Financial Planning **Update**

Ten Tax Planning Decisions to Make Before Year End

Ideally, tax planning is an exercise you conduct routinely throughout the year, rather than a "last chance" attempt to change the course of an entire tax year. Nevertheless, oftentimes, your annual income and eligible deductions become much clearer as the end of the year approaches. That's when year-end tax planning takes center stage.

For example, year-end is a good time to carefully consider whether to accelerate deductions and postpone income (or vice versa) to take advantage of current year tax savings or to mitigate future tax liabilities. It can also be helpful to compare how 2016 is shaping up compared with your 2015 return, and to identify new potential tax benefits—or pitfalls.

As 2016 comes to a close, take some time to decide whether you should:

1 Accelerate, defer or recognize all of your earned income

Since many tax benefits are either lost or get phased out depending on a taxpayer's adjusted gross income, accelerating or deferring income can affect:

- Itemized deductions
- Personal exemptions
- Education savings bond interest exclusion
- Education credits
- Student loan interest deductions
- Maximum Roth IRA or regular IRA contributions

As a result, it may be prudent to keep income below the threshold amount (see chart on next page) by deferring it or by utilizing above-the-line tax deductions. Likewise, grouping similar categories of net investment income activities may help reduce the impact of the net investment income tax (NIIT).

If you have children, you may need to decide whether or not to include the child's investment income on your return. This may make sense if it would not push you into a higher tax bracket.

In addition, if you expect to receive a year-end bonus, consider adjusting your withholding to cover for any shortfall in estimated taxes during the year. Ask a tax advisor about "income smoothing" techniques designed to level income and avoid uncertain tax brackets, which can help avoid penalties for underpayment of estimated taxes.

Finally, if you're contemplating a sale, consider an installment sale. Income reported under the installment sale method is recognized as the installment payments are made, essentially deferring that income into later years.

2 Use investment losses to offset capital gains

Tax rates on capital gains and dividends range from zero to 20% depending on the taxpayer's individual income tax bracket. If you are in the 10-15% income tax brackets, strategically realizing capital gains and offsetting losses may allow you to rebalance your investment portfolio at a zero percent capital gains rate.

Here's how it works: You sell investments in which you have a gain and also sell those in which you have a loss, offsetting the gains with losses, dollar for dollar. If you have excess losses, you can also offset up to $3,000 of ordinary income and carry additional capital losses into future years. Be wary of wash sale rules: You cannot re-purchase the same (or a substantially identical) investment within 30 days either before or after the loss sale.

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③ Take advantage of PATH Act Extenders from 2015

The Protecting Americans from Tax Hikes (PATH) Act of 2015 included a number of significant changes in the tax law. Here are a few to consider at year end:

- **American Opportunity Tax Credit** – equal to 100% of the first $2,000 of qualified tuition and related expenses plus 25% of the next $2,000 of qualified tuition and related expenses.
- **Teachers classroom expenses deduction** – an above-the-line deduction of up to $250 for elementary and secondary classroom expenses.
- **Itemized deduction for state and local sales taxes** – may be used in lieu of state and local income taxes when itemizing deductions.
- **Qualified charitable donations of IRA funds** – can be excluded from income for individuals aged 70½ up to $100,000 (for each spouse). The donation will satisfy the Required Minimum Distribution (RMD) requirements.
- **100% gain exclusion** on the sale of qualified small business stock.

④ Avoid taxes on an IRA rollover, even if you missed the 60-day deadline

During 2016, the IRS announced a new waiver procedure for taxpayers who inadvertently miss the 60-day rollover deadline. Generally, in order to avoid current taxation, a taxpayer must roll a distribution received from an employer plan or IRA to another plan or IRA within 60 days of receiving the distribution. The IRS can waive the 60-day limit in certain circumstances. Previously, a private letter ruling from the IRS was needed in order to obtain that relief. However, the IRS has now provided a simpler "self-certification" procedure that allows taxpayers who meet one of 11 criteria to make a late rollover without seeking a private letter ruling.

The Current Tax Environment

Individual taxpayers are subject to the following tax rates:	
Ordinary income	10% to 39.6%
Capital gains	15% or 20%
Net investment income	3.8%
Alternative minimum tax	26% or 28%

Threshold amounts

39.6% top tax bracket starts with taxable income at:	**2016**	**2017**
Married Filing Jointly	$466,950	$470,700
Single	$415,050	$418,400
Head of Household	$441,000	$444,550
Married Filing Separately	$233,475	$233,350

⑤ Transfer interests in closely held or family-owned entities

Proposed Section 2704 Regulations would impose major restrictions on valuation discount planning. These regulations, if finalized, would impact the valuation of interests in many family controlled entities for estate, gift and generation-skipping purposes. If these regulations are finalized, taxpayers will lose significant estate planning techniques, such as the elimination of discounts for minority interests and lack of marketability.

A public hearing on the proposed regulations is scheduled for December 1, 2016 and final regulations could become effective sometime in 2017. Taxpayers who are considering transferring interests in closely held or family-owned entities should consider making the transfers as soon as possible.

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⑥ Donate, donate, donate

When you gift appreciated stock to a charity, the charity avoids paying tax on the built-in gain in the stock. However, the IRS requires a written acknowledgment from the charitable organization for any donation of cash or property that totals more than $250. It must contain the date and amount of the gift and state that no goods or services were provided to taxpayer. The acknowledgment must coincide with the donation of the gift.

Ask your financial planner about these other advanced charitable giving techniques:

- Donor-advised funds
- Private foundations
- Charitable trusts

⑦ Maximize deferrals into qualified plans

One of the best ways to minimize current income taxes is to maximize contributions to qualified retirement plans. This includes 401(k)/ 403(b) employer sponsored retirement plans, where, at the very least, you could defer enough to capture the employer matching amount.

Self-employed individuals should consider establishing a SEP or Solo 401(k). For 2016, You can contribute up to $53,000 of your net self-employment income to a SEP-IRA. With a solo 401(k), you can defer up to $18,000 (or $24,000 if 50 or older). The business can contribute up to 25% of earned income. Both amounts cannot exceed the $53,000 threshold.

Similarly, setting aside pre-tax dollars into flexible spending accounts or health savings accounts (FSAs and HSAs) could save on taxes. Employers typically solicit enrollment in these plans toward the end of the year.

Finally, although not necessarily considered a current tax savings strategy, a Roth conversion may save on taxes in the future. Converting amounts currently to “fill” a tax bracket allows taxpayers to take advantage of their current tax bracket without moving into the next. Plus, the earnings can grow tax free.

In addition, there are no RMDs required with a Roth IRA. Plus, if the assets in the Roth fail to appreciate as you hoped, you can recharacterize (or undo) the conversion and move the funds back to a traditional IRA. Be sure to consult your tax advisor and to perform tax projections to make sure you properly fill tax bracket buckets.

⑧ Take advantage of estate tax planning strategies

For 2016, the estate tax exclusion rises to $5.45 million and the top estate tax remains at 40%. Here are some strategies to consider implementing to ease estate taxes:

- **Gift appreciated stock to adult children** who do not fall under the kiddie tax rule. They can choose to sell the stock, and their tax rate will likely be lower than yours.
- **Make annual exclusion gifts** of up to $14,000.
- **Establish a 529 plan for children or grandchildren.** Both college savings plans and prepaid tuition plans offer tax-deferred contributions. When used to pay for qualified education expenses, the earnings portion of your withdrawal is free from federal income tax. However, there is no federal income tax deduction for your contribution. Some states may exempt earnings on qualified withdrawals from state income tax and/or offer a deduction for contributions to an in-state plan.
- **Given today’s low interest environment, take advantage of estate freeze strategies** such as GRATs (Grantor Retained Annuity Trusts) and IDGTs (Intentionally Defective Grantor Trusts), while these strategies are still available.

⑨ Make distributions from trusts

Trust income tax rates are currently high at 39.6% for taxable income of $12,400 in 2016. You can minimize this burden on the trust by passing out trust income to beneficiaries. Keep in mind, the net investment income tax (NIIT) applies to trust income so distribution planning is critical, as is considering whether certain types of income are passive or nonpassive.

Mortgage interest deduction change for unmarried homeowners

Do you own a home with someone who is not your spouse? The IRS has recently ruled in favor of allowing single taxpayers to claim mortgage interest deductions on up to $1.1 million of debt on the same property. Previously, interpretation of the tax code was that the $1.1 million debt limitation applied per residence. The new guidance extends the deduction per taxpayer.

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10 Purchase property for your business

The Section 179 expensing limit is currently $500,000 with a $2 million overall investment limit. These numbers are indexed for inflation so the 2017 amount is $510,000 with a $2.03 million overall investment limit. In addition, there is now a shorter recovery period on leasehold improvements (the prior period was 39 years). Also, the Research and Development Credit was made permanent.

Tax-planning is a year-round endeavor that becomes increasingly important as you gain greater clarity into your income and deductions at year end. From managing income and harvesting gains and losses to taking full advantage of available tax strategies, there are many choices to consider that can affect your tax outcome.

Ultimately, the decisions you make will depend on your income level and the complexity of your financial situation. To learn more about year-end tax planning strategies, work with your financial planner.

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