Burr Tax Alert: 2017 Year-End Tax Planning in Light of Tax Reform

By James M. McCarten December 2017

What a week for U.S. tax law! Last Friday, three days before the deadline he had set for himself and Congress, President Donald Trump put his signature to the Tax Cuts and Jobs Act of 2017 ("TCJA" or the "Act"), which enacts the tax reform crafted and passed by the House and the Senate along party lines.

While a few of the new tax provisions became law as soon as the President signed the Act (the "date of enactment"), by far the majority of its provisions do not become effective until January 1, 2018. For that reason, by far the majority of inquiries we receive regarding the new tax law ask what action(s) can our clients take before the New Year in order to minimize their federal tax obligations for both 2017 and 2018. Accordingly the first priority clients express to us is to make sure they understand what action(s) they should consider taking before January 1, 2018. The second priority our clients express to us is to question the new law's provisions which will impact them in 2018 and beyond.

That approach to setting priorities in addressing issues arising out of the TCJA makes a lot of sense to us too, especially since taxpayers now have less than four (4) days, and less than two (2) business days, to take affirmative action for 2017 tax planning or lose many planning options altogether. The importance of the timing of 2017 planning is even more important for our clients who would prefer enjoy this time watching College Football Playoffs rather than spend that time reaching for deductions and tax planning strategies which may or may not ultimately withstand IRS scrutiny.

Therefore, this Burr Alert is designed to identify and focus on those tax planning strategies we believe have some validity and viability if implemented **before** January 1st; i.e., before the new provisions of the TCJA become effective. We will then begin to release a series of Burr Alerts during January which will detail the tax changes which the TCJA is bringing to our clients in different industries, to our clients using different legal/tax structures (for tax planning) and to our clients closely tied to a special type of taxation (e.g., international tax and estate/gift tax).

Year-End Tax Planning for Individuals

I. Prepaying Deductions in 2017 which are Limited or Eliminated by Tax Reform in 2018.

A. Background. As a trade-off for doubling the Standard Deduction and reducing the individual tax rates, the TCJA limits and often completely eliminates certain itemized deductions; for example, the deduction for state and local taxes ("SALT") is limited to $10,000 per year beginning Jan. 1, 2018, and almost all miscellaneous itemized deductions are eliminated. Further, mortgage interest for personal residence debt will be limited beginning January 1, 2018 to the interest paid on the first $750,000.00 of Principal (though all mortgages in place prior to January 1, 2018 are grandfathered at the $1 million level).

B. Be Careful Before Adopting a Year-End Strategy. Popular publications from *Forbes* to the *Wall Street Journal* have included articles over the last couple of weeks suggesting that most taxpayers should strongly consider taking advantage of the common sense strategy that if a deduction is to be eliminated or artificially capped in 2018, the taxpayer should prepay as many of those "lame-duck" deductions in 2017 while they are still deductible. Unfortunately, there are several factors which complicate such a simplified analysis.

1. Beware the AMT. While the alternative minimum tax ("AMT") is likely to become irrelevant for a majority of individuals filing jointly in 2018 (the AMT exemption has been increased to $109,400 and the phase-out thresholds has been increased to $1,000,000 under the TCJA), prepaying certain items such as real estate taxes, state income taxes and miscellaneous itemized deductions may, if you are or become subject to the AMT for the 2017 tax year because of such payments, not provide any meaningful tax benefit. On the other hand, there likely is nothing to lose by making your final 2017 state income tax estimated tax payment and paying all 2017 real estate taxes before the end of the year. Nevertheless, we strongly recommend that our clients consult with their CPA about the impact of the AMT before paying any deduction in 2017 which is scheduled to be capped or eliminated in 2018.

2. Prepaying 2018 State Income Taxes. A few professional commentators on TV, radio and in print even suggest that taxpayers should make 2018 state income tax estimated payments and claim the deduction in 2017. Burr Forman does not agree that such a strategy should be implemented. Do you believe that you currently owe income tax on income you have not received or earned? We didn't think so. If there is no clear liability for that tax, there is no deduction; such payments are *voluntary deposits* under the tax law. Do not prepay any state income tax for 2018 and expect to qualify that payment for a deduction.

3. An Important Recent Development. Yesterday, Wednesday, December 27, in apparent response to the very public efforts of a number of tax advisors and the comments of some prominent state politicians to circumvent the $10,000 cap on SALT deductions implemented in 2018 by pre-paying their 2018, and in some cases, 2019 real property taxes, the IRS took the seldom used action of issuing an IRS Advisory (IR-2017-210, Dec. 27, 2017) stating that the deductibility of 2018 real property taxes which are prepaid in 2017 succeeds or fails based upon whether those taxes were actually assessed prior to 2018. Accordingly, taxpayers should seek the advice of their tax advisor before assuming that the prepayment of real estate taxes will be beneficial in 2017.

II. The Deductibility of Interest on Home Equity Loans.

Under Tax Reform, interest on home equity loans and lines of credit will not be deductible beginning in 2018. Therefore, taxpayers should consider paying off such loans and all outstanding interest before year-end. Another viable strategy for some taxpayers will be to refinance the original mortgage and any outstanding home equity debt into a new mortgage (so long as the total debt does not exceed the current $1 million limit) in order to ensure that all mortgage interest is deductible once the new rules become effective in 2018.

III. Moving? Is it Deductible? Get it Paid!

Like many other deductions, the moving deduction is eliminated after January 1, 2018 (except for active military). If you are moving, best to move the process along in 2017 in order to be able to claim the above the line moving expense.

IV. Defer Income?

With top tax rates for many families with two (2) working parents dropping by between 3% to 4.6%, many taxpayers might be tempted to defer bonus and other income into 2018 rather than being taxed on it for 2017. That may be a viable strategy for some; however, for those working under a written contract or written bonus plan designed to avoid the complications of Code Section 409A, **do not** make that decision without checking with your tax advisor. If a deferral is made which unintentionally violates Code Section 409A, taxes, penalties and extra interest totaling as much as 65 to 70% of the compensation deferred could be triggered.

V. Charitable Deductions.

Under the TCJA, the charitable deduction is retained and, in fact, expanded. The question, though, for many middle-class taxpayers is whether they will be able to itemize in 2018 and thus utilize the expanded charitable deduction (the increased amount of the standard deduction may result in a better tax calculation for such taxpayers). Since charitable deductions are much less likely to create other tax problems (like an AMT liability), some individuals may find it advantageous to bunch 2017 and budgeted 2018 charitable deductions, paying both before year-end. Burr still recommends, though, that you check with your tax preparer first before adopting this strategy.

Year-End Planning for Small and Large Businesses

I. Take Advantage of the Lower Corporate Tax Rate.

The centerpiece and primary focus of the President's year-long push for Tax Reform was to reduce the "uncompetitively high" corporate tax rate imposed by the U.S., as well as to reduce the tax rate imposed on pass-through business income. Under the TCJA, the top corporate tax rate is reduced from 35% to 21% beginning on January 1, 2018. For pass-through entities; i.e., partnerships, S corporations and LLC's, a new deduction becomes available in 2018 in an amount equal to 20% of *qualified business income* (note that this deduction is, unfortunately, substantially limited when the business taxpayer is a successful *specified service business*; e.g. health, law, accounting, financial services, performing arts and any business in which the principal asset is the reputation or skill of an employee or owner).

II. To Defer Income or Not?

Just as with individual taxpayers, part of the trade-off to obtain these lower business tax rates was the limitation and/or elimination of certain business deductions. Therefore, the decision for company CFOs and tax personnel no matter the type of entity is whether to defer the recognition of income into 2018 if a cash-basis taxpayer (and, to the extent possible, even when an accrual-basis taxpayer); does the deferral result in less tax being paid cumulatively? Many times, that decision is not quite as clear as the company might wish. Burr Forman again advises its business clients to check with their CPA to determine if income deferral is a good strategy for that specific business and its owners.

More to Come

The Act itself, which was passed by the House and Senate on Friday, December 22, 2017, is nearly 500 pages in length and when the managers of the Conference Committee which negotiated the final terms of the Act issued their explanation of its provisions, that explanation was nearly 570 pages in length. Clearly the TCJA is a complex and exacting revision of tax concepts which have existed since before the 1986 changes to the tax laws. There is much that taxpayers, their advisors and the IRS will be learning about the new concepts contained in the Act and unexpected implications of what initially seem to be basic changes as we continue to review and then work within the framework of the new law. As we gain a better understanding of the impact of Tax Reform, we will release additional Burr Alerts to share that understanding with you.

If you would like more information on or to discuss the application of any of the concepts above to you or your business, or any other tax matter, please feel free to contact any of our tax lawyers directly:

Ed Brown and/or **Jim McCarten** in Burr's Atlanta office at (404) 815-3000;
Jim McCarten and/or **Josh Ehrenfeld** in Burr's Nashville office at (615) 724-3200;
Allen Sullivan and/or **Bruce Rawls** in Burr's Birmingham office at (205) 251-3000;
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or contact the Burr & Forman attorney with whom you regularly work.