FOCUS ON TAX PLANNING

When leaves fall is your call to tax plan for capital gains

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As year-end approaches, investors should review their capital gains to see what, if any, options they have to reduce their tax exposure for 2017.

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First, identify the capital assets you have sold or are planning to sell, then discuss how they are taxed. This is important to determine how much tax benefit you will achieve through planning.

There are two types of capital gains tax rates. Short term for capital gains on investments held for one year or less are taxed as ordinary income.

The other is long term for capital gains taxed on investments owned for more than a year, which are taxed on your current marginal tax rate based on your filing status.

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ILLUSTRATION/THREEART

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For reference purposes, the top marginal tax rate for individuals in 2017 is 39.6 percent; people in that bracket will have their long-term capital gains taxed at 20 percent.

If they are in the 15 percent bracket or lower, they will have their long-term capital gains taxed at zero percent.

Now you can understand the potential tax savings on holding an investment for longer than a year.

OFFSETTING GAINS

Offsetting short-term capital gains with capital losses will give you the greatest tax benefit, since short-term capital gains are taxed at ordinary income rates, which can be taxed as high as 39.6 percent.

Any losses on the sale of a personal residence, vehicle or second home cannot be taken against capital gains.

> When reviewing your investments at year-end, remember any capital losses you recognize will not only reduce capital gains but also reduce net investment income.

Losses from the sale of an investment to a family member similarly will be disallowed. This transaction may occur in a sale of stock of a family held

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to provide other penalty relief arguments, including reasonable cause, to increase the chances of success.

You also can get an abatement and refund of penalties already paid. If you already paid the penalties but would like them abated and refunded, you can fill out and submit the IRS Form 843: Claim for Refund and Request for Abatement.

REASONABLE CAUSE EXCEPTION

If you do not qualify for the FTA program, all penalties have provisions for abatement for a reasonable cause exception.

The reasonable cause exception generally does not include lack of funds.

You may, however, be unable to pay your taxes, but this reason alone will not qualify for penalty abatement.

The IRS has a bit more leeway when it comes to the abatement of penalties than it does with interest.

HIGHER THRESHOLD

The IRS threshold for what constitutes reasonable cause is a higher bar – it would generally require the hospitalization of a taxpayer or a member of the immediate family or some kind of disaster.

Once the circumstance that gives rise to a reasonable cause exception has ended, the IRS generally expects the taxpayer to take action to come back into compliance.

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business with certain related parties.

NET INVESTMENT INCOME TAX

Capital gains also may be subject to net investment income tax at a rate of 3.8 percent.

This tax is calculated based on your modified adjusted gross income over certain statutory thresholds.

For married individuals filing a joint return, the statutory threshold amount is $250,000. It is $200,000 for an individual filing single.

Since the net investment income tax is part of the Affordable Care Act, repealing the tax is likely under President Trump's plan.

ESTIMATE YOUR INCOME

When reviewing your investments at year-end, remember any capital losses you recognize will not only reduce capital gains but also reduce net investment income.

So it is of the utmost importance to estimate your income for 2017 to determine your tax benefit before you sell an investment for a capital loss.

In many states, you can net capital losses with capital gains.

For federal purposes, any capital loss in excess of capital gains for the current year can be carried forward and limited to $3,000 a year and can be used to offset ordinary income.

BE WARY OF WASH SALE

When selling an investment such as a stock for a loss, be mindful of wash sale rules.

Under a wash sale, your tax loss is disallowed if – within 30 days before the date of the loss sale or 30 days after that date – you acquire "substantially identical stocks or securities."

The wash sale rules only apply to losses, not gains.

All is not lost if you fail wash sale rules, as the disallowed loss will be added to the cost basis of your investment.

BE AWARE OF NEW RULES

Be aware of any existing or pending law changes that may affect your 2017 capital gains tax planning.

For example, if a capital gains tax rate reduction is effective for 2018, capital losses taken in 2017 will give you a greater tax benefit.

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