

2016 YEAR-END TAX PLANNING CHECKLIST





Congress made year-end tax planning a little easier for 2016. The Protecting Americans from Tax Hikes (PATH) Act of 2015 made a number of expiring tax provisions permanent, such as the Section 179 deduction and Research and Development Credit, but extended others only through the end of 2016. While this legislation gave clarity to 2016 tax planning, several provisions require action on the part of Congress in order to be extended into tax year 2017 and beyond.

Key provisions addressed by the Act include:

For individuals:

- » Earned Income Tax Credit (EITC) made permanent with expanded eligibility requirements
- » American Opportunity Credit for qualified education expenses made permanent
- » Exclusion from income of qualified charitable distributions from IRAs made permanent for those over 70½
- » Deducting mortgage insurance premiums as interest through 2016
- » Exclusion of cancellation of debt income from a foreclosure, short sale or mortgage workout through 2016

For businesses:

- » Permanent extension of the Section 179 Deduction
- » Research & Development tax credit made permanent with expanded benefits
- » Bonus depreciation extended through 2019
- » Energy efficient credits through 2016

It is important to note changes to several tax return deadlines, including multi-member LLCs and partnerships being due March 15, while the C Corporation due date has been moved back one month to April 15.

When the new Administration moves into Washington in January 2017, it is certain that changes will follow. How these changes will impact the long-term tax picture remains uncertain. With that in mind, you should not lose sight of the **short-term tax dollars** to be saved immediately through 2016 year-end strategies.

Yeo & Yeo's year-end tax planning checklist of additional action items may help you save tax dollars if you act before year-end.

These are just some of the year-end steps that can be taken to save taxes. Not all actions may apply in your particular situation, but you or a family member can likely benefit from many of them.

Your Yeo & Yeo tax professional can help narrow down the specific actions that you can take and tailor a tax plan for your current situation and future changes. **Please review the following list and contact us at your earliest convenience** so that we can help advise you on which tax-saving moves to make.

Visit the [Tax Resource Center](#) at yeoandyeo.com for additional tax planning resources including:

- » **Tax and Estate Planning Guides Online**
- » **Weekly Tax Bites on Yeo & Yeo's Blog**
- » **Tax Planning Calendars**



YEAR-END PLANNING INDIVIDUALS

- Postpone income until 2017 and accelerate deductions into 2016** to lower your 2016 tax bill. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2016 that are phased out over varying levels of adjusted gross income. These include child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. However, in some cases it may pay to actually accelerate income into 2016. For example, this may be the case where a person's marginal tax rate is much lower this year than it will be next year.



- Estimate the effect of any year-end planning moves on the alternative minimum tax (AMT) for 2016**, keeping in mind that many tax breaks allowed for purposes of calculating regular taxes are disallowed for AMT purposes. These include the deduction for state property taxes on your residence(s), state income taxes, miscellaneous itemized deductions, and personal exemption deductions. Other deductions, such as for medical expenses, are calculated in a more restrictive way for AMT purposes than for regular tax purposes in the case of a taxpayer who is over age 65 or whose spouse is over age 65 as of the close of the tax year. As a result, in some cases, deductions should not be accelerated.
- It may be advantageous to try to arrange with your employer to **defer a bonus** that may be coming your way until 2017.
- Consider using a credit card to pay deductible expenses** before the end of the year. Doing so will increase your 2016 deductions even if you don't pay your credit card bill until after the end of the year.
- If you expect to owe state or local income taxes when you file your return next year, consider asking your employer to **increase withholding of state and local taxes, or make estimated tax payments** before year-end to pull the deduction of those taxes into 2016 if doing so won't create an alternative minimum tax problem.
- Consider deducting state and local sales and use taxes** instead of state and local income taxes, if you had major purchases in 2016 resulting in more sales tax than state income tax paid within the year.
- If you are facing a penalty for underpayment of estimated tax and having your employer increase your withholding isn't viable or won't sufficiently address the problem, **take an eligible rollover distribution from a qualified retirement plan** before the end of 2016. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2016. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2016, but the withheld tax will be applied pro rata over the full 2016 tax year to reduce previous underpayments of estimated tax. However, you may only make a non-trustee-to-trustee rollover once every 12 months.
- You may be able to save taxes this year and next by **applying a bunching strategy to "miscellaneous" itemized deductions** (i.e., certain deductions that are allowed only to the extent they exceed 2% of adjusted gross income), medical expenses and other itemized deductions.
- You may want to **pay contested taxes** to be able to deduct them this year while continuing to contest them next year.
- You may want to **settle an insurance or damage claim** in order to maximize your casualty loss deduction this year. However, casualty losses are only deductible to the extent they exceed 10% of your adjusted gross income plus \$100.
- Increase the amount you set aside for next year in your employer's **health flexible spending account (FSA)** if you set aside too little for this year. The maximum annual contribution to an FSA that a cafeteria plan can allow is \$2,600 for tax year 2017.
- If you are eligible to make health savings account (HSA) contributions in December of this year, **you can make a full year's worth of deductible health savings account contributions** for 2016. This is so even if you first became eligible on December 1, 2016. The maximum annual contribution to an HSA for 2016 is \$3,350 for self-only and \$6,750 for family coverage. The contribution limit for self-only coverage rises to \$3,400 in 2017 while the family coverage limit remains the same.
- Make gifts sheltered by the annual gift tax exclusion** before the end of the year and thereby save gift and estate taxes. You can give \$14,000 in 2016 to each of an unlimited number of individuals, but you cannot carry over unused exclusions from one year to the next. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.
- Take required minimum distributions (RMDs) from your IRA, 401(k) plan, or other employer-sponsored retirement plan** if you have reached age 70½. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. If you turned age 70½ in 2016, you can delay the first required distribution to 2017, but if you do, you will have to take a double distribution in 2017—the amount required for 2016 plus the amount required for 2017. Think twice before delaying 2016 distributions to 2017—bunching income into 2017 might push you into a higher tax bracket or have a detrimental



YEAR-END PLANNING FOR INDIVIDUALS, CONT.

impact on various income tax deductions that are reduced at higher income levels. However, if you will be in a substantially lower bracket in 2017 it could be beneficial to take both distributions in that year.

- If you are 70½ or older, **consider making charitable contributions** (up to \$100,000) **directly from your IRA**, referred to as Qualified Charitable Distributions (QCD). While these contributions will not be deductible on Schedule A as itemized deductions, they will not be included in your adjusted gross income either, but will go towards satisfying your RMD. They may also have the added benefit of not being taxable in your state of residence, including Michigan.
- Consider making contributions to Roth IRAs** instead of traditional IRAs. Roth IRA payouts are tax-free and thus immune from the threat of higher tax rates, as long as they are made 1) after a five-year period, and 2) on or after attaining age 59½, after death or disability, or for a first-time home purchase.
- If you believe a Roth IRA is better than a traditional IRA, and want to remain in the market for the long term, **consider converting traditional-IRA money invested in beaten-down stocks** (or mutual funds) **into a Roth IRA if eligible to do so**. Keep in mind, however, that such a conversion will increase your adjusted gross income for 2016. As a general rule, we advise our clients to pay any taxes resulting from a conversion with non-retirement funds to maximize the future benefit it will produce. Withholding federal and state taxes from a conversion would also generate an additional 10% penalty on the amounts withheld.
- If you converted assets in a traditional IRA to a Roth IRA earlier in the year, the assets in the Roth IRA account may have declined in value, and if you leave things as is, you will wind up paying a higher tax than is necessary. You can back out of the transaction by **recharacterizing the conversion**, that is, by transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA via a trustee-to-trustee transfer. You can later reconvert to a Roth IRA, if doing so proves advantageous.
- Tax breaks to consider in 2016** because they are scheduled to expire this year:
 - Exclusion of taxable cancellation of debt income in a foreclosure, short sale or mortgage workout for principal residence.
 - A wide variety of breaks designed to encourage energy efficiency and conservation.
 - Deducting MIP as interest. If you can afford to make additional principal payments toward your mortgage this year to eliminate your mortgage insurance premium (MIP) next year, you may want to do so.
 - Above-the-line tuition deduction up to \$4,000.
 - Medical expenses paid for those taxpayers age 65 or older will be subject to the 7.5% AGI limitation in 2016, but the limitation will increase to 10% for all taxpayers in 2017.



Higher-income-earners have unique concerns to address when mapping out year-end plans. Individuals receiving wages and other earned income in excess of \$200,000 (\$250,000 for married couples filing jointly and \$125,000 for married couples filing separately) need to be wary of the additional 0.9% Medicare tax. There is also a 3.8% surtax on certain unearned income. The surtax is 3.8% of the lesser of: (1) net investment income, or (2) the excess of modified adjusted gross income over an unindexed threshold amount of \$250,000 for joint filers or surviving spouses, \$125,000 for a married individual filing a separate return, and \$200,000 in any other case.

As year-end nears, a taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on the individual's estimated modified adjusted gross income and net investment income for the year. Some taxpayers should consider ways to minimize additional net investment income for the balance of the year, others should try to see if they can reduce modified adjusted gross income other than net investment income, and still others may need to consider ways to minimize both. Net investment income includes taxable interest, dividends and capital gains, as well as passive income, such as income from rental activities that do not constitute a trade or business. We can assist with strategies to minimize or eliminate this additional tax.

- Give appreciated stock as a charitable contribution.** The value of your donation is the fair market value of the stock on the date of the contribution, and you will not have to pay any tax on the appreciation of the stock. This will also prevent the gain from being subject to the 3.8% tax on net investment income.
- Consider realizing losses on the sale of stock to offset other investment gains** while substantially preserving your investment position to minimize the burden of the 3.8% tax on net investment income. This is especially important if your taxable income exceeds \$400,000 (\$450,000 married filing joint), as the long-term capital gain rate increases from 15% to 20% for those individuals. There are several ways this can be done. For example, you can sell the original holding, then buy back the same securities at least 31 days later. It may be advisable for us to meet to discuss year-end trades you should consider making as there are limitations to the amount of capital losses that can be deducted in any given year.



YEAR-END PLANNING BUSINESSES & OWNERS

- Businesses should consider **buying and placing in service machinery, equipment and software** before year end to qualify for the 50% bonus first-year depreciation allowance.
- Businesses may take **50% bonus depreciation on qualifying improvement property** placed in service after the date the building was placed in service. Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property; this not only includes qualified leasehold improvements, but may include improvements to the interior of a building that would otherwise be depreciated over 39 years.
- Acquire and place in service business equipment and machinery** qualifying for the business property expensing option. The maximum amount you can expense for a tax year is \$500,000. The \$500,000 amount is reduced by the amount by which the cost of qualifying property placed in service during 2016 exceeds \$2,000,000 (the investment ceiling). Computer software and qualified real property is subject to a \$250,000 limit.
- Businesses may be able to **take advantage of the “de minimis safe harbor election” to expense the costs of inexpensive assets, materials and supplies**, assuming the costs do not have to be capitalized under the Code Sec. 263A uniform capitalization rules. To qualify for the election, the cost of an expensed unit-of-property cannot exceed \$5,000 if the taxpayer has an applicable financial statement, e.g., a certified audited financial statement. If there is no applicable financial statement, the cost of an expensed unit of property cannot exceed \$2,500. Where appropriate, purchase such qualifying items before the end of 2016.
- A corporation should consider **accelerating income from 2017 to 2016** if doing so will prevent the corporation from moving into a higher bracket next year. Conversely, it should consider deferring income until 2017 if doing so will prevent the corporation from moving into a higher bracket this year.
- A corporation should consider **deferring income until next year** if doing so will preserve the corporation’s qualification for the small corporation alternative minimum tax exemption for 2016. Note that there is never a reason to accelerate income for purposes of the small corporation alternative minimum tax exemption because if a corporation doesn’t qualify for the exemption for any given tax year, it will not qualify for the exemption for any later tax year.
- A corporation, other than a “large” corporation, that anticipates a small net operating loss (NOL) for 2016 and substantial net income in 2017 may find it worthwhile to **accelerate just enough of its 2017 income or to defer just enough of its 2016 deductions** to create a small amount of net income for 2016. This will permit the corporation to base its 2017 estimated tax installments on the relatively small amount of income shown on its 2016 return, rather than having to pay estimated taxes based on 100% of its much larger 2017 taxable income.
- If your business qualifies for the domestic production activities deduction for its 2016 tax year, consider whether the 50%-of-W-2 wages limitation on that deduction applies. If it does, **consider ways to increase 2016 W-2 income**, e.g., by bonuses to owner-shareholders whose compensation is allocable to domestic production gross receipts. Note that the limitation applies to amounts paid with respect to employment in calendar year 2016, even if the business has a fiscal year.
- To reduce 2016 taxable income, consider **deferring a debt-cancellation event** until 2017.
- To reduce 2016 taxable income, consider **disposing of a passive activity** in 2016 if doing so will allow you to deduct suspended passive activity losses.
- If you own an interest in a partnership or S Corporation, consider whether you need to **increase your basis in the entity** so you can deduct a loss from it for this year.
- Please note **accelerated filing deadlines** that take effect for tax years beginning after 12/31/15:
 - W-2, W-3, and certain 1099-MISC forms are due to the IRS on January 31 in 2017, instead of the last day of February.
 - The deadline for calendar year C Corporation returns has been extended by one month to April 15, instead of March 15. The extension period has been shortened to five months, instead of six. The extension due date remains at September 15. Different due dates apply to fiscal year ends.
 - Partnership returns are now due a month earlier, on March 15, instead of April 15. Partnerships are now eligible for a six-month extension until September 15.
 - The reporting on Foreign Bank and Financial Accounts (FBAR) deadline has moved up from June 30 to April 15. FBAR filers can request a six-month extension until October 15.

