The Solari Report

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Year-End Tax Planning 2016 with Patty Kemmerer

Catherine Austin Fitts

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C. Austin Fitts: Ladies and gentlemen, it is a pleasure to welcome back to The Solari Report Patty Kemmerer, who is a CPA. In fact, she is both Solari's and my personal CPA. She is a partner and founder of Kemmerer & Schooley in Virginia, CPAs. One of the reasons I always ask Patty to help us at year-end is because she has remarkable breadth across all sectors from business – both large and small – to not-for-profits to individuals. She has an impressive grasp of the tax issues and financial planning issues that hit everyone across all these different sectors at year-end.

Patty, thank you again. I know this is a very busy time of the year for you, so I appreciate you joining us on The Solari Report.

Patty Kemmerer: It's my pleasure. I'm happy to be back.

C. Austin Fitts: I've asked you to be prepared to talk about some of the changes that may be in the wind – and there is a lot of interest in that – but let's just start with current law. Let's start with what we know for a fact is the current law, although some of it could change.

We have provisions expiring – and there are a lot this year – and new ones coming in. Let's just start there. Under current law, what are the provisions that are expiring at the end of 2016 that we should be aware?

Patty Kemmerer: There are a lot of them with more than 30 provisions expiring. I just wanted to touch on the ones that I see most often and which seem to be the most popular.

Of course, these could be retroactively reinstated, but as of now, these are scheduled to expire at the end of 2016. One could be the income exclusion for discharge of principal residence debt. If someone's house goes to foreclosure or they have a short sale, and are forgiven the debt that they owe to the mortgage company, if it's been their principal residence they have been able to

exclude that up to $2 million for the last several years. That particular law is set to expire at the end of this year.

C. Austin Fitts: Let me just underscore what that means because I think this one is huge. In 2017, if this is not reinstated and if you default on your mortgage, you go to foreclosure on the mortgage you have written down. I guess it's in all states; it's not just in certain states.

Patty Kemmerer: Yes, it's Federal.

C. Austin Fitts: Let's say you have a $500,000 mortgage that is fully written down. You have $500,000 of income that needs to be declared. Is that correct?

One of the things that people have enjoyed is a deduction for qualified higher education expenses.

Patty Kemmerer: That is correct. Now there are other alternatives that you could still not have to claim that income. For example, if the taxpayers are insolvent at the time that the debt is discharged that would allow them to escape having to declare the income. But not everyone who is foreclosed upon is insolvent.

C. Austin Fitts: So I know we're not going to discuss all 30, but let's keep going.

Patty Kemmerer: One of the things that people have enjoyed is a deduction for qualified higher education expenses. This is not a higher education credit for the American Opportunity Credit and the Lifetime Learning Credit; this is a deduction that is on the front of the 1040 Form that if you don't qualify to take the credits, and the deduction is actually larger, you're going to want to take the deduction perhaps. But that particular law is going away at the end of this year. So the credits are still available, but the deduction will no longer be available. That is what we call an 'above the line' deduction where it's deducted from your other income before taxes apply; it's not a credit. So that is one of the things that is going away.

We also have credits for qualified energy efficient home improvements that will

expire at the end of the year. Things like insulation, exterior doors and windows, skylights, certain roofing materials, electric heating pumps and water heaters, central air, gas, propane or oil for water heaters, furnaces, or hot water boilers are examples of this.

The maximum credit over a lifetime is only $500, but that is a credit. When we say a ‘credit’ versus a ‘deduction’, credit is a dollar-for-dollar reduction in tax. So it’s a $500 credit that people have been allowed to take over the last several years.

There is a maximum $200 credit for windows, $150 for boilers, and $300 for everything else. If you are thinking about getting new windows, new doors, a new furnace, or what have you, now is the time to do it because it has to be in service by December 31. It can’t just be under contract to be put in; it has to be in to get the credit. So that is what people need to know if they’re thinking about doing it. You still have about three weeks to get it done before the end of the year. So that is something that you might want to consider doing if it was something that was on your list to do regardless.

Also, the upfront deduction for energy-efficient improvements to commercial buildings is also set to expire at the end of this year.

One other one that is changing is the medical expense deduction. Previously everyone could deduct medical expenses that exceeded 7.5% of their AGI, which is their adjusted gross income. A couple of years ago that changed. Everyone except people over age 65 had to exceed 10% of their adjusted gross income to get medical expense deduction on their Schedule A.

After 2016, even people over age 65 are going up to the 10% threshold. So everyone will be at 10% of their adjusted gross income before they can deduct any medical expenses. Medical expenses include long-term care insurance and health insurance premiums as well as prescriptions, doctor visits, lab tests, hospital visits, etc. So it is any out-of-pocket costs.

C. Austin Fitts: For some people, that could be significant.

Let’s talk about what is coming into effect in 2017. Well, it’s coming into effect

this year.

Patty Kemmerer: Yes, it's coming into effect this year. The Retirement Act of 2015 added five new categories to the list of public safety employees who can start taking their retirements out penalty-free at age 50. So this only applies to this group of employees who are public safety employees. The ones added to the list are Federal law enforcement officers, customs officers, border protection officers, firefighters, and air traffic controllers. So all of those folks, along with the original list, which I apologize that I don't have in front of me, are eligible to take their retirement distribution starting at age 50 without penalty.

There were many acts in the last year. The Trade Act increases penalties for failure to file and furnish 1099s. So if you have a business and are required to file W2's for your employees and 1099 Miscellaneous Forms to your contractors – which would be non-employee compensation 1099s – they are doubling the penalty for failing to file and failure to provide those documents to the subcontractors and the employees.

C. Austin Fitts: Do you remember offhand what the penalty is?

Patty Kemmerer: For 1099s it was $50 for a failure to prepare them. I don't remember what the W2s are, but now they've doubled the penalty. So if you don't file and don't give them to the people, it's $100.

They've also upped the limit for big corporations , which used to be around $150,000 total penalty; now it's almost $600,000. So they've increased the limitation on that penalty. Not filing things when they're supposed to and providing them to the payees could hurt larger corporations.

C. Austin Fitts: Right.

Patty Kemmerer: Another benefit that everybody has been enjoying is the Section 179 deduction. We were worried that last year it was going to expire and it was going to drop from $500,000 per year back to $25,000 per year, which it was years ago. The law was reinstated for another year, and now it has been permanently restored.

C. Austin Fitts: Explain what the Section 179 deduction is.

Patty Kemmerer: Sure, that is a write-off of assets that you purchased for your business. You can deduct up to $500,000 in new purchases for the firm. This has to be fixed assets for things that you're going to use in your business, not things that you are going to resell or anything like that. So they have to be things that you're going to use in your business.

As long as you don't spend more than $2 million per year on new assets, you can deduct up to $500,000 each year.

C. Austin Fitts: And that is very valuable for small business.

Patty Kemmerer: It is valuable.

C. Austin Fitts: The R&D credit?

Patty Kemmerer: The R&D credit has been expanded, and qualified small businesses can choose to claim part or all of the credit the first time against your employer FICA instead of your income tax if you elect to do that, which is interesting. The credit is based on wages that you pay to employees who are doing the research and development.

You can reduce your employee taxes on those wages if you elect to take the credit for that instead of your income taxes.

You can reduce your employee taxes on those wages if you elect to take the credit for that instead of your income taxes.

C. Austin Fitts: I'm going to need you to send me a very detailed definition or show me where the definition is of 'research and development'.

Patty Kemmerer: I'd be happy to do that.

C. Austin Fitts: That is interesting.

Patty Kemmerer: I have a client who is taking it. It's an engineering firm,

which is an interesting one for research and development, but they are allowed this credit.

C. Austin Fitts: That is intriguing. When did that start? Is that just for 2016?

Patty Kemmerer: Yes, this is coming for 2016. This is an expansion, and is a new and valuable rule that you can make this election.

C. Austin Fitts: Talk about the PATH Act.

Patty Kemmerer: There are a lot of things going on with the PATH Act. It is part of what I was talking about before where the W2s and 1099 Miscellaneous need be filed. The deadline for those filings has been moved from February 28th, which is when they've always been for years filed with the IRS. That date has been moved up to January 31.

C. Austin Fitts: We moved it on the corporate calendar, and there was a big discussion of how that had to have priority over all the other things.

Patty Kemmerer: Absolutely. The penalties have doubled if you're late.

The reason for this is because people who've stolen social security numbers and report social security or whatever on their return are filing a lot of fraudulent tax returns in January and February. They get big refunds, and it wasn't even their money.

It takes the IRS until May or June to figure this out. By now, the money has been spent. It's gone. So to try to curb some of this, they have moved the deadline up so that they have access to the information at an earlier date. That's the reason for that.

C. Austin Fitts: I had one business colleague who filed for a large refund. He had a lot coming back to him. When he filed, he discovered that an identity theft person had taken it. It took him six months to get his refund. If you look at the float, it was not an inconsequential amount of money.

Patty Kemmerer: I also had a client who had a large refund coming, and they

wouldn't give it to him until he could prove that he was the taxpayer.

C. Austin Fitts: I am sympathetic with the IRS on that one.

Patty Kemmerer: I am as well.

C. Austin Fitts: If you review the problems they've had, it's extraordinary.

Patty Kemmerer: It is extraordinary.

It's just the W2 and the Miscellaneous that have non-employee compensation on it. All other 1099s are onto the old rule still. So this is just the compensation ones that are required to be filed sooner.

Then we also had the Surface Transportation and Veterans Heath Care Choice Improvement Act. That is a mouthful. It covered a whole lot of things, but the thing that was most interesting was that people who have investments in foreign bank accounts or foreign brokerages – and there are a lot of people out there who do and who have $10,000 or more in them at any time during the year – have to file the FBAR, the Foreign Bank Account Report, which is now the Fin CEN 114. It has to be submitted online.

It has always been due June 30th, and now it's due April 15th.

C. Austin Fitts: Right, which is a fight for a lot of people.

Patty Kemmerer: It is, but they do have the opportunity to file for an extension. The IRS hasn't told us yet how we're going to file for that extension, but they said that there is going to be an extension allowed until October 15th. When the deadline was June 30th, there were no extensions. So at least now we have the opportunity to file for an extension if we can't get it done by April 15th because we're busy doing other things like the 1040s.

C. Austin Fitts: Let me ask you one question about this because I used to have a lot of clients who had money in an online depository for their gold where you could access and buy and sell online. I was apprehensive about fraud. I never had a deposit stolen from it; the security was very secure.

The Pew Foundation just came out with a new survey, and it said that 6% of the American people trust that the data they give to the government is confidential and their privacy is protected. Frankly, I think that is an optimistic percentage as far as I'm concerned.

Whenever I've had clients who have had the digital gold file their FBAR and their FIN CEN, I would have them give the last four numbers on the account, but not the first four numbers just for protection. I figured that they could find the account with the last four numbers. The IRS is not going to have any problem finding or getting the account from the company, but that way you're protected from the kind of tax identity fraud problems that I see as dangerous.

You would probably tell me that I'm noncompliant.

Patty Kemmerer: Yes, I was thinking that.

C. Austin Fitts: Clearly if you're filing the form and everything is appropriate and proper, there is no intention to defraud; there is only obvious concern about safety.

If you see how many times this last year the government was hacked and this kind of data was lost, I think it's justifiable. You don't have to say anything.

Patty Kemmerer: Has anybody received any letters?

C. Austin Fitts: Nobody has gotten any letters.

Patty Kemmerer: That's good.

C. Austin Fitts: These are all people who are very, very faithful in their filing of all their forms and do it all right and everything else, but they are concerned with confidentiality as am I.

Let's move on to partnership tax returns.

Patty Kemmerer: They have changed the due date for Partnership Tax Returns (Form 1065). Partnership tax returns have always been due on April

15th, and it's been a big hassle for individual taxpayers who are getting K1s (1065) from those partnerships that they have to put onto their personal returns. So the IRS finally went, "Hey, maybe we should do something about this."

They moved the date up for filing partnership returns to March 15th so that the K1s can be issued in a much more timely manner and so the individuals can get their tax returns filed on time.

As a tradeoff, they have extended the due date for regular corporations, which we call C corporations, to April 15th because they don't issue K1s to the shareholders; they pay the taxes themselves. So the April 15th deadline works pretty well for C corps unless you have a June 30 year-end. If you have a June 30 yearend, you still have to file your returns on September 15th, which is two and a half months after the end of your fiscal year.

The calendar year corporations get three and a half months. June 30 year-end corporations get two and a half months and I don't know why. Don't ask me because I have no clue because this question is above my paygrade. I don't know why it was decided that that was the case, but any other fiscal year end date still gets the three and a half months except June 30th.

C. Austin Fitts: If the tax preparers have to meet the C corporation and individuals on the same date, that seems to be a huge burden.

Patty Kemmerer: Yes. It's a burden because we certainly have to figure out if the C corps are going to owe the tax. Unlike S corporations and partnerships that pass through their income to the individuals that own them, the C corporations pay their taxes. So if we're going to file an extension and can't get it done on time, we have to know if they're going to owe taxes. They must pay the tax with their extension because extensions are extensions of time to file; they are not extensions of time to pay.

That is true for individuals and everything. They're always extensions of time to file, not extensions of time to pay.

C. Austin Fitts: The thing that is so interesting about this is during my whole life; the equity markets have all traded around earnings announcements related to that March 15th date. So it's going to be fascinating to see how the earnings announcements and other reports work if the tax date is moved to April 15th.

Patty Kemmerer: I agree.

C. Austin Fitts: I have no idea how this is going to work.

Patty Kemmerer: It will be interesting.

C. Austin Fitts: Yes, it will be interesting.

Onto the really big one: Obamacare.

Patty Kemmerer: It's big, but it could be changing. Who knows?

Right now, there was a Congressional committee report that was published regarding this. The whole program is not that old, and already more than $750 million in improper Affordable Care Act tax credits may not be recoverable due to errors and fraud. Already this thing is costing the American taxpayer quite a bit of money due to errors and fraud, so it will be interesting to see if anything changes here.

Starting in 2016, employers with 50 or more employees and or full-time equivalent employees now are subject to the employer shared responsibility provisions. So that means that they must offer minimum coverage to at least 95% of their full-time employees. A full-time employee works, on average, at least 30 hours a week. If they don't, they have to pay a penalty for each month that they're not in compliance.

The scary thing about this is a lot of employers are trying to keep their employees at 29 hours a week to avoid this whole issue. But let's say you have one employee that trips over the 30 hours a week on average, and they have purchased health insurance from the marketplace. If you haven't offered that person health insurance through your company, you're in noncompliance.

The thing of it is that you may not even know it's happened until further down

the road.

C. Austin Fitts: Is the fine per employee, or for all the employees even if it's only one?

Patty Kemmerer: That would be the only full-time employee because they are the only person who has tripped over the 30-hour average. So you have one employee, and there is a penalty for that employee that you have to pay. I think it's a fixed fine; I don't believe it's per employee.

C. Austin Fitts: I cannot tell you how many people I talk to who are wildly upset about the penalties on the individuals. The businesses tend to grin and bear it.

Patty Kemmerer: This is on the business side. It's been a bit of a problem because employers are trying to keep their employees' hours down, and they have to work to make a living. So they're doing two or three jobs because they can't get anything more than 29 hours anywhere. This mainly affects people who work in restaurants and stores and that type of thing.

This is on the business side. It's been a bit of a problem because employers are trying to keep their employees' hours down, and they have to work to make a living.

C. Austin Fitts: Right.

Patty Kemmerer: It's made it tough on everyone. Then, of course, there are penalties on individuals who don't have coverage. That penalty is the greater of 2.5% of the total household adjusted gross income or $695 a month per adult and $347.50 a month per child for a maximum of $2,085; it's the greater of those two things.

If 2.5% of your total household AGI is greater than $2,085, then you have to pay that larger number.

C. Austin Fitts: What I'm hearing from families all across America is they spend about $2,000 in cash every year on going to see the doctor or the dentist

on healthcare. Now instead of being able to afford that, they're going to need to use that money to pay the penalty. So they're losing 100% of their healthcare.

Patty Kemmerer: When this first started, people said, "I'd rather just pay the penalty because it's cheaper than healthcare." But that may not be the case any longer.

C. Austin Fitts: Right.

Patty Kemmerer: Of course, as we've all heard on the news, the health care rates have skyrocketed as well through the marketplace, so it's a lose-lose situation.

C. Austin Fitts: It's not only that the rates have skyrocketed, but also I know many people who had a plan for years, and then Obamacare hit, and it required them to spend between 10-25 hours to figure out their new plan because they were forced to change. So they got thrown off, and they had to spend 10-25 hours on this. If you're working three jobs, that is a lot of time.

Now the rates have gone up for them 50-100%, but they have to spend another 10-25 hours to find something new.

If you look at the shadow work involved in this, it's extraordinary. Many families had $100 - $1,000 a month of discretionary income, and this has wiped it out.

Patty Kemmerer: It's just really tough.

C. Austin Fitts: The Speaker of the House, Ryan, has said that the Republicans' number one priority is Obamacare. We don't know what they mean by that, but what they've said is they want to address the immediate pain. I'm assuming that both business and individual penalties are part of what they're describing, but we have yet to see this.

Frankly, healthcare – fueled by Obamacare – has driven the US stock market for the last three or four years. It's going to be very interesting.

Since the election, healthcare stocks have been down a lot. It's going to be

fascinating to see how this translates into what happens in the markets.

Patty Kemmerer: Absolutely.

C. Austin Fitts: Okay. Next is investment income tax.

Patty Kemmerer: This is a net investment income tax that is 3.5%, which is applied to your investment earnings such as interest, dividends, and capital gains – not the business income – or sale of a business interest.

This is an add-on tax that people who are married filing jointly have $250,000 or married filing separate have $125,000. All others have $200,000 of income that this will apply once they're over that threshold. Then they have to pay this tax on their investments.

C. Austin Fitts: With yields coming way, way down over the last couple of years, taking a bite out of something when you're only getting 1-2% doesn't look like a lot, but it's very painful.

Patty Kemmerer: Right. This law, as well as the next one that I'm going to talk about, was all part of Obamacare. It wasn't all about healthcare; this was part of that package.

There was also an additional Medicare tax on wages and self-employment income of 0.9% for people in the same tax brackets where their adjusted gross is $250,000 for married filing jointly and $125,000 for married filing separate and $200,000 for all others.

Employers are supposed to take care of the 0.9% if it's a W2 wage, but self-employed persons have to pay those themselves. So those are the thresholds and the rates for 2017 for both of them – that investment income tax and the additional Medicare tax.

Do you want to talk about retirement plans?

C. Austin Fitts: Absolutely. Let's dive into retirement plans. That's something that Solari subscribers are always very interested in.

Patty Kemmerer: Great! Let's talk about it. If eligible, it's not too late for a business owner to set up a solo 401k. You have until December 31st to set that up. What a solo 401k is designed for a business owner who has no employees except for perhaps their spouse. If their spouse is an employee, they can still get a solo 401k.

If that is your situation, it's not too late to set that up for 2016, and it must be established by December 31st. It does not have to be funded until the due date of your tax return plus extensions.

This is a great benefit because it allows you to take the deferred retirement contributions, which is for a person who is under 50 and at $18,000 a year. If over age 50 the amount is $24,000 a year. Your business can also contribute up to 25% of your self-employment income, so this is a huge benefit.

If you are in that situation, you may want to talk to your advisor about opening a 401k before the end of the year if you have the money to put in it. If you extend your return to October 15th, then you have until October 15th to fund the retirement plan.

C. Austin Fitts: Particularly if that money is going to get taxed. That is an excellent way to shelter income.

Patty Kemmerer: Right. It shelters your income taxes, but it doesn't shelter your self-employment tax. That is one thing that you need to know as a self-employed business owner: It does not protect your self-employment tax.

The deduction for the retirement is actually on the front of your return, not on your Schedule C form. At least you can shelter your income tax for Federal and state and make the contribution, and it's still your money. Granted it has restrictions about when you can take it out and this and that, but you're taking it from your right pocket and putting it into your left pocket for that bay down the road. It is still your money, and it's a great thing.

If you have employees in your business and you haven't set it up, it's already too late. You needed to set that up by October 1st. So if you have other employees besides yourself and your spouse, you've missed that deadline. But, there is still time to open a SEP Plan; a self-employed pension plan. You don't have to open

that until you're ready to fund it.

If you're filing your returns on April 15th (and I believe it is April 18th this year), you need to get that opened and funded a few days before the deadline because it has to be funded by the deadline. You don't even have to open it until you're ready to fund it. It's something that you can decide as you get closer to the deadline.

C. Austin Fitts: What can we do with IRAs?

Patty Kemmerer: There is still the ability to contribute to Roth or a traditional IRA. They have to be contributed by April 15th – or in this case, it's April 18th – of 2017 for 2016. The Roth, of course, is after-tax dollars when you put it into the account. You don't get a deduction for it, but it does have deferred earnings. If you follow all the rules, it's not taxable when you take it out at retirement age.

C. Austin Fitts: Right.

Patty Kemmerer: A traditional IRA, if you don't qualify for a Roth – and some people don't because they make too much money and don't – you could put money into a traditional IRA. It may or may not be deductible, depending on whether or not you have a retirement plan or your spouse has a pension plan from another company that they're contributing to and also depending upon what your adjusted gross income is for the year.

If you can't fund a Roth but you can fund a traditional, and then later roll it over to the Roth if you want to do the Roth. If it were a deductible contribution to a traditional IRA, you would have to pay the tax on it at the time of the rollover. If it was already not taxable when you contributed because you're allowed to contribute but your spouse is in a retirement plan and you make too much money for the deduction, then that's an easy rollover into the Roth without really having much of any impact on your tax situation if you do it fairly soon.

C. Austin Fitts: Patty, what about withdrawals? What about people who are required to withdraw because they're over 70 ½? When do they have to make their withdrawals?

Patty Kemmerer: At age 70 ½ you have until April 15th of the year following the year that you turn 70 ½ to make your first withdrawal, but that same year you have to make your second withdrawal because you're now 71 ½. You do have until April 15th of the following year to make the first withdrawal.

Some people are interested in contributing their IRA contribution to a charity. If you're interested in doing that, the Consolidated Appropriations Act of 2016 – which is another act that was passed – made this a permanent option for people who are over 70 ½. It permits you to make an annual direct transfer from your IRA to a qualified charity. If you do that, you don't have to report the distribution on your tax return.

This benefit is if you would like to give to a charity because you don't have to report it.

This benefit is if you would like to give to a charity because you don't have to report it. Thereby, you don't have an increase in your Medicare premiums because you don't exceed that number. I forget what the magic number is that you have to stay under to keep your premiums down. Also, it won't put your income up more so that you pay more on your social security income if you're in that lower tax bracket. It's a great way to fund a charity of your choice without having to report the income.

C. Austin Fitts: Right. It doesn't sound like it would be a benefit, but once you start getting into the entanglement of social security and Medicare, it's a huge benefit.

Patty Kemmerer: Exactly. You've got to keep that income down.

C. Austin Fitts: Let's say I'm sitting here and I'm looking towards the end of the year. Under current law, I need to review my retirement situation; I need to review my healthcare situation, and to make sure I've got it calendared and scheduled to make the tax deadlines – whether it's the 1099 or filing my taxes in March or April. The other thing that I have to say because it's so important each and every year is to make sure you have all your documentation, and have redundant copies of all your documentation.

I would say that proper archiving of all your records and reports is critical, particularly if they are lucky enough to have a CPA such as you and they need to make sure that they've got all their documentation into you.

If you're going to file on April 15th for a small business or an individual, when do you need all the documentation – both to make sure they did their estimated payments and to file in a smooth and professional process?

Patty Kemmerer: In our firm, we ask for the documentation at least five weeks ahead of the deadline. Different companies vary, depending on their resources. I would plan for no later than March 15th to get everything into your CPA to ensure that they can get it done by April 18th unless they've given you an earlier date.

C. Austin Fitts: And when are estimated payments due?

Patty Kemmerer: The first estimated tax payment for 2017 is due on April 18th – the same day as the tax returns are due.

C. Austin Fitts: But the last time you can make the estimated payment for 2016 is mid-January?

Patty Kemmerer: January 15th is the last day. If you're in a state that you pay estimated taxes, we always recommend to our clients that they pay those by December 31st of this year. If you don't pay them until January, you can't deduct them on this year's return; you have to wait until next year's return to deduct them. You can only deduct them in the year that you pay them.

C. Austin Fitts: Right. The other thing is if tax rates get lowered, you want to take that deduction this year.

Patty Kemmerer: Yes. I guess we can talk about some of those proposals.

C. Austin Fitts: Yes. Let's go into 'What if' land and take a look at the GOP proposals first. What has the GOP been proposing for tax reform?

Patty Kemmerer: Right now we have seven tax brackets for individuals, and they're proposing three. Our highest tax bracket right now is 39.6%. Under the

GOP proposal, there would be three brackets: 0-12%, 25%, and 33% would be the highest.

Sole proprietorships and small businesses that are passing through net income through individuals like S corporations and partnerships are capped at 25%. So this sounds like a pretty decent deal. Even if the rest of your income pushes you into the 33% bracket, your tax on your business income from self-employment or K1s is capped at 25%, which is great.

C. Austin Fitts: Right.

Patty Kemmerer: They also want to repeal that pesky alternative minimum tax. This tax is one of the most confusing and crazy parts of the tax code, quite frankly. Thank goodness we have software that can figure this all out for us because it would take us hours and hours and hours to figure this all out with a pencil and a piece of paper.

They want to repeal that, which is also a great thing. It does increase people's taxes if they're in a particular bracket. It's interesting the way it falls.

People making between $200,000 - $250,000 and $500,000 - $600,000 get hit with it. Once you get over $750,000 in taxable income, it goes away. It hits the middle- income taxpayers the hardest.

C. Austin Fitts: It's like, "If we can't get you any other way, we'll come back and get you this way."

Patty Kemmerer: Exactly. Personally, I'd love to see it go away. It's just a headache and is costly.

They are also proposing a 50% deduction on net capital gains, dividends, and interest income. So if you have capital gains from the sale of a security or you have dividends or interest, you can just whack 50% of it off the top, and pay taxes on the other 50%, which is great. That actually reduces those rates that I already spoke about – the 12%, 25%, and 33%. It cuts those in half on your investment income.

C. Austin Fitts: Right, and then it's simpler.

Patty Kemmerer: It's much easier. They are proposing a postcard tax return for those who are eligible, which is also very interesting.

C. Austin Fitts: I would love that. The House has always been very, very big on simplification because the more complex the system is, a more costly it is for everybody involved.

Keep going.

Patty Kemmerer: They're also proposing to consolidate the basic standard deduction, the additional standard deduction for blind and elderly, and the personal exemptions into a single deduction of $24,000 for married filing jointly and $18,000 for single individuals with a child in the household, and $12,000 for all others. This amount will be adjusted annually for inflation.

Instead of claiming so many exemptions and so many deductions for blind and so forth, it's going to be one flat deduction that you can take that will be all those things wrapped up into one number.

C. Austin Fitts: So are you saying that it's the same for a family with one child as it is for a family with eight children?

Patty Kemmerer: Yes.

C. Austin Fitts: Wow!

Patty Kemmerer: They're talking about that.

C. Austin Fitts: Does that mean that large families are going to get significantly impacted?

Patty Kemmerer: That could happen. It's yet to be seen, but it could occur.

In theory, if you have eight kids, you are hopefully making enough money to support them all. Maybe you're in a higher tax bracket regardless. We just have to see how all these things shake out.

The child tax credit for each child you can still get; there's the carrot. Right now

it's $1,000 under current law. They're proposing $1,500 per child, and they're also adding a $500 credit for non-child dependents such as an elderly parent. That was never there before. So you have this standard number that you're going to use, and get these add-ons for the number of kids and other dependents that you have. They giveth, they taketh away. That's the way it works.

For middle- income families in their proposal, they say 'middle- income families', but they don't define what they mean by that. What do they consider middle income? I'm not sure. I don't have the answer. All itemized deductions except for mortgage interest and charitable donations are eliminated under this proposal. No more real estate taxes, state income taxes, property taxes, etc.

C. Austin Fitts: State income taxes are not?

Patty Kemmerer: Correct. They would not be deductible any longer under this proposal.

C. Austin Fitts: It's peculiar because since Reagan the Republicans have never won California. I guess this is to get California back.

Patty Kemmerer: Perhaps.

C. Austin Fitts: And no property taxes?

Patty Kemmerer: Right. That's all supposed to be rolled into the flat deduction. I think they still want to incentivize people to buy homes. They're allowing the mortgage interest to be deductible.

C. Austin Fitts: If they try to push for vouchers for education reform and those vouchers come with Federal requirements but being funded by local property taxes and you're not allowed to deduct those property taxes, the politics of that is going to be significant.

Patty Kemmerer: It will be.

By the way, these proposals all came out in June.

C. Austin Fitts: Right. So who knows?

Patty Kemmerer: They're already six months old.

C. Austin Fitts: The Republicans have been proposing tax reform for many, many years. Every year they do it, and every year something emerges, and they say, "That's never going to happen."

This is very complicated, and it dovetails with the appropriations bill. Now we will get there because we have a President-elect who is committed to tax reform.

Let's review special interest provisions.

Patty Kemmerer: They want to repeal special interest provisions, but from what I've read they haven't defined what those are. I'm not exactly sure where they're going with the special interest groups, so we'll have to wait and see.

C. Austin Fitts: It may be, in theory, not possible to deduct auto loans?

Patty Kemmerer: Possibly.

C. Austin Fitts: Let's take a look at the business proposals.

Patty Kemmerer: This is still the GOP proposal. They want to allow full and immediate write-offs of investment of tangible and intangible assets. Everything except land, which is because the Section 179 that we were talking about is limited to $500,000, which just blows it away. That says, "Whatever you spend, you can deduct it in the year that you buy it."

C. Austin Fitts: That is fabulous.

Patty Kemmerer: They're trying to incentivize economic growth with all of these proposals.

C. Austin Fitts: Part of the problem, Patty, is the software guys have been able to do that essentially. If you research what's involved in creating software, it's given them a huge advantage up against the guys who produce the energy

and grow the food. So anybody doing concrete work has a long depreciation schedule while Silicon Valley and Hollywood are like Yahoo deducting everything 100% upfront. So to a certain extent, I think this is leveling the playing field.

Patty Kemmerer: I agree; I think it's going to be great if they can get this through.

C. Austin Fitts: It would be fantastic.

Patty Kemmerer: Again, they were talking about the 25% of tax on the sole proprietor and pass-through business net income. That's the cap on that.

C. Austin Fitts: That is fabulous.

Patty Kemmerer: It is fabulous.

The advantage of that system is abundance. We have an abundance of stuff, but so much that we get sick on it.

Here's another thing that is very interesting. Sole proprietors and pass-throughs will deduct compensation paid or treated as having been paid – reasonable compensation to owners. Previously a Schedule C person who is a sole proprietorship and put all their business income and expenses on Schedule C; net income is what they took as their income from self-employment. Now they can take a reasonable salary out of their Schedule C income.

I'm assuming – and you know what they say about assuming –only the compensation piece would be subject to social security and Medicare tax, and the net income left over, like with an S corporation, after taking a reasonable salary would not be subject to FICA. That's just an assumption on my part. I have nothing to base that on whatsoever but it just makes sense to me.

They would have to put their wage income in from their business on the front of the Schedule C with the wages as if somebody else was paying them. Depending on the rest of their income, the wage income that they're taking out of their business could possibly be taxed at a higher rate than 25%.

C. Austin Fitts: Right. The clear intention is to make life easier for the sole

proprietor.

Patty Kemmerer: Correct. Over the last 30+ years since I have been doing this, I've been trying to explain to sole proprietors that the money that they take out of their business is not deductible against their business income. I don't know how many times I've had to explain that over the years because people don't understand it. "I'm taking this money out. Why can't I deduct it?"

You can't. Now if this passes, you will be able to do that.

C. Austin Fitts: Good.

Patty Kemmerer: What do we talk about next?

C. Austin Fitts: Lower tax rates.

Patty Kemmerer: The GOP proposal is to cut the rate down to a flat rate of 20%. Right now we have a graduated rate that caps at 35% for corporations, and this would just make it 20%. No matter how little or how much you make, it's 20%. That is a lot simpler and probably a bit fairer.

With C corporations, in particular, there is double taxation. If you take dividends from your C corporation, the corporation cannot deduct that. So the corporation pays tax on their net income before dividends. Then they pay you a dividend, and then you have to pay tax on the dividend.

So the corporation is paying tax on it, and you're paying tax on it. But with this new proposal to reduce the dividend income by 50% before the tax is applied, there is an excellent benefit for C corporation owners. They get a lower rate, and then get only to pay 50% of their dividends.

C. Austin Fitts: I think it's fair between the President-elect's proposals and the GOP's proposals. The pressure to bring the corporate tax rate and to kill a lot of the different deductions and gains and simplify is very, very significant, but it could be a tremendous help to small business.

Patty Kemmerer: Exactly.

C. Austin Fitts: Let's talk about interest expense because this is the one that I don't understand and I want to; it's important.

Patty Kemmerer: It is important, and I don't understand it either. The proposal is: Interest expense is only going to be allowed up to the amount of interest income each year. If you have an excess expense, it gets carried forward until you can use it. There is no limit to how many years you can carry it forward.

I'm not exactly sure what the rationale is for this particular proposal. I'd love to do some more research on it and come back to you if I get any insight into this, but right now I don't have real insight.

C. Austin Fitts: Here is part of the rationale: For years on the Republican side, they have wanted to take away the incentives that encourage debt and a debt-financed economy, and want to promote equity. The problem is how to do that because of the addiction to interest expense – both from mortgages and in business.

The challenge here, and the reason I'm surprised that the Republicans proposed it is because we've gone through a period where the stock market has been engineered up with companies issuing debt at very cheap rates because of the lower interest rates, and using that money to buy back stock.

We've watched the corporate world bulk up on debt. It's very cheap, but if you took away the interest deduction, you would leave a lot of corporations screaming.

It's a tradeoff for bringing the tax rate down; it depends on how that tradeoff works. But there is a clear intention here to encourage an economy to move off the debt model, which clearly we have to. The question is: How?

Patty Kemmerer: Exactly. I think you're probably right. That is probably what their thinking was behind this particular proposal, but it is big. There's no doubt about it.

C. Austin Fitts: It's huge.

Patty Kemmerer: Let's talk about net operating losses. We've had this rule that if you have a net operating loss in 2016, you carry it back to 2014. You take it back two years. If you can use it against profits for 2014 that you already claimed, you can get a refund. If there is still some left over, then you roll forward to 2015. Then you use some of it toward your 2016 income. After all of that, you roll it into 2017, 2018, etc.

Their proposal is to no longer allow the carry back; you can only carry forward. That has always been an election that you could make. You could elect only to carry forward and not back, but if you neglect to make the election and you don't carry back, and the next year you have a profit, and use it that year, the IRS is going to say to you, "Sorry, you can't do it. You've got to carry back first."

So if you didn't make that election, sometimes it caused a problem.

If you have a net operating loss and you can carry it back and get a refund, which was a good thing because if you had money, you wouldn't have had a loss. So it's good to go back and get refunds on prior years so that you have more operating capital to work with going forward.

C. Austin Fitts: I have to tell you, Patty, that if Hamilton Securities could not have done this in 1998, I doubt that I would be here talking to you right now.

Patty Kemmerer: The fact that they're eliminating it and it was a pain to make sure that the client didn't forget to make the election if they didn't want to go back. However, it was a nice benefit to go back and get refunds so that you have money to get yourself going again if you have a loss in your current year. That is going away under this proposal.

C. Austin Fitts: Wow! That means that businesses need greater reserves.

Patty Kemmerer: Indeed, and that may be part of the incentive on that as well.

C. Austin Fitts: So let's turn to the President-elect proposals. It's peculiar, but to keep up with what he's saying, I always start with his Twitter feed.

There has been quite a lot of discussion debate proposals flying around, so it's very hard to nail down the specifics of exactly what is being proposed.

Patty Kemmerer: Exactly, and these are from September.

C. Austin Fitts: Right, so we need to take this all with a grain of salt. Until the inauguration and until you have a couple of the key players pass Senate confirmation, we're not going to get clear direction on this. But let's dive in on what it looks like right now.

Patty Kemmerer: As of September when they put this out, they were proposing the same three brackets as the GOP proposal, so that is the same.

They want to retain the existing capital gains structure, unlike what the GOP was proposing where you just whack 50% off before you pay tax on it. They want to keep it the way it is; you pay tax on 100% of it. It's 15% if you're under $250,000 of adjusted gross income, and it's 20% if you're over $250,000 adjusted gross income. So that would remain the same under this proposal.

Interest and dividends will continue to be taxed as ordinary income with no deduction, the same as it has been. Trump does want to repeal the 3.8% net investment income tax and the 0.9% alternative minimum tax clauses that were in the Obamacare law.

C. Austin Fitts: It's amazing because I can sit with somebody who is extremely wealthy but they've been hammered by interest rates coming down. They know it's a subsidy out of their net worth into the government because the government is borrowing their money for almost free.

When the government comes along and hits them with that 3.8% tax, for some reason it hits a nerve. It can be a relatively small amount of money, but the insidiousness of playing the game on the yields and then grabbing back more money on the tax really hits them.

You can squeeze more emotion out of a wealthy person on this one than just about any other tax increase I've ever seen.

Patty Kemmerer: I agree with you; I saw the same thing. When I tell people,

"Oh, by the way, there is a 3.8% on top of the capital gains rate," and they're saying, "What?"

C. Austin Fitts: Another midnight special provision.

Patty Kemmerer: Exactly.

Trump is proposing a standard deduction of $30,000 for joint filers and $15,000 for single filers. The GOP was at $24,000, $18,000, and $12,000. The Trump proposal eliminates the 'head of household' status; you're either married or single. There is no 'head of household' status under his proposal. He is going to eliminate that one.

So there will be a cap on itemized deductions. Itemized deductions would stay the same, but you can't deduct more than $200,000 for married filing jointly and $100,000 for single. That is the cap.

C. Austin Fitts: So that is going to cap mortgage interest deductions, correct?

Patty Kemmerer: It will. There's already that million-dollar limit for deducting, so I don't think that mortgage interest deductions are going to push you over these numbers. Other things might, such as a high amount of state income tax deduction.

C. Austin Fitts: Here is who is going to get hurt: In California where the housing prices are enormous, and you get these huge, jumbo mortgages, you're not going to be able to deduct your property taxes – which are huge – and you're going to get squeezed in the mortgage as well. This is 'kind of the get California' proposal.

Patty Kemmerer: Perhaps. I still think that the $1.1 million mortgage cap for deductions would be hard-pressed to exceed $200,000 on a married filing joint return. There would have to be other things that were piling on like your state tax deduction and income tax deduction that would push you over the limit.

I don't think I have any clients who exceed this. I had one client who did a couple of years ago because he had a windfall in his business and had to make large estimated tax payments to the state where he lived. That pushed him over,

but I rarely see deductions at these levels on the returns that we do.

He wants to repeal the death tax altogether, but capital gains more than $10 million that are held until death will be taxed. So if you have capital gains over $10 million that you're holding, it will be taxed.

C. Austin Fitts: So you don't get a write-up in basis the way you do now.

Patty Kemmerer: That is correct.

Contributions of appreciated assets into a private charity established by the decedent or the decedent's relatives will be disallowed, and it is currently allowed. I will say that estate tax is not my forte, so I'm not going to say any more on that.

All taxpayers will be able to establish a new dependent care savings account for the benefit of specific individuals, including unborn children.

He wants to change the childcare thing. Right now it's a credit, and he wants to make it an above-the- line deduction so that it would be a deduction for childcare or elder care. There would be a deduction for taxpayers who use unpaid caregivers, such as parents or grandparents, which is pretty sweet. That will not be available to taxpayers with AGI over $500,000 for married jointly or $250,000 for single, but it's compelling.

I'm not exactly sure how the unpaid caregiver deduction will work, but we shall wait and see.

C. Austin Fitts: We should thank Ivanka Trump for that one.

Patty Kemmerer: Absolutely. I agree with you completely.

All taxpayers will be able to establish a new dependent care savings account for the benefit of specific individuals, including unborn children. Total contributions are limited to $2,000 a year, and it may be used for dependent care. Any funds that are remaining in the account when the child turns 18 can be used for education. That is another interesting proposal.

C. Austin Fitts: It's a little bit of competition with 529s.

Patty Kemmerer: Indeed. Low- income households would get a government match of 50% on the parental contribution up to $1,000, which is nice for low-income families to help provide daycare expenses. They have to work, so that is a big help.

C. Austin Fitts: It's interesting. I am constantly saying to people, "Get a 529 account and tell all your relatives to put money in that instead of getting gifts for birthdays and Christmas because you have way too many toys, and you're not saving enough."

That would give them another option because not everybody relates to 529s.

Patty Kemmerer: Exactly. It's an interesting proposal. I would be interested to hear what the details are on this. We will see if it goes anywhere.

Let's switch to businesses. Trumps proposal would lower the corporate tax rate to 15%. It's not just corporations; it's available for all sized businesses.

The GOP was 25%; his is 15%. He would also eliminate the corporate alternative minimum tax.

C. Austin Fitts: My understanding is if you look at what has been happening with corporate taxes, it has been falling steadily while the individual has been growing. Part of that is not because of the rate; it's because of the deductions and different games they're planning, it's quite extraordinary. So part of this simplification, as I understand it, is to get rid of those dirty tricks and deductions and the complexity that is bringing their effective rate even much lower.

Patty Kemmerer: Exactly. The proposal eliminates most corporate tax expenditures except the research and development credit, so it's 15% on your corporate income.

C. Austin Fitts: You can still deduct costs of products or labor, right? Is it not flat on revenue?

Patty Kemmerer: That is correct. I guess I should say 'gross profit'.

C. Austin Fitts: So it's not minus interest expense: It's labor, cost of goods sold, research and development, and you get to a net. You don't get to play the games with the debt structure.

Patty Kemmerer: Exactly. Part of the proposal is that manufacturing businesses that are in the US can elect to expense capital investment and loss and lose the deductibility of the corporate interest expense. That's for manufacturing. Companies can choose to expense capital investment, but it's just for manufacturing.

C. Austin Fitts: Right.

Patty Kemmerer: If they make the election to do it, they can't go back and revoke it once three years have passed. Once three years have passed, they're stuck with it.

C. Austin Fitts: Right.

Patty Kemmerer: He also wants to increase the business tax credit for onsite childcare. He is raising that from $150,000 to $500,000, but it has to be recaptured over five years. Currently, on the $150,000 they have ten years to recapture it.

While it's generous, paying it back is going to be a bit of an ouch over five years.

C. Austin Fitts: And they have to pay it back dollar-for-dollar in the full amount?

Patty Kemmerer: Yes, and I'm not sure how many businesses are going to be excited about this one. I think it needs a little bit more work. We'll see on that.

So businesses that can pay a portion of employees' childcare expenses because they don't have an onsite childcare facility can exclude those contributions from their income.

C. Austin Fitts: This is why we always want to have Republican and Democrat nominees running for President who have working children with small children.

Patty Kemmerer: Exactly.

C. Austin Fitts: Let's talk about this tax rate. Patty, you see a very broad number of small and middle-sized businesses in your practice. How much of a difference do you think this is going to make to your portfolio of small business in America? Do you believe that this is going to increase their investment in assets in their business, particularly if they get relief on Obamacare?

Patty Kemmerer: I do think it will increase investment. That's one of the big things that they are trying to accomplish with both of these proposals.

I don't think either one of them is going to be enacted intact; I believe there are going to be a lot of 'give and take'. So we don't know which of these proposals is going to come to fruition. We also don't know how long it's going to take.

C. Austin Fitts: Right. It could be a very rocky transition. But I will tell you something: You can swing back all the corporate money and incentivize the corporations all you want, but there is only one way you're going to get an increase of jobs in this country, and that is if you take your boot off small business and entrepreneurial start-ups.

Patty Kemmerer: I agree.

C. Austin Fitts: There is a great deal that they can do. Tax relief is the fastest way you can get small business going, but you're going to have to do a lot of regulatory relief as well.

I'm looking at what they're talking about, and it makes me optimistic. As you said, 2017 could be a very interesting transition because we've got a world of people in Washington who, when money is cheap, get political power from toll boothing to get leverage. The problem is that when the economy needs relief, and you need things to get going, you need a very different attitude. It's going to be interesting to see how Washington copes with this.

Patty Kemmerer: Exactly. We don't know if these things are going to pass in 2017. If I knew that for sure, I would say that if you are a cash-based business and planning on making investments in your business, and there is a potential to fully deduct them next year, you may want to delay them to next year. But we just don't know.

If the tax rates go down for businesses, you'll want to defer your revenue to next year if you possibly can. We just don't know which of these things is going to get through and how long it's going to take. We don't know if 2017 is going to be the year or not.

C. Austin Fitts: What I would say is: If something is immediately deductible this year, I would take it this year. I would defer all my office expenses for next year. I would deduct as much as I could this year because I do think that rates are going to come down. For something that is only partially deductible next year, then you wait. If it is 100% deductible this year, load up on office supplies. They always have great paper and office supplies sales in December. I would just say to load up.

Patty Kemmerer: Yes, and if you're on a cash basis, those things work. If you're accrual basis, maybe not so much.

C. Austin Fitts: Exactly.

Patty Kemmerer: I definitely would recommend to anybody who is listening and thinking about some of these things to speak with your tax advisor and see what their take is on it. Put your heads together and come up with a plan.

C. Austin Fitts: Right. This is not so much a tax issue, but if rates do come down and they do pull that money back into this country, for many small businesses there is going to be a lot of new opportunities. You want to be thinking about what that is and how you can be prepared to execute that.

I think it's going to be unbelievably interesting. We all need to be like Bobo dolls next year as we watch. You can get into a manic depressive state when you consider tax reform because one day you're going to be rich, and the next day bankrupt, depending on what they do.

Patty, this has been incredibly informative. You were terrific to look at both the GOP and President-elect proposals because they are not easy to unpack and make straightforward, clear and coherent, but you've done it once again.

Before you go, could you just describe your firm, how it works, and the fact that you're in Virginia? I'm obviously in Tennessee and Solari is in Delaware and Solari Investment Advisors is in Tennessee, and we do things all over the world. You work with people all over the country and deal both domestic and international. Describe a little bit about your practice. If somebody is interested, I cannot recommend you highly enough. I know because I've worked with you for a long, long time.

I lost you, which was one of the worst things that ever happened to me, but I got you back again. So I give my strongest recommendation for individuals or businesses.

Tell us about how we contact you if we're interested.

Patty Kemmerer: I thank you for all of that. We are in Virginia, and we do work with people all over the country. We have clients who I've never even met but whom I've been working with all over the world.

My business partner, Rita Schooley, and I have both been in practice in the public accounting arena for over 30 years, so we have a ton of experience. We would be happy to have anyone who is interested in speaking or contact us by phone at 703-870-3699 or you could look us up on the web at www.KS-CPAS.com.

C. Austin Fitts: Patty, you have a wonderful holiday season. Don't work too hard on all those estimations. I know I'll be talking with you before March and April 15th.

Patty Kemmerer: Yes.

Austin Fitts: Thank you for joining us on The Solari Report.

Patty Kemmerer: Thank you for having me. I appreciate it.

MODIFICATIONS
Transcripts are not always verbatim. Modifications are sometimes made to improve clarity, usefulness and readability, while staying true to the original intent

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