12,400. However, irrevocable trusts and estates are entitled to a "distribution deduction" for taxable income earned in the specified year, as long as the taxable income is distributed by the 5th day of the 3rd month of the following year (March 5, if the irrevocable trust or estate is using a calendar year). In this event, the taxable income is shifted from the irrevocable trust or estate's fiduciary income tax return to the beneficiaries' personal tax return for the specified year, where the taxable income may be taxed at lower rates.

<u>Year-End Tax-Planning Moves for Businesses & Business Owners</u>:

- Businesses should consider making expenditures that qualify for the business property expensing option. For tax years beginning in 2016, the expensing limit is $500,000 and the investment ceiling limit is $2,010,000. Expensing is generally available for most depreciable property (other than buildings), off-the-shelf computer software, and certain qualified improvements to rental, retail and restaurant properties. The generous dollar ceilings mean that many businesses that make purchases before the end of 2016 will be able to currently deduct most (or all) of their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. This opens up significant year-end planning opportunities.

- Businesses also should consider making expenditures that qualify for 50% bonus first year depreciation if bought and placed in service this year. The bonus depreciation deduction is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the full 50% first-year bonus write-off is available even if qualifying assets are in service for only a few days in 2016.

- Businesses may be able to take advantage of the "de minimis safe harbor election" to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report), or $2,500 if there's no AFS. Where the UNICAP rules aren't an issue, purchase such qualifying items before the end of 2016.

- A corporation should consider accelerating income from 2017 to 2016 if it will be in a higher bracket next year. Conversely, it should consider deferring income until 2017 if it will be in a higher bracket this year.

- A corporation should consider deferring income until next year if doing so will preserve the corporation's qualification for the small corporation AMT exemption for 2016.

- A corporation (other than a "large" corporation) which anticipates a small net operating loss (NOL) for 2016 (and substantial net income in 2017) may find it worthwhile to accelerate just enough of its 2017 income (or to defer just enough of its 2016 deductions) to create a small amount of net income for 2016. This will permit the corporation to base its 2017 estimated tax installments on the relatively small amount of income shown on its 2016 return, rather than having to pay estimated taxes based on 100% of its much larger 2017 taxable income.

- If you own an interest in a partnership or S corporation, consider whether you need to increase your basis in the entity so you can deduct a loss from it for this year.

I hope this information is helpful to you. If you or your accountant would like more details about any item discussed in this letter or any other aspects of income tax or estate and gift tax planning, please let me know.

Very truly yours,

Linda C. Slider

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