December 8, 2016

2016 Year End Tax Planning

Dear Client:

Many people are making plans for the year-end holidays and the coming new year. Not to be overlooked should be year-end tax planning. Every individual can develop a year-end tax planning strategy that reflects his or her situation. This letter is intended to provide insight and comments on a number of areas, including a list of suggested areas for taxpayers to consider at year end such as the American Opportunity Tax Credit Act made permanent by the 2016 PATH legislation, certain Life Events that require consideration of tax planning implications and what to look for ahead given the change in the White House.

Income and deductions for the entire year typically become more clear for most taxpayers as they move ever closer to the end of the calendar year. The last few months of the year provide an important “last chance" to change the final course of the entire tax year before it closes for good. Initiating traditional techniques designed to accelerate deductions and delay income can yield substantial tax savings.

The impact of recent tax legislation and significant IRS rule changes during 2016 raises the stakes. The *Protecting Americans from Tax Hikes Act* (PATH Act), passed in late 2015, changed both dramatically and through some nuanced revisions, the dynamics of planning for the expiration of various tax breaks and the permanence of others. The IRS for its part has been busy fine-tuning Affordable Care Act requirements, creating safe-harbor benefits under the “re-pair regulations,” clarifying the definition of marriage for tax purposes, and more, all of which impact the 2016 tax year.

Taxpayers at year-end should review their own personal situations. Comparing how 2016 is looking against 2015 returns can help identify new tax benefits -or expose new tax pitfalls that may otherwise be missed.

YEAR-END TAX PLANNING

**Tax Rate Exposure** - Balancing the impact of the existing tax rates on a variety of transactions during the year and at year-end can be challenging: the ordinary income tax rates, the capital gain rates, the net investment income tax rate, and the alternative minimum tax (AMT), all may play a role.

- **Ordinary income tax rates**. One of the most significant changes over three years ago that still reverberates with many taxpayers is the creation of the 39.6 percent bracket, up from a top 35 percent rate.

- **Net Investment Income (NII) tax**. The NII tax is 3.8% on the lesser of net investment income or the excess of modified adjusted income over the threshold amount. The threshold amount is equal to $250,000 modified adjusted gross income (MAGI) in the case of joint returns or a surviving spouse; $125,000 in the case of a married taxpayer filing a separate return, and $200,000 for other filers. If possible, keep general income below the threshold amounts by spreading income out over a number of years or offsetting the income with above- the-line deductions.

- **Additional Medicare Tax**. The Additional Medicare Tax is 0.9 percent of covered wages and other compensation above threshold dollar amounts that mirror the threshold amounts of the NII tax regime.

- **Capital Gains and Dividends**. The tax rates on qualified capital gains (net long-term gains) and dividends range from zero to 20 percent, depending upon the individual's income tax bracket. Spikes in income, whether capital gains or other income, may push gains into either the 39.6 percent bracket for short-term gain or the 20 percent capital gains bracket. Spreading the recognition of certain income between 2016 and 2017 may help minimize the total tax paid for the 2016 and 2017 tax years.

- **Capital losses**. Cashing out stocks with a built-in loss may be a simple means of providing a loss to be taken against current ordinary income. Individuals can deduct up to $3,000 of additional losses, whether net long-term or short-term; losses above $3,000 can be carried forward and deducted in succeeding years. If the investment remains economically attractive, taxpayers can buy the same stock more than 30 days before or after they sell shares in the same company. This avoids the "wash sale" rules, which would disallow the loss. The wash-sale rule, however, applies only to losses; gains are recognized in full, a benefit if acceleration of some income into 2016 is a goal, whether to absorb excess losses or otherwise.

- **Adjusted gross income caps**. 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 taxpayers' AGI level include:

    - itemized deductions
    - personal exemptions
    - education savings bond interest exclusion
    - maximum child's income on parent's return
    - education credits
    - student loan interest deduction adoption credits
    - maximum Roth IRA contributions maximum IRA contributions for individuals.

**American Opportunity Tax Credit**. The PATH Act made the American Opportunity Tax Credit (AOTC) permanent. The AOTC is equal to 100 percent of the first $2,000 of qualified tuition and related expenses, plus 25 percent of the next $2,000 of qualified tuition and related expenses.

An education tax credit is generally allowed only for payments of qualified tuition and related expenses for an academic period beginning in the same tax year as the year the payment is actually made. However, if qualified expenses are paid during one tax year for an academic period that begins during the first three months of the following tax year, the academic period is treated as beginning during the tax year in which the expenses were paid.

**State and local sales tax deduction**. The PATH Act made permanent the itemized deduction for state and local general sales taxes. That deduction may be taken in lieu of state and local income taxes when itemizing deductions. Generally IRS tables based upon federal income levels together with a taxpayer's number of dependents are used for this optional deduction. Taxpayers who wish to claim more than the table amounts must provide adequate substantiation.

**Exclusion for direct charitable donation of IRA funds**. The PATH Act made permanent the exclusion from gross income of qualified charitable distributions for individuals aged 70 1/2 or older. The exclusion covers distributions of up to $100,000 received from traditional or Roth IRAs ($100,000 for each spouse on a joint return). The transfer to the charity from the IRA must be completed by December 31, 2016, to treat it taking place in 2016.

**Tuition and fees deduction**. The PATH Act extended the above-the-line deduction for qualified tuition and related expenses for two years, for expenses paid before January 1, 2017. The maximum amount of the tuition and fees deduction is $4,000 for an individual whose AGI for the tax year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose AGI does not exceed $80,000 ($160,000 in the case of a joint return).

**Exclusion for discharge of indebtedness on principal residence**. The PATH Act extended the exclusion from gross income of discharged qualified principal residence indebtedness, applicable to discharges of qualified principal residence indebtedness occurring before January 1, 2017, or discharges that are subject to an arrangement that is entered into and evidenced in writing before January 1, 2017.

**Mortgage insurance premium deduction**. The PATH Act extended the treatment of qualified mortgage insurance premiums as qualified residence interest retroactively for two years, to apply to amounts paid or accrued through 2016, and not properly allocable to a period after December 31, 2016.

**Nonbusiness energy property credit**. The PATH Act extended the nonrefundable non-business energy property credit allowed to individuals, making it available for qualified energy improvements and property placed in service before January 1, 2017.

## 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 can impact year-end tax planning. The PATH Act permanently extended many tax incentives that were previously temporary, removing for the first time in many years the year-end concern over their temporary applicability.

- **Marriage**. Marital status (single, married or divorced) for the entire tax year is determined on December 31st. Because the income tax brackets vary depending upon filing status, a marriage penalty or a marriage benefit may result for any particular couple. As a general rule, if each partner has income approximately in the same amount of the other, they will pay more filing a married, joint return rather than as two single individuals. Accelerating or postponing marriage or divorce at year-end might be considered based upon this difference in tax brackets.

- **Dependents**. A child born at any time during the tax year is considered a child for that entire tax year. Subject to AGI limits, a child born at year-end 2016 entitles the parent to a full $4,050 personal exemption, a full $1,000 child credit, and up to a $3,000 child care credit if eligible. These benefits also have cut-off ages that are keyed to the age a dependent turns before the close of the tax year: under 19 (or under 24 if a student) for the dependency exemption and the “kiddie” tax rules, under age 17 for the child credit, and under age 13 for the child care credit. These age limits change for disabled children.

- **Retirement**. Taxpayers may want to take a look at a number of different provisions at year-end in anticipation of retirement, at the point of retirement, or after retirement. Many of these provisions have opportunities and deadlines keyed to the tax year. Three strategies especially stand out for year-end consideration:

  - **Minimum distribution requirements**. Most retirement arrangements (other than Roth IRAs) require that participants begin to take annual payments of benefits in the year they turn age 70 1/2. While distributions generally must be made at the end of the calendar year, distributions for the first year can be delayed until April 1 of the succeeding year.

  - **Roth conversions / reconversions**. A traditional IRA may be converted to a Roth IRA. As with rollovers to traditional IRAs, the 10-percent additional tax on early distributions does not apply; however, unlike rollovers to traditional IRAs the amount converted is taxable in the year of conversion.

  - **Roth reconversions**. Once a Roth IRA has been recharacterized back to a (new) traditional IRA, the (new) traditional IRA can be (reconverted to a Roth IRA, provided the taxpayer meets the eligibility requirements in the reconversion year. This reconversion option is most often used to allow a “do-over” when assets that are transfer lose value before year end. Any amount converted to a

Roth IRA is included in gross income as a distribution for the tax year in which the amount is distributed or transferred from the traditional IRA. When a rollover spans two tax years, the taxable amounts from the traditional IRA are included in gross income in the year in which the amounts are withdrawn from the traditional IRA.

## AFFORDABLE CARE ACT

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.

**Individual Shared Responsibility Payments**. For 2016, the individual shared responsibility payment is the greater of 2.5 percent of household income that is above the tax return filing threshold for the individual's filing status or the individual's flat dollar amount, which is $695 per adult and $347.50 per child, limited to a family maximum of $2,085, but capped at the cost of the national average premium fora bronze level health plan available through the Marketplace in 2016.

**Medical expense deduction**. Taxpayers who itemized deductions (for regular tax purposes) may claim a deduction for qualified unreimbursed medical expenses to the extent those expenses exceed 10 percent of adjusted gross income (AGI), unless the taxpayer falls within an age-based exception. Taxpayers (or their spouses) who are age 65 or older before the close of the tax year, may apply the old 7.5 percent threshold for tax years but only through 2016.

## POST-ELECTION TAX POLICY[1]

Donald Trump's election as the 45th President of the United States on November 8 is expected to bring changes to the tax laws for both individuals and businesses. President-elect Trump had made tax reduction a centerpiece of his economic plans during his campaign, saying he would, among other things, propose lower and consolidated individual income tax rates, expand tax breaks for families, and repeal the Affordable Care Act. As the next few weeks and months unfold, taxpayers will learn more about Trump's tax plans.

More immediately, the results of the November 8 election may impact year-end 2016 tax planning, because of last-minute provisions soon expected to be passed by the "lame-duck" Congress, or by the new Congress early in 2017, and made retroactive.

Further, the 115th Congress, which will convene in January 2017, will find the GOP in control of both the House and Senate, therefore allowing Trump to more easily move forward his

[1] Seigneur Gustafson LLP does has no affiliation to any political party and offers this unbiased report for informational purposes only.

proposals. It remains to be seen; however, what compromises will be necessary between Congress and the Trump Administration to find common ground. And beyond moving forward individual tax proposals, it also remains to be seen whether they can be packaged within a mandate for broader "tax reform" and "tax simplification."

During the campaign, Trump released an outline detailing his plans for his first 100 days in office. Within the "100 day plan presentation, Trump listed several tax proposals to immediately work with Congress on enacting:

- **The Middle Class Tax Relief and Simplification Act**—According to Trump, the legislation would provide middle class families with two children a 35 percent tax cut and lower the "business tax rate" from 35 percent to 15 percent. During the campaign, Trump described the plan as "an economic plan designed to grow the economy 4 percent per year and create at least 25 million new jobs through massive tax reduction and simplification."

- **Affordable Childcare and Eldercare Act** – A proposal during the campaign would allow individuals to deduct childcare and elder care from their taxes, incentivize employers to provide on-site childcare and create tax-free savings accounts for children and elderly dependents.

- **Repeal and Replace Obamacare Act** – A proposal made by Trump during the campaign to fully repeal the Affordable Care Act.

- **American Energy & Infrastructure Act** —A proposal described by Trump during the campaign that "leverages public-private partnerships, and private investments through tax incentives, to spur $1 trillion in infrastructure investment over 10 years."

Individual Taxation

- During the campaign, Trump proposed to compress into only three tax brackets the current seven tax brackets, which currently tops out at 39.6 percent. Trump's proposal would reduce rates on ordinary income to 12, 25, and 33 percent.

- Under Trump's plan, the standard deduction would increase to $15,000 for single individuals and to $30,000 for married couples filing jointly. In contrast, the 2017 standard deduction amounts under current law are $6,350 and $12,700, respectively, as adjusted for inflation.

- Trump also proposed during the campaign to implement a cap on the amount of itemized deductions that could be claimed at $100,000 for single filers and $200,000 for married couples filing jointly. Additionally, according to campaign materials, all personal exemptions would be eliminated, as would the head of household filing status.

- The current rate structure for capital gains would apparently remain unchanged under Trump's plan. Trump presumably would also retain the same rates for qualified dividend income. However, Trump has proposed to repeal the 3.8 percent net investment income (NII) tax imposed on passive income, including capital gains.

- During the campaign, Trump proposed to repeal the federal estate and gift tax. The unified federal estate and gift tax kicks in at $5.490 million for 2017 (essentially double at $10.980 million for married individuals).

- Alternative Minimum Tax (AMT) During the campaign, Trump proposed to eliminate the alternative minimum tax (AMT)

- During the campaign, Trump proposed to repeal the Affordable Care Act (ACA). Repeal of the ACA would include repeal of the 3.8 percent net investment income (NII) tax.

- Trump proposed during the campaign to create a new deduction for child and dependent care expenses, as well as increasing the earned income tax credit (EITC) for working parents who would otherwise not qualify for the deduction. Trump's plan, as explained during his campaign, would provide:

- "Spending rebates" to lower-income families for childcare expenses through the Earned Income Tax Credit. "The rebate would be equal to a certain percentage of remaining eligible childcare expenses, subject to a cap of half of the payroll taxes paid by the taxpayer," according to campaign materials. "Above-the-line" deductions for child and elder care expenses, for qualified taxpayers with income up to certain thresholds.

- Trump also proposed during the campaign to create Dependent CARE Savings Accounts (DCSAs), tax-favored savings accounts for children, including unborn children, and dependent care expenses, which would be matched by a government contribution. The savings accounts would have an annual contribution limit. Trump's plan would also expand the credit for employer provided child care.

- Trump proposed during the campaign to tax Carried interest as ordinary income.

We are here for you as you navigate the end of 2016 and beginning of the new year. Call on your SG advisor to assist as needed. We hope you have a joyous holiday season ahead filled with hope, peace and good health to you and your friends and family.

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