WHITEPAPER

2017 Year-End Tax Planning

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What will 2018 bring?

Each year we prepare this planning guide to help our clients navigate common tax planning issues that arise at year end. For some of these year-end planning issues, you need to compare the tax benefits/burdens under the current year's tax regime with the tax benefits/burdens under next year's tax regime. That can be difficult when, as now, no one knows what next year's tax regime will be.

Income Tax Uncertainty. There have been high-level proposals, involving lowering the federal income tax rates but expanding the tax base (by restricting deductions). In late September, the Trump Administration and select members of Congress released a "unified framework" for tax reform. Although that document provides some details, there are many specifics that will have to be worked out by the House Ways and Means Committee and the Senate Finance Committee. Therefore, this guide will assume the 2018 tax rules will continue the current tax regime. If matters change, we would expect to either update this guide or distribute a Tax Alert.

Estate and Gift Tax Uncertainty. There is also uncertainty about the future of the estate and gift tax. There have been proposals to repeal the estate tax. These proposals do not include a repeal of the gift tax, and many commentators believe that the gift tax would be retained (to prevent gifting becoming an income-tax planning maneuver). In addition, planning for the estate tax is not constrained to one year at a time; it is a multi-year process, but any repeal of the estate tax now can be "undone" by a later Congress reenacting the estate tax.

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See last page for important information.

Basic tax planning

A E L E IMA ED A E

Although estimated tax payments are not always a year-end planning matter, there are a few planning tips that are related to year end.

Federal (and most state) estimated tax payments are due quarterly on April 15, June 15, September 15 and January 15 (except if the 15th falls on a Saturday, Sunday or legal holiday). To the extent withholdings from your salary do not satisfy the amount due, you may have to make additional payments to the IRS by these quarterly due dates in order to avoid an underpayment penalty. There are three ways to calculate your federal quarterly estimated tax payments; you can choose the method that requires the smallest payment.

Method #1: 90% Rule. Each quarter, pay 25% of 90% of the current year's tax. This requires that you predict the current year's tax.

Method #2: 100/110% Rule.

- If your adjusted gross income (AGI) on last year's return was $150,000 or less and you filed singly or jointly ($75,000 for married filing separately), then your quarterly payment under this method must be 25% of 100% of last year's tax, reduced by certain credits. This requires no prediction.
- If your AGI was more than these amounts, then your quarterly payment must be 25% of 110% of last year's tax (which is mathematically equivalent to 27.5% of 100% of last year's tax).

Method #3: Annualization. Each quarter, based on the year-to-date pace of your income, you predict what would be 90% of the current year's tax. You pay 25% of that for the first quarter. For the second quarter, you would pay whatever additional amount would make your year-to-date estimated tax payments total 50% (of 90% of the predicted tax), etc. This annualized method can be favorable if your income is not earned evenly throughout the year.

Planning tip. Taxes that are withheld from wages are deemed to have been withheld ratably on the estimated tax payment dates throughout the year. This can be beneficial if at year end you find that you have underpaid prior quarters' estimated taxes. If you file an updated form W-4, your employer will withhold more tax, and a portion of that amount will be deemed to have been retroactively and evenly paid in prior quarters during that year, possibly mitigating an estimated tax underpayment penalty.

Similar withholding rules apply to distributions from IRAs. If it is advantageous, you can withdraw from your IRA and have tax withheld at a higher rate than default withholding. The taxes that are withheld are deemed to have been withheld ratably on the estimated tax payment dates throughout the year. Because you would incur income tax on withdrawn amounts, this can make most sense if you are over 70½ and must withdraw required minimum distributions. In that case, you would not be incurring additional income tax since you must withdraw from your IRA; rather you would just be having more tax withheld from your required minimum distributions.

Similar rules apply to Social Security retirement benefits. If you are receiving Social Security retirement benefits and want to have income tax withheld, that is accomplished by filing a Form W-4V, Request for Voluntary Withholding. If you file that form, income tax will be withheld until you file another Form W-4V directing otherwise. Any withheld amounts are deemed to have been withheld on the four estimated tax due dates.

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Traditionally, the estimated taxes discussed above have encompassed income taxes, self-employment taxes, and alternative minimum taxes. Beginning in 2014, however, taxes due under the 3.8% Medicare surtax also must be included in estimated tax calculations. Similarly, the additional 0.9% Medicare tax imposed on wages and self-employment income above certain thresholds must be included in estimated tax calculations.

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Income tax deductions are subject to many limitations. It can be beneficial to time the payment of deductible amounts, either accelerating payment into the current year or delaying payment into the next year. Two possible reasons to do this are (1) deduction thresholds that can vary from year to year, and (2) the "Pease" limitation, which can vary from year to year.

Thresholds. Several categories of deductions have thresholds that must be exceeded before a deduction is allowed. For example, medical expenses are deductible as an itemized deduction only to the extent they exceed 10% of adjusted gross income (AGI).[1] As another example, so-called "miscellaneous itemized deductions" are deductible only to the extent they exceed 2% of AGI. If you can control the timing of these deductible payments, two planning ideas are as follows.

1. If your AGI is lower in one year than another, then these thresholds will also be lower for that year. If you make a deductible expenditure in the year in which your threshold is lower, you might obtain a larger tax deduction.
2. If your expenditures don't exceed the threshold when paid each year, then "bunching" them together in one year might allow you to exceed the threshold. Other factors will also affect this, such as whether your AGI is fairly steady.

Phase-out of itemized deductions—the "Pease" limitation.[2] Subject to limitations described below, certain itemized deductions are phased out once your AGI exceeds certain thresholds, which depend on your filing status, summarized in the following chart.[3]

F	AGI F L
Married filing jointly	$313,800
Married filing separately	156,900
Single	261,500
Head of Household	287,650

You are required to reduce the amount of certain itemized deductions by 3% of the excess of your AGI over these threshold amounts (but the reduction cannot be more than 80% of the total of these deductions). Some of the itemized deductions subject to this limitation include:

- State and local taxes;
- Mortgage interest;
- Charitable contributions; and
- Miscellaneous itemized deductions.

The following itemized deductions are not subject to this limitation:

- Medical expenses (which are already subject to a "floor" of 10%);
- Investment interest; and
- Casualty, theft or wagering losses.

This limitation is applied after the application of any other limitation on the itemized deduction. For example, this limitation would apply to miscellaneous itemized deductions after the 2% floor has been taken into account. Similarly, this limitation would apply to charitable deductions after the various AGI limitations applicable to charitable deductions (discussed on page 12) have been taken into account.

Example of the Pease limitation. Assume during 2017, a married couple filing jointly has adjusted gross income of $500,000 and total itemized deductions of $50,000. Of these itemized deductions, $10,000 are miscellaneous itemized deductions, and $40,000 are mortgage interest and taxes. The miscellaneous itemized deductions would be allowed only to the extent they exceed the 2% floor. The 2% floor would be $500,000 x 2% = $10,000. As a result, none of the miscellaneous itemized deductions would be allowed; itemized deductions now total $40,000.

Next, we apply the Pease limitation to the remaining itemized deductions of $40,000.

AGI	$500,000
Pease threshold	313,800
Excess of AGI over threshold	186,200
3% of Excess	**$ 5,586**

The phase-out results in a further reduction in itemized deductions of $5,586. Total allowable itemized deductions would be $40,000 minus $5,586, or $34,414.

Understanding the effect of the Pease limitation. It is important to understand which particular deductions are reduced by the Pease limitation; otherwise you can be mistaken in your planning. This will depend on your particular tax situation, illustrated in the following examples.

[1] For many years this "floor" was 7.5% of AGI; 2014 was the first year it was raised to 10%. For tax years 2014 through 2016, the floor remained at 7.5% if you or your spouse had attained age 65 by December 31. Beginning in 2017, there is no longer a 7.5% floor available.

[2] This limitation had expired for years 2010 through 2012 but is in effect again for 2013 and thereafter.

[3] These same thresholds also govern the phase-out for personal exemptions. Each taxpayer is allowed a $4,050 deduction (in 2017) for each personal exemption, and each taxpayer is allowed one personal exemption for (i) him/herself; (ii) his/her spouse; and (iii) each dependent. This deduction is phased out by 2% for each $2,500 (or fraction thereof) that AGI exceeds these thresholds. If your filing status is married filing separately, the deduction is phased out by 2% for each $1,250 (or fraction thereof) that AGI exceeds these thresholds.

Example 1. Assume you are married filing jointly, your AGI is $650,000, and your itemized deductions are as follows:

I	
State and local taxes	$20,000
Mortgage interest	15,000
Charitable contributions (after AGI limitations)	15,000
Miscellaneous itemized deductions (after 2% floor)	5,000
Total subject to Pease	**$55,000**
I *not*	
Medical expenses (after 10% floor)	$ 7,500
Investment interest	4,000
Total not subject to Pease	**$11,500**

Your threshold for purposes of the Pease limitation is $313,800, and your AGI of $650,000 exceeds that by $336,200. The amount of itemized deductions phased out is the lesser of (i) 3% of that excess ($10,086), or (ii) 80% of the $55,000 of deductions subject to the phase-out ($44,000). As a result, $10,086 of deductions will be phased out under the Pease limitation.

In this Example 1 there are $55,000 of deductions subject to the Pease limitation, and $10,086 of deductions are phased out. Of the four deductions totaling $55,000, which comprise the $10,086 that are phased out by the Pease limitation?

There is no ordering rule required by the statute. However, in this Example 1, state/local taxes and mortgage interest must be paid; charitable contributions and the miscellaneous deductions are optional expenditures. From that perspective, it is fair to view the phase-out as denying a deduction for $10,086 of the $35,000 you would have paid anyway for taxes and mortgage interest. To put it another way, given that the $35,000 you paid for taxes and mortgage interest is more than the amount of deductions phased out, your charitable contribution of $15,000 truly increased your itemized deductions by $15,000. The point of this Example 1 is that it would be a mistake to think that your charitable contributions must be adjusted to account for the Pease limitation. In this example, your charitable contributions are not affected by the Pease limitation.

Example 2. Assume you are married filing jointly, your AGI is $650,000, and your itemized deductions are as follows:

I	
State and local taxes	$ 0
Mortgage interest	0
Charitable contributions (after AGI limitations)	55,000
Miscellaneous itemized deductions (after 2% floor)	0
Total subject to Pease	**$55,000**
I *not*	
Medical expenses (after 10% floor)	$ 7,500
Investment interest	4,000
Total not subject to Pease	**$11,500**

The totals are the same as from Example 1, and the Pease limitation would again phase out $10,086 of itemized deductions. However, because your only deduction subject to the Pease limitation is the $55,000 charitable contribution, in this Example 2 your charitable contribution deduction has indeed been reduced by the Pease limitation.

In short, the effect of the Pease limitation will depend on the particular itemized deductions you have. You should not assume that charitable contributions will be affected; they might be (as in Example 2), or they might not be (as in Example 1).

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When calculating AMT, each taxpayer is entitled to an AMT exemption. For several years, the AMT exemption amounts had been scheduled to revert to their 2000 levels, pursuant to a prior law. Many people would have become newly exposed to AMT due to this decrease in exemption. For several years, Congress enacted a one-year “patch” to avoid this for one more year. That approach changed in 2012. As part of 2012 legislation, Congress enacted a “permanent patch,” increasing the AMT exemption and, just as importantly, indexing it for inflation. The following chart summarizes the AMT exemptions for 2017.

2017 AM E *	
Married filing jointly	$84,500
Married filing separately	42,250
Single	54,300
*As AGI increases over a certain threshold, the AMT exemption is phased out, possibly to $0.	

If you are subject to AMT, your marginal federal income tax rate is 26% or 28%,[4] compared with a top marginal bracket of 39.6% for regular tax purposes.[5] Thus, once you are subject to AMT, it can actually be beneficial to recognize income while in that tax bracket. Conversely, some deductions (such as charitable contributions and mortgage interest) are more valuable if your income tax rate is 39.6% than if your income tax rate is 28%. Other deductions (such as state income taxes) are not deductible for AMT purposes and therefore are "wasted" if incurred in a year you are subject to AMT.

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The maximum tax rate imposed on most[8] long-term capital gain is 20%. The maximum rate on "qualified dividends" is also 20%. This maximum rate begins at the level of taxable income at which you would be subject to the highest marginal rate of 39.6%, which is summarized in the following chart (these thresholds are for 2017; they are indexed for inflation and change annually):

F	20
Married filing jointly	$470,700
Head of Household	444,550
Single	418,400
Married filing separately	235,350
Trusts and Estates	12,500

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Long-term capital gains are often viewed as "better" than short-term gains because of the lower tax rate applicable to long-term gains. Similarly, short-term losses are often viewed as more valuable than long-term losses because under the netting rules they offset 39.6% gain, whereas long-term losses offset 15%/20% gain. However, the capital gain netting rules described above apply to the entire year's cumulative capital gains and losses. There is no universal rule that your next capital transaction is better being short-term or long-term. Rather, it depends how it would affect the entire year's capital gains and losses.

Below are two examples illustrating that (i) a long-term capital gain is not necessarily better than a short-term capital gain and (ii) a short-term capital loss is not necessarily better than a long-term capital loss. In each case, it depends on how it would affect the entire year's capital gains and losses.

Example: You want to raise $50,000 in cash and can do that by selling one of two stocks. One will generate $10,000 of long-term capital gain; the other will generate $10,000 of short-term capital gain. Which is better?[9]

You might assume it is better to incur the long-term capital gain because it is more favorably taxed at 15%/20%, but that's true only with respect to the entire year's net long-term gains. For a particular transaction, long-term is not necessarily better.

Consider if we add the assumption that you have previously recognized $10,000 of capital losses during this tax year. Under the netting rules described above, assuming no other gains or losses, this $10,000 capital loss will offset either of the $10,000 gains being considered, whether it be the short-term gain or the long-term gain. Given that, which $10,000 gain would you rather leave behind, so to speak—(i) the short-term gain potentially taxed at 39.6% or (ii) the long-term gain taxed at 15%/20%? It would probably be better to incur the $10,000 of short-term capital gain now, knowing it will be fully offset by the already-existing loss, and leave for later the $10,000 long-term gain, which already qualifies for the favorable 15%/20% rate.

Thus, although generally long-term capital gains are to be preferred when viewing the entire year's capital gains, for this particular transaction it could be more beneficial to recognize short-term capital gain.

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There is no universal rule that your next capital transaction is better being short-term or long-term. Rather, it depends on how it would affect the entire year's capital gains and losses.

Example: You have $10,000 of short-term capital gain for the year so far, and you want to "harvest" a $10,000 capital loss. You can generate a $10,000 loss by selling either of two stocks. One will generate a $10,000 long-term capital loss; the other will generate a $10,000 short-term capital loss. Which is better? It might seem better to harvest the short-term capital loss, but that's not necessarily true.

Under the netting rules discussed previously, either loss will fully offset the $10,000 short-term capital gain. Think of the short- term capital loss as normally offsetting 39.6% income and the long-term capital loss as normally offsetting 15%/20% income. Under this particular fact pattern, incurring the long-term capital loss will actually allow it to offset 39.6% income. Therefore, it might be better to incur the long-term capital loss and save the short-term capital loss (though it will eventually "mature" into a long-term capital loss).

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Depending on your tax situation, you might prefer to have a year-end gain taxed in 2017 or 2018. Similarly, with a loss, you might prefer to recognize the loss sooner in 2017 or later in 2018. In general, you can achieve whatever result you want if you follow the tax rules summarized below.

[8] As listed above, certain types of gain, such as recapture and gain from collectibles, can be taxed at higher rates.

[9] These examples assume that the sale of either stock, and therefore the retention of either stock, is consistent with your investment strategy. Always remember that it is risky to make investment decisions based solely on tax consequences.

Most of the rules summarized below depend on the "trade date," which is when your order to buy or sell is entered. One rule, however, depends on the "settlement date," which is normally two or three business days after the trade date. (This can differ depending on the particular type of security involved.) The rules below assume that stock is sold on an exchange. In a private transaction, state commercial law governs when the transaction is closed and a gain or loss is recognized. In order to get the tax result you want, it is important to understand which rule applies to your transaction.

Gains. For gains, there is one rule that covers both long and short positions[10]—the gain is recognized for federal income tax purposes on the trade date.

- **Long positions.** A "long" position means you purchased stock, you own it, and you will profit if the stock's price increases. If you sell stock that you own for a gain, the gain is recognized for tax purposes as of the trade date. So, if you want to defer the gain until 2018, your trade date must be in 2018.
- **Short positions.** A "short" position means you borrowed stock to immediately sell it; you do not own it but rather must repay it to the lender, and you will profit if the stock's price decreases (because you can then repurchase the stock at a lower price to repay your debt). If you shorted stock and now want to close out that short to take a gain, the gain will be taxed as of the trade date. So, if there is a gain in the short position, then closing with a trade date of December 29, 2017 and a settlement date of January 3, 2018 (two business days later)[11] will trigger the gain in 2017. If you want to defer the gain until 2018, your trade date must be in 2018.

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If you sell stock that you own for a gain, the gain is recognized for tax purposes as of the trade date. So, if you want to defer the gain until 2018, your trade date must be in 2018.

Losses. For losses, there's one rule for long positions, another for short positions.

- **Long positions.** If you own stock and want to sell it for a loss, the loss is incurred as of the trade date (same rule as for gains on long positions). So, if you want to be able to take the loss on your 2017 tax return, make sure your trade date for the sale is on or before December 31, even if that sale settles in January 2018.
- **Short positions.** If you shorted stock and now want to close out that short to take a loss, the loss is recognized for tax purposes on the settlement date when the shares are delivered to close the short. So, if you want to be able to take the loss on your 2017 tax return, make sure your trade date will be early enough so that the settlement date will also be in 2017.

	L	
Gain is triggered on	Trade Date	Trade Date
Loss is triggered on	Trade Date	Settlement Date

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Although the Wash Sale Rule can be triggered at any time and so is not limited to year-end planning, it often comes into play when you "harvest" a loss, which often occurs at year end.

The rationale behind the Wash Sale Rule is to disallow a current tax loss if you haven't changed your economic position due to a quick sale/repurchase. So, if you sell stock at a loss and reacquire "substantially identical securities" within 30 days before or after the loss[12] (total of 61 days), that is a "wash sale" and the result is:

- The loss is disallowed currently;
- The disallowed loss is added to the basis of the reacquired securities, in effect deferring the loss until you sell those reacquired securities (there is an important exception, noted in the paragraph "Beware repurchasing in an IRA" on the following page); and
- The holding period of the "old" securities carries over to the holding period of the reacquired securities.

The result is approximately the same as if you had not sold/reacquired the shares. IRS Publication 550 states that the Wash Sale Rule is also triggered if the reacquisition is by your spouse or your controlled corporation.

The Wash Sale Rule can also apply to short sales. For example, assume that you short stock and the stock price appreciates, which means you have a built-in loss. Assume you close the short position to incur the loss and, within 30 days, you short the same stock again. The Wash Sale Rule would apply and the loss would be disallowed.

Be aware that with multiple investment managers and separate investment accounts, the Wash Sale Rule can be inadvertently triggered. There is no requirement that it be triggered intentionally. For example, assume fund manager A of your separately managed account sells shares of ABC stock to harvest a loss, while fund manager B buys ABC stock within 30 days. That is a wash sale.

[10] This assumes the short position is not a "short against the box."

[11] On September 5, 2017, U.S., Canadian and Mexican financial industries reduced the number of days required to settle trades for certain securities, from three business days after the trade date (T+3) to two business days after the trade date (T+2).

[12] It is irrelevant whether the year end is straddled. A loss incurred in December followed by a repurchase in January still triggers the Wash Sale Rule if the requirements are met.

The Wash Sale Rule can apply partially. For example, if you sell 100 shares at a loss but reacquire only 60 shares of the same stock, the Wash Sale Rule would apply to 60 shares. For the other 40 shares that were sold at a loss, the loss would be allowed.

Beware repurchasing in an IRA. The Wash Sale Rule will apply even if the loss is incurred in a taxable account and the repurchase occurs in an IRA (traditional or Roth). In a 2008 Revenue Ruling, the IRS stated that, assuming the conditions of the Wash Sale Rule are met, the loss would be disallowed, but the disallowed loss would not be added back to the basis of the security repurchased inside the IRA. This is a worse result than if the repurchase had occurred in a taxable account, in which case the disallowed loss would have been added to the basis.

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Each of the following constitutes a reacquisition under the Wash Sale Rule. That means if you recognized a loss 30 days before or after any of these transactions in the same or “substantially identical” stock, the loss is disallowed. Although some of these reacquisitions might be beyond your control, that just means you need to control when you incur the loss.

- Buying the same stock on the market (including via a dividend reinvestment program)
- Receiving the same stock as a compensatory stock bonus[13]
- Being granted a compensatory stock option (the Wash Sale Rule can be triggered by the acquisition of an option to purchase the security, as well as by the reacquisition of the security itself)[14]
- Exercising a compensatory stock option (unless the grant of the option previously triggered the Wash Sale Rule; an option can trigger the Wash Sale Rule only once)
- Buying a listed option on the stock on an exchange
- Acquiring certain convertible preferred stock, convertible into the security that was sold for a loss
- Selling “deep in the money” puts

There are straightforward ways to avoid the Wash Sale Rule.

- You could incur a loss and then wait 30 days before reacquisition. Remember, the loss is incurred on the trade date if you are selling long stock, while the loss is incurred on the settlement date if you are closing a short position for a loss.
- An approach similar to the preceding idea is to first purchase more of the stock that you intend to sell (called “doubling up”), and then wait 30 days before selling the stock for a loss. (You would need to be sure to properly identify the stock being sold for the loss. How to do that is discussed in the next section.) The main difference between this approach and the approach described in the preceding paragraph is that you would be “in” the market during the 30-day waiting period.
- You could make sure that what is reacquired is not “substantially identical securities.”
  - For stocks, a different issuer/company is not “substantially identical.” Therefore, you could sell your stock and reacquire shares of a different company that is in the same sector as the stock you sold.
  - For bonds, you could purchase the bonds of a different issuer. It is possible to stay with the same issuer, but the terms of the bond would have to be sufficiently different.
  - For mutual funds, former IRS Publication 564 stated the following: “In determining whether the shares are substantially identical, you must consider all the facts and circumstances. Ordinarily, shares issued by one mutual fund are not considered to be substantially identical to shares issued by another mutual fund.” Publication 564, however, has been discontinued. Publication 550 states that it incorporates Publication 564. Unfortunately, Publication 550 does not address mutual funds (or ETFs) in the context of the Wash Sale Rule.
- If you have triggered the Wash Sale Rule and the triggering repurchase has not occurred within an IRA, then the disallowed loss has been deferred by adding the disallowed loss to your basis in the replacement shares. If you sell those replacement shares and do not reacquire “substantially identical” securities for 30 days, then the Wash Sale Rule would not apply to that later sale.

[13] There is no clear guidance whether a restricted (i.e., non-vested) stock grant constitutes a reacquisition.

[14] There is also no clear guidance whether a non-vested stock option grant constitutes a reacquisition.

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Like the Wash Sale Rule, this issue can arise any time and is not limited to year-end planning. However, because year-end planning often includes recognizing gains or losses for tax purposes, it is important to be sure that the tax lots sold will generate the desired gain or loss.

To understand why this issue can be important, consider the following example.

Example. Assume your account holds two lots of ABC shares. One lot consists of 1,000 shares purchased at $100/share on January 5 for $100,000. The second lot consists of 1,000 shares purchased at $75/share on March 16 for $75,000. You want to sell 1,000 shares. Which lot should be sold?

Answer: It depends on your situation. The first lot has a higher basis and will generate less capital gain, which is normally to be preferred. However, if you have tax losses that can offset the gains, it might make sense to sell the second lot.

There are rules for determining which lots are considered sold for tax purposes. If you know the rules and follow them properly, you can be treated as having sold whatever lot you choose. If you do not affirmatively address this, a result will be imposed on you via a default rule, which might or might not produce the best tax result.

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You can identify which shares you want to sell, and those will be the shares you are considered to have sold. This process is known as "specific identification" and has two requirements:

1. When the trade is requested, you must communicate to your financial advisor which shares are to be sold. This can be done orally or in writing.
2. You must receive written confirmation of your identification within a reasonable time.

If you do not follow the "specific identification" method described above (or you fail to meet both requirements), then the default rule applies, which is first in, first out (FIFO). In other words, the first shares you acquired in the account are deemed to be the first shares sold from the account.

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Beginning with 2012, the rules for determining which mutual fund shares (including DRIP shares) have been sold, and the basis in those shares, have changed. The rules are complicated, and the rule that you will be subject to can depend on your investment manager's default method. These rules are beyond the scope of this summary.

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If you know the rules and follow them properly, you can be treated as having sold whatever lot you choose. If you do not affirmatively address this, a result will be imposed on you via a default rule, which might or might not produce the best tax result.

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The general rule is that if a stock (or any security) becomes worthless during the year, it is treated as if you sold it for $0 on December 31, resulting in a capital loss. You must be able to prove the stock is worthless. Bankruptcy might be such proof, but if the bankruptcy is a reorganization and the company might emerge as a continuing enterprise, then the stock is probably not worthless.

This rule is not optional. If the stock becomes worthless, you must deduct it in the year it first becomes worthless or not at all. This can lead to a sort of dilemma if you have an asset that might be worthless but it's not certain:

- If you deduct the stock as worthless before it actually becomes worthless, the IRS can disallow the loss. The stock must be totally worthless to get the write-off.
- If you wait too long to deduct the stock as worthless, the IRS can claim it was first worthless in a prior year. If the statute of limitations for that prior year has expired, it would be too late to go back and amend the prior year's return to claim the loss.

Because of this, some advisors suggest that it is better to claim worthlessness sooner rather than later. An alternative might be to sell the stock for pennies. A sale is much more easily identifiable as a transaction triggering a loss than is worthlessness.

Rules that expire/revive annually

For many years, several tax provisions have been enacted only for a year or two, and every year or two taxpayers would have to wait to see whether the provisions were extended. Each year in this Year-End Tax Planning brochure we have updated the status of these provisions. In December of 2015, legislation was passed addressing five of these provisions, discussed below. For all five, the provisions were extended permanently, which means that taxpayers no longer need to worry whether they will be extended year-by-year. Although Congress can always enact new legislation, these provisions are no longer dependent on annual extensions.

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This provision was enacted in 2004 and has been extended several times since then. Under this provision, you could deduct as an itemized deduction either your state income tax paid or your state sales tax paid. If you chose to deduct your state sales tax paid, you could choose either (i) your actual sales tax paid or (ii) an amount allowed under the IRS table. Because you had to choose between deducting sales tax or income tax, this sales tax deduction was most beneficial for those who live in states without an income tax.

In December of 2015, legislation was passed extending this provision for 2015 and permanently thereafter.

I A DI IB I CHA I IE

Under a law first passed in 2006, each year a taxpayer may exclude up to $100,000 of an IRA distribution that is transferred directly to a “qualified” charity. The amount is excluded from your income (and you would receive no deduction). You have to be 70½ or older at the time of the transfer (and meet several other requirements). In December of 2015, legislation was passed extending this provision for 2015 and permanently thereafter.

C E A I EA EME

IRAs

E I ED MI IM M DI IB I

You must begin withdrawing required minimum distributions (RMDs) from your traditional IRA by April 1 of the year following the year you turn 70½. Failure to withdraw your annual RMD could expose you to an excise tax equal to 50% of the excess of (i) the amount you should have withdrawn, over (ii) the amount actually withdrawn. Therefore, you should be sure that you avoid an unnecessary 50% excise tax by timely withdrawing your RMD.

If you turned 70½ in 2017, you are allowed to take your first RMD anytime from January 1, 2017 to April 1, 2018. (For all future years, you can withdraw that year's RMD from January 1 to December 31 of that year.) However, this does not mean that you should necessarily wait until April 1, 2018. If you withdraw your 2017 RMD in 2018, you will still have to take your 2018 RMD by December 31, 2018. That would mean two IRA distributions in the same year, which would "bunch" taxable income into one year and might not be best overall.

DI IDE A I HE I ED I A

When an IRA owner dies, the pace at which the funds "inside" the IRA must be paid out to the beneficiaries will depend in part on who the beneficiaries are and whether they qualify as "designated beneficiaries," a technical term with a technical definition.

The determination of whether an IRA's beneficiaries are "designated beneficiaries" is made as of September 30 of the year following the year of the IRA owner's death. This allows for disclaimers to be implemented and/or distributions to be made before the designated beneficiaries are determined.

When an IRA's designated beneficiaries have been determined, if an IRA has multiple designated beneficiaries, then generally the payout term will be governed by the oldest beneficiary's life expectancy, which can be to the disadvantage of younger beneficiaries with longer life expectancies. However, if the multiple beneficiaries timely establish and fund separate accounts, then usually the IRA distribution schedule can be based on each beneficiary's life expectancy. To qualify for this special rule, the separate accounts must be established and funded by December 31 of the year following the year of the IRA owner's death.

Therefore, if you inherited an IRA from a decedent who died in 2016, and if there are multiple designated beneficiaries (determined as of September 30, 2017), it could be to your advantage to create and fund separate accounts before December 31, 2017. You should consult with your tax advisor to determine whether this would be beneficial for you.

I HE I ED I A

If you inherited an IRA from a decedent who died in 2016, and if there are multiple designated beneficiaries (determined as of September 30, 2017), it could be to your advantage to create and fund separate accounts before December 31, 2017.

H C E I , ECHA AC E I A I A D EC E I

Since 2010, individuals can convert traditional IRAs and funds held in other tax-favored retirement vehicles to Roth IRAs regardless of income. (Prior to 2010, if you had "modified" adjusted gross income in excess of $100,000 or if your filing status was married filing separately, you were not allowed to convert.) As a result, many individuals have converted traditional IRAs to Roth IRAs.

If your Roth IRA portfolio has decreased in value since conversion, it is possible to have the conversion "undone." This can raise several issues, discussed here at only a very high level; we encourage you to contact your Merrill Lynch advisor to discuss any of these matters in more depth.

As an initial matter, it is important to understand the different terms used. When a traditional IRA is changed/transferred to a Roth IRA, that is called a "conversion." If a conversion is later undone by the deadline, that is called a "recharacterization." If the amounts recharacterized are then converted to a Roth IRA again, that is called a "reconversion."

If you converted your traditional IRA to a Roth IRA in 2016 and are considering recharacterizing, the deadline for recharacterizing a 2016 conversion is October 16, 2017.

If you converted your traditional IRA to a Roth IRA in 2016 and have recharacterized that conversion in 2017, be aware that will retroactively increase your required minimum distribution (RMD), if any, for 2017. This is because your 2017 RMD is based on the December 31, 2016 balance in your traditional IRAs, which would have excluded balances in Roth IRAs. The effect of a recharacterization is to treat the conversion as retroactively not happening, which means the December 31, 2016 balances of your traditional IRAs will retroactively be increased, increasing your 2017 RMD.

If you converted your traditional IRA to a Roth IRA in 2016 and have recharacterized that conversion in 2017, you could reconvert

those amounts to a Roth IRA beginning 30 days after the recharacterization. If you intend to reconvert shortly following the recharacterization, you might have the choice of reconverting in 2017 or 2018. One factor to consider is that by reconverting in 2018, you could cause the income (and resulting tax) to be recognized a full year later than if you reconverted in 2017. This, however, is just one factor to consider.

Finally, if you converted your traditional IRA to a Roth IRA this year (2017), you can recharacterize that conversion in 2017. You could also delay recharacterization until October 15, 2018, if certain conditions are met.

Recharacterized amounts cannot be reconverted until the later of (i) 30 days after recharacterization or (ii) the year after conversion. Therefore, any 2017 conversion that is recharacterized in 2017 cannot be reconverted until January 1, 2018, at the soonest. Because of these restrictions, there appears to be little reason to recharacterize a 2017 conversion sooner than 30 days before January 1, 2018.

Year-end charitable gifts

CHA I ABLE I C ME A DED C I LIMI A I

A gift to charity is normally deductible as an itemized deduction. However, you might not be able to deduct all of your charitable contributions. There are limitations, summarized in the following chart, based on (i) the type of property given and (ii) the type of charity. (These AGI limitations are in addition to, and are applied before, the Pease limitations discussed on page 3.)

Some common planning ideas from this chart are:

1. It is usually better to make a gift of appreciated long-term (held longer than one year) stock to a charity than to make a gift of appreciated short-term stock. A gift of appreciated long-term stock is deductible at its value; a gift of appreciated short-term stock is deductible only to the extent of basis. To put it another way, a gift of long-term appreciated stock entitles you to deduct the appreciation even though you have not been taxed on it.
2. In the case of a gift of appreciated long-term stock to a private foundation, a deduction for the fair market value is allowed only if the stock is "qualified appreciated securities." Generally that means publicly traded stock, but you should always consult your tax advisor.

If the amount you contributed to charities this year is more than you can deduct because of the AGI limitations summarized in the chart below, the excess can be carried forward for up to five years. (Special rules for certain conservation easements are discussed on page 10.)

	C (D A F)		F (-)	
	D A[1]	AGI L[2]	D A[1]	AGI L[2]
Cash	Amount of cash	50%	Amount of cash	30%
Short-term[3] capital gain property or ordinary income property	Tax Cost/Basis	50%	Tax Cost/Basis	20%
Long-term[3] capital gain property	Fair Market Value	30%	Tax Cost/Basis (Fair market value if publicly traded stock[4])	20%
Tangible personal property (e.g., art) – If it will be used by the charity in conducting its exempt functions	Fair Market Value	30%	Tax Cost/Basis	20%
Tangible personal property (e.g., art) – If it will NOT be used by the charity in conducting its exempt functions	Tax Cost/Basis	50%	Tax Cost/Basis	20%

[1] In all cases where the deduction is limited to tax cost/basis, if the fair market value is lower (i.e., the asset has depreciated), the deduction will be the lower fair market value.

[2] Charitable contributions that are not deductible due to the AGI limitations can be carried forward for up to five years.

[3] Short-term property is property held one year or less. Long-term property is property held more than one year.

[4] Gifts of publicly traded stock may be deducted at full fair market value, but the deduction for gifts of bonds (even publicly traded bonds) is limited to tax cost/basis.

Due to multiple contributions, you might trigger several of these limitations. How these limitations interact with each other is a complicated matter beyond the scope of this summary, and you should consult your tax advisor.

BE A E GIF F CE AI I E ME

The preceding section referred to a gift of publicly traded stock. Many investments do not fall neatly into that category and might not qualify for the favorable charitable income tax deduction rules just summarized. For example:

- Depending on how it is structured, a charitable gift of your interest in a gold exchange traded fund (ETF) can result in a deduction equal only to your basis in the investment, not the fair market value. The same might be true of a structured note.
- For a gift of a bond, the interest component might not qualify for a charitable deduction.
- Gifts of leveraged property raise complicated tax issues.

In sum, you should confirm with your tax advisor whether a charitable gift of a particular investment would allow you the full charitable income tax deduction.

MAKI G E HE DED C I I 2017

Gift of cash. You may want to make a year-end charitable gift of money in order to take the deduction in 2017. Depending on how you make the gift, there are different rules governing the determination of what year you can take the deduction.

- If you deliver cash or a check, the charity must receive it by December 31, 2017, in order for you to take the deduction in 2017.
- If you mail a check, it must be postmarked by December 31 or earlier, ***and*** it must be received by the charity in the ordinary course of mail deliveries. You can control when you have an envelope postmarked but probably cannot control if/when the envelope will be received, so this isn't the best approach.
- If you use a credit card, the gift occurs when the charge is made, regardless of when you pay your credit card bill.

BE A E CHA I ABLE GIF F CE AI I E ME

Many investments do not fall neatly into the category of "publicly traded stock" and might not qualify for the favorable charitable income tax deduction rules.

Gift of stock. The date on which a gift of securities is completed depends on how the securities are delivered.

- **Securities held in street name (DTC).** These are considered transferred on the date the brokerage firm transfers title, a process that normally takes one or two business days. NOTE: The transfer is not made at the time that instructions to transfer the shares are given to your agent. Rather, it is the date the transfer is made on the books of the issuing corporation or transfer agent.
- **Physical certificates you hold.** If you have the physical stock certificate, your gift of those shares to charity is completed on the date you deliver an endorsed certificate to the charity. If you mail the certificate and endorsement (which should be mailed separately), the securities are considered gifted to the charity on the date of the mailing if they are received by the charity in the ordinary course of mail deliveries.
- **Physical certificates held elsewhere.** This would include securities held in a safe deposit box or trust department with your advisor/broker, but not in street name. If the advisor/broker is considered your agent, the transfer will not be considered complete until the date the transfer agent records the transfer, which can take several weeks. If the advisor/broker has stock powers on file, the securities can be converted to DTC, at which point the much quicker process described above for securities held in street name will applyng (en10.1ar

CHA I ABLE EMAI DE A D 3.8 MEDICA E A LA I G

Beginning in 2013, a new 3.8% Medicare surtax is imposed on an individual's "net investment income" to the extent "modified adjusted gross income" exceeds certain thresholds. The surtax does not apply to a CRT itself; however, distributions from a CRT can have surtax consequences to the recipient/beneficiary. As a result, there is a year-end planning opportunity for CRTs: harvesting capital losses. Even for CRTs that have accumulated mostly long-term capital gains, harvesting losses can have a surtax benefit.

Intra-family wealth transfers

GE E AL E A E LA E IE

As has been mentioned for other planning ideas, reviewing your estate plan is not necessarily a year-end planning matter. However, there are several gift and estate tax planning matters that are addressed each year end (discussed below), and therefore it can also be a good time to think about this important matter. As a general matter, we suggest you have your overall estate plan reviewed regularly by an estate planning professional. The reasons might not be obvious, so we list several here.

A useful working definition of "estate planning" is: (1) having your assets (2) go where you want them to go (3) in the manner you want (i.e., in trust or outright) (4) with minimum taxes. Any one or more of these elements can change year to year.

Assets change. The value of your assets can change, causing the size of bequests to be very different from what you had in mind. Also, assets change locations, which can change which document governs that asset at your death. For example, funds inside an IRA will pass pursuant to your Beneficiary Designation, but once funds are distributed from your IRA they will be governed by your Will.

Recipients change. Where you want your assets to go can change for many reasons. This could be due to a change in your family. Marriage can cause you to now engage in marital trust planning. Divorce can render marital planning inappropriate. The advent of children will require trust planning. The advent of grandchildren can require generation-skipping transfer tax planning. An unnatural order of deaths can change your estate desires.

The need for trusts changes. You might have wanted a trust for a beneficiary's inheritance, but now a trust might not be needed either because the beneficiary is now older and mature or perhaps because the dollars involved are now too little to merit a trust.

The reverse could also be true—you might not have thought a trust was needed before, but now the beneficiary has proven to be a spendthrift. Or perhaps asset protection is more of a concern. For example, the beneficiary might now be in a profession prone to lawsuits.

Tax rules change. This has increased in importance the last few years because it must now be factored in that we cannot know what the tax rules will be when your estate plan gets "activated." Though the tax rules have been stable in recent years, in the not-too-distant past there were frequent changes to the various exemption amounts and tax rates governing wealth transfers, both at the federal level and at many state levels. In addition, as noted in the introductory paragraphs of this summary, many changes are currently being discussed, both in the income tax world and in the estate tax world.

Because there is always the possibility that the tax rules are changed, there is always the possibility that your estate plan could become outdated without your doing anything. If you would like to discuss having your estate plan reviewed, please contact your Merrill Lynch advisor.

$14,000 A AL E CL I GIF

Gift of money. If you would like to make a gift by check and have it qualify for the $14,000 annual gift tax exclusion for 2017, two requirements must be satisfied:

1. The donee must deposit the check in 2017; and
2. It must clear in the ordinary course of business (which can happen in January).

A holiday gift of a check that doesn't get deposited until after New Year's Day is considered a gift in 2018. A cashier's check can avoid this, since a gift of a cashier's check, like cash, is complete upon delivery.

The annual exclusion amount is indexed for inflation. Although the amount for 2018 has not been officially announced as of this writing, we expect the annual gift tax exclusion to increase to $15,000 in 2018.

Gift of stock. The rules for completing a gift of stock to a family member are the same as the rules set out above for a year-end gift of securities to a charity, with one exception. If you mail a properly endorsed stock certificate to a family member, the gift is not completed until received.

GIF 529 LA

Paying for a grandchild's college education can be a good way to transfer wealth and may be more appealing than just making gifts to a trust. A 529 college savings plan (a "529 plan") offers a way to accelerate gifts and frontload a savings program. 529 plans allow you to make five years' worth of $14,000 annual exclusion gifts in 2017. This is as much as $70,000 from a single donor, or $140,000 from a married couple. These gifts are treated as if they are made ratably over the current year and next four tax years.

Contributions between $14,000 and $70,000 made to a 529 plan in one year can be prorated over a five-year period without you incurring gift taxes or reducing your lifetime federal estate or gift tax exemption. If you contribute less than the $70,000 maximum, additional contributions can be made in subsequent years without your incurring federal gift taxes or reducing your lifetime federal estate or gift tax exemption, up to a prorated level of $14,000 per year. For contributions between $14,000 and $70,000 made in one year, if the account owner dies before the end of the five-year period, a prorated portion of the contribution is included in the taxable estate.

Be aware that such planning must be coordinated with all other gifting techniques, which might also affect how much of your $14,000 annual exclusion is available each year. If you make a gift of five years' worth of annual exclusion gifts to a 529 plan, no additional annual exclusion gifts can be made to the beneficiary within this five-year period (other than any additional increase in the annual exclusion amount during that five-year period).

If you are funding a 529 plan toward the end of 2017 and want to maximize the frontloading of the account, consider contributing only $14,000 ($28,000 for a couple) to the account this year. You could then frontload by contributing $75,000 ($150,000 for a couple) in January 2018. (This is based on next year's expected annual exclusion of $15,000.) This will allow you to contribute a total of $89,000 by January 2018 ($178,000 for a couple). In contrast, if you first contribute $70,000 ($140,000 for a couple) to the account in December 2017, you would not be able to contribute more for the next four years (other than an additional $1,000 per year per person if the annual exclusion increases to $15,000).

BE A E HE KIDDIE A

Year-end planning can involve gifts to children. In general, making a gift of a financial asset to your children will cause them to be subject to income tax on the future earnings. However, under the "kiddie tax," a certain amount of your children's investment income can be taxed at your highest income tax rate. The "kiddie tax" applies to children under 18 and to 18-year-olds if their earned income doesn't exceed one-half of the amount of their support. It also applies to 19- to 23-year-olds if they are full-time students and their earned income doesn't exceed one-half of the amount of their support if at least one parent is living at the end of the tax year and the child is not filing a joint return for the tax year. Interestingly, there is no "surkiddie" tax. That is, although your child's investment income might be taxed at your highest rate for regular income tax purposes, that income will not be subject to your 3.8% Medicare surtax. Rather, your child may be subject to the 3.8% Medicare surtax, based on his/her own income threshold.

F 2017

	B	( )		
Single				
$ 0	$ 9,325	$ 0	10%	$ 0
9,325	37,950	933	15	9,325
37,950	91,900	5,226	25	37,950
91,900	191,650	18,714	28	91,900
191,650	416,700	46,644	33	191,650
416,700	418,400	120,910	35	416,700
418,400		121,505	39.6	418,400
Married Filing Jointly				
$ 0	$ 18,650	$ 0	10%	$ 0
18,650	75,900	1,865	15	18,650
75,900	153,100	10,453	25	75,900
153,100	233,350	29,753	28	153,100
233,350	416,700	52,223	33	233,350
416,700	470,700	112,728	35	416,700
470,700		131,628	39.6	470,700
Non-grantor Trusts				
$ 0	$ 2,550	$ 0	15%	$ 0
2,550	6,000	383	25	2,550
6,000	9,150	1,245		