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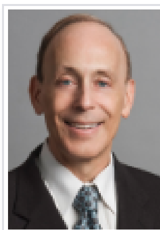
It's not too late to finds ways to reduce your taxes

November is almost over. The April 15, 2018, due date for your personal income tax return is five months away. It is not too late to act now to reduce your tax liability.



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November is almost over. The April 15, 2018, due date for your personal income tax return is five months away. It is not too late to act now to reduce your tax liability. However, you must move quickly.

Should you try to reduce your income tax liability? The pending tax legislation will lower the individual income tax rates for years beginning after Dec. 31, 2017. That means you may be in a higher bracket in 2017 than in 2018. So the likely answer is "yes, you should reduce your income tax liability in 2017." Of course, no one knows for sure because the pending legislation may change before it is passed. Also, you must consider the impact of the potential elimination of the deduction for state and local taxes. Have your CPA run alternative scenarios, e.g., pro forma versions of your IRS Form 1040.

You must have realistic expectations of what is possible. There are no legal and ethical income tax reduction structures that are grand slam home runs; there are only singles and doubles. California, in 2003, and the federal government, in 2010, added 40 percent penalties for transactions which lack economic substance. Rev. and Tax. Code Section 19774 and IRC Section 7701(o). Beware of nonsense that is being offered. Beware of anything involving a deduction for the purchase of life insurance, a particular IRS hot button.

If you have a closely held business, which is true for most lawyers, you should have a well-conceived and well-operated defined-benefit pension plan, the biggest and safest deduction. If you already have a defined-benefit plan, there are three indications that you need better advice: If your current deduction is $200,000 and you want $400,000 to $800,000; if your defined benefit trust has $2 million and you are told it is "fully funded"; and if you have 12 employees and are told the cost of covering them is "too much." If someone suggests an IRC Section 831(b) micro-captive insurance company so you can get up to a $2.2 million deduction, be *very* careful. After the U.S. Tax Court's Aug. 21, 2017, anti-taxpayer decision in *Avrahami*, it is difficult to plunge whole-heartedly into this structure without a thorough review of the potential downside and without using one of the few top-tier captive managers. If you already have a micro-captive, you must carefully consider your continued participation.

If you don't have a closely held business, or need more deductions than are available through the business, there are two structures worth considering. Both are based on the charitable deduction and are interesting, even if you are not terribly motivated to give to charity.

The first is for people primarily interested in investing in liquid assets. Here's an example: transfer $500,000 to a charitable lead annuity trust, or CLAT. You receive an up-front $500,000 charitable deduction because the CLAT will distribute $500,000 to a charity in 15 years. This deduction is good against up to 30 percent of your adjusted gross income. Because the charity will not receive the $500,000 for 15 years, the CLAT must pay interest on that promise which, currently, is 2.4 percent. Each year for 15 years the CLAT must pay $12,000 to the charity. Good news: The charity can be your own family run private foundation. More good news: If the CLAT earns about 6.6 percent each year on its investments, at the end of 15 years it will have $1 million: $500,000 to distribute to your family foundation, and another $500,000 to go back to you or -- better -- to an irrevocable trust for your children's benefit. If you have a taxable estate, that is a great way to get money to your children outside your lifetime transfer tax exclusion (currently $5.49 million per person, but the pending legislation proposes to double that). So there are three good points to a CLAT: upfront deduction for 100 percent of your contribution; the money goes to your own family foundation; any excess goes to your children free of estate, gift tax and income tax. There is one bad point: You pay the tax on the CLAT's income. That means you want investments that create capital gains to keep a low tax liability. This is not a grand slam homerun, but it is interesting to some people.

The second structure is a charitable limited partnership (or LLC). You contribute $500,000 to the limited partnership. You retain the 1 percent general partnership interest; you donate the 99 percent limited partnership interest to a cooperating public charity. Your deduction for the gift of limited partnership interests is not 99 percent of $500,000 due to the lack of marketability and lack of control associated with limited partnership interests; but it is quite high. The money is invested, for the first four years, in publicly traded stocks and bonds. The charity receives 99 percent of the income. Once four years has transpired, you borrow most of the money from the partnership, paying a market rate of interest, giving appropriate collateral. You invest in real estate. Assume you earn 10 percent compounded annually over three decades and pay 3 percent deductible interest, The arbitrage over three decades is about 12 times. Not a grand slam, but very attractive. We fully disclose this to the IRS and the California Franchise Tax Board to avoid any misunderstanding.

In conclusion, it is not too late to take steps to reduce your 2017 income tax liability, which is reflected in the tax paid with your personal return due April 15, 2018. However, you must act quickly so that you have adequate time to understand the few alternatives and, if you like one of them, to implement the structure.