June 27, 2017

Dear Friends and Colleagues,

A dramatic tax overhaul is on the table in Washington for the first time in thirty years. If Congress and the White House are able to pass tax reform, we could see significant tax code changes that impact our overall tax burden.

But that’s no easy task. Current proposals suggest big changes to the tax bracket structure, personal deduction exemptions, and child care credits. Tax breaks we’ve relied on in the past may change or disappear. Or, the political process may jam up again and reform will grind to a halt. The outcome is far from certain.

What is certain is that while Washington debates, you need to be on top of your tax situation to ensure you can be nimble, flexible, and prepared for when change comes.

**Uncertain tax laws call for ‘small ball’ planning**

In baseball everyone loves a dramatic home run. But a long time ago, teams found out they could beat a power-hitting opponent with a disciplined, methodical strategy that emphasized small gains and flexibility. By gradually getting players on base with modest base hits, they could eventually run up the score using this “small ball” strategy.

If ever there were a time when the principles of small ball could be used in your tax strategy, it’s now. The uncertainty surrounding tax reform in Washington makes it risky to make big moves in your tax strategy. It also means being locked in to old planning could hurt you if any of the major tax changes contemplated by lawmakers go through.

It’s time to stay nimble. It’s time to get on base with some small, but important steps. When tax reform gets done, you’ll need to be ready to hit the ground running and score. Here’s how:

**Get flexible**

Begin by looking at flexibility in your taxable income. If the tax system changes, you could find yourself on the wrong side of a new tax bracket structure or ineligible for an important deduction you’ve claimed in the past. Be prepared with strategies to lower your taxable income. This could include increasing your contributions to tax-deferred retirement plans.
Shift assets

Another technique to lower taxable income is to shift income-producing assets to family members with lower tax rates. Unearned income up to $2,100 can be taxed at your child’s lower tax rate. But be careful, unearned income greater than this will be taxed at the parent’s tax rate rather than the child’s.

Offset gains

Offsetting capital gains with capital losses is another planning method. Selling losing stocks, for example, will allow you to deduct your capital loss against any realized gains from your portfolio. Also, any excess capital losses up to $3,000 can be deducted against your regular income every year. Unused capital losses can be saved and “harvested” for deductions in future years. Having this option available to you will give your tax strategy extra adaptability in the face of change.

Beware of special tax assessments

It’s important to keep your income flexible in order to avoid special tax assessments. A 0.9% Medicare surtax is charged on wages or self-employment income beginning at $200,000 for single filers, and a 3.8% net investment income tax impacts the highest tax bracket. Any of these amounts and thresholds could change under coming legislation.

Remember the tried-and-true

Remember, there are some tried-and-true strategies that will likely remain viable in the face of any changes, such as:

- Maximizing your retirement plan contributions; contribute at least up to your employer’s match.
- Making employer-sponsored retirement plan contributions before year-end, if you are a business owner.
- Reviewing your tax withholdings or estimated tax payments. Changes this year to your job, marital status, or dependents could affect your previous tax estimates.

Don’t let taxes eat away the legacy you plan to leave

With federal estate taxes on the table for reform, now is a good time to review some estate planning principles and determine whether potential tax reform could impact the legacy you plan to leave to your heirs.
The basis challenge

While rescinding the estate tax altogether has been suggested, we can only speculate what might actually happen. Currently, when assets are inherited, the value is “stepped up,” or readjusted to the fair market value at the time of the owner’s death. One proposal of estate tax reform has suggested that stepped up basis would be replaced by carryover basis, which would carry your basis forward to your heirs. There is a big difference in the two methods of basis. With the step up in basis, if you leave your home to your children and if they sell it relatively soon, they will likely face no income tax due on the sale. However, with the carryover basis, your children could owe capital gains tax on all the appreciation in market value since you’ve owned the home.

Gifts as a solution

One means of leaving a legacy is gifting before your death. You can leave gifts of up to $14,000 per year per recipient without having to pay gift tax. If you gift as a married couple, you can double that amount. Under current law, transfers of property after your death are sheltered from the estate and gift tax up to $5.49 million.

Succession planning – why it’s even more important this year

Tax reform is making its way through the halls of our nation’s capital and business owners should take note, especially if they are planning to retire in the not-too-distant future. Here are two ways proposed changes to the tax code might shape your company’s succession planning strategy.

Tax bracket changes

Proposals are in the works to reduce the number of individual tax brackets to three tiers from seven. The top rate may drop to 33% from 39.6%. This is significant because many veterinary practices are organized as subchapter S corporations. These type of entities report profits, but the taxes are paid on the tax returns of the shareholders.

Because of this, if you’re planning to retire with a severance package, you might want to wait to collect that compensation until after tax reform has passed. Suppose you’re expecting a $500,000 payout from the business. Under current tax rules, your income would be taxed at 39.6%. If you defer that compensation until 2018, your tax bill could be reduced by 6.6% ($33,000). In some cases, the business might recognize a deduction in the current year at the higher rate, while the individual owner recognizes income in the next year at a lower rate.
Expense projections and income

Whether you sell your business to a third party or maintain operations with existing employees, proposed changes to the tax law should be factored into your financial projections. Owners and managers will want a clear understanding of the company’s expense projections. For example, if Congress enacts currently proposed revisions to capital investment rules, the cost of doing business might fluctuate. One proposal suggests full expensing of new business investment in the year it’s made. If passed, a prolonged depreciation schedule could go away, and you may need to revise expense projections.

Should you have any questions about the above, please feel free to contact our office.

Sincerely,

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