



**CORDASCO
& COMPANY P.C.**

Certified Public Accountants

2016

**YEAR-END INCOME TAX PLANNING
FOR INDIVIDUALS**
Long Format

UPDATED November 2, 2016

www.cordascocpa.com

2016 YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

INTRODUCTION

It's that time of year again. Time to focus on year-end planning strategies. Year-end planning is particularly important this year given the large number of recent tax law changes that offer new tax savings opportunities, in addition to the many "time-tested" tax savings techniques that continue to apply.

Planning Alert! It seems every year we are faced with a long list of popular tax breaks that have either recently expired, or are scheduled to expire in the near future. Fortunately, the PATH Act has made many (but not all) of these tax breaks *permanent*. For example, the following tax breaks that were previously scheduled to expire are now permanent: Election to deduct state and local "sales" taxes instead of deducting state and local "income" taxes; Contributions by individuals who have reached age 70½ of up to \$100,000 from their IRAs directly to charity without triggering any income tax; Deduction of up to \$250 for qualifying school supplies by school teachers; Expanded charitable contribution deduction for qualified conservation easements, and others. In this letter we identify and discuss those tax breaks that are now permanent, as well as remaining tax breaks that are currently *scheduled to expire after 2016*.

We are sending you this letter to help you navigate *new* tax planning opportunities available to individuals because of recent law changes. In this letter, we also remind you of the *traditional* year-end tax planning strategies that help lower your taxable income and postpone the payment of your taxes to later years.

Tax Tip. Many of the tax breaks that could reduce your 2016 income tax liability are dependent on the amount of your adjusted gross income, modified adjusted gross income, or taxable income. We highlight these income thresholds prominently in this newsletter.

Caution! Tax planning strategies suggested in this letter may subject you to the alternative minimum tax (AMT). For example, many deductions are not allowed for AMT purposes, such as: personal exemptions, the standard deduction, state and local income taxes, and real estate taxes. Also, the AMT can be triggered by taking large capital gains, having high levels of dividend income, or exercising incentive stock options. Therefore, *we suggest that you call our firm before implementing any tax planning technique discussed in this letter*. You cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the AMT and any state income tax) with and without that strategy.

Please Note! This letter contains ideas for Federal income tax planning only. *State income tax issues are not addressed.*

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MONITOR STATUS OF TAX BREAKS EXPIRING AFTER 2016

For over a decade, we have been faced with a long list of popular tax breaks with set expiration dates. In the past, Congress temporarily extended the majority of these tax breaks every few years. On December 18, 2015, the President signed the *Protecting Americans From Tax Hikes Act Of 2015 (PATH Act)* which removed the expiration dates for several (but not all) of these tax breaks – making them permanent. However, the following tax breaks were not made permanent, and are currently *scheduled to expire at the end of 2016*: Deduction (up to \$4,000) for Qualified Higher Education Expenses; Deduction for Mortgage Insurance Premiums as Qualified Residence Interest; and, Temporary 10% Credit (with a lifetime cap of \$500) for Qualified Energy-Efficient Home Improvements (e.g., qualified energy-efficient windows, storm doors, roofing).

Caution! Although Congress has traditionally extended a majority of expiring tax breaks in the past, there is no guarantee that it will do so in the future.

Tax Tip. Regardless of how Congress ultimately addresses these expiring tax breaks, there may be real tax savings available if you take advantage of these provisions *before the end of 2016*.

Planning Alert! The following are several other tax breaks scheduled to *expire after 2016* that warrant additional attention:

- **Income Exclusion For Discharge Of Qualified Principal Residence Indebtedness.** A special rule allowing you to exclude from income the discharge (e.g., forgiveness) of all or a portion of a mortgage loan (not exceeding \$2 million) that was incurred to purchase, construct, or substantially improve the individual's principal residence is extended *through the end of 2016*.

Planning Alert! The exclusion also applies to qualifying debt *discharged after 2016* if the discharge is made under a binding written agreement *entered into before 2017*.

Tax Tip. This exclusion could potentially apply to debt forgiveness involving the “short sale” or foreclosure of a principal residence.

- **30% Credit For Qualified Energy-Efficient Fuel Cell Property, Small Wind Energy Property, Geothermal Heat Pump Property.** Individual taxpayers are allowed a 30% personal tax credit known as the residential energy efficient property (REEP) credit, for expenditures for installing the following energy-efficient property in the taxpayer's residence: 1) *Qualified fuel cell property*; 2) *Qualified small wind energy property*; and 3) *Qualified geothermal heat pump property*. These credits are scheduled to *expire for property placed-in-service after 2016*.
- *Please note that the 30% REEP credit for “Qualified Solar Electric Property” and “Qualified Solar Water Heating Property” doesn't expire after 2016.*

- **Planning Alert!** This 30% credit applies if you install the qualifying energy-efficient property in or on property located in the U.S. that you use as a residence. The residence does *not* have to be your “*principal residence*.” So, installations for a second residence or vacation home may qualify. The 30% credit also applies to the on-site installation costs. If you are the initial purchaser of your newly-constructed residence that contains qualifying energy-efficient components (e.g., solar water heater, solar electric generating property, geothermal heat pump), you should ask the builder to provide you with a reasonable allocation of the cost of the home attributable to the qualified energy property (including labor costs for on-site preparation, assembly, and installation of the property).

Caution! To *take the 30% credit for 2016*, the property must *actually be installed* no later than *December 31, 2016*.

PATH ACT MAKES SEVERAL POPULAR EXPIRING TAX BREAKS PERMANENT

At the time the *PATH Act* passed, the following individual tax breaks had previously expired. However, the legislation retroactively reinstates these provisions and makes these provisions *permanent* for future years: **1)** Election to deduct state and local sales taxes; **2)** Enhanced American Opportunity Tax Credit up to \$2,500 for qualified tuition; **3)** Enhanced “refundable” child tax credit up to \$1,000 for dependents under age 17; **4)** Enhanced earned income tax credit (EITC) provisions; and **5)** Expanded deduction and carryover limits for charitable contributions of conservation easements. *In addition*, the following are several other tax breaks that were made permanent that warrant additional attention:

Tax-Free IRA Payments To Charities If You Are Age 70½ Or Older. For the past several years, we have had a popular rule that allows taxpayers, who *have reached age 70½*, to have their IRA trustee transfer *up to \$100,000* from *their IRAs directly to a qualified charity*, and *exclude the IRA transfer from income*. The IRA transfer to the charity also counts toward the IRA owner’s “*Required Minimum Distributions*” (RMDs) for the year. If you wish to contribute to a charity and you are at least 70½, this tax break effectively allows you to exclude all or a portion of your otherwise taxable RMDs from income. This, in turn, could allow your 2016 modified adjusted gross income (MAGI) to stay below the thresholds for the 3.8% NIIT (i.e., \$250,000 for joint returns; \$200,000 if single), that might otherwise be imposed on your investment income (e.g., dividends, interest, capital gains), and could also increase various credits and deductions for 2016 that would otherwise be phased out as your adjusted gross income increases. In addition, this could potentially reduce the portion of your social security payments that would otherwise be taxable. Moreover, in future tax years, this exclusion could reduce the amount of your Medicare Part B and Part D premiums which generally increase as your MAGI increases.

Tax Tip. To qualify, the check from your IRA must be made out “directly” to your designated charity. In addition, if the contribution is \$250 or more, you must get a timely, qualifying receipt from the charity for the charitable contribution. **Good News!** Although this provision was previously available only for a limited number of years, the *PATH Act* makes it permanent.

Planning Alert! To take advantage of this exclusion for 2016, the direct transfer from your IRA to the charity ***must be completed by December 31, 2016***. It may take the IRA custodian several days to complete all the necessary paper work to complete the transfer. Consequently, you should start the process of transferring the funds from your IRA to the charity ***well before December 31, 2016***.

Enhancement Of School Teachers' Deduction. Historically, teachers have been allowed an “*above the line*” deduction (with annual cap of \$250) for various school supplies. However, starting ***in 2016***, in addition to allowing teachers a deduction for school supplies, the PATH Act allows teachers to deduct (subject to the overall annual cap of \$250) amounts paid ***for certain professional development courses***. Such courses must be related **1) To the curriculum in which the teacher provides instruction, or 2) To the students for which the teacher provides instruction**. Before this change, a teacher’s unreimbursed expenses for professional development were classified as *miscellaneous itemized deductions* subject to the 2% threshold which, many times, caused the teacher to get little or no tax benefit from the expenditure.

Planning Alert! Starting ***in 2016***, teachers should be aware of this change and retain documentation of unreimbursed costs they incur for professional development courses. Also the \$250 annual cap on this deduction is indexed for inflation starting in 2016. However, for 2016, the cap remains at \$250 even after considering inflation.

OTHER RECENT TAX LEGISLATION THAT COULD IMPACT PLANNING FOR 2016

In addition to the *PATH Act* (mentioned above), Congress passed several other pieces of legislation between June 29, 2015 and February 24, 2016 containing a variety of new tax provisions. These new laws include the Defending Public Safety Act, the Trade Preference Extension Act, the Surface Transportation Act, and the Consolidated Appropriations Act. The following are selected provisions from this *Legislation* that are generally ***first effective in 2016***:

Starting In 2016, Taxpayers Must Have Form 1098-T In Order To Claim Education Credits Or Tuition Deductions. Generally, educational institutions are required to provide Form 1098-T to students and file a copy of Form 1098-T with the IRS. This form contains information regarding the student’s qualifying tuition and related fees that are used to determine various education-related tax credits and deductions. ***Effective for tax years beginning after June 29, 2015***, the Trade Act provides that the following education tax breaks will not be allowed unless the taxpayer possesses a valid Form 1098-T from the educational institution: **1) The *American Opportunity Tax Credit*** (up to \$2,500 per qualifying student – generally used for the first four years of post-high school education); **2) The *Lifetime Learning Credit*** (up to \$2,000 per qualifying taxpayer – generally used for graduate school), **and 3) The college *Tuition and Fees Deduction*** (up to \$4,000). This new documentation requirement effectively means that, if you qualify for any of these education tax benefits, ***you will need Form 1098-T before you can claim an education credit or deduction*** on your 2016 return.

Planning Alert! As mentioned previously in this letter, the *American Opportunity Tax Credit* (as well as the Lifetime Learning Credit) is now permanent; however, the *Tuition and Fees Deduction* of up to \$4,000 is *scheduled to expire after 2016*.

New Due Date And Allowable Extensions For FinCEN Form 114 (FBAR). Generally, if you own (or have signatory authority over) foreign financial accounts exceeding an aggregate value of \$10,000 at any time during the year, you are required to file FinCEN Form 114 (“*Report of Foreign Bank and Financial Accounts*” or “FBAR”). Previously, the due date for filing this FinCEN Form 114 was June 30 of the year immediately following the reporting year, and no extensions were available. *For years beginning after 2015*, the *Transportation Act* provides that the *initial due date* for *FinCen Form 114* will be *April 15th* of the following year (i.e., generally the same initial due date for your Form 1040). The Act also provides for a maximum *extended due date* until the following *October 15th*. In addition, the IRS is authorized to waive the penalty for failure to timely request an extension for filing the form for any taxpayer who is required to file FinCEN Form 114 for the first time.

Planning Alert! According to proposed regulations issued by the Treasury Department in March 2016, the *due date for the 2016 FinCEN Form 114* is *April 15, 2017*. The proposed regulations also provide that “extensions to October 15 of the reporting year are available upon request.” However, the regulations do not say how the extension is to be requested or whether the extension request will be automatically approved.

New Extended Due Date For Filing An Estate Or Trust “Income Tax” Return (Form 1041). The *Transportation Act* did not change the “*Initial*” due date for filing a Form 1041 income tax return for an estate or trust (i.e., the 15th day of the fourth month of the following year). However, *for tax years beginning after 2015*, the Act provides that the “*Extended*” due date of Form 1041 will be the “*last*” day of the ninth month following year-end, instead of the “*15th*” day of the ninth month following year-end.

The “Minimum Penalty” For Failure To File Income Tax Returns Timely Has Become More Costly. Effective for returns required to be filed in calendar years after 2015, The Trade Act increases the minimum penalty for failing to timely file an income tax return. The Act increases the “*minimum*” penalty for failure to file within 60 days of the due date (including extensions) *from the lesser of \$135 or 100 percent* of the unpaid tax, *to the lesser of \$205 or 100 percent* of the unpaid tax. Going forward, the \$205 penalty amount is adjusted for inflation. The Trade Act retains the rule allowing waiver of the penalty where the failure to file is due to “*reasonable cause*” and not due to willful neglect.

Tax Tip. There is *no “minimum” penalty where there is no “net” tax due*. For example, if the tax is \$10,500 and the tax withheld is \$10,600, even if the return is filed late, no minimum penalty is due because there is no net tax due.

Planning Alert! This change only applies to the “*minimum*” penalty for failure to file the return. However, current law continues to provide that the penalty may actually be greater than this “minimum” penalty. For example, subject to the “minimum” penalty just discussed, the penalty under current law for failing to file a Form 1040 is generally **5% per month** of the net amount of tax due, with a maximum penalty percentage of 25%.

New Income Tax Basis And Reporting Rules For Certain Inherited Property. Generally, an individual who inherits property from a decedent receives an “income tax basis” in the property equal to the property’s *fair market value* on the date of the decedent’s death. In addition, if the “*fair market value*” of all the property included in a decedent’s taxable estate exceeds \$5,450,000 (for deaths in 2016), the estate must file an “*estate tax return*,” and may be required to pay an estate tax. ***Effective for property with respect to which an estate tax return is filed after July 31, 2015***, the Transportation Act generally provides that the “*income tax basis*” in the hands of the recipient of the inherited property ***may not exceed*** the value of the property **as reported in the estate tax return** – but only if the inclusion of the property in the estate tax return increases the estate tax liability. Also, executors of these larger estates (i.e., large enough to require the filing of a Federal estate tax return) ***that file the estate return after July 31, 2015***, are required to file a new information return (Form 8971) generally within 30 days following the filing of the estate tax return. However, the IRS delayed the deadline for the initial filing of Form 8971 ***until June 30, 2016*** for any Forms 8971 due on or before June 30, 2016.

- **Planning Alert!** The penalty for failing to file Form 8971 is generally the same as the penalty for failure to file a Form 1099 (i.e., for 2016, generally \$260 for failing to file with the beneficiary, and an additional \$260 for failing to file a copy with the IRS). The IRS has announced that Form 8971 is not required if the decedent’s gross estate (including adjusted taxable gifts made before the decedent’s death) is not large enough to ***require the filing of an estate tax return*** (for decedents who died in 2016 the estate tax return filing threshold is \$5,450,000). The IRS also says that Form 8971 is not required for an estate that falls below the filing threshold even if the estate actually files an estate tax return for other reasons (e.g., to make a generation-skipping transfer tax exemption allocation or election, to make the portability election where the estate of the first spouse to die did not utilize all of the estate’s exclusion amount, or to make a protective filing to avoid any penalty if an asset value is later determined to cause a return to be required or otherwise).

POSTPONING TAXABLE INCOME MAY SAVE YOU OVERALL TAXES

Deferring income into 2017 is a good idea if you believe that your marginal tax rate for 2017 will be equal to or less than your 2016 marginal tax rate. In addition, deferring income into 2017 could increase various credits and deductions for 2016 that would otherwise be phased out as your adjusted gross income increases.

Deferring Income Could Help You Stay In Lower Tax Brackets. Deferring taxable income from 2016 to 2017 may reduce your exposure to higher tax brackets if, for example: **1)** The deferral of income causes your 2016 taxable income to fall below the thresholds for the highest 39.6% tax bracket (i.e., \$466,950 for joint returns; \$415,050 if single), or **2)** As discussed in more detail later, you have income subject to the 3.8% Net Investment Income Tax (3.8% NIIT) and the income deferral causes your 2016 modified adjusted gross income (MAGI) to fall below the thresholds for the 3.8% NIIT (i.e., \$250,000 for joint returns; \$200,000 if single). If, after considering these factors, you believe that deferring taxable income into 2017 will save you taxes, consider the following strategies:

- **Self-Employment Income.** If you are self-employed and use the cash method of accounting, consider delaying year-end billings to defer income until 2017.

Planning Alert! If you have already received the check in 2016, deferring the deposit does not defer the income. Also, you may not want to defer billing if you believe this reduces your chances of getting paid.

- **Installment Sales.** If you plan to sell appreciated property in 2016, you might be able to defer the gain until later years by taking back a promissory note instead of cash. If you qualify for installment treatment, the gain will generally be prorated over the term of the note and is taxed to you as you collect the principal payments. This is called reporting your gain on the “installment method.”

Planning Alert! Although the sale of real estate and closely-held stock generally qualify for this deferral treatment, some sales do not. For example, even if you are a cash method taxpayer, you cannot use this gain deferral technique if you sell publicly-traded stock or securities. Also, you may not want to take back a promissory note in lieu of cash if you believe this reduces your chances of getting paid.

Tax Tip. Since the “installment method” essentially allows you to spread a single gain over several years, this could cause your income in the year of sale (and possibly subsequent years) to fall below the income thresholds that kick in the top 39.6% rate, or the top 20% capital gains rate. In addition, this could also prevent your income from exceeding the thresholds for the 3.8% NIIT (discussed in more detail below).

Tactics For Deferring Income By Minimizing Distributions From IRAs, Etc. Generally, once you reach age 70½ or if you inherit someone else’s IRA or qualified retirement plan account, there are strict rules that require you to begin taking “*Required Minimum Distributions*” (RMDs) from the account. However, there are various ways to delay or defer the RMDs – allowing you to postpone taxable income. The following are various suggestions for minimizing the tax impact of RMDs for you and your heirs:

- **Naming The Proper Beneficiary For Your Retirement Plans And IRAs.** If you want to postpone the distribution (and therefore the taxation) of amounts in your traditional IRA or a qualified retirement plan as long as possible, there are several things to consider. First and foremost, it is critical that you name the appropriate beneficiaries, such as an individual or a “qualified trust.” If your estate is the beneficiary of your IRA or qualified plan account, your heirs may miss out on substantial tax deferral opportunities after your death. In addition to naming an individual or individuals as your beneficiary, you should also name a “contingent beneficiary” in case your primary beneficiary dies before you. If you do not name a qualified beneficiary or if your estate is your beneficiary and you die before reaching age 70½, your entire retirement account generally must be distributed and taxed within *five years* after the year of your death. This could cause your beneficiaries to lose valuable tax deferral options.

Planning Alert! The rules for maximizing the tax deferral possibilities for IRAs and qualified plan accounts are complicated. We will gladly review your beneficiary designations and offer planning suggestions. However, here are some actions, relating to retirement plans and IRAs that should *be considered before the end of 2016*:

- **IRA Owners Who Attain Age 70½ During 2016.** If you reached age 70½ at any time during 2016, you must begin distributions from a traditional IRA account *no later than April 1st of 2017*. A 50% penalty applies to the excess of the required minimum distribution (RMD) over the amount actually distributed. In addition, if you wait until 2017 to take your first payment, you will still be required to take your second RMD no later than December 31, 2017, which will cause you to take two payments in 2017. This “bunching” of the first two required annual payments into one tax year (2017) could cause your income to be taxed in a higher tax bracket and, therefore, result in more overall tax than if you received the first required payment in 2016.

Tax Tip. Assuming you otherwise wish to contribute to charity, you could avoid being taxed in 2016 on all or part of an RMD by transferring all or part of the RMD (up to \$100,000) directly to a charity (as discussed above). If you reached age 70½ in 2016, and you own an IRA or other qualified retirement account, we will gladly help you navigate these rules to your best advantage.

- **Post Mortem Planning For Retirement Plan And IRA Distributions.** If you are the beneficiary of an IRA or qualified plan account of someone that has died in 2016, there are certain planning techniques you should consider as soon as possible.

Tax Tip. If the decedent named multiple beneficiaries or included an estate or charity as a beneficiary, we should review the situation as soon as possible to see if there is anything we can do to avoid certain tax traps. The rules for rearranging IRA beneficiaries for maximum tax deferral are complicated and are subject to rigid deadlines. Acting before certain deadlines pass is critical. If the owner died in 2016, the best tax results can generally be achieved by making any necessary changes *no later than December 31, 2016*. If you need assistance, please call our office as soon as possible so we can advise you.

- **Rollovers By Surviving Spouses.** If an individual *over age 70½* died during 2016 and the beneficiary of the decedent’s IRA or qualified plan is the surviving spouse, and the *surviving spouse* is *over 59½*, the surviving spouse should consider rolling the decedent’s qualified plan or IRA amount into his or her name *on or before December 31, 2016*. If the decedent’s retirement account is rolled into an IRA in the surviving spouse’s name *before 2017*, then: **1)** Provided the surviving spouse has not reached age 70½, no distributions are required in 2017, or **2)** If the surviving spouse is at least 70½, the required minimum distribution in 2017 will be determined using the Uniform Lifetime Distribution Table that results in a smaller annual required payout. Therefore, *converting the account into the surviving spouse’s name on or before December 31, 2016*, could substantially reduce the amount of the required minimum distribution for 2017 where the decedent was at least 70½.

Planning Alert! If the surviving spouse is not yet 59½, leaving the IRA or qualified plan account in the name of the decedent may be the best option if the surviving spouse needs to withdraw amounts from the retirement account before age 59½. If the account is transferred into the spouse’s name, and the spouse receives a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty.

TAKING ADVANTAGE OF DEDUCTIONS

“Above-The-Line” Deductions Become Even More Important In Light Of Recent Tax Increases. So-called *“above-the-line”* deductions reduce both your *“adjusted gross income”* (AGI) and your *“modified adjusted gross income”* (MAGI), while *“itemized”* deductions (i.e., below-the-line deductions) do *not* reduce either AGI or MAGI. Deductions that reduce your AGI (or MAGI) are particularly favorable because they not only reduce your taxable income, they also may free up other deductions (and tax credits) that phase out as your AGI (or MAGI) increases (e.g., itemized deductions, personal exemptions, IRA contributions, education expense deductions and credits, adoption credit, etc.). In addition, “above-the-line” deductions could serve to reduce your MAGI below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8 % NIIT only applies if MAGI exceeds \$250,000 if married filing jointly; \$200,000 if single).

- **“Above-The-Line” Deductions.** *“Above-the-line”* deductions include allowable deductions for IRA or Health Savings Account (HSA) contributions, health insurance premiums for self-employed individuals, qualified student loan interest, alimony payments, moving expenses, and business expenses for a self-employed individual.

Tax Tip. Unreimbursed *“employee”* business expenses are classified as *“miscellaneous itemized deductions”* and trigger two potential limitations: **1)** Aggregate “miscellaneous itemized deductions” are allowed only to the extent they exceed 2% of your AGI, and **2)** Any excess is included in “itemized deductions” which are reduced once your AGI exceeds certain thresholds (e.g., for 2016 – \$311,300 for joint returns; \$259,400 if single). However, if you arrange for your employer to reimburse you for your “qualified”

employee business expenses under an “*accountable reimbursement plan*,” the reimbursement is excluded from your income (which is generally the equivalent of an “above-the-line” deduction).

- **Accelerating “Above-The-Line” Deductions.** As a cash method taxpayer, you can generally accelerate a 2017 deduction into 2016 by “*paying*” for the deductible item in 2016. “Payment” typically occurs in 2016 if a check is delivered to the post office, if your electronic payment is debited to your account, or if an item is charged on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express) in 2016.

Caution! If you post-date the check to 2017 or if your check is rejected, no payment has been made in 2016.

Planning Alert! The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payment are not deductible in 2016.

- **Deductions For Business Expenses Paid By Partners.** Generally, the IRS allows a partner in a partnership (or owner of an LLC treated as a partnership) to take an “above-the-line” deduction for business expenses the owner *paid on behalf* of the partnership (or LLC) *only if* there is an agreement (preferably in writing) between the partner and the partnership providing that those expenses are to be paid by the partner, and that the expenses will not be reimbursed by the partnership.

Tax Tip. If you are a partner or LLC owner paying unreimbursed expenses on behalf of your partnership or LLC, to be safe, you should have a written agreement with the entity providing that those expenses are to be paid by you, and that the expenses will not be reimbursed by the partnership or LLC.

Accelerating “Itemized” Deductions Into 2016. As mentioned above, although “*itemized*” deductions (i.e., *below-the-line* deductions) do *not* reduce your AGI or MAGI, they still may provide valuable tax savings. *Itemized deductions* generally include charitable contributions, state and local income taxes (or, alternatively state and local sales taxes), property taxes, medical expenses, unreimbursed employee travel expenses, home mortgage interest, and gambling losses (to the extent of gambling income). However, if your itemized deductions fail to exceed your standard deduction in most years, you are not receiving maximum benefit for your itemized deductions. You could possibly reduce your taxes over the long term by bunching the payment of your itemized deductions in alternate tax years. This may produce tax savings by allowing you to itemize deductions in the years when your expenses are bunched, and use the standard deduction in other years.

Tax Tip. The easiest deductions to shift from 2017 to 2016 are *charitable contributions*, *state and local taxes*, and your January, 2017 *home mortgage interest payment*. For 2016, the standard deduction is \$12,600 on a joint return and \$6,300 for single individuals. If you are blind or age 65, you get an additional standard deduction of \$1,250 if you’re married (\$1,550

if single). **Watch Out For AMT!** Certain itemized deductions are not allowed in computing your alternative minimum tax (AMT), such as state and local taxes (including state income taxes) and unreimbursed employee business expenses. Before you accelerate 2017 itemized deductions into 2016, to be safe, we should calculate your taxes “with and without” accelerating the deduction so we can determine the AMT impact of this strategy.

“Bunching” Medical Expenses. Generally, you are allowed an *itemized deduction* for un-reimbursed medical expenses (including un-reimbursed health insurance premiums) only to the extent your aggregate medical expenses exceed **10%** of adjusted gross income (AGI). However, if either you or your spouse is **at least age 65** before the close of the year, your threshold is 7.5% of AGI instead of 10% (whether you file a joint return or separate returns).

Planning Alert! *After 2016*, the threshold for those at least age 65 **increases from 7.5% to 10% of AGI**. If you or your spouse are age 65 or older and anticipate more than negligible medical expense in the near future, consider accelerating as many elective medical expenses (i.e., braces, new eye glasses, etc.) into 2016 as possible – if this will allow you to exceed the 7.5% of AGI threshold. Waiting until 2017 will require your medical expenses to exceed the 10% threshold.

- **Qualified Long-Term Care Services.** Generally, deductible medical expenses include the cost of maintenance or personal care services prescribed by a “licensed health care practitioner” for a “chronically ill” individual. However, you must meet certain requirements before you may deduct these types of expenses as medical deductions.
- **IRS Medical Mileage Rate.** For 2016, the standard IRS medical deduction mileage rate for use of your vehicle for essential medical care purposes is **19 cents per mile**.
- **Qualified Long-Term Care Insurance Premiums.** Generally, qualified long-term care insurance premiums qualify as deductible medical expenses – subject to dollar caps based on your age (which are adjusted annually for inflation). **For 2016**, the **maximum amount** you can deduct for these premiums is: if you are age 40 or less - \$390; age 41 to 50 - \$730; age 51 to 60 - \$1,460; age 61 to 70 – \$3,900; and over age 70 - \$4,870.

Tax Tip. These dollar caps are per individual, not per return. So, for example, if you and your spouse are both age 65 and you each have a qualified long-term care policy, you could each deduct up to \$3,900 of your respective premiums for 2016. Also, if you are a self-employed taxpayer, you are generally allowed an “*above-the-line*” deduction (discussed above) for the premiums up to the dollar caps.

Don't Miss Use-It-Or-Lose-It Deadline For Flex Plans. If you participate in a cafeteria or flexible savings account plan (flex plans), you can generally elect to make a pre-tax salary reduction contribution to the plan. You can then access that account to reimburse yourself tax-free for qualified expenditures (e.g., medical expenses, dependent care assistance, and adoption assistance). For most *calendar-year* plans, you must clean out your 2016 account by March 15, 2017, or forfeit any funds that aren't used for qualifying expenses.

Qualified Home Office Can Generate Valuable Tax Benefits. Qualifying for home office deductions (e.g., depreciation, insurance, utilities, repairs and maintenance) often takes careful planning. To qualify, your home office must be used "*regularly and exclusively*" as your "*principal place of business*." For example, your home office will generally be deemed your *principal place of business* if you use the office to perform *management or administrative duties* for your business *and* there is *no other fixed location* where you perform substantial management or administrative duties for that business. If you are an "employee" (as opposed to being self-employed), in addition to meeting these requirements, you must also establish that your home office is "*for the convenience of your employer*" (this generally means you're not provided an office at work).

- **Tax Tip.** The IRS says that if you have a qualifying home office, you can deduct the costs of traveling from your home office to another work location as a business expense. So, by having a qualified home office, you will generally have more deductible business travel expenses.

Note! The "*business standard mileage*" rate for 2016 is *54 cents* per mile. Furthermore, if you're an employee who qualifies for home office deductions, you should ask your employer to reimburse your home office expenses. This reimbursement is *excluded from your income* if reimbursed under an "*accountable reimbursement plan*."

Planning Opportunities For Charitable Contributions. The following are charitable-giving planning techniques that could reduce your 2016 tax bill:

- **If You Are At Least Age 70½ – Consider A Direct Transfer From Your IRA To A Charity.** If you are at least age 70½, don't forget to consider the special rule allowing your IRA to make contributions directly to charities to which you wish to contribute as discussed previously.
- **"Pay" Your Charitable Contribution In 2016.** A charitable contribution deduction is allowed for 2016 if the check is *mailed on or before December 31, 2016*, or the contribution is made by a credit card charge in 2016. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay the note or pledge.
- **Contributions Of Appreciated Property.** If you are considering a significant 2016 contribution to a qualified charity (e.g., church, synagogue, college), it will generally save you taxes if you contribute *appreciated* long-term capital gain property, rather than selling the property and contributing the cash proceeds to the charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation.

Caution! Your current year deduction for appreciated capital gain property is generally limited to 30% of your AGI, with a 5-year carryover of the excess.

Tax Tip. If you want to continue to hold an investment position in stock that you contribute to charity, consider purchasing stock that is the same or similar to the appreciated stock you contributed. That way, you will have a higher “tax” basis in the replacement stock, without having to recognize the gain on the stock contributed to charity.

Caution! If you plan to contribute appreciated realty or stock for 2016, make sure that you begin the paperwork for the transfer early enough so that all documentation is completed by ***December 31, 2016.***

- **Planning Alert!** If you intend to use “loss” stocks to fund a charitable contribution, you should sell the stock first and then contribute the cash proceeds. This will allow you to deduct the capital loss from the sale, while preserving your charitable contribution deduction. If you contribute the loss stock directly to the charity, although you will get a charitable deduction equal to the value of the contributed stock, you will ***lose the capital loss*** deduction.

Caution! Be sure to satisfy the rigid documentation requirements discussed in the next segment. For example, contributions of property other than publically traded securities, generally require a “qualified appraisal” if the property is valued at more than \$5,000.

Be Careful – IRS And The Courts Are Rigidly Enforcing The Documentation Requirements For Charitable Contributions!

The IRS regulations provide that you may not take a deduction for a charitable contribution unless you strictly comply with the rigid documentation requirements imposed by the Internal Revenue Code. Over the last several years (including 2016), there have been a series of Court cases disallowing an entire charitable contribution deduction because the taxpayer failed to satisfy one or more of the following documentation requirements:

- **Contributions Made In Cash.** In order to deduct a “cash” contribution to a charity, you must have a receipt, letter, or other written communication from the charity (showing the name of the charity, the date and the amount of the contribution).

Planning Alert! If your cash contribution is \$250 or more, you ***must also satisfy*** the ***“Mandatory Documentation Requirements For Contributions Of \$250 Or More,”*** discussed below.

- **Contributions Made By Check, Debit Card, Or Charge Card.** If you make a contribution by check, you are required to have either a receipt described above for “*Contributions Made In Cash,*” a copy of the cancelled check, or some other bank record (e.g., a bank statement). If your contribution is by debit card or by charge card, you are required to have either a receipt as described above for “*Contributions Made In Cash,*” or a bank record (e.g., a bank statement or a credit card statement).

Planning Alert! If your contribution is \$250 or more, you *must also satisfy* the “*Mandatory Documentation Requirements For Contributions Of \$250 Or More,*” discussed below.

- **Mandatory Documentation Requirements For Contributions Of \$250 Or More.** If you contribute *\$250 or more* (whether by cash, check, charge card, or property) to a charity, you are allowed a deduction *only if* you receive a “*qualifying written receipt*” from the charity by the time you file your return (a cancelled check is not enough) **and** the return is timely filed. The *qualifying written receipt* must contain the following information: **1)** The amount of cash and a description (but not value) of any property other than cash you contributed to the charity, **2)** A statement as to whether the charity provided you with any goods or services in return for your contribution, and **3)** A description and good faith estimate of the value of any goods or services, if any, the charity provided to you (or, if applicable, a statement that the goods and services consisted solely of intangible religious benefits). ***In addition,*** for all noncash contributions, the receipt must contain the date of the charitable contribution, the location of the contribution, and a description of the property contributed.
- **Planning Alert!** As mentioned above, both the IRS and the Courts require you to strictly comply with each and every rigid documentation requirement in order for you to deduct a charitable contribution. ***For example,*** last March the Tax Court denied a minister a charitable deduction aggregating almost \$20,000 for alleged cash donations in part because he did not obtain a timely *qualifying written receipt* for contributions of \$250 or more.
- **Property Contributions Of More Than \$500.** If you contribute non-cash property of a similar type *valued over \$500*, you must not only *satisfy* the “*Mandatory Documentation Requirements For Contributions Of \$250 Or More,*” discussed above, but you must also maintain and report with your return certain additional information including the date you acquired the property, your basis in the property, your valuation method, etc.

Planning Alert! If you are claiming a deduction of *more than \$500* for a *vehicle, a boat, or an airplane* that you contributed to charity, the law also requires that you obtain a *Form 1098-C* in order to deduct your contribution.

- **Property Contributions Of More Than \$5,000.** You must obtain a *qualified appraisal* for contributions of property *valued in excess of \$5,000*, unless the property is: **1)** Securities for which market quotations are readily available, or **2)** Non-publicly traded stock valued at \$10,000

or less. Furthermore, you must also *satisfy* the “**Mandatory Documentation Requirements For Contributions Of \$250 Or More,**” discussed above.

- **Contributions Of Clothing And Household Items.** Even if you meet the previously-discussed documentation requirements, you are not allowed a deduction for charitable contributions of *clothing or household items* unless the items are in “*good used condition or better.*”

Tax Tip. You should consider contributing your clothing and household items to charities that have a policy of accepting only items that are in good condition.

Maximizing Your Home Mortgage Interest Deduction. If you are looking to maximize your 2016 itemized deductions, you can increase your home mortgage interest deduction by paying your January, 2017 payment *on or before December 31, 2016.* Typically, the January mortgage payment includes interest that was accrued in December and, therefore, is deductible if paid in December.

Planning Alert! Make sure that you send in your January, 2017 mortgage payment early enough in December for your lender to actually receive it before year-end. That way, your lender should reflect that last payment on your 2016 Form 1098, and we can avoid a matching problem on your 2016 return. Here are some other planning strategies for the interest deduction you should consider:

- **Look For Deductible “Points.”** Points paid in connection with the purchase or improvement of your *principal residence* are immediately deductible. Points are deductible even if the bank labels them as something else. For example, points include “loan-processing fees,” “loan premium charges,” or “loan origination fees” so long as they don’t represent fees for services, etc. (e.g., appraisal, title, inspection, attorneys’ fees, credit checks, property taxes, or mortgage insurance premiums).
- **Remember To Deduct Seller-Paid Points.** If you bought a house this year and negotiated for the seller to pay your points at closing, the IRS says you can deduct those seller-paid points as though you paid them yourself.
- **Pay Off Personal Loans First.** If you have both home mortgage loans and other personal debt, pay off the personal debt first because interest on personal debt is generally not deductible but home mortgage interest is generally deductible. This will maximize your interest deduction.

Pay Careful Attention To The Payment Of Your State And Local Income Taxes. If you anticipate deducting your state and local income taxes, consider paying them (fourth quarter estimate and balance due for 2016) and any property taxes for 2016 *prior to January 1, 2017* if your tax rate for 2016 is higher than or the same as your projected 2017 tax rate. This will provide a deduction for 2016 (a year early) and possibly against income taxed at a higher rate.

Caution! If you expect your 2016 AGI to be above the threshold for phasing out “itemized deductions” (e.g., above \$311,300 for joint returns; \$259,400 if single), but expect your 2017 AGI to be below those thresholds, accelerating your tax payment into 2016 may not be advisable.

Planning Alert! State and local income and property taxes are not deductible for AMT purposes. Consequently, you should not employ this tactic without carefully calculating the alternative minimum tax impact. Also, “overpayment” of your 2016 state and local income taxes is generally not advisable if a refund in 2017 from a 2016 overpayment will be taxed at a higher rate than the rate that applied to the 2016 deduction. *Please consult us before you overpay state or local income taxes!*

- **PATH Act Made The Option To Deduct Sales Taxes Permanent.** For the past several years, taxpayers could “elect” to deduct “either” state and local *income* taxes or state and local *sales* taxes, as itemized deductions. This election has been particularly popular among residents who live in states with little or no state income taxes, or states where the state income taxes paid are generally less than the sales taxes paid. This provision previously expired after 2014, however the PATH Act reinstates it retroactively, and also *makes it permanent.*

TAX PLANNING FOR INVESTMENT INCOME (INCLUDING CAPITAL GAINS AND THE 3.8% NIIT)

Planning With The 3.8% Net Investment Income Tax (3.8% NIIT). The *Affordable Care Act* (ACA) enacted the *3.8% Net Investment Income Tax (3.8% NIIT)* on *net investment income* of higher-income individuals. This tax applies to individuals with modified adjusted gross income (MAGI) exceeding the following “*thresholds*” (which are *not indexed* for future inflation): **\$250,000** for *married filing jointly*; **\$200,000** if *single*; and **\$125,000** if *married filing separately*. The 3.8% NIIT is imposed upon *the lesser of* an individual’s: **1)** Modified adjusted gross income (MAGI) in excess of the *threshold*, or **2)** Net investment income. *Trusts and estates* are also subject to the *3.8% NIIT* on the *lesser of*: **1)** The adjusted gross income of the trust or estate in excess of \$12,400 (for 2016), or **2)** The undistributed net investment income of the trust or estate.

The 3.8% NIIT not only applies to traditional types of investment income (i.e., interest, dividends, annuities, royalties, and capital gains), but it also applies to “business” income that is taxed to a “passive” owner (as discussed in more detail below) unless the “passive” income is subject to S/E taxes. If you believe that the 3.8% NIIT may apply to you, consider the following planning techniques:

- **Shifting To Investments That Generate Income Exempt From The 3.8% NIIT.** Fortunately, the following types of income are *not subject* to the *3.8% NIIT*: *tax-exempt bond interest*; gain on the sale of a principal residence *otherwise excluded* from income under the *home-sale*

exclusion rules (i.e., up to \$250,000 on a single return, up to \$500,000 on a joint return); and *distributions from qualified retirement plans* (e.g., 401(k) plans, IRAs, §403(b) annuities, etc.).

Tax Tip. Investments that generate tax-exempt income (e.g., tax exempt municipal bonds) potentially provide higher-income individuals with a double benefit: **1)** The interest will not be included in the individual’s MAGI, thus reducing the chance that the individual will exceed the income thresholds for the 3.8% NIIT, and **2)** The tax-exempt interest itself is exempt from the 3.8% NIIT as well as from Federal income taxes.

Planning Alert! Although taxable distributions from qualified retirement plans (e.g., IRAs, 401(k) plans, etc.) are exempt from the 3.8% NIIT, the taxable distributions will increase your “modified adjusted gross income” (MAGI). Therefore, to the extent the taxable distributions cause your MAGI to exceed the thresholds for the 3.8% NIIT (e.g., \$250,000 for joint returns; \$200,000 for singles), the distributions could cause your other “net investment income” (e.g., dividends, interest, capital gains, rents, passive income) to be hit with the 3.8% NIIT.

- **Roth IRAs.** Tax-free distributions from a Roth IRA are exempt from the 3.8% NIIT, and do not increase your MAGI (and, thus will not increase your exposure to the 3.8% tax). Therefore, these tax-favored features should be factored into any analysis of whether you should contribute to a Roth IRA. However, if you are considering converting a traditional IRA into a Roth, the income triggered in the year of conversion would increase your MAGI and, therefore, may increase your exposure to the 3.8% NIIT on your *net investment income* (e.g., dividends, interest, and capital gains).

Planning Alert! If you want a Roth conversion to be *effective for 2016*, you must transfer the amount from the regular IRA to the Roth IRA *no later than December 31, 2016* (you do not have until the due date of your 2016 tax return).

Caution! Whether you should convert your traditional IRA to a Roth IRA can be an exceedingly complicated issue, and this new 3.8% NIIT is just one of many factors that you should consider. *Please call our firm* if you need help in deciding whether to convert to a Roth IRA.

- **“Tax-Deferred” Investments.** The 3.8% NIIT does not apply to earnings generated by a *tax-deferred annuity* (TDA) contract *until the income is distributed*. Thus, after first considering the economics, investing in a TDA in your higher-income years may allow you to defer the annuity income until later years when your MAGI is below the 3.8% NIIT thresholds.

- **“Passive” Income.** “*Net Investment Income*” for purposes of the 3.8% NIIT generally includes net income from a business activity if you are a “passive” owner (unless the income constitutes *self-employment* income that is subject to the 2.9% Medicare tax). This could include income from an S corporation in which you do not “materially participate”, income as a limited partner, and rental income. You will generally be deemed a “passive” owner if you do not “materially participate” in the business as determined under the traditional “passive activity loss” rules. For example, under the *passive activity loss* rules, you may be a “passive” owner unless you spend more than 500 hours working in the business during the year or meet one of the other “material participation” tests. Furthermore, *rental income* is generally deemed to be “passive” income under the *passive activity loss* rules, regardless of how many hours you work in the rental activity.

Tax Tip. In certain situations, real estate rentals may not be “passive” income and could be exempt from the 3.8% NIIT. For example, if you are a “qualified real estate professional,” or you lease property to a business and you “materially participate” in the business operations of the lessee, the rental income may be exempt from the 3.8% NIIT. If you believe you may qualify for one of these rental exceptions, or you otherwise believe you may have “passive” income from non-rental business activities, please contact our firm. We will gladly evaluate your situation to determine whether there are steps you could take before the end of 2016 to avoid “passive” income classification, and thus, reduce your exposure to the 3.8% NIIT.

Traditional Year-End Planning With Capital Gains And Losses. Generally, net capital gains (both short- term and long-term) are potentially subject to the 3.8% NIIT. This could result in an individual who is otherwise taxed in the 39.6% ordinary income tax bracket paying tax on his or her *net long-term capital gains* at a **23.8%** rate (i.e., the maximum capital gains tax rate of 20% plus the 3.8% NIIT). This individual’s *net short-term capital gains* could be taxed as high as **43.4%** (i.e., 39.6% plus 3.8%). Consequently, traditional planning strategies involving the timing of your year-end sales of stocks, bonds, or other securities are more important than ever. The following are time-tested, year-end tax planning ideas for sales of capital assets.

Planning Alert! Always consider the *economics of a sale or exchange first!*

- **Planning With Zero Percent Tax Rate For Capital Gains And Dividends.** Long-term capital gains and qualified dividends that would be taxed (if ordinary income) in the 15% or lower ordinary income tax bracket, are taxed at a zero percent rate. For 2016, taxable income up to \$75,300 for joint returns (\$37,650 if single) is taxed at the 15% rate, or below.

Tax Tip. Taxpayers who have historically been in higher tax brackets but now find themselves between jobs, recently retired, or expecting to report higher-than-normal business deductions in 2016, may temporarily have income low enough to take advantage of the zero percent rate for 2016. If you are experiencing any of these situations, please call our firm and we will help you take advantage of this zero percent tax rate for long-term capital gains and qualified dividends.

- **Lower-Income Retirees.** The zero percent rate for long-term capital gains and qualified dividends is particularly important to lower-income retirees who rely largely on investment portfolios that generate dividends and long-term capital gains. Furthermore, gifts of appreciated securities to lower-income family members who then sell the securities could reduce the tax on all or part of the gain from as high as 23.8% to as low as zero percent.

Caution! If the donee is subject to the so-called *kiddie tax*, this planning technique will generally not work.

- **Timing Your Capital Gains And Losses.** If the value of some of your investments is less than your cost, it may be a good time to harvest some capital losses. For example, if you have already recognized capital gains in 2016, you should consider selling securities *prior to January 1, 2017* that would trigger capital losses. These losses will be deductible on your 2016 return to the extent of your recognized capital gains, plus \$3,000.

Tax Tip. These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as the: \$2,500 American Opportunity Tuition Tax Credit, \$1,000 Child Credit, \$13,460 Adoption Credit, etc.

Planning Alert! If, within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the “wash sale” rules (although the disallowed loss will increase the basis of the acquired stock).

Tax Tip. If you are afraid of missing an upswing in the market during this 60-day period, consider buying shares of a different company in the same sector. Also, there is *no* wash sale rule for *gains*. Thus, if you decide to sell stock at a gain in order to take advantage of a zero capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

- **Planning With Capital Loss Carryforwards.** If you have substantial capital loss carry forwards coming into 2016, and your stock sales to date have created a *net* capital loss exceeding \$3,000, consider selling enough appreciated securities *before the end of 2016* to decrease your net capital loss to \$3,000. Stocks that you think have reached their peak would be good candidates. All else being equal, you should sell the short-term gain (held 12 months or less) loss securities first. This will allow your *net* capital loss (in excess of \$3,000) to offset your short-term capital gains, while preserving favorable long-term capital gain treatment for later years.

Planning Alert! Your *net* short-term capital gain can be used to free up a deduction for any “investment interest” you have incurred (e.g., interest you have paid on your margin account). If you eliminate your short-term capital gains by recognizing your short-term capital losses, you may be restricting your ability to deduct your investment interest.

Tax Tip. If you are considering selling “loss” investments held 12 months or less, and you also have short-term capital gains and investment interest expense, please call our office. We will help you determine a strategy that will maximize your tax savings.

OTHER MISCELLANEOUS PLANNING CONSIDERATIONS

Consider Contributing The Maximum Amount To Your IRA. As your income rises and your marginal tax rate increases, deductible IRA contributions generally become more valuable. Also, making your deductible contribution to the plan as early as possible generally increases your retirement benefits. As you evaluate how much you should contribute to your IRA, consider the following limitations. If you are married, even if your spouse has no earnings, you may be able to deduct up to \$5,500 (\$6,500 if at least age 50) of contributions to a traditional IRA account for each of you (i.e., a total of \$11,000 - \$13,000 if both of you are at least age 50). However, the *earned income* on your joint return must at least equal the total contributions.

Caution! No more than \$5,500 (\$6,500 if at least age 50) may be contributed to either your IRA account or your spouse’s IRA account for 2016. If you are an active participant in your employer’s retirement plan during 2016, your IRA deduction is reduced ratably as your adjusted gross income increases from **\$98,000 to \$118,000** on a joint return (**\$61,000 to \$71,000** on a single return). However, if you file a joint return with your spouse and your spouse is an active participant in his or her employer’s plan and you are not an active participant in a plan, your IRA deduction is reduced as the adjusted gross income on your joint return goes from **\$184,000 to \$194,000**.

Planning Alert! Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. For 2016, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **\$184,000 to \$194,000** on a joint return or from **\$117,000 to \$132,000** if you are single.

Planning Alert! Unlike the rule for traditional IRA contributions, the amount you may contribute to a Roth IRA is reduced if your adjusted gross income falls within these phase-out ranges regardless of whether you or your spouse is a participant in another retirement plan. In addition, contributions to a Roth IRA are not deductible.

- **Workers At Least Age 70½.** If you are age 70½ or older, you *cannot* make a contribution to a traditional IRA for yourself.

Tax Tip. If you are working, age 70½ or older, have a spouse under age 70½, and otherwise qualify, you can make a deductible IRA contribution to a separate traditional IRA for your spouse (not to exceed earned income) even where the spouse has no earned income. Also, if you otherwise qualify, you can contribute to a nondeductible Roth IRA even after you reach age 70½ as long as you have sufficient earned income.

Don't Overlook The "Shared Responsibility Tax" Rate For Those Who Fail To Carry Qualified Health Care Coverage. The "*Shared Responsibility Tax*" (*SR Tax*) rate increased from 2% of household income (in excess of the income filing threshold) for 2015, to 2½% for 2016 – for those individuals who fail to carry qualified health care coverage for all of 2016, and don't qualify for an exemption. More specifically, for those without health care coverage for all of 2016, the *SR Tax* is generally the ***greater of: 1)*** 2½% of household income (in excess of the filing threshold), or ***2)*** \$695 per adult (\$347.50 per child) limited to a household maximum of \$2,085. Also, the *SR Tax* may not exceed the cost of the national average for a bronze level health plan available through the government health insurance exchanges. The *SR Tax* is prorated on a monthly basis for individuals without coverage for only part of 2016. **For example**, assume a single individual (under age 65): **1)** Was uninsured for the ***entire 2016 year*** and does not qualify for an "exemption," and **2)** Earned **\$70,350** (which is also the person's "*household income*"). The *SR Tax* for **2016** would be **\$1,500**.

Planning Alert! Spouses filing a joint return are jointly liable for any *SR Tax* on the return, including any *SR Tax* due for qualifying dependents.

Consider Increasing Withholding If Facing An Estimated Tax Underpayment Penalty. If you have failed to pay sufficient estimated taxes during 2016 potentially causing an estimated tax underpayment penalty, ***increasing your withholdings before the end of 2016*** may solve the problem. Any income tax withholding (including withholdings at the end of 2016 from a year-end bonus or an IRA distribution) is generally deemed paid 1/4 on April 15, 2016; June 15, 2016; September 15, 2016; and January 16, 2017. Therefore, amounts ***withheld on or before December 31, 2016*** may reduce or eliminate your penalty for underpaying estimated taxes.

Tax Tip. If you are a higher-income individual with ***investment income*** that will trigger the **3.8% NIIT** for 2016, the additional NIIT could subject you to the underpayment penalty if you haven't adjusted your estimated tax payments or withholdings to cover the 3.8% NIIT and do not otherwise meet one of the exceptions to the penalty (i.e., paying in 110% of last year's tax). Increasing your withholdings on or before December 31, 2016 could eliminate the penalty.

- **Planning Alert!** If you take an IRA distribution and have taxes withheld from the distribution to avoid an underestimate penalty, you must roll the distribution amount (unreduced by the withheld taxes) into an IRA within 60 days of the distribution to avoid paying taxes (and possibly a 10% penalty) on the IRA distribution. You are allowed to take a distribution from an IRA and roll it over into a new IRA, ***only one time per year*** (i.e., the 12-month period beginning with the date you received the distribution).

Caution! If you used this withholding technique last year by having taxes withheld from an IRA distribution in 2015, ***be very careful*** that you do not violate the ***one-rollover-per-year*** rule if you plan to use this technique again this year. Please call our firm before you initiate an IRA distribution in order to increase your tax withholdings.

Recent IRS Release Explains Self-Employment Tax Treatment For Owners Of Limited Liability Companies (LLCs). “General” partners of businesses operating as partnerships are generally subject to Social Security and Medicare taxes (Self-Employment Tax or S/E tax) on their business income passing through from their partnership and reported on Schedule K-1. By contrast, “limited” partners are generally exempt from S/E tax on the partnership’s Schedule K-1 pass-through business income (except for “guaranteed payments” they receive). However, it has never been entirely clear whether and to what extent pass-through business income to the owner of a Limited Liability Company (LLC) is subject to S/E tax.

In a recently-released IRS Chief Counsel Advisory (CCA), the IRS ruled that a majority owner (Member/Owner) of an LLC that owned and operated a group of franchise restaurants should be treated as a “general” (not “limited”) partner and, therefore, should be subject to S/E tax on all pass-through business income from the LLC reported on his Schedule K-1. The Member/Owner was actively involved in the LLC’s business operations – serving as Operating Manager, President, and Chief Executive Officer. The CCA generally concluded that an owner of an LLC could possibly qualify for the “limited partner” exception to the S/E tax *only if* the LLC owner was a “*mere investor*” who did not “*actively participate*” in the business operations of the LLC. Since the Member/Owner in this situation was not a “mere investor” and “actively participated” in the LLC’s restaurant operations, the CCA concluded that the S/E tax should be imposed on the entire amount of his business income from the LLC.

Planning Alert! The CCA *did not provide a specific definition* of the terms “*mere investor*” or “*actively participate*.” Presumably, the IRS intends to apply these critical terms on a case-by-case, facts-and-circumstances basis.

The following are several other important observations and conclusions contained in the CCA:

- The Member/Owner’s wife also owned an interest in the LLC, however she had no active involvement in the operations of the LLC. The CCA concluded that the LLC’s Schedule K-1 business income that passed through to her was not subject to S/E tax because the IRS determined on these facts that she was a “mere investor” and did not “actively participate” in the LLC’s operations.
- The Member/Owner was paid “guaranteed payments” on which he paid S/E tax. He argued that since his “guaranteed payments” reasonably compensated him for the services he provided to the LLC, he should not be required to pay S/E tax on his share of the LLC’s pass-through K-1 business income. The IRS rejected this argument entirely, and ruled that the existence of “guaranteed payments” had no bearing as to whether the Husband would be treated as a “limited partner” for S/E tax purposes.
- The Member/Owner also argued that the income he received from the LLC other than the “guaranteed payments” represented a return on his capital investment in the LLC and should not be subject to S/E tax. Again the IRS completely rejected this argument and said that the S/E tax

provision “*provides an exclusion for limited partners, not for a reasonable return on capital, and does not indicate that a partner’s status as a limited partner depends on the presence of a guaranteed payment or the capital-intensive nature of the partnership’s business.*” [Emphasis added].

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. In addition, please call us before implementing any of the planning ideas discussed in this letter, or if you need additional information.

Note! The information contained in this letter represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of the provisions discussed may apply to a specific situation.

Disclaimer: Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of promoting, marketing, or recommending to another party any transaction or matter addressed herein. The preceding information is intended as a general discussion of the subject addressed and is not intended as a formal tax opinion. The recipient should not rely on any information contained herein without performing his or her own research verifying the conclusions reached. The conclusions reached should not be relied upon without an independent, professional analysis of the facts and law applicable to the situation.