KAKENMASTER REPORT

A Newsletter from Kakenmaster & Associates and Libertyville Insurance Agency

Tax Issue 2017 Volume XX Issue II

**Tax Reform & Recordkeeping**

**In this issue:**
Find out what the tax reform proposals could mean for your 2018 tax picture.

**What Should I Save?**
See pages 3 and 4 to help you determine what tax records you need to retain according to the IRS.

**529 Funds for Off-Campus Housing:**
The IRS will approve room and board expenses for off-campus housing from 529 plans as long as the student is enrolled at least half-time. However, those expenses must not exceed the room and board allowance included in the cost of attendance, as determined by the college or university.

**2018 S.S. Wage Base:**
The Social Security wage base will rise just 1.2% to $128,700 in 2018, after jumping by 7.3% in 2017.

**Questions?**
Feel free to call us today with any tax questions. This is just one of the ways we can serve you throughout the year.

# Proposed Tax Reform Framework Announced

On September 27, the Trump Administration, the House Committee on Ways and Means, and the Senate Committee on Finance released its *Unified Tax Reform Framework*. According to the White House, this framework will serve as a template for the tax-writing committees that will develop legislation through a transparent and inclusive process. The official overview released by the Trump Administration regarding the framework is included below.

***Lowers Rates for Individuals and Families:*** The framework shrinks the current seven tax brackets into three - 12%, 25% and 35% - with the potential for an additional top rate for the highest-income taxpayers to ensure that the wealthy do not contribute a lower share of taxes paid than they do today.

***Doubles the Standard Deduction and Enhances the Child Tax Credit:*** The framework roughly doubles the standard deduction so that typical middle-class families will keep more of their paycheck. It also significantly increases the Child Tax Credit.

***Eliminates Loopholes for the Wealthy, Protects Bedrock Provisions for Middle Class:*** To provide simplicity and fairness, the framework eliminates many itemized deductions that are primarily used by the wealthy, but retains tax incentives for home mortgage interest and charitable contributions, as well as tax incentives for work, higher education and retirement security.

***Repeals the Death Tax and Alternative Minimum Tax (AMT):*** The framework repeals the Death Tax and substantially simplifies the tax code by repealing the existing individual AMT, which requires taxpayers to do their taxes twice.

***Creates a New Lower Tax Rate and Structure for Small Businesses:*** The framework limits the maximum tax rate for small and family-owned businesses to 25% - significantly lower than the top rate that these businesses pay today.

***To Create Jobs and Promote Competitiveness, Lowers the Corporate Tax Rate:*** So that America can compete on a level playing field, the framework reduces the corporate

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# Gift-Giving and Estate Planning 101

The *Unified Tax Reform Framework* contains one line referring to the estate tax: "The framework repeals the death tax and the generation-skipping transfer tax." However, the framework does not include the repeal of the gift tax, which applies to transfers made while you are living. Currently, the tax laws allow for an overall transfer of $5,490,000 of assets during life and after death without incurring any gift or estate tax, and double the amount for married tax filers.

**Definition of a Gift:** According to the IRS, a gift is any transfer to an individual, either directly or indirectly, where full consideration (measured in money or money's worth) is not received in return. In 2017, individuals can give up to $14,000 per year, per person as a gift to as many people as they choose without incurring a gift tax. Any gifts in excess of the $14,000 annual exclusion amount must be reported as taxable gifts. However, the tax laws allow you to give your spouse an unlimited amount of cash or anything of value with no gift tax consequences. If your spouse is not a citizen the limit is $149,000 in 2017.

**Nontaxable Gifts:** There are also gifts that are never counted as taxable gifts such as payments made directly to a medical provider for medical expenses that would otherwise qualify as itemized deductions; donations to qualified charitable organizations (these are deductible); donations to political organizations (these are nondeductible); and payments made directly to an educational institution for tuition only. (Please note that in addition to the unlimited education exclusion to the educational institution, a gift up to $14,000 can be used for other purposes such as books, supplies, and living expenses. Payments to qualified 529 Education Savings Accounts do not qualify for this exclusion).

**Valuing Gifts:** A gift is "value-based" on the fair market value on the date the transfer is complete. This is important because the gift-recipient's basis must be reported on Form 709. This amount becomes a carryover basis from the donor to the gift-recipient. If the amount is too low based on current market value, a large capital gains can occur when the asset is sold. Unlike an asset that is passed along after death, the beneficiary would receive a basis amount equal to the fair market value of the asset at the time of death. This is referred to as "step-up basis," which may help lower the capital gains.

For example, your father has a house that has a value basis of $50,000. The fair market value of the house is now $325,000. If your father gave you the house as a gift, your tax basis would be $50,000. If you inherited the house after your father's death in 2017, the tax basis would be $325,000, its fair market value on the date of his death. These are the capital gains scenarios if you sell the house for $335,000 shortly after you inherit it:

- Your gain on the sale is $275,000 ($325,000 minus $50,000) if you received the house as a gift.
- Your gain on the sale is $10,000 ($335,000 minus $325,000) if you received the house as an inheritance.

**State Estate and Gift Taxes:** Also note that according to the Tax Foundation, 14 states and Washington, D.C., have their own estate and/or inheritance tax rates. Illinois is one of the states that also has a separate estate tax.

Finally, when gathering your tax items remember to include information on any gifts you may have given throughout the year. Although there is no statute of limitations for failure to file gift tax returns, it is best to file complete and accurate gift tax returns late than not at all.

### Extension for Estate Tax Portability Election

The portability election allows the estate of a decedent who is survived by a spouse to make a portability election, which allows the surviving spouse to apply the decedent's unused exclusion amount to the surviving spouse's own transfers during life and at death. The amount received by the surviving spouse is called the deceased spousal unused exclusion (DSUE) amount.

Previously, the IRS had provided a simplified method for obtaining an extension of time to make a portability election if the estate was too small to be required to file an estate tax return and if the decedent was survived by a spouse. However, this simplified method was available only on or before December 31, 2014, which has caused a burden for both the taxpayer and the IRS to process portability election requests. In response to this issue, the IRS is allowing an extension for the portability extension which requires the executor to file a complete and properly prepared Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return on or before the later of **January 2, 2018, or the second annual anniversary of the decedent's date of death.** Please note that this extension is only available to estates that are too small to be required to file an estate tax return.

# Tax Reform Cont'd...

tax rate to 20% (currently 35%) - below the 22.5% average of the industrialized world.

***To Boost the Economy, Allows "Expensing" of Capital Investments:*** The framework allows, for at least five years, businesses to immediately write off (or "expense") the cost of new investments.

### How Will the Proposed Tax Cuts be Offset?

As the committees develop legislation they will be looking for ways to raise revenue to help offset the cost of rate cuts. Although many of these areas will most likely be heavily defended by lobbyist groups, below are some of the largest individual tax expenditures that some consider to be targets to help offset lower tax rates.

**Capital Gains and Dividends:** The tax reform framework released does not address capital gains and dividends, but some believe the rates will remain the same, 15% maximum for individuals and 20% for taxpayers in the upper income tax brackets. It is not clear how it may affect the 0% rate for those in the 10% and 15% brackets. They also expect the 3.8% surtax to remain intact.

**Pass-Through Businesses (applies to sole proprietorships, partnerships, and S corporations):** The framework calls to create a new maximum rate of 25%, but some expect it to end up at 28%. The framework does not discuss tax deferral under Sec. 1031 like-kind exchanges.

**State and Local Income and Property Taxes:** The framework calls for the elimination of state and local tax deductions, as well as the property tax deduction.

**Exclusion from Tax for Employer-Provided Health Insurance:** Currently premiums are not included as an employee's taxable wages, even though the employer is able to deduct the amounts as a business expense. Some believe this may be a targeted revenue raiser.

**Second Homes and Home Acquisition Indebtedness:** The deduction for second homes and the lowering of the current $1 million ceiling on indebtedness may also be another source to help offset the tax cuts.

***Estate Tax:*** The plan eliminates the estate tax and generation-skipping taxes.

# Retention of Tax Returns and Records

One of the most frequently asked questions we receive from our clients is in regard to the retention of tax returns and the associated records. The answer varies depending on the type of document and the type of transaction.

According to the IRS, the length of time you should keep a document depends on the action, expense, or event which the document records. Generally, the IRS can audit your return for up to three years. On the flip side, an individual tax filer can amend a return and claim refunds within three years of its original filing date, or within two years of the date you paid taxes for that return, whichever is later.

**Tax Returns and Related Documents:** The IRS also will advise you to keep your old tax returns and records even longer if you failed to report income for a given year and that amount exceeds 25% of the gross income shown on your return. If this is the case, you will need to retain your old records and returns for at least six years. If a fraudulent return was filed, or a tax return was not filed in a given year, tax forms and documents need to be kept indefinitely.

Before tossing your tax returns, look over all related documents. Keep any records relating to property. When, and if, you sell the property, you will need this information to calculate any depreciation, amortization, or depletion deduction to determine if there is a gain or a loss. Once you sell the property, you should keep these records relating to property until the period of limitations expires for the year in which you dispose of the property, which is normally three years.

**Security Transactions:** For security transactions, such as mutual funds, stocks, and bonds, you will need to retain your purchase documents so that you can report the cost on your tax return in the year you sell the asset. You also need to retain documentation of stock splits, dividend reinvestments and nontaxable distributions. The IRS also recommends that you keep records for seven years if you file a claim for a loss from worthless securities or bad debt deduction.

**Inherited Property and Gifts:** If you inherit a property you will need to know the value of the property at the date of death and should retain this information up to the time you sell, plus three years after. For other gifts, keep documentation of the donor's cost until you sell the gift, plus three years.

**Retirement Accounts:** It is important to keep track of any nondeductible contributions to retirement accounts by retaining copies of Form 8606 and your 1040s for each year these contributions are made, as

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***Happy Thanksgiving to you and yours!***

***Financial, Insurance, and Real Estate Services for Businesses and Individuals***

***Preparing for Your 2017 Taxes***

Watch for the ***Kakenmaster Report Data Sheet*** issue to arrive in your mailbox in the beginning of January. This issue provides a simple way to compile your 2017 tax data.

***Tax Appointments:***
Schedule your tax appointment soon to help ensure that you will receive the appointment time that is best for you. We also offer convenient drop-off service.

***Online Portal:***
Kakenmaster's secure client portal will allow you to upload your confidential tax documents securely and conveniently. It will allow us to send you files such as your completed tax return and other documents. The client portal is password protected, allowing your tax information to be transmitted safely and securely. Visit www.kakenmaster.com for more information.

# Record Retention cont'd...

well as Form 5498 that reflects distribution from the accounts.This will allow you to prove that you have already paid taxes on these contributions and avoid paying taxes again when the money is distributed. You should retain these records for three years after depleting the account. It is also recommended to keep records of contributions to a Roth IRA, money that was converted from a traditional IRA to a Roth IRA, Roth contributions from an employer plan that were rolled over to a Roth IRA, and traditional (pre-tax) contributions to an employer plan that were converted and deposited into a Roth IRA.

**Businesses/Employer:** The IRS requires employers to keep all records of employment taxes for at least four years after filing the fourth quarter of the year. This also includes records of fringe benefits provided, including substantiation. Documentation on the cost of assets and depreciation should be retained as permanent records of the business.

# Thank You!

We would like to say thank you once again for trusting us as your tax preparer. We would also like the opportunity to serve your friends and family. This referral coupon is good for $30.00 off tax consultation services to any new tax clients. As a thank you for your referral, we will also send you a $30.00 thank you check. Thank you for choosing and recommending Kakenmaster and Associates to your family and friends.

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