

## PLANNING LETTER

Year-End 2016

### **KITTRIDGE** \* **TAX & ACCOUNTING SERVICES**

Dear Clients and Friends,

As 2016 winds down, a lame-duck Congress is unlikely to take action on tax legislation. The pace of activity may change next year, with a new Administration and ongoing talk of tax reform, and 2017 could bring welcome and needed improvements. Whatever happens, we're here to keep you updated as events unfold in the tax world.

Until political clarity emerges, however, you're smart to make the most of established rules in your year-end tax planning. Evaluate your financial situation, select what moves will provide the most savings, and execute your plan in a timely manner. Currently available deductions, credits, and other tax benefits will reduce your 2016 tax burden and put you on track to accommodate new planning opportunities as they arise in the future.

This *Letter* offers suggestions and strategies to help you achieve your tax-saving plans. Contact us for answers to questions you may have, and to arrange a year-end tax review. As always, feel free to share this *Letter* with friends or associates who are interested in minimizing taxes.

*John P. Kittredge, Jr. CPA/MBA*



# Create a tax-saving plan to reduce your 2016 tax bill

**C**ontrary to what you may have heard, there is one sure way to reduce your tax bill: Create a tax-saving plan. And here's more good news – you still have time to establish and implement your plan before the end of the year. Consider these suggestions as you put your plan together.

## Make use of tax deferral strategies

Participating in a retirement plan is a tax deferral strategy with a double benefit. You get to put off paying federal income tax on money you earn currently and you can also put off paying tax on the income earned on the money you deposit in your plan. That's true for a plan you participate in at work, such as a 401(k), a plan you establish for your own business, such as a Simplified Employee Pension (SEP) plan, and an account you set up with income earned from wages, salaries, and tips, such as an Individual Retirement Account (IRA).

Investors can employ the tax deferral strategy too. A simple method is to wait to sell investments that have appreciated in value until your holding period exceeds a year. At that point, you can benefit from long-term capital gain rates, which generally max out at 20%. Alternatively, you can wait to sell until you can offset gains with losses from other investments. Of course, you'll want to balance this tax-saving strategy with sound investment decisions.

## Reduce your taxable income

On your personal income tax return, expenses you can deduct "above-the-line," standard or itemized deductions, and allowable exemptions for yourself and your family members can all reduce

your taxable income. For example, if you're a teacher, you may benefit from the \$250 above-the-line deduction for expenses you pay out of pocket such as books and supplies. In addition, this year you can also deduct your expenses for professional development. Above-the-line means the deduction is available even if you don't itemize.

The last quarter of the year is also a good time to sum up your outlays for expenses that qualify as itemized deductions. These include taxes, home mortgage interest, and charitable contributions, and are generally deductible in the year you pay them. Totalling how much you've already paid will show you if you have enough to itemize, or if you might want to consider accelerating or postponing expenses to shift the deductions into the current or future year, whichever gives you the bigger tax benefit.

**Tip.** If you're age 65 or older, under current law, 2016 is the last year the 7.5% threshold for medical expenses is available. Starting in 2017, your medical expenses will need to exceed 10% of your adjusted gross income in order to claim a deduction. If you're close to meeting the threshold this year, you may want to renew prescriptions before the end of the year, or schedule routine doctor visits.

Are you a business owner? Changes to the Section 179 depreciation expensing election can help you claim bigger deductions this year. One change to be aware of is an expanded definition of Section 179 property, which now permanently includes computer software and real property such as qualified leasehold and retail improvements, and restaurant property. Another change to note: Air conditioning and heating units are now eligible for Section 179 expensing.

## Proposed rules make estate planning an important part of your year-end review

Is your estate plan up-to-date? A year-end review as part of your overall tax planning is a good idea, especially in light of recently issued proposed rules that will make significant changes to certain estate planning techniques. Here's what you need to know.

**What's changing.** The new rules will limit the "valuation discounts" created when assets are transferred between individuals. These discounts help reduce the amount of your assets subject to gift and estate taxes, and are particularly relevant when you have more than \$5,450,000 in

assets (\$10.9 million for a couple). Since the top estate and gift tax rate is 40%, taking advantage of these discounts can help reduce the tax bill on your estate.

**Who's affected.** This type of estate planning usually involves the use of a family limited partnership to transfer ownership of assets such as businesses and real estate from parents to children. With this strategy, control of the partnership is dispersed among family members, making the partnership assets harder to sell. Due to the difficulty in selling, the

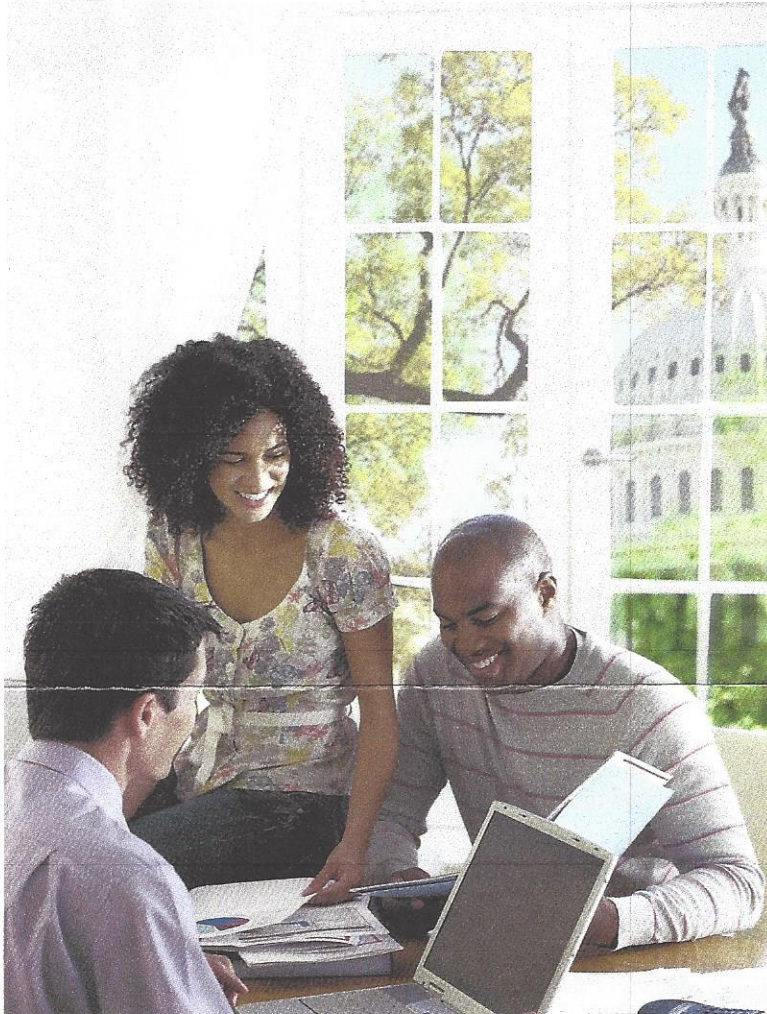
value of the assets is reduced, creating a valuation discount. Once the rules go into effect, you may have to pay more gift and/or estate tax when utilizing this type of estate planning.

**When the change will happen.** Currently, the new rules are expected to be finalized in January 2017.

Contact us for details, and to schedule a review of your estate plan. □







credit this year, be aware you'll need a copy of the information statement (Form 1098-T) sent by your school. This year, schools are generally required to report on Form 1098-T only the tuition and qualified expenses that you actually paid. However, you may buy books and credit-eligible materials from a supplier other than your school. Those costs would not be on the Form 1098-T that you receive. To include the expenses in the calculation of your tax benefit, keep receipts as proof of your payments.

Some "green" cars still qualify for federal tax credits too. When you buy a new personal or business plug-in electric drive vehicle in 2016, you may qualify for a credit of as much as \$7,500. Eligible vehicles include cars, light trucks, and motorcycles. In general, the vehicle must be under 14,000 pounds and powered by a rechargeable electric motor. There's also a credit for fuel cell motor vehicles, which are powered by cells that convert chemical energy into electricity. The base credit is \$4,000 for vehicles weighing less than 8,500 pounds.

### ■ Avoid penalties

A good way to save tax dollars is to avoid paying extra because of missed deadlines or mistakes, including the underpayment of federal estimated tax. If you receive income not subject to withholding such as alimony or rent, verify that you're on track to pay estimates that total at least the smaller of 90% of the tax for 2016 or 100% of the tax shown on your 2015 return. Special rules apply when your income exceeds \$150,000.

Don't want to make estimated payments? If you have earned income, increasing the amount withheld from your paycheck between now and the end of the year can help avoid a penalty. If you're married and both working, remember to account for the 0.9% Medicare surtax when your joint income exceeds \$250,000.

Looking for more tax planning opportunities? Contact us to schedule a year-end tax review and to explore additional options tailored to your specific circumstances. □

### ■ Benefit from credits

Credits can reduce your personal and business taxes dollar for dollar – one reason they're valuable enough to warrant giving special attention to the details. As an example, if you plan to claim the American Opportunity Tax Credit or other education

## ■ 2016 tax rules – a quick review ■

**Income tax rates** – Range from 10% to 35% unless taxable income exceeds \$415,050 for singles or \$466,950 for married couples. Rate on income above those amounts is 39.6%.

**Estate & gift tax** – Annual tax-free gifts allowed with \$14,000 per gift limit. Estate tax exemption of \$5,450,000 for 2016 with 40% top tax rate.

**Breaks now permanent** – 1) optional deduction for state and local sales tax in lieu of state and local income tax; 2) the \$250 deduction for classroom supplies paid by teachers; and 3) IRA-to-charity transfer of up to \$100,000 by

taxpayers 70½ or older.

**Itemized deductions** – Limited for single taxpayers with adjusted gross income (AGI) above \$259,400 and married couples with AGI above \$311,300.

**Alternative minimum tax** – Exemption amount for 2016: \$53,900 for singles; \$83,800 for married filing jointly.

**Business expensing** – Up to \$500,000 for new and used equipment and 50% bonus depreciation for new assets.

**Personal exemptions** – Phased out for singles with AGI above \$259,400 and marrieds with AGI above \$311,300.

**Capital gains & dividends** – Long-term gains taxed at 15% for most taxpayers. Zero percent for those in 10% and 15% ordinary income brackets; 20% for those in 39.6% ordinary income bracket.

**Medicare tax on earned income** – Medicare surtax of 0.9% imposed on wages and self-employment income exceeding \$200,000 for singles and \$250,000 for married couples.

**Net investment income tax** – A 3.8% tax imposed on unearned income for singles with modified AGI exceeding \$200,000 and for couples with modified AGI exceeding \$250,000. □



# Keep up with Affordable Care Act information reporting

**A**s 2017 approaches, turning your attention to your reporting requirements under the health care law can prevent a beginning-of-the-year rush to gather information. Need additional incentive? Consider this: Though the IRS offered extended deadlines and relief from filing penalties last year, those breaks will likely not apply to this year's returns. Here's what to think about as you prepare for the upcoming filing season.



- **How many employees you have.** The key here is understanding that your employee count includes full-time employees as well as full-time equivalent employees. You're an "applicable large employer," or ALE, if your business employed an average of at least 50 full-time employees, including full-time equivalent employees, on business days during the preceding calendar year. Special rules apply to related companies with a common owner, seasonal workers, and new employers.

- **What's the definition of full-time and full-time equivalent?** A full-time employee is one who works an average of 30 or more hours per week (or 130 hours per month). Full-time equivalents are determined by multiplying the number of part-time employees by average hours worked and dividing the result by the hours required for full-time status.

**Example.** Twenty employees working an average of 15 hours per week are equivalent to 10 full-time employees (20 employees times 15 hours divided by 30 hours).

- **How do you count employees?** Here's the general rule. Add the total number of full-time employees for each month of the prior calendar year to the total number of full-time equivalent employees for each month of the prior calendar year. Divide that number by 12. Is the answer fewer than 50? You're not an ALE, and you generally have no reporting requirements. If the answer is 50 or more, you are an ALE.

- **The forms you'll need to file.** If your employee count reveals that you are an ALE, you're required to file a Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage*, for each employee who was a full-time employee for any month of the calendar year. You'll also have to file one or more Forms 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*. Form 1095-C informs individual employees about the health coverage offered by your business. Form 1094-C reports the summary of all your Forms 1095-C. □

## 2017 DEADLINES

Form 1095-C (copies sent to employees) ► January 31, 2017

Forms 1094-C and 1095-C (copies due to IRS, if filed on paper) ► February 28, 2017

Forms 1094-C and 1095-C (copies due to IRS, if filed electronically) ► March 31, 2017

## YEAR-END 2016

NOTE: This newsletter is issued annually to provide you with information about minimizing your taxes. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.

## Wrap up tax benefits for year-end charitable gifts

**A**re you contemplating gifts to charity at the end of this year? Not only do you help out a worthy cause, you can also reduce your 2016 tax bill if you itemize your deductions. Here's how to make sure you'll get the full benefit.

- **The general rule.** Generally, you can deduct the full amount of contributions you make to a qualified charitable organization, up to 50% of your adjusted gross income for the year. Did you make a large contribution? You can carry the excess forward for five years. Just remember that you have to get written acknowledgment from the charity for monetary gifts of \$250 or more.

**Tip:** A contribution made by credit card late in the year is still deductible if posted to your account this year. You can charge an online donation on December 31, and take a deduction on your 2016 return, even if you don't pay the credit card bill until 2017.

- **"This for that" gifts.** When you make a gift of more than \$75 that entitles you to receive goods or services in return, the charity must provide a good faith estimate of the goods or services received and the amount of payment exceeding the value of the gift. You can deduct the portion that exceeds the fair market value.

- **Gifts of your time.** Although you can't deduct the value of volunteer services you provide, you can write off out-of-pocket expenses incurred on behalf of a charity. Examples include long-distance travel, lodging, and local transportation.

- **Gifts of property.** In general, the annual deduction for gifts of property is 30% of your adjusted gross income. You can carry the remainder forward for five years. If you donate appreciated property you've owned for more than a year, in most cases you can deduct the property's fair market value. You'll need an independent appraisal for gifts over \$5,000.

**Tip:** To claim the full deduction, the gift must be used to further the charity's tax-exempt mission. For instance, if you donate a painting to your alma mater, it must be displayed where students can study it.

If you have questions about charitable giving tax rules, contact us. We'll help you lock in deductions before January 1. □