2016 TAX PLANNING TIPS

Last minute strategies to reduce your 2016 tax bill

RETIREMENT CONTRIBUTION PLANNING:

- <u>IRA:</u> Remember to plan your cash flow to make an IRA contribution by April 18, 2017. The maximum 2016 IRA contribution is $5,500 ($5,500 in 2017). If you are age 50 or older by December 31, 2016, the maximum amount is $6,500. Roth IRA contributions are restricted to adjusted gross income phaseout amounts, with complete phaseout at $132,000 for single taxpayers and $194,000 for married taxpayers. IRA plans can be set up as late as April 18, 2017.
- <u>401K:</u> The maximum 2016 contribution to your 401K is $18,000. If you are age 50 or older by December 31, 2016 and your plan has been amended to allow it, the maximum amount is $24,000.
- <u>SEP:</u> The maximum 2016 SEP contribution is $53,000. You have until the due date of your tax returns, including extensions, in which to make the 2016 contribution and to set up the plan.
- <u>Roth IRA rollover:</u> There is no adjusted gross income limitation that restricts the rollover of a regular IRA into a Roth IRA. Funds rolled over from a regular IRA to a Roth IRA will be taxed under the regular IRA distribution rules, but no penalties will apply.
- <u>IRA One-Rollover-Per-Year Rule</u>: First effective in 2015, you can only make one rollover from an IRA to another (or the same) IRA in any 12-month period, regardless of the number of IRAs you own. This applies to all IRAs including SEP and SIMPLE IRAs and traditional or Roth IRAs. Transfers that are <u>not</u> limited include trustee-to-trustee transfers between IRAs and rollovers from traditional IRAs to Roth IRAs.
- <u>Required minimum distribution (RMD):</u> Required minimum distributions must be made in 2016 for taxpayers that have reached age 70 ½. Failure to take a required withdrawal by 12/31/16 could result in a penalty up to 50% of the amount not withdrawn. You do have the option of delaying the required distribution to April 1, 2017 (this only applies to the year in which you turn 70 ½), but if so you will have to take a double distribution in 2017.
- <u>Tax-free distributions for charity:</u> Taxpayers over age 70 ½ are allowed to exclude IRA distributions from their gross income if they are donated to a qualified charity. This is now a permanent provision of the law.

DEDUCTION AND CREDIT PLANNING:

- <u>Medical expenses:</u> Medical expenses are only deductible if they exceed **<u>10%</u>** of your adjusted gross income (7.5% if you *or* your spouse is age 65 or older, but only through 2016). California did not conform to this new provision; medical expenses are deductible for all individuals regardless of age as long as they exceed 7.5% of your adjusted gross income. Only expenses that are paid or charged on a credit card by December 31, 2016 are eligible.
- <u>Health savings accounts:</u> Health Savings Account (HSA) contribution limits for 2016 are $3,350 if single or $6,650 for a family. For taxpayers aged 55 or older, the limits are $4,350 if single and $7,650 for a family.
- <u>Taxes:</u> State taxes are deductible on your federal tax return. State estimated income tax payments and property taxes that are due in 2017 can be paid in 2016. *CAUTION*: If you are subject to AMT (alternative minimum tax), there is no tax benefit by prepaying these taxes in 2016. For taxpayers who pay little or no state income tax, state sales tax can be claimed in lieu of state income taxes as an itemized deduction. This is now a permanent provision of the law.
- <u>Mortgage interest:</u> Mortgage interest is deductible to the extent the proceeds were used to acquire, construct or improve your personal residence(s) to a maximum principal amount of $1,000,000. In addition, you are allowed a home equity loan up to $100,000 that does not have any usage requirements. Refinancing a mortgage and taking cash proceeds may impact the amount of interest that is deductible. No part of a home equity loan is deductible for AMT purposes to the extent that it is not used to acquire, construct or improve a residence.

- Energy *efficient* improvements: Unless there is an additional extension, 2016 is the final year to claim the 10% credit for energy efficient home improvements, including extra insulation, energy saving windows or doors, or installing an energy efficient furnace ($500 maximum lifetime credit; $200 for windows and skylights). The improvement must be placed in service before 1/1/17.
- Energy *generating* equipment: This credit is equal to 30% of the total cost for property such as solar electric panels or solar water heaters (excluding solar heaters installed for heating a swimming pool or hot tub). This credit was extended through 12/31/2021, but is reduced to 26% in 2020 and 22% in 2021. To receive the credit in 2016, the solar property must be placed in service before 1/1/17 (even if the project is financed or paid over multiple years). See our separate sheet for additional details.
- Charitable contributions: Be sure to ask for receipts to substantiate all amounts for both non-cash donations and cash donations. Cash donations can also be substantiated by canceled checks or bank statements that verify the charity's name, date and amount. Donations charged on a credit card by December 31, 2016 are eligible as a deduction for 2016, even if you don't pay the credit card balance until 2017. Donations of cars, boats, and airplanes need to be reported at their fair market value. If fair market value is more than $500 and the charity does not keep the vehicle, your deduction is limited to the amount for which the charity later sells the vehicle. Charitable contributions have varied limitations based on your adjusted gross income. Any amounts not eligible due to these limitations can be carried forward for five years. Any donation deduction amount for cars, boats and airplanes of more than $500 requires your tax return to include a statement from the charity identifying the vehicle and stating the amount for which it was sold. Be sure to obtain these statements from the charity and include them with your organizer package.

BUSINESS EXPENSE PLANNING:

- Health insurance premiums: As a self-employed person, you are able to deduct 100% of health insurance premiums paid for yourself, your spouse, and your dependents. This also includes dental and vision insurance, plus limited amounts for long-term care insurance. It does not include disability or life insurance.
- Depreciation:
  - *"Section 179 deduction"* Equipment purchases are eligible for a "Section 179 deduction" of up to $500,000 for 2016. The equipment must be "placed in service" by December 31, 2016. Note that purchasing too much equipment (over $2,000,000) will restrict your total "Section 179 deduction". These limits were made permanent with the passage of last year's "extender" provisions, but will be indexed for inflation in future years ($510,000 maximum in 2017 with a $2,030,000 threshold).
  - *Bonus depreciation* The special 50% bonus depreciation is still available through 2017. As of current law, bonus depreciation will decrease to 40% in 2018 and 30% in 2019. Bonus depreciation is only available for new (not used) purchases.

INVESTMENT PLANNING:

- Capital gains and losses: Income that results from the sales of stock, investment property, and rental property (above depreciation recapture) is considered capital. Long-term gains result from sales that have been held over one year. The federal income tax rate on long-term capital gains is limited to 20% in 2016. The Medicare surtax of 3.8% on investment income for taxpayers with income exceeding certain thresholds also took effect in 2013. Losses are deductible to the extent of gains plus $3,000. Any excess loss is carried over to subsequent years for an unlimited amount of time. *CAUTION*: If you are subject to AMT (alternative minimum tax), the capital gains tax rate benefit may be partially offset by an increased AMT liability amount.
- Sale of home: When selling your principal residence, you may exclude up to $500,000 of capital gain if married or $250,000 of capital gain if single. A sale of a home in 2016 (and beyond) could trigger the increased capital gain rate and the 3.8% Medicare surtax if there is a taxable gain. Since there is no exclusion for the sale of a second home, vacation home, or rental property, the entire capital gain could be subject to these higher rates for sales in 2016 and beyond.

- Gifts: Amounts transferred up to $14,000 per person per year are considered exempt from gift taxation. Amounts given above this amount require the "giver" to file a gift tax return and either elect to use part of their "life-time exclusion" or to pay a gift tax. This tax return is due April 18, 2017 or October 16, 2017 if an extension is filed. There are no requirements for the recipient of the gift. The 2017 limit is $14,000.
- Social security: Up to 85% of social security benefits may be taxable depending on your modified adjusted gross income. For one-time events you should give consideration to the year of receipt. Please call us for an individualized analysis.
- Net operating loss (NOL): A net operating loss occurs if certain non-personal income and expenses create a negative amount. This loss is first carried back to the previous two years by filing an amended tax return to claim a refund and then forward for twenty years, unless an election is made to forgo the carry back period and only go forward.

ALTERNATIVE MINIMUM TAX:

- Some of the standard year-end planning ideas will not reduce tax liability if you are subject to the alternative minimum tax (AMT) because different rules apply. Because of the complexity of the AMT, we recommend a personalized analysis of your AMT exposure, which will include the preparation of a tax projection report.

ADDITIONAL PAST TAX BREAKS THAT WERE EXTENDED LAST YEAR

The following tax provisions were at risk of expiration in a prior year and were either extended or made permanent in 2015. This is good news for taxpayers – some significant tax breaks and no waiting in anticipation for Congress to make a decision!

- **Above-the-line deduction for educator expenses**

The $250 above-the-line deduction for qualified educator expenses is now permanent.

- **Exclusion for discharged home mortgage debt**

The discharge of indebtedness income from qualified principal residence debt was extended through 2016. Debt written off by a lender, including mortgage debt, is excluded from gross income for taxpayers meeting certain criteria.

- **Treatment of mortgage insurance premiums as deductible qualified residence interest**

Taxpayers below certain thresholds can deduct mortgage insurance premiums as qualified residence interest through 2016 (unless further extended).

- **State and local sales tax deduction**

The option to deduct state and local sales tax in lieu of state income tax is now a permanent provision of the law. This can be advantageous for taxpayers that do not pay state income tax (either for tax liability reasons or because they live in a state without income tax).

- **Above-the-line deduction for higher education expenses**

Taxpayers may claim an above-the-line deduction for qualified tuition and related expenses for higher education through 2016 (unless further extended). This is often more advantageous than taking a credit for many taxpayers.

- **Work Opportunity Tax Credit**

The WOTC offered employers a tax credit for hiring eligible veterans and nonveterans. This credit was extended through 2019.