LUTZ AND CARR
CERTIFIED PUBLIC ACCOUNTANTS, LLP

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Annual Individual Income and Estate/Gift Tax Update

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On January 20, 2017 Donald Trump was sworn into office as the 45th President of the United States. During the course of his campaign and the time leading up to his inauguration President Trump proposed various tax plans that will impact individuals if and when these changes are set into law.

This memo summarizes the key tax reforms of President Trump that are relevant to the majority of our clients and provides updates on selected provisions tax laws currently in effect. Please feel free to contact members of our staff for help with your questions.

1) Possible Tax Law Changes with the New Trump's Administration

A. Repeal of the Affordable Care Act

One of the first items on the agenda of the new Trump administration is to repeal the Affordable Care Act (the "ACA"), also known as "Obamacare". Under the ACA, a 3.8% tax is generally imposed on the net investment of individuals who have adjusted gross income over $200,000 for single filers and $250,000 for those who are married filing jointly, and a .9% additional Medicare tax is imposed on the earned income of individuals with adjusted gross incomes of over $200,000 for single filers and $250,000 for those who are married filing jointly. If the proposal gets approved by the Congress, taxpayers would not be subject to these taxes going forward. Furthermore, health insurance would not be mandatory for individuals which means there would be no penalties for not having health insurance.

B. Tax brackets would reduce from 7 to 3 with rates of 12, 25 and 33 percent

The number of tax brackets would reduce from seven to three with new tax rates of 12%, 25%, and 33%. The highest tax bracket of 33% is for single filers with taxable income of more than $112,500 and for married joint filings with taxable income of more than $225,000. The 25% tax bracket is for single filers with taxable income between $37,500 and $112,500 and married joint filers with taxable income between $75,000 and $225,000. The 12% tax bracket is for single filers with taxable income between $0 and $37,500 and for married joint filers with taxable income between $0 and $75,000.

The tax rates for long-term capital gains and qualifying dividends of 0%, 15%, and 20% will stay, but would apply with the proposed ordinary income tax rates as follows: taxpayers in the 12% tax bracket would be taxed at 0%; those in the 25% tax bracket would be taxed at 15%; and those in 33% would be taxed at 20%.

C. Elimination of the alternative minimum tax

The alternative minimum tax (AMT) is a parallel federal income tax imposed by the federal government that runs concurrent with the regular income tax. Generally under the existing law, certain deductions that are allowed for regular income tax purposes are not allowed for AMT purposes. Taxable income and the resulting tax for both regular tax and AMT are determined under the rules applicable to each system and taxpayers pay the higher of the two taxes. The plan would eliminate the AMT and subject taxpayer to only the regular income tax regime.

D. Repeal of the federal estate and gift tax

The current maximum estate tax rate is at 40% for those with gross estates that exceed $5.49 million per person and $10.98 million for a married couple that elects portability in 2017. Under President Trump's plan the estate tax would be abolished, however beneficiaries of estates over $10 million would not receive a step up in basis, which meaning that the beneficiaries would most likely be taxed on gains arising from the ultimate sale of the inherited property.

E. Standard deduction for single individuals and married couples filing jointly would increase to $15,000 and $30,000, respectively

The standard deduction would increase for unmarried individuals to $15,000 and to $30,000 for married joint filers. Exemptions would be eliminated. Itemized deductions would remain the same, but there would be a cap for the total dollar value of itemized deductions claimed of $100,000 for single individuals and of $200,000 for married joint filers.

The head of household filing status would be eliminated. Presumably, taxpayers who would file under head of household would file as individual taxpayers.

F. A new deduction for child and dependent care expenses

Taxpayers whose income are under $500,000 for married couples and $250,000 for unmarried individuals would be able to take a deduction for dependent children under the age of thirteen and for eldercare costs incurred for a dependent. In addition, the plan would create new "dependent care savings accounts" to which taxpayers would be allowed to make tax-deductible contributions.

2) Relevant Current Individual Income Tax Provisions - Federal

A. 2017/2016 Long Term Capital Gain and Dividend Income Rates

For 2017, the capital gains and qualified dividend rate is 20 percent for taxpayers with taxable income above $418,400 ($470,700 for married taxpayers, $444,550 for heads of household.) The 3.8 percent Medicare surtax (see below) applies to these gains in addition to the higher rates. For 2016, these thresholds were $415,020, $466,950 and $441,000, respectively.

All other taxpayers will continue to be subject to tax on capital gains and qualified dividends at a maximum rate of 15 percent. A zero percent rate will also continue to apply to capital gains and qualified dividends to the extent a taxpayer's taxable income is below the top of the 15 percent income tax bracket. For 2017, the zero percent capital gain bracket ends at $75,900 (married joint) and $37,950 (single). For 2016, these amounts are $75,300 and $37,650, respectively.

The 28 and 25 percent tax rates for collectibles and unrecaptured Code Sec. 1250 gain, respectively, remain unchanged.

B. Top Federal Ordinary Income Tax Rate

Taxpayers with taxable income above $418,400 ($470,700 for married taxpayers, $444,550 for heads of household) will be taxed at the 39.6 percent rate in 2017, after going through the other tax brackets. For 2016, the top rate began at $415,050, $466,950 and $441,000, respectively.

C. 3.8% Medicare Surtax on Net Investment Income

The 3.8 percent Medicare surtax on certain unearned income of individuals, trusts, and estates remains in place for 2016. Individuals with modified adjusted gross income exceeding certain thresholds ($250,000 for married individuals filing jointly or $200,000 for unmarried individuals), will pay a tax of 3.8 percent on net investment income. For purposes of this tax, investment income generally includes royalties, interest, dividends, income from businesses involved in the trading of financial instruments or commodities and businesses that are passive activities. Net capital gains are included whether short-term or long-term. Investment income excludes distributions from qualified retirement plans and excludes any items that are taken into account for self-employment tax purposes. The tax is calculated on Form 8960.

D. .9% Medicare Surtax on Self-Employment Income

Wage earners and self-employed individuals continue to pay an additional 0.9 percent tax on earned income that exceeds the threshold ($250,000 for married joint and $200,000 for single). In general, self-employed individuals are allowed an income tax deduction of one-half of the self-employment taxes paid. However, no deduction is allowed for any portion of the additional 0.9 percent tax. The tax is calculated on Form 8959.

E. Foreign Earned Income Exclusion

The exclusion of earned income from foreign sources for U.S. taxpayers living abroad is $102,100 in 2017, up from $101,300 in 2016.

F. Simplified Home Office Deduction

The IRS allows a simplified, optional method of claiming a home office deduction. The optional deduction is limited to $1,500 per year based on $5 per square foot for up to 300 square feet. These amounts apply to both the 2017 and 2016 tax years.

G. Student Loan Interest Deduction

The maximum amount of deductible student loan interest is $2,500 for both 2017 and 2016. You will not be able to take a student loan interest deduction if your modified adjusted gross income is $80,000 or more ($165,000 or more if you file a joint return.)

H. Medical and Dental Expense Deductions

The threshold for claiming the itemized medical and dental expense deduction remains at 10 percent of AGI for 2017. For taxpayers (or spouse) who are 65 and older, the 7.5 percent will no longer apply.

I. Pease Limitation

The Pease limitation reduces the total amount of higher-income taxpayer's otherwise allowable itemized deductions by 3 percent of the amount by which the taxpayer's adjusted gross income exceeds an applicable threshold. The applicable threshold levels for 2017 are $313,800 for married couples and surviving spouses ($287,650 for head of households, $261,500 for unmarried taxpayers and $156,900 for married taxpayers filing separately.) For 2016, these thresholds were $311,300, $285,350 and $259,400, respectively.

J. Personal Exemption Phase-Out

Under the phase-out, the total amount of exemptions that may be claimed by a taxpayer is reduced by 2 percent for each $2,500 or portion thereof (2 percent for each $1,250 for married couples filing separate returns) by which the taxpayer's adjusted gross income exceeds the applicable threshold level (same thresholds as those for the Pease Limitation, listed above.) The personal exemption amount remains at $4,050 for 2017.

K. Standard Deduction for Married Taxpayers Filing Jointly

The Standard deduction for joint filers is $12,700 for 2017. For single filers, the standard deduction is $6,350 in 2017.

L. AMT Exemption

The 2017 AMT exemption amounts are $84,500 for married filing joint, $54,300 for single and head of household, and $42,250 for married filing separate filers. The amounts for 2016 were $83,800, $53,900 and $41,900, respectively.

M. Child and Dependent Care Credit

The maximum credit is 35 percent of qualified child care expenses with a $3,000 cap for one qualifying child and a $6,000 cap on expenses for two or more qualifying children. The credit is reduced to 20% for those with higher income. These amounts apply to both the 2017 and 2016 tax years.

N. Adoption Credit

For 2017, the adoption credit phases out for modified adjusted gross income between $203,540 and $243,540 and the limit on the credit is $13,570. For 2016, these amounts were $201,920, $241,920 and $13,460, respectively. Employer-provided adoption assistance is equivalent to the credit amount.

O. Kiddie Tax

The amount of a child's unearned income not subject to the parents' tax rate for 2017 remains at $1,050. The kiddie tax is a tax on unearned income (interest, dividends and capital gains) earned by children under the age of 19 and college students under the age of 24.

P. IRA Rollovers

Taxpayers can convert a traditional IRA to a Roth IRA without regard to the taxpayer's income and without regard to whether the taxpayer is a married individual filing a separate return. However, while the 10-percent additional tax on early distributions does not apply, the amount converted is taxable in the year of conversion.

Q. Achieving a Better Life Experience (ABLE) Act

The ABLE Act is a tax-advantaged savings account for individuals with disabilities. Income earned by the accounts are not taxed and contributions to the account made by any person (the account beneficiary, family and friends) would not be tax deductible.

R. Enhanced American Opportunity Credit

The American Opportunity Tax Credit rewards qualified taxpayers with a tax credit of 100 percent of the first $2,000 of qualified tuition and related expenses and 25 percent of the next $2,000 for a total maximum credit of $2,500 per eligible student. The AOTC applies to the first 4 years of a student's post-secondary education. The credit begins to phase-out for married filing joint tax returns with income between $160,000 and $180,000 and for others with income between $80,000 and $90,000. Couples with income above $180,000 and others with income above $90,000 may not claim the credit. The Hope Scholarship Credit of $1,800 for the first two years of post-secondary education continues to be available.

S. <u>State and Local Sales Tax Deduction</u>

The election to claim an itemized deduction for state and local general sales taxes paid is permanently available.

T. <u>Teachers' Classroom Expense Deduction</u>

This deduction allows primary and secondary education professionals to deduct (above-the-line) qualified expenses up to $250 paid out-of-pocket during the year. The deduction will be indexed for inflation in the future.

U. <u>Contribution of Capital Gains Real Property for Conservation</u>

The rule allowing for contributions of capital gain real property for conservation purposes to be taken against 50 percent of adjusted gross income is permanent.

V. <u>Residential Energy Efficient Property Credits</u>

Two nonrefundable personal tax credits are available to individuals for qualified residential energy expenditures. The residential alternative energy credit is equal to 30 percent of the cost of eligible solar water heaters, solar electricity equipment and fuel cell plants. The maximum amount of credit for the installation of qualified fuel cell property for any tax year is $500 per half kilowatt hour. This credit is extended through 2022.

The nonbusiness energy credit for 10% of purchases of nonbusiness energy efficient property (windows, doors, etc...), up to $500, was extended through 2016.

There are limitations to these credits based on your tax liability. However, unused amounts may be carried forward.

W. <u>Deduction for Qualified Tuition and Related Expenses</u>

The above-the-line deduction for qualified tuition and related expenses was extended through 2016. Taxpayers cannot claim the higher education tuition deduction in the same tax year that they claim the American Opportunity or Hope credits. The deduction phases out if your modified adjusted gross income is more than $80,000 ($160,000 if married filing joint).

X. Exclusion of Cancellation of Indebtedness on Principal Residence

The provision to exclude from income cancellation of mortgage debt on a principal residence of up to $2 million was extended through 2016.

3) Other Relevant Current Individual Income Tax Provisions – New York

A. Top New York State Income Tax Brackets

For 2017, the NY income tax bracket is 8.15 percent for taxpayers with taxable income between $215,400 and $269,300. After this bracket, the rate reduces to 7.35 percent for taxable income between $269,300 and $1,077,550 and then increases sharply to 49.02 percent on taxable income between $1,077,550 and $1,131,500, and then drops to 9.62 percent for taxable income over $1,131,500.

For 2016, the NY income tax bracket was 8.15 percent for taxpayers with taxable income between $214,000 and $267,500. After this bracket, the rate reduced to 7.35 percent for taxable income between $267,500 and $1,070,350 and then increased sharply to 49.02 percent on taxable income between $1,070,350 and $1,123,950, and then dropped to 9.62 percent for taxable income over $1,123,950.

4) Estate and Gift Tax – Selected Updates

A. Federal Estate Tax

The maximum federal estate tax rate is 40 percent with an annual inflation-adjusted exemption of $5,490,000 for estates of decedents dying in 2017.

B. New York State Estate Tax

For deaths between April 1, 2016 and March 31, 2017, New York taxes estates of more than $4,187,500. The exempt amount will increase each year until 2019, when it should match the exemption from federal estate tax, which by then is likely to be almost $6 million. The New York exemption will increase by $1.0625 million on April 1 of every year until 2017, when it will reach $5.25 million. Then, on January 1, 2019, it will increase to the federal estate tax exemption in place at the time. The New York exemption amount will continue to increase with the federal exemption amount.

C. Portability

Portability allows the estate of a decedent who is survived by a spouse to make an election to permit the surviving spouse to apply the decedent's unused exemption to the surviving spouse's own transfers during life and at death. This provision is currently permanently available.

D. Annual Exclusion Gifts

The annual exclusion from the determination of taxable gifts is $14,000 in 2017 and 2016. The annual exclusion of gifts to a spouse who is not a U.S. citizen is $149,000 in 2017, up from $148,000 in 2016.

5) Reporting Requirements for Individuals Owning Foreign Assets

A. FATCA

The Foreign Account Tax Compliance Act, (commonly referred to as "FATCA") generally requires foreign financial institutions to report information to the IRS and withhold U.S. income tax in some situations. FATCA also modified the rules covering U.S. source income earned by non-U.S. individuals and entities. If you are a U.S. resident with foreign accounts, a U.S. resident doing business with non-U.S. residents, or a foreign resident doing business in the U.S., please contact us for more information on how FATCA applies to your situation.

B. Form 8938 and FinCen Form 114

Individuals owning foreign assets totaling more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year ($100,000 and $150,000 respectively for married taxpayers), must report those assets on Form 8938. If you are residing abroad, you are required to file only if your foreign assets are more than $200,000 on the last day of the tax year or more than $300,000 at any time during the year ($400,000 and $600,000 respectively for married filing jointly.) Failure to report foreign assets will result in an initial penalty of $10,000. This requirement is in addition to FBAR reporting on Form FinCen Form 114 when total aggregate foreign bank balances exceed $10,000. Form 8938 is filed with Form 1040.

The above thresholds apply to both the 2017 and 2016 tax years.

The FinCen Form 114 (commonly known as the “FBAR”) must be electronically filed using FinCen’s BSA E-filing system. We will transmit these forms electronically for our clients. For the 2016 tax year, the due date of the FBAR has changed to April 18, 2017 (or October 15, 2017 if the filing of the taxpayer's personal income tax return is extended) to coincide with an individual's personal income tax return.

6) Affordable Care Act Penalties

Since 2014, under the Patient Protection and Affordable Care Act, qualified individuals and small employers have been able to purchase private health insurance through state exchanges. Certain individuals who obtain coverage through an exchange can qualify for a premium tax credit and/or cost sharing reductions established to help make the purchase of insurance more affordable. Individuals who do not have health insurance may be subject to a penalty to be paid with their tax return.

For 2016 and 2017, this penalty is the higher of 2.5% of household income or a “per-person penalty” which is $695 per adult and $347.50 per child under the age of 18 who is not insured (the maximum per-person penalty is $2,085).

7) Social Security and Medicare Taxes for Household Employees

For 2016 and 2017, the threshold for paying Social Security and Medicare taxes on the wages of household employees is $2,000.

Household employment wages paid to workers under age 18 are exempt from social security and Medicare taxes unless household employment is the worker’s principal occupation.

Federal income tax withheld and federal unemployment tax will be reported and paid on the individual's Form 1040, Schedule H. State taxes withholdings and unemployment insurance are required to be paid quarterly.

8) Proposed Regulations that Will Affect Estate, Gift and Generation-Skipping Transfer Tax

The IRS has issued proposed regulations that will eliminate valuation discounts for intra-family transfers of interests in family-controlled entities, such as corporations, partnerships and LLCs. Taxpayers have been able to apply a discount of approximately 30 percent on the value of interests that were transferred to other family members through gifting. The elimination of the valuation discounts will increase the value of such interests transferred, and thus, reduce the lifetime estate tax exemption amount available after the transfer and potentially increase the donor's estate tax liability. A public hearing on the regulations was held on December 1, 2016. If the proposed regulations are enacted into law, they will become effective 30 days after they are enacted. We expect that the earliest the regulations will become final will be sometime in 2017.

9) Table of Selected Deductions and Mileage Rates for 2017/2016

	2017	2016
Retirement-Related Benefits:		
SEP contribution	$54,000	$53,000
Elective deferrals under a 401(k) and 403(b) plan	$18,000	$18,000
401(k) and 403(b) catch-up contributions (50 and over)	$6,000	$6,000
IRA deduction	$5,500	$5,500
IRA catch-up deduction (50 and over)	$1,000	$1,000
SIMPLE contribution	$12,500	$12,500
SIMPLE catch-up contribution (50 and over)	$3,000	$3,000
Maximum compensation for defined contribution plans	$270,000	$265,000
Defined benefit contribution limit (retirement age 62-65)	$215,000	$210,000
Other Benefit Limits:		
Transportation exclusion - mass transit	$255	$255
Transportation exclusion - parking	$255	$255
Flexible Spending Account contributions	$2,600	$2,550
Standard business mileage rate	.535/mile	.54/mile
Charitable mileage rate	.14/mile	.14/mile