2016 Year-End Tax Planning

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Tax Extenders: In each of the past few years, taxpayers have been forced to wait for Congress to act at year-end to extend many important tax provisions on a temporary basis. Fortunately, last December many of these items were extended permanently as part of the Protecting Americans from Tax Hikes Act (PATH Act). Several other items were extended through the end of 2016.

Permanent	Through Dec. 31, 2016
Qualified Charitable Distributions from an IRA	Tuition and Fees Deduction
Educator Expense Deduction	Cancellation of Indebtedness on Principal Residence
Itemized Deduction for State & Local Sales Tax	Itemized Deduction for Mortgage Insurance Premiums
American Opportunity Tax Credit	Nonbusiness Energy Credits
Solar Energy Credits	

While the PATH Act provided some level of stability for tax planning, the recent election results could dramatically change the tax landscape for 2017 and beyond. With Republican control of the White House and Congress, it is likely we will see tax reform in 2017 that will attempt to streamline the tax system and lower the tax burden. While these generally would be positive developments for taxpayers, uncertainty around these changes will make year-end tax planning somewhat challenging.

The most likely changes, based on President-Elect Trump's campaign proposals and the Republican tax reform blueprint released in June, would include reducing the seven current tax brackets down to just three. Additionally, the Alternative

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Minimum Tax (AMT) and Affordable Care Act (ACA) tax surcharges would be eliminated. Itemized deductions would likely be capped, but the standard deduction would be increased. Personal exemptions would also be eliminated.

Possible 2017 Tax Changes

Single	**Ordinary**	**LT Gains**
$0 - $37,500	12%	0%
$37,500 - $112,500	25%	15%
$112,500 or more	33%	20%
Standard Deduction		$15,000
Itemized Deduction Cap		$100,000

Married Filing Jointly	**Ordinary**	**LT Gains**
$0 - $75,000	12%	0%
$75,000 - $225,000	25%	15%
$225,000 or more	33%	20%
Standard Deduction		$30,000
Itemized Deduction Cap		$200,000

Some of these changes, such as unwinding the AMT and ACA, will be more challenging than others and may not be implemented in 2017. While tax rates will likely go down next year, there is still much negotiation to be done before the final numbers are determined.

Given the likelihood that tax rates will be lower in 2017, most taxpayers should focus on deferring income and accelerating tax deductions at year-end to limit current-year adjusted gross income (AGI) and taxable income.

Reducing AGI: In broad terms, AGI is your gross income before any deductions or personal exemptions. To reduce this, you need to find ways to lower items such as gross wages, self-employment income, or capital gains.

Employees looking to reduce gross wages should try to maximize their pre-tax deductions (e.g., through 401k contributions, flexible spending accounts, etc.). Some taxpayers may also have the ability to defer year-end wages or bonuses.

Self-employed taxpayers have a bit more flexibility to lower their income by year-end. Income can be deferred by delaying client billing until January. Deductions can be accelerated by paying January invoices by December 31st or making purchases by year-end.

Taxpayers should review their investment portfolios and look to offset capital gains with capital losses as a way to reduce AGI before year-end. This may also be a good time to consider giving appreciated securities to family members or charity. Transferring appreciated securities to family members in lower tax brackets may result in a tax savings upon disposition; however the "Kiddie Tax" must be considered for transfers to children under age 24. Donating appreciated securities held long-term can allow you to avoid tax on the appreciation while recognizing a charitable deduction for the full value of the securities.

Planning Point: *Year-end planning is a good time to review investments to ensure they are in line with your current tax situation. For example, you may find that municipal bonds are a better option than U.S. Treasury bonds if you are in a higher ordinary tax bracket and possibly subjected to the Net Investment Income Tax.*

Taxpayers taking discretionary distributions from their retirement plans could defer a year-end distribution until January to help lower AGI. Even those over age 70½ with required minimum distributions (RMD) may be able to lower AGI by making a qualified charitable distribution (QCD) to satisfy some or all of the their 2016 RMD requirements.

Under the current tax system, reducing your AGI is a key to lowering your tax liability, as it lowers your income subject to tax and also helps you avoid or limit exposure to various phase-outs and other taxes.

Reducing Taxable Income: Once you have taken steps to reduce your AGI, itemized deductions are available to help you further reduce your taxable income. Unfortunately, many of these deductions have a limited tax benefit due to phase-outs based on your AGI. Despite these limitations, taxpayers could benefit from making certain payments by year-end. In some cases, mortgage or state tax payments due in January could be made by December 31st to accelerate those deductions. Charitable contributions, including non-cash gifts, are great way to reduce your taxable income. When donating used clothing or household items, it is especially important to keep good records of the donated items. Taking pictures on a smart phone is a great way to record the quantity and quality of those donated items.

Other Considerations: Over the past few years, tax planning has continued to become more complex. In addition to the regular tax system and the AMT, taxpayers are now faced with navigating phased-out tax benefits and additional taxes related to the ACA.

While they may be eliminated next year, the AMT and ACA taxes need to be accounted for as part of your year-end tax plan for 2016. Remember that the AMT can take away many itemized deductions, such as miscellaneous investment expenses and the deduction for state income taxes. Even though these deductions will reduce regular taxable income, you may end up getting no tax savings from these expenses due to the AMT.

Prior to the ACA, we typically would recommend taxpayers defer paying the above expenses until the following year if they were in the AMT, since they would receive no tax benefit for making the payments early. Since state income tax payments and miscellaneous investment expenses are deductions for the Net Investment Income Tax (NIIT), however, there now may be an incentive to make these payments by year-end to reduce income subject to the NIIT.

Affordable Care Act (ACA) Taxes	
Net Investment Income Tax (NIIT): 3.8% tax on net investment income applies to Single Filers with AGI over $200,000 or Joint Filers with AGI over $250,000	**Additional HI (Medicare) Tax:** for taxpayers with wages or self-employment income over the threshold amount ($250,000 for Married Filing Jointly and $200,000 for Single filers), there is an additional tax of 0.9% imposed on their earned income. Employers should withhold this additional tax on behalf of their employees, but they may not always be aware you are over the threshold. For example, if each spouse has wages of $150,000, their employer may not be taking out the additional HI withholding as they are not aware the combined income is over the limit.

Estate and Gift Tax: In addition to proposed income tax changes, it appears that Republican leaders will seek to repeal the Estate and Gift Tax system in 2017. This has been a longstanding goal; and, given the control Republicans now have in Washington, a repeal seems possible.

Given the possibility of a repeal, how should taxpayers approach year-end gifting to family members? In most cases, reducing the taxable estate is only part of the motivation for donors. For those looking to help friends and relatives financially, there are still many tax-efficient ways to make year-end gifts.

For example, you can consider making annual exclusion gifts of up to $14,000 per person ($28,000 for a married couple) as a way to reduce your taxable estate. For donations to a Section 529 Education Plan, you may be able to make gifts of up to $70,000 per person ($140,000 for a married couple) at one time. Additionally, taxpayers generally can pay medical expenses or tuition directly on behalf of a donee without any limitations.

This is a sampling of some common year-end tax planning strategies, but it is important to note that each taxpayer has a unique tax situation. Your financial counselor and team are available to discuss your circumstances in more detail to develop the appropriate plan for you.

This letter is general and educational in nature and should not be construed as investment, tax, or legal advice. Individuals should seek advice from their financial counselors or other tax advisors before undertaking actions in response to the matters discussed.

Source: 2016 CCH