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To Our Clients and Friends:

As we get closer to the end of yet another year, it's time to implement tax saving strategies. With just two months left in 2017, we've seen a lot of discussion in Washington, but no sweeping tax law changes to date.

Despite the current uncertainties, keeping the line on your taxable income is more important than ever. Absent any last minute legislation, the top federal income tax rate for 2017 remains at 39.6%, but higher-income individuals can also be hit by the 0.9% additional Medicare tax on wages and self-employment income and the 3.8% Net Investment Income Tax (NIIT), which can both result in a higher-than-advertised marginal federal income tax rate.

Before we get to specific suggestions, here are two important considerations to keep in mind.

1. Effective tax planning requires considering both this year and next year—at least. Without a multiyear outlook, you can't be sure ideas intended to save taxes on your 2017 return won't backfire and cost additional money in the future.

2. Be on the alert for the Alternative Minimum Tax (AMT). Although there has been talk about repealing the AMT, it is still on the books and needs to be considered in all of your planning because what may be a great move for regular tax purposes may create or increase an AMT problem. There's a good chance you'll be hit with AMT if you deduct a significant amount of state and local taxes, claim multiple dependents, exercised incentive stock options, or recognized a large capital gain this year.

This letter presents some planning ideas to consider while there is still time to act before the year-end.

Consider Deferring Income and Accelerating Deductions

Assuming your tax rates won't be appreciably higher next year, take advantage of strategies that defer income from the current year to later years and those that move deductions from later years into the current year are always popular. These time-honored strategies could be particularly effective this year if tax reform with lower tax rates is enacted, but doesn't take effect until next year.

Accelerate Itemized Deductions in 2017. If you currently take advantage of itemized deductions, you may want to accelerate next year's deductions into this year. First, you'll get the benefit of the additional tax deductions this year. Additionally, if tax reform is enacted and effective next year, not only may your tax rate be lower next year thereby reducing your tax savings from the deductions, but some of these deductions could be limited, eliminated, or rendered useless by an increased standard deduction.

For example, you might consider pursuing elective medical procedures if you think total medical expenses will exceed 10% of your adjusted gross income or paying property taxes and/or state income taxes early. But, watch out for the AMT, as these taxes are not deductible for AMT purposes. Increasing charitable contributions you make this year is also a good idea. Consider taking the following measures:

- Make charitable contributions you would normally make in early 2018 at the end of 2017. Note that donations charged to a credit card are deductible in the year charged, not when payment is made on the card. Thus, charging donations to your credit card before year-end enables you to increase your 2017 charitable donations deduction even if you're temporarily short on cash.

- Make a gift to a donor-advised fund. These funds essentially allow you to obtain an immediate charitable contribution deduction for setting aside funds that will be used for future charitable donations. With these arrangements, which are available through a number of major mutual fund companies, as well as universities and community foundations, you can contribute money or securities to an account established in your name. You then choose among investment options and, on your own timetable, recommend grants to charities of your choice. The minimum for establishing a donor-advised fund is often $10,000 or more. These funds can make sense if you want to obtain a tax deduction now but take your time in determining or making payments to the recipient charity or charities. As an alternative, you can consider setting up your own private foundation.

Defer Income until 2018. There are various ways to defer income until the following tax year. For example—

- If you're in business for yourself and a cash-method taxpayer, you can postpone taxable income by waiting until late in the year to send out some client invoices. That way, you won't receive payment for them until early 2018. Of course, before deferring income, you must assess the risk of doing so. You might also consider prepaying a reasonable amount of deductible business expenses such as office supplies and repairs and maintenance before the end of this year. Setting up a retirement plan and/or making additional deductible retirement plan contributions for the year is another idea.

- If you're a participant in a 401(k) plan and have not already maxed out your elective contributions to the plan this year, consider increasing contributions through the year-end. Depending on your employer's plan, you may be able to contribute 100% of your compensation up to $18,000 ($24,000 if you are age 50 or older).

- For sales of property, consider an installment sale that shifts part of the gain to later years when the installment payments are received.

Tax-smart Strategies for Your Business

Investments in Equipment, Software, and Certain Real Property. If you have plans to buy a business computer, office furniture, equipment, vehicle, or other tangible business property or to make certain improvements to real property, you might consider doing so before year-end to capitalize on the following tax breaks:

- *Section 179 Deduction.* For 2017, the maximum Section 179 deduction is $510,000 (assuming property purchases for the year don't exceed $2,030,000). Therefore, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions and eligible real property costs if your business is not expected to have a tax loss for the year, as you cannot claim a Section 179 write-off that would create or increase an overall business tax loss. Also, you might want to consider delaying purchases in excess of $510,000 until next year as it is possible that next year's expensing allowance could be even more generous.

- *First-year Bonus Depreciation.* Above and beyond the Section 179 deduction, your business also can claim first-year bonus depreciation equal to 50% of the cost of most new (not used) equipment and software placed in service by 12/31/17. Note that 50% bonus depreciation deductions can create or increase a loss for your business's 2017 tax year. The bonus depreciation rate is scheduled to drop to 40% for property placed in service in 2018.

De Minimis Safe Harbor Election*.* Taxpayers are allowed a separate election to automatically expense low cost assets, materials and supplies assuming the costs do not have to be capitalized under special inventory rules (UNICAP). To qualify for this election, the cost of the unit of property cannot exceed $5,000 and the taxpayer must have a certified financial statement. Such a financial statement includes an audited financial statement, review or compilation. If there is no certified financial statement, the cost of the unit property allowed to be expensed cannot exceed $2,500.

Domestic Production Activities Deduction. Taxpayers can claim a deduction of the lesser of 9% of the taxpayer's domestic production activities income (United States Income) or the taxpayer's overall taxable income. The deduction is also limited by business wages. This deduction applies to businesses that entirely or partly manufacture, produce or extract in the United States and that are profitable in the U.S. and overall activity.

Set up Tax-favored Retirement Plan. If your business doesn't already have a retirement plan, now is the time to set one up. Current retirement plan rules allow for significant deductible contributions. Even if your business is only part-time, contributing to a SEP-IRA or SIMPLE-IRA can enable you to reduce your current tax liability while increasing your retirement savings. With a SEP-IRA, you generally can contribute up to 20% of your self-employment earnings, with a maximum contribution of $54,000 for 2017. A SIMPLE-IRA, on the other hand, allows you to set aside up to $12,500 for 2017 plus an employer match that could potentially be the same amount. In addition, if you will be age 50 or older as of year-end, you can contribute an additional $3,000 to a SIMPLE-IRA. If you're age 50 or older as of year-end and your business has no employees, a solo 401(k) can allow for a contribution of up to $60,000. Note that the contribution limits for 2018 for the SEP-IRA maximum will be $55,000; and the SIMPLE-IRA maximum remains the same at $12,500.

Evaluate Inventory for Damaged or Obsolete Items. Inventory is normally valued for tax purposes at cost or the lower of cost or market value. Regardless of which of these methods is used, the end-of-the-year inventory should be reviewed to detect obsolete or damaged items. The carrying cost of any such items may be written down to their probable selling price (net of selling expenses). This rule does not apply to businesses that use the Last in, First out (LIFO) method because LIFO does not distinguish between goods that have been written down and those that have not.

To claim a deduction for a write-down of obsolete inventory, you are not required to scrap the item. However, in a period ending not later than 30 days after the inventory date, the item must be actually offered for sale at the price to which the inventory is reduced.

Making the Most of Year-end Investment Moves

Depending on your taxable income, the 2017 federal income tax rates on long-term capital gains and qualified dividends are 0%, 15%, and 20%, with the maximum 20% rate affecting taxpayers with taxable income above $418,400 for single taxpayers, $470,700 for married joint-filing couples, and $444,550 for heads of households. High-income individuals can also be hit by the 3.8% NIIT, which can result in a marginal long-term capital gains/qualified dividend tax rate as high as 23.8%. Regardless, that rate is substantially lower than the top regular tax rate of 39.6% (43.4% if the NIIT applies).

Holding on Longer Can Lower Your Taxes. If you hold appreciated securities in taxable accounts, owning them for at least one year and a day is necessary to qualify for the preferential long-term capital gains tax rates. In contrast, short-term gains are taxed at your regular rate, which can be as high as 39.6% (43.4%, if the NIIT applies). Be sure to consider this when evaluating your investment portfolio. Whenever possible, try to meet the more-than-one-year ownership rule for appreciated securities held in your taxable accounts. (Of course, while the tax consequences are important, they should not be the only consideration for making a buy or sell decision.)

Sell the Right Shares. Generally, when you sell stock or mutual fund shares, the shares you purchased first are considered sold first, which is good news if you are trying to qualify for the long-term capital gain rate. But, there may be situations where you're better off selling shares that have been held a year or less rather than those held longer. Selling recently purchased shares at little or no gain (because you purchased them at a higher price) may be better than selling shares held for more than one year if that sale would produce a significant gain. Whenever you want to sell shares other than those you purchased first, you must properly notify your broker as to the specific shares you want sold.

Harvest Capital Losses. Selling securities that are losing (currently worth less than you paid for them) before year-end can be a tax-smart idea. The resulting capital losses will offset capital gains from other sales this year, including high-taxed short-term gains from securities owned for one year or less. For 2017, the maximum rate on short-term gains is 39.6%, and the 3.8% NIIT may apply too, which can result in an effective rate of up to 43.4%. However, you don't need to worry about paying a high rate on short-term gains that can be sheltered with capital losses.

If capital losses for this year exceed capital gains, you will have a net capital loss for 2017. You can use that net capital loss to shelter up to $3,000 of this year's high-taxed ordinary income ($1,500 if you're married and file separately). Any excess net capital loss is carried forward to next year.

Year-end Moves for Seniors Age $70^1/_2$ Plus

Make Charitable Donations from Your IRA. IRA owners and beneficiaries who have reached age $70^1/_2$ are permitted to make cash donations totaling up to $100,000 per individual IRA owner per year—$200,000 per year maximum on a joint return if both spouses make QCDs of $100,000—to IRS-approved public charities directly out of their IRAs. These so-called *Qualified Charitable Distributions,* or QCDs, are federal-income-tax-free to you, but you get no itemized charitable write-off on your Form 1040. That's okay because the tax-free treatment of QCDs equates to an immediate 100% federal income tax deduction without having to worry about restrictions that can delay itemized charitable write-offs. It also reduces your AGI. QCDs have other tax advantages, too. To qualify for this special tax break, the funds must be transferred directly from your IRA to the charity.

Take Your Required Retirement Distributions. Individuals with retirement accounts must generally take withdrawals based on the size of their account and their age every year after they reach age $70^1/_2$. Failure to take a required withdrawal can result in a penalty of 50% of the amount not withdrawn. There's good news though—QCDs discussed above count as payouts for purposes of the required distribution rules. This means, you can donate all or part of your 2017 required distribution (up to the $100,000 per individual IRA owner limit on QCDs) and convert taxable required distributions into tax-free QCDs.

Also, if you turned age $70^1/_2$ in 2017, you can delay your 2017 required distribution until April 1, 2018. However, waiting until 2018 will result in two distributions in 2018—the amount required for 2017 plus the amount required for 2018. While deferring income is normally a sound tax strategy, here it results in bunching income into 2018. Thus, think twice before delaying your 2017 distribution to 2018—bunching income into 2018 might throw you into a higher tax bracket or have a detrimental impact on your tax deductions.

Ideas for the Office

Maximize Contributions to 401(k) Plans. If you have a 401(k) plan at work, it's just about time to tell your company how much you want to set aside on a tax-free basis for next year. Contribute as much as you can stand, especially if your employer makes matching contributions. You give up "free money" when you fail to participate to the max for the match. Note that in 2018 the contribution limit will increase to $18,500 (the Catch-up contribution for individuals aged 50 or over will remain at $6,000).

Adjust Your Federal Income Tax Withholding. If it looks like you are going to owe income taxes for 2017, consider bumping up the federal income taxes withheld from your paychecks now through the end of the year. When you file your return, you will have to pay any taxes due less the amount paid in and/or withheld. However, as long as your total tax payments (estimated payments plus withholdings) equal at least 90% of your 2017 liability or, if smaller, 100% of your 2016 liability (110% if your 2016 adjusted gross income exceeded $150,000; $75,000 for married individuals who filed separate returns), penalties will be minimized, if not eliminated.

Review Your Health Insurance Costs and Coverage

Make Sure You Have Adequate Health Insurance Coverage. If you and your family don't have adequate medical coverage (referred to as minimum essential coverage), you may be subject to a penalty. Although there has been talk about repealing this penalty, it is still on the books and needs to be considered. Medical insurance provided by your employer or through an individual plan purchased through a state insurance marketplace generally qualifies as adequate coverage. The penalty amount varies based on the number of uninsured members of your household and your household income. If you have three or more uninsured household members, the penalty could be $2,085 or more for 2017.

Take Advantage of Flexible Spending Accounts (FSAs). If your company has a healthcare and/or dependent care FSA, before year-end you must specify how much of your 2018 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying dependent care costs. Watch out, though, FSAs are "use-it-or-lose-it" accounts—you don't want to set aside more than what you'll likely have in qualifying expenses for the year.

If you currently have a healthcare FSA, make sure you drain it by incurring eligible expenses before the deadline for this year. Otherwise, you'll lose the remaining balance. Medical items or procedures to consider include buying new glasses or contacts, dental work you've been putting off, or prescriptions that can be filled early.

Consider a Health Savings Account (HSA). If you are enrolled in a high-deductible health plan and don't have any other coverage, you may be eligible to make pre-tax or tax deductible contributions to an HSA of up to $6,750 for a family coverage or $3,400 for individual coverage—plus an extra $1,000 if you will be 55 or older by the end of 2017 (if you are not a 2% or greater owner). Distributions from the HSA will be tax free as long as the funds are used to pay unreimbursed qualified medical expenses. Furthermore, there's no time limit on when you can use your contributions to cover expenses. Unlike a healthcare FSA, amounts remaining in the HSA at the end of the year can be carried over indefinitely.

Don’t Overlook Estate Planning

Currently, the unified federal gift and estate tax exemption for 2017 is $5.49 million, and the federal estate tax rate is 40%. While there has been talk of repealing the federal estate tax, as of today, there is no change in the law. Regardless, your estate plan may need updating to reflect the current estate and gift tax rules, whatever they turn out to be. Also, you may need to make some changes for reasons that have nothing to do with income taxes. The annual gift tax exclusion limit is $14,000 for 2017 and increases to $15,000 for 2018.

Conclusion

Through careful planning, it’s possible your 2017 tax liability can still be significantly reduced, but don’t delay. The longer you wait, the less likely it is that you’ll be able to achieve a meaningful reduction. The ideas discussed in this letter are a good way to get you started with year-end planning, but they’re no substitute for personalized professional assistance. Please don’t hesitate to call us with questions or for additional strategies on reducing your tax bill. We’d be glad to set up a planning meeting or assist you in any other way that we can.

As we distribute this letter, proposals on tax reform are due out of committee. They will still need to be debated and approved. We will keep you advised when the final changes are approved.

Best Wishes for the upcoming Holiday Season

Kutchins, Robbins & Diamond, Ltd.