2016 YEAR-END tax planning guide for INDIVIDUALS
2016 started with a welcome change: The Protecting Americans from Tax Hikes (PATH) Act brought much-needed certainty to tax planning for individuals. It made several lucrative tax breaks permanent and extended others temporarily.

As the year has worn on, however, political uncertainty has caused many people to wonder where income tax rates are headed in the future. The answer is critical in deciding

when to recognize income

and incur deductible expenses

In some cases, you may decide to incur expenses before year end to take advantage of tax breaks — or to postpone recognizing certain income items until next year.

Additionally, proposed tax law changes could affect the timing of estate planning moves. It’s important to review your estate plan before year end to avoid missing out on tax-saving opportunities that may be limited or unavailable in the future.
Our tax team doesn’t have a crystal ball. But, with the election finally behind us, we’re ready to help you focus on the future. We understand the concerns and challenges you face. We’re following tax and legislative proposals and will continue to let you know when major changes happen.

In the meantime, here’s a brief summary of tax planning opportunities for you to consider before year end, as well as links to relevant blogs we’ve posted in 2016 that provide more details on recent developments.

“As individuals plan for the future, tax planning will play an essential role when preparing for retirement and beyond. Proper planning can help reduce both their income tax and estate tax burden.”

Laura Yalanis, CPA/MST - Shareholder, KLR Tax Services Group
When tax planning at year end, focus on your “marginal” rate. That’s the rate you’ll pay on your next dollar of income. Your marginal rate depends on your income and your filing status.
Alternative Minimum Tax (AMT)

If you’re subject to the AMT, your tax rate may be lower . . .

26% or 28%

. . . but more of your income will be taxed because certain income items are treated differently, such as:

- Incentive stock option exercises
- Accelerated depreciation adjustments and related gains
- Tax-exempt interest on certain private-activity municipal bonds

And certain deductions aren’t allowed, such as:

- State and local income tax
- Property tax
- Home equity debt interest not used to improve your home
- Some miscellaneous itemized deductions

You must pay the AMT if your AMT liability is higher than your regular income tax liability.
The timing of *when* you recognize income, or incur deductible expenses, can have a big impact on your tax bill. Typically it’s beneficial, to the extent possible, to defer income to the next year and accelerate expenses to the current year. This reduces your current year’s tax bill.

But if you expect to be in a *higher* tax bracket next year — or tax rates to increase — then it’s generally better to do the opposite: accelerate income and defer deductions.

### Common Timing Strategies

**Income Items**
- Bonuses
- Self-employment income
- Retirement plan distributions
- U.S. Treasury bill income

**Expenses**
- Charitable contributions
- State and local income taxes
- Property taxes
- Mortgage interest

Timing strategies can also help you [avoid the AMT](#) - or they could trigger it if you’re not careful.
Adjusted Gross Income (AGI)-Based Reduction on Itemized Deductions

If your AGI exceeds certain limits, your itemized deductions will be reduced. (Exceptions: deductions for investment interest, medical expenses and casualty, theft and wagering losses.) The size of the reduction depends on the extent to which your income exceeds the threshold.

80% is the maximum reduction in your deductions.

AGI - Threshold for 2016 Itemized Deductions

<table>
<thead>
<tr>
<th></th>
<th>Single</th>
<th>Head of Household</th>
<th>Married</th>
<th>Married Filing Separately</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$259,400</td>
<td>$285,350</td>
<td>$311,300</td>
<td>$155,650</td>
</tr>
</tbody>
</table>

If you’re close to the threshold, deferring income might help you stay under it and protect your deductions. If you’re above the threshold but might not be next year, you may be better off deferring deductible expenses.
The biggest itemized deduction for many taxpayers is for home-related expenses.

**Mortgage Interest and Property Tax Deductions**

$1 million is the limit on the mortgage debt on which you can deduct interest on your principal residence and second home (combined).

$100,000 is the limit on the home equity debt on which you can deduct interest regardless of how you used the debt.

**Beware:** Interest on home equity debt not used to improve your home isn’t deductible for AMT purposes.

You can also deduct 100% of the property tax you pay on all of your homes.

**Home Office Deduction**

If you use part of your home exclusively for business, you may be able to deduct actual expenses allocable to the space, including some that otherwise wouldn’t be deductible, such as utilities and depreciation.

Or you can use a simplified calculation of $5 per square foot up to a $1,500 maximum.
Gain Exclusion on Home Sales

If you sold your principal residence in 2016, you may be able to exclude all (or part) of the gain.

Maximum Gain Exclusion

<table>
<thead>
<tr>
<th></th>
<th>Single</th>
<th>Head of Household</th>
<th>Married</th>
<th>Married Filing Separately</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$250,000</td>
<td>$250,000</td>
<td>$500,000</td>
<td>$250,000</td>
</tr>
</tbody>
</table>

Various tests must be met to qualify for this break, and gain that’s attributable to a period of “nonqualified” use of the home may be subject to capital gains tax. **Any gain that isn’t covered by the exclusion might be subject to the net investment income tax (NIIT).**

If you’re planning to sell a second home, consider making it your principal residence for a period long enough to qualify for the exclusion. Or, if it’s a rental property and the sale is likely to generate a significant gain, consider a like-kind exchange.

Moving Expense Deduction

If you moved for work or business reasons, you may be eligible to **deduct your moving expenses**. If you **moved to a new state** it’s also important to familiarize yourself with the tax laws in your new home state and understand the requirements for filing a multi-state tax return in 2016.
Health care costs are on the rise, causing many employers to cut back on health-care benefits. In 2016, many taxpayers are paying more out-of-pocket for medical expenses than in previous years, often because premiums have increased and/or their plans have higher deductibles and copayments. Fortunately, various tax breaks can help take the bite out of these increases.

**Medical Expense Deductions**

- **10%** of AGI is the threshold for deducting medical expenses for most taxpayers.

“Bunching” these expenses into alternating years may get you past the threshold and maximize your tax savings.

- **7.5%** of AGI is the threshold for deducting medical expenses *if you’re age 65 or older*.

This threshold is scheduled to increase to 10% in 2017, so qualifying seniors should consider bunching discretionary medical expenses into 2016.
Health Savings Accounts (HSAs) and Health Care Flexible Spending Accounts (FSAs)

Exceeding the AGI threshold for the medical expense deduction can be challenging for many taxpayers. Fortunately, HSAs and FSAs allow you to make pre-tax contributions and are used for tax-free funding of qualified medical expenses.

2016 Contribution Limits*

<table>
<thead>
<tr>
<th>Account Type</th>
<th>Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>HSA Self-Only Coverage</td>
<td>$3,350</td>
</tr>
<tr>
<td>HSA Family Coverage</td>
<td>$6,750</td>
</tr>
<tr>
<td>HSA Catch-Up Contribution (50+)</td>
<td>$1,000</td>
</tr>
<tr>
<td>Health Care FSA</td>
<td>$2,550</td>
</tr>
</tbody>
</table>

* Additional rules and limits apply to these accounts.

Self Employed?

Instead of making contributions to employer-provided HSAs and FSAs, self-employed taxpayers who pay their own medical and dental insurance premiums can generally deduct those costs “above the line.” This can lower AGI, making it easier for the self-employed to exceed the AGI threshold for the medical expense deduction.

Uninsured? Under the Affordable Care Act, taxpayers without health insurance face penalties equal to the greater of:

- 2.5% of their income, or $695 per adult + $347.50 per child. The maximum penalty is $2,085. These amounts have doubled since 2015.
If you’re charitably inclined, charitable giving can be one of the most powerful tools in your tax planning toolbox. Plus, you have complete control over when and how much you give.

100% of a donation to qualified charities is generally deductible.

But the charitable deduction is subject to an AGI-based reduction if your AGI exceeds the applicable threshold. And your annual deduction for qualified charitable donations is limited to 50% of your AGI.

Lower limits may apply to certain donations. Beware of these limits and donation deadlines as you consider year-end charitable giving.

Donate Appreciated Securities Rather Than Cash

Giving away publicly traded appreciated stock you’ve held more than one year offers a double tax benefit:

1. You can deduct the full fair market value of the stock.

2. You avoid the capital gains tax you’d owe if you sold the stock.

But don’t donate stock that has lost value. You’ll enjoy a bigger tax benefit by selling the stock, recognizing the loss and donating the proceeds.
Qualified Charitable Contributions from IRAs

$100,000 is the maximum amount you can transfer from your IRAs directly to qualified charities tax free if you’re age 70½ or older.

A rollover can help fulfill your required minimum distribution, and it’s especially beneficial if the 50% of AGI limit would reduce your charitable deduction.

When you make a qualified charitable distribution from your IRA, the income is excludable from AGI. The donation is not deductible on Schedule A. This can yield better tax results, especially for those who are subject to AGI-based reductions on itemized deductions, which include charitable donations.

Substantiation Requirements

For your donations to be deductible, you must properly substantiate them. Requirements depend on the type and amount of donation.
Tax planning for investments is a top priority for many individuals. Of course, there are many non-tax factors you should consider before making investment decisions. But, timing gains and losses on sales can help minimize taxes.

15% is generally the long-term capital gains tax rate, but your rate is 20% if you’re in the 39.6% ordinary income tax bracket.

Short-term capital gains and taxable interest income are taxed at ordinary income tax rates as high as 39.6%. You also may owe 3.8% NIIT.

### Taxes on Capital Gains

<table>
<thead>
<tr>
<th></th>
<th>2016 Top Rate, Including NIIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term gain</td>
<td>43.4%</td>
</tr>
<tr>
<td>Most long-term gain</td>
<td>23.8%</td>
</tr>
<tr>
<td>Long-term gain on collectibles, such as artwork and antiques</td>
<td>31.8%</td>
</tr>
<tr>
<td>Long-term gain attributable to certain recapture of prior depreciation on real property</td>
<td>28.8%</td>
</tr>
</tbody>
</table>

If your net capital losses exceed net capital gains, you’re limited in how much loss you can deduct per year against ordinary income. The limits on deducting capital losses against ordinary income are:

- for most taxpayers: **$3,000**
- for married taxpayers who file separately: **$1,500**

Loss carryovers can be a valuable tax saving tool. But they disappear once a taxpayer dies.
Passive Activities

Do you materially participate in the businesses you’re invested in? If not, beware of the passive activity rules. In general, losses from passive activities can only be taken against passive activity income. Unused passive losses can be carried forward until you earn other passive income or you sell an investment.

Income from these types of activities involves some different considerations and planning strategies.

Qualified Small Business Stock (QSBS)

100% of the gain from the sale or exchange of QSBS is tax free, as long as:

1. The QSBS was acquired on or after September 28, 2010.
2. The QSBS was held for more than five years.

To qualify as QSBS, the stock generally must have been issued by a C corporation that doesn’t own assets worth more than $50 million and that’s in an active trade or business. Additional rules apply.

Qualified vs. Nonqualified Dividends

Dividends are an important part of your return on investment. But not all dividends were created equal for tax purposes. There are two types of ordinary dividends:

Nonqualified dividends are taxed at ordinary income rates.

Qualified dividends are taxed at the more favorable long-term capital gains rates.
Many high net worth taxpayers earn stock-based executive compensation, including:

- Incentive stock options (ISOs)
- Nonqualified stock options (NQSOs)
- Restricted stock

Special rules apply to stock-based compensation. Year-end planning can help you decide whether to exercise options and/or sell stock.
Parents and grandparents worry about rising college costs. The College Board estimates that the annual cost for living on campus and attending a four-year university for 2015-2016 ranges from:

- $24,061 for an in-state public university
- $47,831 for a private university

Fortunately, you can contribute money to various college savings programs. Contributions aren’t deductible for tax purposes, but earnings accumulate tax-free if you follow the rules.

### College Savings Programs

<table>
<thead>
<tr>
<th></th>
<th>529 Plans</th>
<th>Coverdell Education Savings Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Contribution Limits?</td>
<td>No, but you might owe gift tax on contributions over $14,000 annual exclusion.</td>
<td>Subject to annual income limits, and you can contribute only $2,000 per child per year.</td>
</tr>
<tr>
<td>Tax on Withdrawals?</td>
<td>No, if the money is used to pay for qualified college-related expenses.</td>
<td>No, if the money is used to pay for qualified education expenses, including primary and secondary school expenses.</td>
</tr>
</tbody>
</table>

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2016 Year-End Tax Planning Guide for Individuals
### Education-Related Credits and Deductions

The IRS also offers several tax breaks for higher education spending for you and your immediate family members. These breaks may be reduced or eliminated based on your modified adjusted gross income (MAGI).

#### 2016 Tax Credits and Phaseouts for Higher Education Costs

<table>
<thead>
<tr>
<th></th>
<th>American Opportunity</th>
<th>Lifetime Learning</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual Credit</strong></td>
<td>100% of the first $2,000 of education expenses; 25% of expenses between $2,000 and $4,000; maximum credit $2,500 per student</td>
<td>20% of the first $10,000 of qualified education expenses; maximum credit $2,000 per tax return</td>
</tr>
<tr>
<td><strong>MAGI Phaseout</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Range for Joint Filers</td>
<td>$160,000-$180,000</td>
<td>$111,000-$131,000</td>
</tr>
<tr>
<td>Range for Other Filers</td>
<td>$80,000-$90,000</td>
<td>$55,000-$65,000</td>
</tr>
<tr>
<td><strong>Other Notable Rules</strong></td>
<td>Only for the first 4 years of higher education costs</td>
<td>For higher education costs during any beyond the first 4 years</td>
</tr>
</tbody>
</table>

#### Don’t meet these requirements?

Consider deducting up to $4,000 of qualified higher education tuition and fees *per student* in 2016. The phaseout range for this deduction is $116,300–$146,300 (joint filers) or $77,550–$92,550 (other filers).
In addition to contribution limits, traditional IRAs are phased out based on your MAGI. Traditional retirement accounts grow tax-deferred until withdrawn. So making the **maximum contribution** allowed by law is typically a good idea.
Roth Accounts

Contribute after-tax dollars to a Roth account now...

...and take tax-free withdrawals later as long as your withdrawals are “qualified.”

In 2016, the contribution limits are the same for traditional and Roth IRAs. Unfortunately, income-based limits may prevent higher-income taxpayers from contributing. If you’re above the phaseout limit, consider a “back door” Roth IRA.

Retirement Plan Withdrawals

You could owe penalties for withdrawing too soon or too little, depending on your age. Withdrawals are taxed at ordinary income tax — not long-term capital gains — rates. Plus, they could push you into a higher tax bracket, triggering the NIIT.
planning across generations

Can You Save Taxes by Transferring Assets to Children or Grandchildren?

“Shifting” income to children or grandchildren in a lower income tax bracket saves your family taxes as a whole. Specifically, consider transferring appreciated or income-producing assets to them before year end, so that tax on any gains (if an asset is sold) or income generated is subject to their rate — which might be as low as 0%.

**Kiddie Tax**
Income shifting across generations works only for gifts to adults. “Kiddie tax” rules generally apply to:

- **18** Children under age
- **24** Full-time students under age

$2,100 is the threshold at which unearned "kiddie" income begins to be taxed at the parents’ marginal rate for 2016.

**Annual Gift Exclusion**

$14,000 is the gift tax annual exclusion per recipient and donor for 2016. Leverage your exclusions even further with gifts to a Section 529 education savings plan or Coverdell Education Savings Account.

**Gifts of Family-Owned Business Interests**

Family Limited Partnerships (FLPs) and other family-owned estate planning vehicles may lower your estate tax bill by providing discounts from the value of an entity’s underlying assets. But a recent IRS proposal aims to curb these discounts in the future. At this point, it’s uncertain whether this controversial proposal will be finalized, amended or abandoned. So, consider setting up an FLP and making contributions before year end to take advantage of this estate planning opportunity while it lasts.
HAVE YOU SET UP YOUR YEAR-END PLANNING MEETING?

**December 31** is an important tax deadline that you might not be aware of: With a few exceptions, it's the date by which most of your tax planning strategies must be implemented to reduce your 2016 tax bill.

**Contact our tax team** to set up a meeting to brainstorm financial planning strategies to help you succeed in the future — and minimize your tax obligations for 2016.

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