Re: 2016 Year-End Tax Planning for Individuals

Dear Client,

Although tax planning is a 12-month activity, yearend is traditionally the time to review tax strategies from the past and to revise them for the future. Yearend has also become a time when there is an increasing need to take a careful look at what's changed within the tax law itself since the beginning of the year. Opportunities and pitfalls within these recent changes – as they impact each taxpayer's unique situation—should not be overlooked. This is particularly the case during year-end 2016. Here are some of the many consideration that taxpayers should review as year-end 2016 approaches.

Data, including 2015 return

Year-end planning should start with data collection and a review of prior year returns. This includes losses or other carryovers, estimated tax installments, and items that were unusual. Conversations about next year should include review of any plans for significant purchases or dispositions, as well as any possible life changes. Alternative minimum tax liability also needs to be explored as well as potential liability for the net investment income tax and the Additional Medicare Tax.

Investments

Taxpayers holding investments toward the end of the year, whether in the form of securities, real estate, collectibles, or other assets, often have an opportunity to reduce their overall tax bill by some strategic buying and selling (or like-kind exchanging). Balancing the existing tax rates within those considerations is part of that challenge: the ordinary income tax rates, the capital gain rates, the net investment income tax rate, and the alternative minimum tax (AMT), all play a role.

Income caps on benefits

Monitoring adjusted gross income (AGI) at year end can also pay dividends in qualifying for a number of tax benefits. Often tax savings can be realized by lowering income in one year at the expense of realizing a bit more in the other: in this case, either 2016 or 2017. Some of those tax benefits that get phased out depending upon the taxpayer's AGI level include:

- itemized deductions
- personal exemptions
- education savings bond interest exclusion
- maximum child's income on parent's return (form 8814):
- medical savings account adjustments

- education credits
- student loan interest deduction
- adoption credits
- maximum Roth IRA contributions
- maximum IRA contributions for individuals

PATH Act “extenders” and more

Year to year, the tax law changes; and with it, opportunities and pitfalls that need particular attention at year end. In many cases, these changes are accounted for based on a tax-year period. Once the current tax year is over, there often is no going back for a “do-over” for a missed opportunity or to correct a costly mistake. Year-end 2016 is no exception to this rule.

The Protecting Americans from Tax Hikes Act of 2015 (PATH Act), enacted immediately before the start of 2016, permanently extended many tax incentives that were previously temporary, removing for the first time in many years the year-end concern over whether these incentives will be extended either retroactively for the current year or prospectively into the coming year. Not all of these “extenders” provisions were extended beyond 2016, however; and some were modified in the process. Others were extended for up to five years, deferring to “tax reform” a more lasting solution. Here’s a list of the major changes made by the PATH Act, especially focused on how they impact year-end transactions:

- permanent American Opportunity Tax Credit
- permanent teachers’ $250 “classroom” expense deduction
- permanent state and local sales tax deduction election, in lieu of state income taxes
- permanent exclusion for direct charitable donation of IRA funds of up to $100,000
- permanent 100-percent gain exclusion on qualified small business stock
- permanent conservation contributions benefits
- five-year solar energy property
- nonbusiness energy property credit through 2016
- fuel cell motor vehicle credit through 2016
- mortgage insurance premium deduction through 2016
- tuition and fees deduction through 2016

Life events

Life events such as marriage, birth or adoption of a child, a new job or the loss of a job, and retirement, all impact year-end tax planning. A change in filing status will affect tax liability. The possibility of significant changes and/ or significant or unusual items of income or loss should be part of a year-end tax strategy. Additionally, taxpayers need to take a look into the future, into 2017, and predict, if possible, any events that could trigger significant income, losses or deductions.

Retirement strategies

Taxpayers may want to take a look at a number of different provisions in anticipation of retirement, at the point of retirement, or after retirement. Many of these provisions have opportunities and deadlines associated with the concept of taxable year. Among others, these include contributions to employer plans, strategic use of IRAs and "required minimum distributions," and timing Roth IRA conversions and reconversions to maximize your retirement nest egg.

Affordable Care Act compliance

The Affordable Care Act (ACA) imposes new requirements on individuals and tightens or eliminates some tax incentives. Year-end planning for individuals with regards to the ACA may generally be more prospective than retrospective but there are some year-end moves that may be valuable, particularly with health-related expenditures.

Acceleration or delay

Year-end tax planning, especially if done "at the eleventh hour," requires some understanding of the timing rules: when income becomes taxable and when it may be deferred; and, likewise, when a deduction or credit is realized and when it may be deferred into next year or beyond.

<u>Income acceleration/deferral.</u> Taxpayers using the cash method basis of accounting can defer or accelerate income using a variety of strategies. These may include:

- sell appreciated assets
- receive bonuses before January
- sell outstanding installment contracts
- redeem U.S. Savings Bonds
- accelerate debt forgiveness income
- avoid mandatory like-kind exchange treatment

<u>Deduction acceleration/deferral.</u> A cash basis taxpayer generally deducts an expense in the year it is paid, although prepayment of an expense generally will not accelerate a deduction. There are exceptions, including those made in connection with:

- January mortgage payment in December

- tuition prepayment
- estimated state taxes

A New Administration

When the new Administration moves into Washington in January 2017, it is clear that changes will follow. How these changes will impact upon your long-term tax situation remains to be developed. That, and an eventual groundswell for tax reform, make the future more difficult to read than in prior years. Nevertheless, in looking toward the future, you should not lose sight of the short term tax dollars to be saved immediately through 2016 year-end strategies.

Please feel free to call our offices if you have any questions about how year-end tax planning might help you save taxes. Our tax laws operate largely within the confines of “the taxable year.” Once 2016 is over, tax savings that are specific to 2016 may be gone forever.

Sincerely yours,

MICHAEL D DANIELS