December 2016

To Our Clients and Friends:

While many of you are making plans for year-end holidays, what should not be overlooked this time of year is year-end tax planning, especially considering the November election results. Every individual can develop a year-end tax planning strategy that reflects his or her situation, while taking into consideration the potential changes that could occur as a result of the election. We can help you prepare such a strategy, and the earlier we get started, the greater the potential maximization of benefits.

IMPACT OF THE ELECTION

President-Elect Trump proposes significant changes to the tax law including:

- Cutting individual tax rates from seven brackets with a top rate of 39.6% to three brackets of 12%, 25% and a top rate of 33%
- Eliminate the individual and corporate alternative minimum tax (AMT)
- Increase the standard deduction for individuals, to $15,000 for single filers and $30,000 for married filing separate filers
- Cap itemized deductions at $100,000 for single filers and $200,000 married filing separate filers
- Eliminate the 3.8% Medicare tax on investment income
- Cut the corporate tax rate from 35% to 15%
- Full deductibility of business capital investments

These possible changes need to be taken into account in year-end planning.

TRADITIONAL TAX PLANNING

As in past years, traditional year-end income shifting techniques may be valuable. Year-end planning includes considering 2016 and 2017 and determining if it makes sense to accelerate or defer income. President elect Trump has made it clear he will focus on tax reform, which may result in a reduction of income taxes in 2017. Therefore, deferring income to 2017, and accelerating deductions to 2016 may be a beneficial strategy for many individuals.

The alternative minimum tax (AMT) must be evaluated when accelerating deductions. Taking inventory of income and expenses to calculate whether strategies to accelerate or defer one or the other, before the current year closes, should be employed for year-end 2016 as it has been in the past. Assessing current gains and losses to map out a year-end buy, sell, or hold strategy makes particular sense as markets continue to make adjustments after the election. The following income deferral and deduction/credit acceleration techniques may be used to reduce an individual taxpayer's income tax liability:

Income Deferral:

- Receive bonuses earned for 2016 in 2017
- Sell appreciated assets in 2017
- Offset tax losses against current gains (loss harvesting)
- Postpone the redemption of U.S. Savings Bonds
- Declare any special dividends in 2017
- Defer debt forgiveness income if possible
- Minimize retirement distributions
- Execute like-kind exchange transactions
- Take corporate liquidation distributions in 2017

Deductions/Credit Acceleration:

- Bunch itemized deductions into 2016/Standard deduction into 2017
- Accelerate bill payments into 2016
- Pay last state estimated tax installment in 2016 instead of 2017
- Minimize the effect of AGI limitations on deductions/credits
- Maximize net investment interest deductions
- Match passive activity income and losses

Other common year-end planning techniques include:

- Maximizing retirement plan contributions
- Maximizing health savings account contributions
- Consider Roth IRA conversions to use excess deductions or if in a low tax bracket
- Harvest capital losses
- Review flexible spending account decisions for 2017

Charitable Contributions. Taxpayers who contribute cash or property to a qualified organization can claim the contribution as an itemized deduction. Not all nonprofit organizations are qualified organizations for charitable contribution deduction purposes. The IRS provides, and updates monthly, an online search tool that allows users to search for qualified charitable organizations. The IRS's Exempt Organizations Select Check tool can be accessed via the internet at www.irs.gov.

You can generally take a deduction for the fair market value of the cash or property donated. You cannot deduct the value of services you donate to a charity, however, you may be able to deduct charity-related travel and out-of-pocket expenses. Regardless of the type of contribution, you cannot claim a deduction unless you maintain a record of the contribution. This is commonly done by collecting an acknowledgment from the qualified organization stating the date and amount of the contribution.

Consider contributing appreciated property (like stock) to qualified organizations. Your deduction will generally equal the fair market value of the property at the date of the contribution and you will avoid paying capital gains tax on the profit.

In addition to traditional year-end tax strategies, the following issues may also impact your year-end tax planning:

INFLATION-ADJUSTED TAXES AND PHASEOUT AMOUNTS

Income tax. The current tax structure includes income tax rates of 10, 15, 25, 28, 33, 35, and 39.6 percent. For 2016, the threshold amounts for these rates are:

- ***Married taxpayers filing jointly and surviving spouses:*** the maximum taxable income for the 10% tax bracket is $18,550; for the 15% bracket, $75,300; for the 25% bracket, $151,900; for the 28% bracket, $231,450; for the 33% bracket, $413,350; and for the 35% bracket, $466,950. Amounts over $466,950 are taxed at 39.6%.
- ***Married taxpayers filing separately:*** the maximum taxable income for the 10% bracket is $9,275; for the 15% bracket, $37,650; for the 25% bracket, $75,950; for the 28% bracket, $115,725; for the 33% bracket, $206,675; and for the 35% bracket, $233,475. Amounts over $233,475 are taxed at 39.6%.
- ***Heads of households:*** the maximum taxable income for the 10% bracket is $13,250; for the 15% bracket, $50,400; for the 25% bracket, $130,150; for the 28% bracket, $210,800; and for the 33% bracket, $413,350; and for the 35% bracket, $441,000. Amounts exceeding $441,000 are taxed at 39.6%.
- ***Single filers (other than surviving spouses and heads of households):*** the maximum taxable income for the 10% bracket is $9,275; for the 15% bracket, $37,650; for the 25% bracket, $91,150; for the 28% bracket, $190,150; for the 33% bracket, $413,350; for the 35% bracket, $415,050. Amounts over $415,050 are taxed at 39.6%.

Additional HI (Medicare) Tax. Higher income individuals are subject to an additional 0.9 percent HI (Medicare) tax on wages received in connection with employment in excess of $200,000 ($250,000 for married couples filing jointly and $125,000 for married couples filing separately). To avoid an underpayment penalty related to this tax, you can instruct your employer to withhold an additional amount of federal income tax from your wages before year end.

***Itemized Deduction Phase-out (Pease Limitation)*. The Pease limitation on itemized deductions (named for the member of Congress who originally sponsored the legislation) reduces itemized deductions for higher-income taxpayers. For 2016, itemized deductions are reduced when AGI exceeds the following threshold amounts:

- $311,300 for married taxpayers filing jointly and surviving spouses;
- $285,350 for heads of households;
- $259,400 for single filers (other than surviving spouses and heads of households); and
- $155,650 for married taxpayers filing separately.

***Personal Exemptions**.* The personal exemption phase-out requires higher-income taxpayers to reduce the amount of their personal exemptions when their AGI exceeds certain threshold levels. The same threshold limits used in the Pease limitation above apply to the personal exemption phase-out.

If the personal exemption phase-out kicks in, the total amount of exemptions that may be claimed is reduced by two percent for each $2,500 ($1,250 for married couples filing separately) or portion thereof, by which adjusted gross income (AGI) exceeds the applicable threshold.

Kiddie Tax. The net unearned income (in excess of $2,100 for 2016) of certain children under the age of 24 can be taxed at the parent's marginal tax rate. This tax at the parent's rate is commonly referred to as the "kiddie tax." If the child's unearned income is less than an inflation-adjusted ceiling amount, the parent may be able to include the income on the parent's return, rather than filing a return for the child.

For tax years beginning in 2016, the inflation-adjusted amount used to reduce the net unearned income reported on a child's return that is subject to the kiddie tax is $1,050. The child's income can be reported on the parent's return if the child's gross income is more than $1,050 and less than $10,500.

Having income subject to the kiddie tax can mean that income that would otherwise be subject to no tax (because it is offset by the child's exemptions or his standard deduction), or to a low tax rate, will be taxed at the highest rates. So, avoiding the kiddie tax can be a real tax saver.

One method to avoid the kiddie tax is keeping the child’s unearned income at or below $2,100. This can be done by pushing investment income into future years by investing in growth oriented funds which provide little current income. Parents can also transfer money to qualified tuition plans (also known as 529 plans) which do not generate taxable income.

Another way to avoid kiddie tax is to have the child provide at least one-half of their support. If they do, their unearned income will not be subject to the kiddie tax. This can be accomplished by having the child work during the years they are subject to the tax. Parent’s that have a business can hire their children to increase the child’s earned income.

TAXES ON INVESTMENT

Generally, taxable investment accounts are accounts other than retirement accounts, insurance contracts and annuities. When managing investments held in taxable accounts, the measure of success is the net return after taxes, rather than the gross return. The following taxes must be taken into account in order to achieve that objective:

Capital Gains Tax. Capital gains are taxed at a rate of zero percent for taxpayers in the 10 and 15 percent brackets; the 15 percent rate for taxpayers is applicable to those in the 25, 28, 33, and 35 percent brackets; and higher-income taxpayers that are subject to the 39.6 percent income tax rate pay 20 percent.

Tax on Dividend Income. Qualified dividends received from domestic corporations and qualified foreign corporations are taxed at the same rates that apply to capital gains. Certain dividends do not qualify for the reduced rates, including dividends paid by credit unions, mutual insurance companies, and farmers' cooperatives.

Net Investment Income Tax (NIIT). The net investment income tax (NIIT) is a Medicare surtax of 3.8 percent imposed on the lesser of net investment income (NII) or modified adjusted gross income (MAGI) above a specified threshold. Distributions from IRAs, pensions, 401(k) plans, tax-sheltered annuities, and eligible Code Sec. 457 plans are excluded from NII and from the NIIT.

NII includes the following investment income reduced by certain investment-related expenses, such as investment interest expense, investment brokerage fees, royalty-related expenses, and state and local taxes allocable to items included in net investment income:

- Gross income from interest, dividends, annuities, royalties, and rents, provided this income is not derived in the ordinary course of an active trade or business;
- Gross income from a trade or business that is a passive activity;
- Gross income from a trade or business of trading in financial instruments or commodities; and
- Gain from the disposition of property, other than property held in an active trade or business.

Individuals are subject to the 3.8 percent NIIT if MAGI exceeds the following thresholds (not subject to inflation adjustment):

- $250,000 for married taxpayers filing jointly or a qualifying widower with a dependent child;
- $125,000 for married taxpayers filing separately; and
- $200,000 for single and head of household taxpayers.

NIIT is not imposed on income derived from a trade or business, nor from the sale of property used in a trade or business when the owner is actively involved in the business. Therefore, you should carefully differentiate income derived from an active business from passive investment income in order to shield the business income from the NIIT. You should also consider if a grouping election can limit your exposure to the NIIT. Taxpayers can make an election to group activities that constitute an appropriate economic unit. In certain circumstances a grouping election will reclassify passive activities as non-passive and therefore not subject to NIIT.

ALTERNATIVE MINIMUM TAX

You should not ignore the possibility of being subject to the AMT, as doing so may negate certain year-end tax strategies. For example, if income and deductions are manipulated to reduce regular tax liability, AMT for 2016 may increase because of differences in the income and deductions allowed for AMT purposes.

The alternative minimum tax (AMT) exemption amounts are annually adjusted for inflation. For 2016, the AMT exemption amounts are:

- $83,800 for married taxpayers filing jointly and surviving spouses;
- $53,900 for unmarried taxpayers and heads of household, other than surviving spouses; and
- $41,900 for married taxpayers filing separately.

Exemptions for the AMT are phased out as taxpayers reach high levels of alternative minimum taxable income (AMTI). Generally, the exemption amounts are phased out by an amount equal to 25 percent of the amount by which an individual's AMTI exceeds a threshold level.

For 2016, the AMT threshold levels for calculating the exemption phase-out are:

- $159,700 for married taxpayers filing jointly and surviving spouses (complete phase-out at $494,900);
- $119,700 for unmarried taxpayers and heads of household, other than surviving spouses (complete phase-out at $335,300); and
- $79,850 for married taxpayers filing separately (complete phase-out at $247,450).

The AMT rates are 26 percent, and 28 percent on the excess of alternative minimum taxable income (AMTI) over the applicable exemption amount. For tax years beginning in 2016, the taxable excess income above which the 28 percent tax rate applies is $186,300 for married taxpayers filing jointly and unmarried individuals other than surviving spouses; and $93,150 for married taxpayers filing separately.

TAX LEGISLATION

In 2015, Congress passed the Protecting Americans from Tax Hikes (PATH) Act which permanently extended many tax incentives that were previously temporary. However, not all provisions were extended past 2016. The following is a summary of some of the more common individual provisions.

American Opportunity Tax Credit (AOTC). The AOTC is now permanent under the PATH Act. The credit 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. In order to claim the AOTC, a Form 1098-T must be received.

Teachers' classroom expense deduction. The above-the-line deduction of up to $250 for elementary and secondary-school administrators' and teachers' classroom expenses has now been permanently extended under the PATH Act. Eligible teachers may claim this above-the-line deduction in lieu of a miscellaneous itemized deduction. In addition, starting in 2016, professional development expenses (which include courses related to the curriculum in which the educator provides instruction) qualify for the deduction.

State and local sales tax deduction. The itemized deduction for state and local general sales taxes is now permanent under the PATH Act. The deduction may be taken in lieu of state and local income taxes when itemizing deductions.

Exclusion for direct charitable donation of IRA funds. The exclusion from gross income of qualified charitable distributions from an IRA for individuals aged 70 ½ or older is now permanent. The exclusion covers up to $100,000 (per spouse) in distributions received from either traditional or Roth IRAs. The distribution must be made directly to the charity, and must be completed no later than by December 31, 2016.

Other permanent extenders.

- 100 percent gain exclusion on qualified small business stock
- Conservation contributions benefits
- Five-year solar energy property

Extenders expiring at the end of 2016.

- Tuition and fees deduction for qualified tuition and related expenses
- Exclusion for discharge of indebtedness on principal residence
- Qualified mortgage insurance premiums deduction
- Nonbusiness energy property credit

TAX BENEFITS FOR FAMILIES

You should review your family's situation annually to make sure that you take advantage of any applicable child- or education-driven benefits, such as:

- Adoption credit
- Exclusion for adoption assistance programs
- Child and dependent care (CDC) credit
- Child tax credit (CTC) and the refundable (additional) CTC
- Earned income credit (EIC)
- American Opportunity Tax Credit (AOTC)
- Coverdell Education Savings Accounts (ESAs)
- Exclusion for educational assistance programs
- Scholarship programs
- Student loan interest deduction

AFFORDABLE CARE ACT

No year-end tax plan can ignore the Affordable Care Act (ACA). The ACA, as the past six years has shown, impacts almost every individual, starting with the requirement to have minimum essential health coverage or make a shared responsibility payment, unless exempt. Individuals will still be required to report if they had minimum essential coverage on their 2016 tax returns filed in 2017. Individuals without health insurance coverage for the full year may be liable for a shared responsibility payment. Exemptions to this requirement should be carefully reviewed to see whether any may be applicable. It is also possible to project the amount of any payment. Closely related are changes to the medical expense deduction, health flexible spending arrangements (and similar arrangements), insurance coverage for children, and more. Our office can assist you in both understanding these complex ACA provisions and planning for their impact.

ESTATE TAX PLANNING

If you're like most people, you don't like to think about planning your estate. But it's an important part of ensuring the financial security of your loved ones. Estate planning is about more than saving taxes. Your plan should consider who will inherit your assets, and how they will inherit your assets. A number of tools can be used to accomplish your planning goals including wills, trusts, powers of attorney, living trusts, and healthcare powers of attorney.

One of the most common tax saving tools used in estate planning - and one that everyone should at least give careful consideration to - is a program of giving gifts. A carefully planned gift-giving program can reduce the amount of your estate that is subject to tax while still passing on wealth.

The American Taxpayer Relief Act of 2012 (ATRA), passed by Congress on January 1, 2013 and signed into law by President Obama the next day, brought some much-needed certainty to estate and income tax planning. ATRA sets the unified gift and estate tax exclusion at $5 million (indexed for inflation) for 2013 and subsequent years (The basic exclusion amount for an estate of a decedent dying in 2013 is $5.25 million; $5.34 million in 2014; $5.43 million in 2015; and $5.45 million in 2016). The maximum estate and gift tax rate is 40 percent for 2013 and subsequent years.

It's important to review your estate plan in light of these changes. It's possible the exemption and rate changes could have unintended consequences on your plan. A review will allow you to make the most of available exemptions and ensure your assets will be distributed according to your wishes.

Make Annual Gifts to Reduce Your Estate. Whittling your estate down by making annual gifts continues to be a tax-smart strategy. If you have some favorite relatives or unrelated persons, you and your spouse can give each of them up to $14,000 this year and next. You can give up to $28,000 in 2016 and 2017 per recipient per year if you are married and your spouse consents to "split" your gifts. These gifts will reduce your estate tax exposure without any adverse gift tax effects. Making multiple gifts over multiple years can dramatically reduce your exposure to the estate tax. So, the sooner you start an annual gifting program, the better.

Paying Another's Medical and Education Expenses. Another way to further the financial security of others without incurring gift tax is by payment of medical and educational expenses. You can pay an unlimited amount for these expenses tax-free as long as the payments are made directly to the medical services provider or educational institution. The person you benefit does not need to qualify as a dependent for tax purposes. Any medical expenses, however, must not be reimbursed by insurance, to either you or to the beneficiary.

CONCLUSION
The importance of year-end tax planning for 2016 has been heightened by the potential for a reduction in future tax rates. It is possible your 2016 and 2017 tax liability can still be reduced through careful planning. At HBK, we can determine how best to maximize your tax savings for 2016 and beyond. We are available to assist you through each step of this process and we will keep you apprised of any legislative changes impacting your tax circumstance in real time. Please don't hesitate to contact us with questions, concerns or ideas you about how to reduce your taxes.

Established in 1949, HBK CPAs and Consultants (HBK) offers the collective intelligence of hundreds professionals in a wide range of tax, accounting, audit, business advisory, financial planning, and other business operational and support services from offices in four states. HBK professionals deliver industry-specific expertise in manufacturing; healthcare, including long-term care; real estate and construction; automotive dealerships and not-for-profit organizations. HBK combines the technical resources and expertise of a large national accounting and professional consulting firm with the personalized attention of a local company. The firm is ranked in both *Accounting Today* and *Inside Public Accounting* magazines' Top 100, and supports clients globally as a member of BDO Alliance USA. HBK maintains locations in Alliance, Columbus and Youngstown in Ohio; Blue Bell, Erie, Hermitage, Meadville and Pittsburgh in Pennsylvania; Cherry Hill and Princeton in New Jersey; and Fort Myers, Naples, Stuart, and Sarasota in Florida.

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