

Year-end tax planning for calendar year 2016 with checklists

Dear Client:

As the end of the year approaches, it is a good time to think of planning moves that will help lower your tax bill for this year and possibly the next. Factors that compound the planning challenge this year include turbulence in the stock market, overall economic uncertainty, and Congress's all too familiar failure to act on a number of important tax breaks that will expire at the end of 2016.

Some of these expiring tax breaks will likely be extended, but perhaps not all, and as in the past, Congress may not decide the fate of these tax breaks until the very end of 2016 (or later). For individuals, these breaks include: the exclusion for discharge of indebtedness on a principal residence, the treatment of mortgage insurance premiums as deductible qualified residence interest, the 7.5% of adjusted gross income floor beneath medical expense deductions for taxpayers age 65 or older, and the deduction for qualified tuition and related expenses. There is also a host of expiring energy provisions, including: the nonbusiness energy property credit, the residential energy property credit, the qualified fuel cell motor vehicle credit, the alternative fuel vehicle refueling property credit, the credit for 2-wheeled plug-in electric vehicles, the new energy efficient homes credit, and the hybrid solar lighting system property credit.

Higher-income earners have unique concerns to address when mapping out year-end plans. They must be wary of the 3.8% surtax on certain unearned income and the additional 0.9% Medicare (hospital insurance, or HI) tax.

The surtax is 3.8% of the lesser of: (1) net investment income (NII), or (2) the excess of modified adjusted gross income (MAGI) over an unindexed threshold amount (\$250,000 for joint filers or surviving spouses, \$125,000 for a married individual filing a separate return, and \$200,000 in any other case). As year-end nears, a taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on his estimated MAGI and NII for the year. Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than NII, and other individuals will need to consider ways to minimize both NII and other types of MAGI.

The 0.9% additional Medicare tax also may require year-end actions. It applies to individuals for whom the sum of their wages received with respect to employment and their self-employment income is in excess of an unindexed

threshold amount (\$250,000 for joint filers, \$125,000 for married couples filing separately, and \$200,000 in any other case). Employers must withhold the additional Medicare tax from wages in excess of \$200,000 regardless of filing status or other income. Self-employed persons must take it into account in figuring estimated tax. There could be situations where an employee may need to have more withheld toward the end of the year to cover the tax. For example, if an individual earns \$200,000 from one employer during the first half of the year and a like amount from another employer during the balance of the year, he would owe the additional Medicare tax, but there would be no withholding by either employer for the additional Medicare tax since wages from each employer don't exceed \$200,000. Also, in determining whether they may need to make adjustments to avoid a penalty for underpayment of estimated tax, individuals also should be mindful that the additional Medicare tax may be overwithheld. This could occur, for example, where only one of two married spouses works and reaches the threshold for the employer to withhold, but the couple's combined income won't be high enough to actually cause the tax to be owed.

We have compiled a checklist of additional actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make:

Year-End Tax Planning Moves for Individuals

- Realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, then buy back the same securities at least 31 days later. It may be advisable for us to meet to discuss year-end trades you should consider making.
- Postpone income until 2017 and accelerate deductions into 2016 to lower your 2016 tax bill. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2016 that are phased out over varying levels of adjusted gross income (AGI). These include child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2016. For example, this may be the case where a person's marginal tax rate is much lower this year than it will be next year or where lower income in 2017 will result in a higher tax credit for an individual

who plans to purchase health insurance on a health exchange and is eligible for a premium assistance credit.

- If you believe a Roth IRA is better than a traditional IRA, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA if eligible to do so. Keep in mind, however, that such a conversion will increase your AGI for 2016.
- If you converted assets in a traditional IRA to a Roth IRA earlier in the year and the assets in the Roth IRA account declined in value, you could wind up paying a higher tax than is necessary if you leave things as is. You can back out of the transaction by recharacterizing the conversion—that is, by transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA via a trustee-to-trustee transfer. You can later reconvert to a Roth IRA.
- It may be advantageous to try to arrange with your employer to defer, until early 2017, a bonus that may be coming your way.
- Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2016 deductions even if you don't pay your credit card bill until after the end of the year.
- If you expect to owe state and local income taxes when you file your return next year, consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2016 if you won't be subject to alternative minimum tax (AMT) in 2016.
- Take an eligible rollover distribution from a qualified retirement plan before the end of 2016 if you are facing a penalty for underpayment of estimated tax and having your employer increase your withholding is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2016. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2016, but the withheld tax will be applied pro rata over the full 2016 tax year to reduce previous underpayments of estimated tax.
- Estimate the effect of any year-end planning moves on the AMT for 2016, keeping in mind that many tax breaks allowed for purposes of calculating regular taxes are disallowed for AMT purposes. These include the deduction

for state property taxes on your residence, state income taxes, miscellaneous itemized deductions, and personal exemption deductions. Other deductions, such as for medical expenses of a taxpayer who is at least age 65 or whose spouse is at least 65 as of the close of the tax year, are calculated in a more restrictive way for AMT purposes than for regular tax purposes. If you are subject to the AMT for 2016, or suspect you might be, these types of deductions should not be accelerated.

- You may be able to save taxes this year and next by applying a bunching strategy to "miscellaneous" itemized deductions, medical expenses and other itemized deductions.
- For 2016, the "floor" beneath medical expense deductions for those age 65 or older is 7.5% of adjusted gross income (AGI). Unless Congress changes the rules, this floor will rise to 10% of AGI next year. Taxpayers age 65 or older who can claim itemized deductions this year, but won't be able to next year because of the higher floor, should consider accelerating discretionary or elective medical procedures or expenses (e.g., dental implants or expensive eyewear).
- You may want to pay contested taxes to be able to deduct them this year while continuing to contest them next year.
- You may want to settle an insurance or damage claim in order to maximize your casualty loss deduction this year.
- Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retirement plan). RMDs from IRAs must begin by April 1 of the year following the year you reach age 70½. That start date also applies to company plans, but non-5% company owners who continue working may defer RMDs until April 1 following the year they retire. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. Although RMDs must begin no later than April 1 following the year in which the IRA owner attains age 70½, the first distribution calendar year is the year in which the IRA owner attains age 70½. Thus, if you turn age 70½ in 2016, you can delay the first required distribution to 2017, but if you do, you will have to take a double distribution in 2017—the amount required for 2016 plus the amount required for 2017. Think twice before delaying 2016 distributions to 2017, as bunching income into 2017 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2017 if you will be in a substantially lower bracket that year.

- Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year.
- If you become eligible in December of 2016 to make health savings account (HSA) contributions, you can make a full year's worth of deductible HSA contributions for 2016.
- If you are thinking of installing energy saving improvements to your home, such as certain high-efficiency insulation materials, do so before the close of 2016. You may qualify for a "nonbusiness energy property credit" that won't be available after this year, unless Congress reinstates it.
- Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and estate taxes. The exclusion applies to gifts of up to \$14,000 made in 2016 and 2017 to each of an unlimited number of individuals. You can't carry over unused exclusions from one year to the next. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

Year-End Tax-Planning Moves for Businesses & Business Owners

Businesses should consider making expenditures that qualify for the business property expensing option. For tax years beginning in 2016, the expensing limit is \$500,000 and the investment ceiling limit is \$2,010,000. Expensing is generally available for most depreciable property (other than buildings), off-the-shelf computer software, and qualified real property-qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. The generous dollar ceilings that apply this year mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. This opens up significant year-end planning opportunities.

Businesses also should consider making expenditures that qualify for 50% bonus first year depreciation if bought and placed in service this year. The bonus depreciation deduction is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 50% first-year bonus writeoff is available even if qualifying assets are in service for only a few days in 2016.

- Businesses may be able to take advantage of the "de minimis safe harbor election" (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't exceed \$5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed \$2,500. Where the UNICAP rules aren't an issue, purchase such qualifying items before the end of 2016.
- A corporation should consider accelerating income from 2017 to 2016 if it will be in a higher bracket next year. Conversely, it should consider deferring income until 2017 if it will be in a higher bracket this year.
- A corporation should consider deferring income until next year if doing so will preserve the corporation's qualification for the small corporation AMT exemption for 2016. Note that there is never a reason to accelerate income for purposes of the small corporation AMT exemption because if a corporation doesn't qualify for the exemption for any given tax year, it will not qualify for the exemption for any later tax year.
- A corporation (other than a "large" corporation) that anticipates a small net operating loss (NOL) for 2016 (and substantial net income in 2017) may find it worthwhile to accelerate just enough of its 2017 income (or to defer just enough of its 2016 deductions) to create a small amount of net income for 2016. This will permit the corporation to base its 2017 estimated tax installments on the relatively small amount of income shown on its 2016 return, rather than having to pay estimated taxes based on 100% of its much larger 2017 taxable income.
- If your business qualifies for the domestic production activities deduction (DPAD) for its 2016 tax year, consider whether the 50%-of-W-2 wages limitation on that deduction applies. If it does, consider ways to increase 2016 W-2 income, e.g., by bonuses to owner-shareholders whose compensation is allocable to domestic production gross receipts. Note that the limitation applies to amounts paid with respect to employment in calendar year 2016, even if the business has a fiscal year.
- To reduce 2016 taxable income, consider deferring a debt-cancellation event until 2017.
- To reduce 2016 taxable income, consider disposing of a passive activity in 2016 if doing so will allow you to deduct suspended passive activity losses.

- If you own an interest in a partnership or S corporation, consider whether you need to increase your basis in the entity so you can deduct a loss from it for this year.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,

Cohen & Grieb, P.A.