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Tax changes are coming, so act now

> *"There is only one kind of shock worse than the totally unexpected: the expected for which one has refused to prepare."*
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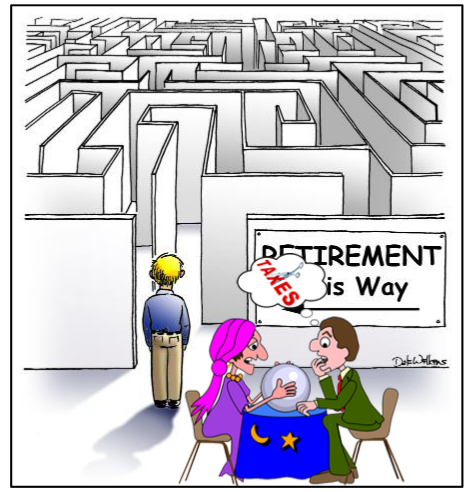
> — Mary Renault, British author (1905 - 1983)

Navigating the Retirement Maze



Among the inevitabilities of life, the two most cited ones are death and taxes. Or just death if you happen to be a real estate tycoon. To those I add a third: tax law changes. The original tax code written in 1913 contained 400 pages. The current version is over 74,000 pages. The regime change in Washington next year almost guarantees significant changes to the tax code. While there are never any certainties about what comes out of Congress, we have some indications of what to expect for 2017. Thus, there are measures that you can take before the end of this year to make the best use existing tax rates in anticipation of what the future will bring. I will discuss some of the likely changes for 2017, and then cover actions you should take while 2016 is still with us.

It's all about your marginal rate

Expect to see the current seven tax brackets reduced to just three: 12, 25, and 33 percent. There is also a likely win for married couples, as the "marriage penalty" will probably disappear. However, some filers may see an increase in their tax rate. Most individual filers currently in the 28 percent bracket ($112,000 to $192,000 in taxable income) would move up into the 33 percent bracket. Ditto for Head of Household filers currently in the 28 percent bracket. The top 1% will see an average decline in taxes of about 27 percent, which will account for nearly half of the total tax reductions.

It's also likely that both the Alternative Minimum Tax (AMT) and the Medicare investment income surtax (NIIT) will disappear. NIIT currently affects individuals and couples with greater than $200K and $250K in taxable income, respectively, increasing capital gains and dividend rates by 3.8 percent. The AMT mostly affects those with high Schedule A "preference items": state income tax, property taxes, medical, and miscellaneous deductions.

Estimating your adjusted gross income for 2016 and 2017 will provide an indication of which tax moves make sense now, and which ones to defer until next year. Your current and estimated future marginal tax rate – how much tax you pay for each additional dollar of income – is the key to tax savings.

Kiss those deductions goodbye

So where does the money come from to make these tax reductions? Mostly from itemizers who use Schedule A. Under the existing tax code, filers take the standard deduction of $6.3K/$12.6K/$9.3K for individuals, couples, and heads of household, respectively, if these amounts exceed their itemized deductions. Most wage earners in states with income tax typically itemize. Current proposals would increase the standard deduction to $12K/$24K or $15K/$30K (Congress vs. Administration), but the only itemized deductions that would survive would be mortgage interest and charitable. Property tax, state and local income tax, employee and investment expenses, and medical expenses would no longer be deductible.

Another proposal is to leave the existing deductions intact but to cap them at $100K/$200K for individuals and couples, respectively, which would mostly affect high earners. To be on the safe side, I recommend assuming the former changes for most taxpayers and acting accordingly before the end of the year.

What to do (and not do) now

Considering these potential changes, there are actions that you can take this year that will reduce your overall tax payments. Keep in mind that these suggestions mostly apply to those likely to see a decrease in their marginal rates next year. Those anticipating an increase, particularly individuals and heads of household, should do the opposite. Consult your financial advisor or accountant for advice specific to your situation.

- **Delay selling appreciated property and securities –** If you are likely subject to the NIIT or are at marginal rates of 35 or 39.6 percent (for short-term gains), wait until next year to realize gains. Other than the likely repeal of the NIIT, long-term gain rates are unlikely to change much, if at all. Harvest tax losses this year.
- **Defer income into 2017 –** Do this if you have the ability to move income into next year, paying attention to how it will affect next year's marginal rate.
- **Accelerate deductions into 2016 –** Deductions are worth more when you are at a higher marginal tax rate. Plus, many of your current deductions could disappear next year. Pay your property taxes, miscellaneous deductions, and estimated state income tax before year end. Use a charitable Donor Advised Fund to deduct multiple years' worth of charitable deductions this year, and gift out to charities over multiple years. (Even better, donate appreciated securities or funds to avoid the capital gains tax.)
- **Postpone excess IRA withdrawals –** If you need funds over and above your RMD, wait until next year to withdraw them at a lower marginal rate. If you turned 70½ this year, you have the option to postpone your 2016 RMD until next April, so hold off if you will likely be at a lower marginal rate. (Note: Taking two years' worth of RMDs in the same year could move you into a higher bracket, so take that into account.)
- **Hold off on Roth conversions –** The main justification for Roth conversions is to convert while at a lower tax rate than one would be in at retirement. Wait until your marginal rate is lower to do this.

Other actions

I'm currently recommending to my clients that they hold off on any estate planning until the new tax rules have been implemented. No point in having your attorney draft the same documents twice. Whether the estate tax survives is unknown. The challenge for Congress and the Administration will be to make the revised tax code revenue neutral, and it remains to be seen how the numbers, even overly optimistic ones, can be made to work out. In the meantime, take those actions this year that have the greatest likelihood of reducing your overall tax bill, and revise your planning accordingly in 2017.

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