CAE CPA
ACCOUNTING • TAXES

2016 INDIVIDUAL TAX PLANNING

We hope that you are looking forward to the Holiday Season. It is hard to believe that it is mid-December and this year is quickly ending. While little happened in the way of tax legislation in 2016, there are certain tax breaks from which you may benefit and certain strategies that can be employed to help minimize taxable income and your federal tax liability.

CONSIDERATIONS FOR 2016

For 2016, the marginal tax brackets are 10%, 15%, 25%, 28%, 33% 35% and the top tax rate of 39.6% which will apply to incomes over $415,050 (single), $466,950 (married filing jointly and surviving spouse), $233,475 (married filing separately), and $441,000 (heads of households). Higher-income taxpayers may also subject to the 3.8 percent net investment income tax and/or the .9 percent Medicare surtax. Finally, there is the alternative minimum tax which can creep up on taxpayers with a multitude of deductions.

The following are some ideas that you may want to consider for 2016.

FUNDING RETIREMENT PLANS & CATCH-UP PROVISIONS CONSIDERATIONS

Fully funding your company 401(k) with pre-tax dollars will reduce current year taxes, as well as increase your retirement nest egg. For 2016, the maximum 401(k) contribution you can make with pre-tax earnings is $18,000. For taxpayers 50 or older, that amount increases to $24,000. If you have a SIMPLE Plan, the maximum pre-tax contribution for 2016 is $12,500. That amount increases to $15,500 for taxpayers age 50 or older.

If certain requirements are met, contributions to an individual retirement account (IRA) may be deductible. For taxpayers under 50, the maximum contribution amount for 2016 is $5,500. For taxpayers 50 or older but less than age 70 1/2, the maximum contribution amount is $6,500. Even if you are not eligible to deduct contributions, contributing after-tax money to an IRA may be advantageous because it will allow you to later convert that traditional IRA to a Roth IRA. Qualified withdrawals from a Roth IRA, including earnings, are free of tax, while earnings on a traditional IRA are taxable when withdrawn.

If you already have a traditional IRA, we should evaluate whether it is appropriate to convert it to a Roth IRA this year. You'll have to pay tax on the amount converted as ordinary income, but subsequent earnings will be free of tax. And if you have a traditional 401(k), 403(b), or 457 plan that includes after-tax contributions, a new rule allows you to generally rollover these after-tax amounts to a Roth IRA with no tax consequences. A rollover of a SIMPLE 401(k) into a Roth IRA may also be available. As with all tax rules, there are qualifications that apply to these rollovers that we should discuss before you take any actions.

SIGNIFICANT OPPORTUNITY - The income limitation for conversions from a traditional IRA to a Roth IRA has been repealed (also available for some 401(k), 403(b) and 457 plans). We expect that for most of our clients, this will be a long-term tax benefit, but each individual situation should be evaluated. If you are interested in exploring the benefits in your situation, please let us know. <u>We recommend all of our clients explore this tax saving</u>

opportunity. Those taxpayers who should consider this strategy include clients concerned about rising tax rates, have room in current marginal tax bracket, have unused net operating losses, existing charitable deduction carryover, interested in avoiding required minimum distributions, interested in funding grandchildren's education, and concerns about estate taxes.

Additionally, the Treasury Department has introduced a starter retirement account known as "myRA," into which you may deposit tax refunds. The program allows you to establish a Roth IRA with a Treasury Department designated custodian. You can continue to participate in the program until your account balance reaches $15,000 or until you have participated in the program for 30 years, whichever occurs first. At any time, you can transfer your balance to a commercial financial services provider to take advantage of a broader array of retirement products available in the marketplace.

Finally, self-directed IRAs allow an IRA owner to have more control over the type of investments that will be held in the IRA. However, the large amount of money held in self-directed IRAs makes them attractive targets for fraud promoters. Thus, self-directed IRA can be costly if not properly managed. In addition, because of the types of investments taxpayers with self-directed IRAs are able to make, taxpayers have a greater risk of running afoul of the prohibited transaction rules. The prohibited transaction rules impose an excise tax on certain transactions - such as sales of property, the lending of money or extension of credit, or the furnishing of goods, services, or facilities - between an IRA and a disqualified person. If you have a self-directed IRA, we need to review the specifics of your arrangement.

CHARITABLE CONTRIBUTIONS

Most charitable contributions made prior to December 31st will qualify for an itemized deduction in 2016. If you are planning any charitable contributions soon, you may benefit if the contribution is made on or before December 31st.

If you are planning any significant charitable contributions, you may want to consider using highly-appreciated capital gain property instead of cash. In many cases, you will be allowed a charity deduction equal to the “fair market value” of the property without having to pay capital gains tax on the prior appreciation. If you are considering any large gift, we suggest you contact us to determine if this approach will benefit your tax situation.

If you have an unusually high-income year, you may want to consider the use of a private donor fund for current and future charitable gifting. This approach can be even more advantageous if you have appreciated investments to fund the private donor fund. Private donor funds allow you to place multiple years of charitable contributions in a mutual fund platform to be distributed at your discretion while allowing the tax deduction to be claimed in the current year. Let us know if you would like to consider this strategy.

Direct tax-free distributions from IRA's to 501(c)(3) charities continue to be available and should be considered for certain situations.

AFFORDABLE HEALTHCARE ACT ("ACA") CONSIDERATIONS

Under Affordable Healthcare Act there is a penalty, known as the "shared responsibility payment," for not having health insurance coverage. You may be liable for this penalty if you or any of your dependents didn't have health insurance for any month in 2016. The penalty is 2.5 percent of your 2016 household income exceeding the filing threshold or $695 per adult, whichever is higher, and $347.50 per uninsured dependent under 18, up to $2,085 total per family. Depending on your income, you may be eligible for an exemption from the penalty.

HEALTHCARE INSURANCE PREMIUM TAX CREDIT

Some taxpayers are allowed a credit for a percent of amounts paid for qualified health insurance coverage. Health Coverage Tax Credit (HCTC) can now be claimed for coverage through 2019. If you received the type of benefits mentioned in 2016, we should determine if you were eligible for the credit and make sure that you receive the tax benefit.

CAPITAL LOSS DEDUCTIONS AND WORTHLESS SECURITIES

Annually you are permitted to deduct up to $3,000 in net capital losses against ordinary income. You are also able to net any capital gains against capital losses prior to applying the $3,000 limitation. The strategy is to review your investment portfolio and recognize up to $3,000 in capital losses in excess of capital gains prior to December 31st. Also, do not overlook any securities that may have become worthless. These investments should also be reported to recognize the capital loss. If you have any near-worthless securities, you may want to consider selling or surrendering the position so that the capital loss can be recognized in 2016. Finally, do not overlook any capital loss carryovers from prior years that can benefit you in 2016.

CAPITAL GAIN RATES CAN BE 0% FOR LIMITED TAXPAYERS

Certain taxpayers that are within the 10% or 15% marginal tax brackets can benefit from a 0% tax rate on long-term capital gains and "qualified dividends". If you fall into this situation, you may want to consider selling your capital gain investments prior to December 31st to benefit from the 0% tax rate.

CAPITAL GAIN RATES CAN BE 20% FOR HIGH INCOME TAXPAYERS

Certain taxpayers long-term capital gains tax rate is increased from the 15% capital gains tax rate to 20% for taxpayers in the highest tax bracket.

AMERICAN OPPORTUNITY CREDIT & VIRGINIA EDUCATION SAVINGS PLAN

If you, your spouse, or a dependent incurred qualified education expenses to attend an accredited postsecondary institution (e.g., a college or university), you may be eligible for the American Opportunity Credit. The maximum annual credit is $2,500 per eligible student. Expenses which qualify for the tax credit include tuition and fees required for the enrollment or attendance at an eligible educational institution.

Beginning in 2016, in order to claim an American Opportunity or lifetime learning credit or a deduction for education-related tuition and fees, you must have received a Form 1098-T. The form reports qualified tuition and related expenses received by the educational institution. The information reported on this form will be matched against the information reported to the IRS. If you have educational expenses eligible for the credit or deduction, you should receive Form 1098-T from the educational institution to which you made payments by January 31, 2017. While the form is supposed to report the aggregate amount of payments received by the educational institution, there is a one year transition period where institutions may report the amount billed for 2016 rather than the amount paid.

Because the form only reports qualified tuition and related expenses, you may see a discrepancy between the amounts you paid and the amounts reported. This is due to the fact that certain expenses, such as fees for room, board, insurance, medical expenses, transportation, etc. are not considered qualified tuition and related expenses and thus are not reported on Form 1098-T.

The 2016 Virginia deduction for contributions to a Virginia 529 plan is $4,000. If you are 70 years old or older, there is no limit on the deduction for contributions. We suggest you review your 2016 contributions to any Virginia 529 plan to be sure you are maximizing your benefits.

DEDUCTION FOR QUALIFIED TUITION AND RELATED EDUCATION EXPENSES

If your modified adjusted gross income (MAGI) does not exceed a certain amount, 2016 is the last year that you may deduct qualified education expenses paid during the year for yourself, your spouse, or your dependents. You can deduct up to $4,000, $2,000, or $0 of tuition and fees paid, depending on the amount of your modified adjusted gross income (MAGI). The $4,000 limit applies if your MAGI does not exceed $65,000 ($130,000 on a joint return). The $2,000 limit applies if your MAGI exceeds $65,000 ($130,000 on a joint return) but does not exceed $80,000 ($160,000 on a joint return). No deduction is allowed if your MAGI exceeds $80,000 ($160,000 on a joint return).

NET INVESTMENT INCOME TAX CONSIDERATIONS

A 3.8 percent tax applies to certain net investment income of individuals with income above a threshold amount. The threshold amounts are $250,000 (married filing jointly and qualifying widow(er) with dependent child), $200,000 (single and head of household), and $125,000 (married filing separately). In general, investment income includes, but is not limited to: interest, dividends, capital gains, rental and royalty income, non-qualified annuities, and income from businesses involved in trading of financial instruments or commodities. Thus, while the top tax rate for qualified dividend income is generally 20%, the top rate on such income increases to 23.8% for a taxpayer subject to the net investment income tax.

If it appears you may be subject to the net investment income tax (NIIT), the following actions may help avoid the tax. We should discuss whether any of these options make sense in light of your financial situation.

(1) Donate or gift appreciated property. By donating appreciated property to a charity, you can avoid recognizing the appreciation for income tax purposes and for net investment

income tax purposes. Or you may gift the property so that the done can sell it and report the income. In this case, you'll want to gift the property to individuals that have income below the $200,000 (single) or $250,000 (couples) thresholds.

(2) Replace stocks with state and local bonds. Interest on tax-exempt state and local bonds are exempt from the NIIT. In addition, because such interest income is not included in adjusted gross income, it can help keep you below the threshold for which the NIIT applies.

(3) If you intend to sell any appreciated assets, consider whether the sale can be structured as an installment sale so the gain recognition is spread over several years.

(4) Since capital losses can offset capital gains for NIIT purposes, consider whether it makes sense to sell any losing stocks, but keeping in mind the transaction costs associated with selling stocks.

(5) If you have appreciated real property to dispose of and are not considered a real estate professional, a like-kind exchange may be more advantageous. By deferring the gain recognition, you can avoid recognizing income subject to the NIIT.

ADDITIONAL MEDICARE TAXES

An additional Medicare tax of 0.9 percent is imposed on wages and self-employment income in excess of a threshold amount. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case. Employers are required to withhold the extra .9 percent once an individual's wages pass $200,000. No deduction is allowed for the additional tax. However, you may be due a credit if, for example, your status is married filing jointly, one of you had wages over $200,000, but joint wages are less than $250,000. On the flip side, you may owe the additional .9 percent if you and your spouse file jointly and each made under $200,000 of wages but together made over $250,000 in wages.

ALTERNATIVE MINIMUM TAX CONSIDERATIONS

Because many deductions taken for regular tax purposes are not allowed for alternative minimum tax ("AMT") purposes, you may be subject to the AMT if you have excessive deductions. Deductions which typically throw taxpayers into an AMT situation include high state and local taxes, interest on home equity loans, a high number of dependent deductions, and a large amount of miscellaneous itemized deductions. For 2016, the AMT rate is 26% on alternative minimum taxable income ("AMTI") up to $185,400 ($92,700 for married filing separately) and 28% on AMTI over that amount. However, you are allowed an AMT exemption depending on your filing status; but the exemption is phased out for taxpayer's above a certain income level.

If you may be subject to the AMT this year, we should discuss what actions can be taken to reduce your exposure. Since the calculation of the AMT begins with adjusted gross income, lowering your adjusted gross income by maximizing contributions to a tax-deferred retirement plan (e.g., 401(k)) or tax-deferred health savings account may be appropriate.

PHASE OUT OF ITEMIZED DEDUCTIONS

Taxpayers with adjusted gross income ("AGI") above a $259,400 (single) and $311,300 (married filing jointly) threshold will lose a portion of their itemized deductions. The phase-out will equal 3% of the amount by which income exceeds these thresholds. The reduction cannot exceed 20% of the itemized deductions.

PHASE OUT OF PERSONAL EXEMPTIONS

Taxpayers with adjusted gross income ("AGI") above a $258,200 (single) and $309,900 (married filing jointly) threshold will lose a portion of their personal exemptions. The personal exemptions will be reduced 2% for each $2,500 (or portion thereof) of income above the threshold.

FOREIGN BANK ACCOUNT REPORTING

If you have an interest in a foreign financial institution, the balances must be disclosed; failure to do so carries stiff penalties. You must file a Report of Foreign Bank and Financial Accounts (FBAR) if: (1) you are a U.S. resident or a person doing business in the United States; (2) you had one or more financial accounts that exceeded $10,000 during the calendar year; (3) the financial account was in a foreign country; and (4) you had a financial interest in the account or signatory or other authority over the foreign financial account. The deadline for filing the form was moved up and it is now due April 15th. However, a six-month extension is available. If an individual is abroad, the due date is automatically.

DEDUCTION FOR MORTGAGE INSURANCE PREMIUMS

If you paid qualified mortgage insurance, it is deductible as qualified residence interest. The insurance must have been paid in connection with acquisition debt for a qualified residence. No deduction is available for amounts paid or accrued after December 31, 2016.

GIFTING APPRECIATING INVESTMENTS TO CHILDREN

If you have children, particularly college age kids, we should consider if there is any income that can be shifted to them so that the tax on the income is paid at the child's tax rate. One strategy is gifting appreciated stock to the child. Where a child has earned income and is taxed at the bottom two income brackets, capital gains generated on the stock sale are taxed at 0 percent, instead of the 15 percent or more that the parent would pay. However, if the child has little or no earned income, the kiddie tax could be a factor. In this case, you will want to limit the child's unearned income to $2,100 or less for 2016 in order to avoid having your top tax rate apply to the child's income.

MISCELLANEOUS TAX CONSIDERATIONS

Other transactions to consider include:
(1) the deduction by elementary and secondary school teachers of up to $250 of qualified expenses they paid during the year ($500 on a joint return if both spouses were eligible educators) and expand the deduction to include expenses in connection with the professional development activities of an educator;
(2) The exclusion from income of imputed income from the discharge of acquisition indebtedness for a primary principal residence;

(3) The equalization of the tax exclusion for employer-paid mass transit and parking benefits and expands such exclusion to include bike sharing programs;
(4) The tax deduction for state and local general sales taxes in lieu of state and local income taxes.

VIRGINIA LIVABLE HOME CREDIT

Virginia has increased the credit to 50% of the cost limited to $5,000 in tax credits for certain qualified home improvements designed to improve the accessibility of your home.

VIRGINIA NEIGHBORHOOD ASSISTANCE ("NAP") CREDITS

The purpose of the Virginia Neighborhood Assistance Act is to encourage individuals, trusts and businesses to make donations to pre-approved 501(c)(3)(4) non-profit organizations, known as Virginia Neighborhood Assistance Programs ("NAPs"). Tax credits are available to individuals and married couples donating cash or securities directly to NAPs. The minimum amount to be donated is $500 by an individual or married couple. Any eligible charitable organization must have applied to participate in the Virginia Neighborhood Assistance Program to be allocated credits. If you contribute to a participating charitable organization, you must fill out the Contribution Notification Form and submit it to the charitable organization. The charitable organization will then notify the Virginia Department of Taxation that you have been transferred credits and you will be issued a tax credit certificate, which will need to be attached to your Virginia tax return. Only a limited amount of credits are available for each qualifying charity each year. You might not receive a credit if the organization has already distributed its share of credits. If you receive more credits than you can use this year, the credits may be carried forward for up to five years.

For more information about the Virginia Neighborhood Assistance Act and for a full list of qualifying charitable organizations, go to the Department of Social Services website at http://www.dss.virginia.gov/community/nap.cgi. Please contact our office if you have questions on the Virginia NAP.

VIRGINIA EDUCATION IMPROVEMENT SCHOLARSHIP TAX CREDITS

Individuals or businesses can make monetary or marketable securities donations to approved foundations. The donations will be used to provide scholarships to low-income new students of non-public schools. Donors will then receive a Virginia tax credit for 65% of the donation, in addition to the normal charitable donation deductions on federal and stale taxes for taxpayers that itemized their deductions. This credit requires a preauthorization process to qualify for tax credits.

OTHER STEPS TO CONSIDER BEFORE THE END OF THE YEAR

The following are some of the additional actions to review before year end to see if they make sense in your situation. The focus should not be entirely on tax savings. These strategies should be adopted only if they make sense in the context of your total financial picture.

TIMING OF INCOME RECOGNITION

If it looks like you may have a significant decrease in income next year, it may make sense to defer income into 2017 or later years. Some options for deferring income include: (1) if you are due a year-end bonus, having your employer pay the bonus in January 2017; (2) if you are considering selling assets that will generate a gain, postponing the sale until 2017; (3) delaying the exercise of any stock options; (4) if you are planning on selling appreciated property, consider an installment sale with larger payments being received in 2017; and (5) consider parking investments in deferred annuities.

Depending on your projected income for 2017, it may make sense to accelerate income into 2016 if you expect 2017 income to be significantly higher. Options for accelerating income include: (1) harvesting gains from your investment portfolio, keeping in mind the 3.8 percent NIIT; (2) converting a retirement account into a Roth IRA and recognizing the conversion income this year; (3) taking IRA distributions this year rather than next year; (4) if you are self-employed and have clients with receivables on hand, try to get them to pay before year end; and (5) settle any outstanding lawsuits or insurance claims that will generate income this year.

TIMING OF DEDUCTIBLE EXPENSES

If you anticipate a substantial increase in taxable income, it may be advantageous to push deductions into 2017 by: (1) postponing year-end charitable contributions, property tax payments, and medical and dental expense payments, to the extent deductions are available for such payments, until next year; and (2) postponing the sale of any loss-generating property.

If you expect a decrease in income next year, accelerating deductions into the current year can offset the higher income this year. Some options include: (1) prepaying property taxes in December; (2) making January mortgage payment in December; (3) if you owe state income taxes, making up any shortfall in December rather than waiting until the return is due; (4) since medical expenses are deductible only to the extent they exceed 10 percent (7.5 percent for individuals age 65 before the end of the year) of adjusted gross income, bunching large medical bills not covered by insurance into one year to help overcome this threshold; (5) making any large charitable contributions in 2016, rather than 2017; (6) selling some or all loss stocks; and (7) if you qualify for a health savings account, setting one up and making the maximum contribution allowable.

ESTATE PLANNING CONSIDERATION:

ESTATE TAX EXEMPTION AND RATES

The maximum estate tax rate is 40%. A $5,430,000 exemption amount is available for estates of individuals dying in 2016. The exemption amount is indexed for inflation each year.

GIFT TAX

The Act unified the estate exemption amount with the gift tax. In other words, the $5,430,000 exemption amount is available to reduce the gift tax during life and any unused amount of the $5,430,000 exemption is available to be used for estate tax purposes at death. The annual exclusion for 2016 is $14,000 and it if an election is made to split the gifts among spouses, the annual exclusion per recipient increases to $28,000.

LIFE EVENTS

Certain life events can also affect your tax situation. If you got married or divorced, had a birth or death in the family, lost or changed jobs, or retired during the year, we need to discuss the tax implications of these events.

MISCELLANEOUS ITEMS

Finally, these are some additional miscellaneous items to consider:

(1) Spend any remaining health flexible spending account balances before year end (unless your employer allows you to go until March 15, 2017, in which case you'll have until then). You should check with your employer to see if they give employees the optional grace period to March 15.

(2) If you rent out a vacation home, we should review at the number of days it was used for business versus pleasure to see if there are ways to maximize tax savings with respect to that property.

Let us know if you have any questions, or if you require any clarification of any of these subjects. We wish you a successful conclusion to 2016 and a Happy Holiday Season.