MICHAEL SILVER & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

2016 Year-End Tax Planning Checklist

As the end of the year approaches, it is time to consider planning opportunities that could help lower your tax bill for this year and possibly the next. The impact of the Trump administration tax policies for 2017 have yet to be revealed. The likelihood exists that federal tax-cut legislation will become law sometime in 2017. Nevertheless, the possibility also remains that comprehensive tax legislation may be delayed until 2018 either because of difficult negotiations or intervening events. The contents of a tax bill, too, could vary — from a compromise between the House GOP's "Better Way" blueprint and President-elect Trump's tax plan as set forth during his campaign.

Executive Summary

In this article, we will expand on the following year-end planning tips:

- Minimize taxable income in order to ensure that your tax breaks are not reduced or eliminated due to phase-outs.
- Consider the timing of controllable income that can be deferred and deductions that can be accelerated. Take advantage of any available expensing and accelerated depreciation deductions.
- Gift appreciated property at year-end to shift taxable gain to lower-bracket family members while taking advantage of the annual gift tax exclusion.
- Use appreciated assets to meet your charitable giving intentions and obligations.
- Make the best use of your tax losses.
- Dispose of passive activities in order to use suspended passive losses.
- Increase the withholding on wages in order to prevent an estimated tax underpayment penalty.
- Review your year-to-date contributions to your retirement plans and/or 401(k) and consider increasing the amounts before year-end.
- Consider a conversion from a traditional IRA to a Roth IRA. If you converted earlier in the year and asset values have declined, consider reversing the conversion in order to avoid paying taxes on the higher value.

Protecting Americans from Tax Hikes Act of 2015

At the end of the 2015, Congress passed the PATH act that made some the tax breaks permanent and extended others for several more years.

INDIVIDUAL

- Tax-free distributions from individual retirement plans for charitable purposes
- Option to deduct state and local sales taxes
- American Opportunity Tax Credit for tuition and related expenses
- Deductions for mortgage insurance premiums through 2016
- Deduction for qualified tuition and related expenses through 2016

BUSINESS

- Research & Development credit
- Increased limitation of $500,000 for expensing Section 179 property
- 15-year straight-line cost recovery for qualified leasehold, restaurant, and retail improvements
- 100% exclusion for qualified small business stock

2016 Tax Planning Checklist — Individuals

The following checklist contains actions that you can take before year-end in order to help reduce your tax liability:

- ☐ Defer income until 2017 and accelerate deductions for 2016. By employing this strategy, you may be able to claim larger deductions, credits, and other tax breaks for 2016 that are phased out over varying levels of income. Deferring income is also favorable for those taxpayers who anticipate being in a lower tax bracket next year. It must be noted, however, that in some cases, it may be beneficial to accelerate income into 2016. This may be the case for a taxpayer whose marginal tax rate is much lower this year than it will be the following year.

- ☐ Determine whether you are likely to be subject to the Alternative Minimum Tax (AMT) and if the actions you are considering will trigger it. Many deductions used to calculate regular tax are disallowed for AMT purposes, some of which include the deductions for state income taxes, real estate taxes, miscellaneous itemized deductions, and personal exemption deductions. Do not accelerate these deductions when you are subject to the AMT or suspect you might be.

- ☐ If possible, it may be beneficial to have your employer defer a year-end bonus until 2017.

- ☐ Take losses on stocks and mutual funds in order to offset any taxable gains realized during the year. However, annual deductible capital losses are limited to $3,000 in excess of your gains. Any unused loss can be carried over to future years.

- ☐ In order to reduce 2016 taxable income, consider disposing of a passive activity if you have suspended passive activity losses.

- ☐ If you plan to make charitable donations, consider donating appreciated capital gain assets (such as stocks) rather than cash. By doing so, you avoid the capital gain tax and 3.8% net investment income tax.

- ☐ Consider using a credit card to pay for charitable contributions before year-end. Even if you don't pay your credit card bill until 2017, you will still receive the deduction in 2016. Don't forget to document your out-of-pocket expenses included when volunteering for a charity.

- ☐ If you expect to owe state income taxes, consider paying your fourth-quarter estimated state income tax payment, as well as your real estate property taxes in December 2016. You can also ask your employer to increase your 2016 state tax withholding, unless you are likely to be subject to AMT.

- ☐ It may be beneficial to bunch in the current year or next year your miscellaneous itemized deductions, which are allowed only to the extent they exceed 2% of adjusted gross income, as well as medical expenses, which are taken only in excess of 10% of your adjusted gross income.

- ☐ Maximize your contributions to retirement plans and 401(k) plans. When you have a business, contributions to the business's plan may reduce your taxable income.

- ☐ If you currently have a traditional IRA, you may benefit from converting to a Roth IRA, which will allow you to transform a tax-deferred future growth into tax-free growth.

    - You will pay taxes on the IRA asset value converted to a Roth, but the assets will continue to grow tax-free and can later be withdrawn tax-free.
    - Converting your IRA to a Roth IRA is more desirable if your current IRA balance includes significant non-deductible IRA contributions, since these amounts will reduce the taxable portion of the conversion.
    - Be aware that the income from the conversion will raise your AGI, and may trigger NIIT, Additional Medicare tax, or itemized deduction phase-outs.
    - If you have converted assets from a traditional IRA to a Roth IRA earlier this year and the assets in the Roth IRA account declined in value, you will end up paying higher taxes than needed. In this case, you can choose to reverse the transaction by transferring the converted amount from the Roth IRA back to a traditional IRA using a trustee-to-trustee transfer. You can then choose to re-convert the IRA to a Roth IRA at the current, lower market value.
    - Roth conversions are not appropriate for everyone, and you should consult your tax advisor before taking action on a conversion.

- ☐ When you reach the age of 70½, you must take required minimum distributions (RMDs) from your IRA, 401(k) plan, and other qualified retirement plans. If you turned 70½ this year, you should consider delaying the first required distribution to 2017, and hence, defer the income for one more year. This will benefit many but not everyone depending on changes in tax rates and personal income changes.

- ☐ If you are eligible to make contributions to your Health Savings Account (HSA), you can still maximize your 2016 contribution before year-end so you will have a full year's worth of deductible HSA contributions. If you do not have an HSA and your insurance plan allows for one, consider establishing and contributing to the account before year-end.

- [ ] For 2017, increase the amount in your employer-sponsored Flexible Spending Account (FSA) if you set aside too little for this year.

- [ ] Consider making a $14,000 ($28,000, if married) gift to family members before the end of year. This will not only reduce the estate taxes ultimately paid, but will also reduce income taxes on the earnings of that money. The benefits are multiplied if the gifts are those of appreciated property.

- [ ] Tuition and medical expenses paid on someone's behalf are free of gift tax and also does not count against the annual gift exclusion. The payments must be paid directly to the school and medical care expenses directly to the healthcare provider. You may want to consider a plan to systematically pay these expenses for certain family members.

- [ ] Avoid potential penalties related to foreign asset reporting by gathering necessary tax records.

2016 Tax Planning Checklist – Businesses and Business Owners

- [ ] Moving into a higher tax bracket next year can potentially be avoided by accelerating income from 2017 to 2016. On the other hand, income should be deferred until 2017 if moving into a higher bracket this year can be prevented. Especially in light of the potential for rates to decline under the Trump administration.

- [ ] The Sec. 179 expensing limit for 2016 is $500,000 with a $2.01 million overall investment limit (before phase-out) allows business to expense the cost of fixed assets such as equipment and furniture and fixtures. The limits for 2017 are $510,000 and $2.03 million, respectively.

- [ ] Businesses should consider the "de minimis safe harbor election" to expense the costs of lower value capital assets, materials, and supplies. Regulations allow businesses to write-off small asset purchases. The amount that can be written off is up to $5,000 per item or invoice if you have an audited financial statement and $2,500 if you do not. To take advantage of this provision, you must follow that policy not only for tax purposes but also for financial statement purposes. In addition, if you issue audited financial statements, your capitalization policy must be in writing.

- [ ] An accrual basis business can accrue and deduct employee bonuses in 2016 and pay them in 2017. The employee will be taxed on the bonus in 2017, and the payment must be made within 2 1/2 months after accrual to qualify.

- [ ] If a business purchases machinery and equipment before year-end, it could secure a half-year's worth of depreciation deductions under the half-year convention by utilizing bonus depreciation. This works unless 40% or more of the total depreciable assets purchased are purchased in the last 3 months of the year. 50% bonus depreciation will continue through 2017. It is then reduced to 40% for 2018 and 30% for 2019.

- [ ] Consider an assessment of your company's retirement plans to determine if a change in plans could allow you to contribute more toward your retirement and provide additional tax deductions. If there is an older owner who is an employee, a defined benefit plan or cash balance plan could allow you to quickly build a substantial retirement fund.

- [ ] A C corporation that anticipates a small net operating loss (NOL) in 2016 and significant net income in 2017 should consider accelerating some of its 2017 income or deferring some of its 2016 deductions in order to produce a small amount of net income for 2016. This will allow it to base its 2016 estimated tax installments on the smaller amount of income shown on its 2016 return, instead of paying estimated taxes on 100% of its much larger 2017 taxable income.

- [ ] Determine if you should increase your basis in a partnership or S corporation so that you can deduct current-year losses by loaning or contribution additional capital to the business.

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Post-Election Planning

As with prior years, 2016 year-end planning should start with data collection and a review of prior year returns. This includes losses or other carryovers, estimated tax installments, and items that were unusual. Conversations about next year should include review of any plans for significant purchases or dispositions, as well as any possible life-cycle changes.

If the general goal for year-end planning has been to balance taxable income between the current and upcoming year to the extent tax bracket rates are equal, planning at year-end 2016 presents a choice between using the new Trump/House blueprint rates as a target or a more conservative approach that moves more taxable income beyond an ideal balance into 2017, but not necessarily counting on a final tax bill arriving at a 15, 28, and 33 percent rate structure for individuals; and a 15 or 25 percent rate level for businesses, depending upon the Trump/House blueprint versions. Within those goals, use of traditional techniques to delay income recognition into 2017 and beyond or to accelerate deductions into 2016 have particular relevance at year-end 2016.

If you have any additional questions about year-end tax planning, or if you need further assistance, please do not hesitate to contact us.

Judy Mason, CPA, CVA, has over 20 years of tax, accounting, business consulting, and compliance experience, serving closely-held and start-up businesses, entrepreneurial and family-owned companies, their owners and families. Her expertise is in federal, state, local, and employment taxation, guiding clients through the complexities of conducting business in a dynamic tax environment. She has successfully defended a broad range of federal income, state income, and sales tax audits for her clients.