



**SIMPSON & COMPANY**  
A PROFESSIONAL CORPORATION  
CERTIFIED PUBLIC ACCOUNTANTS

December 12, 2016

Dear Clients and Friends:

With a new administration taking shape in our nation's capital after the elections, you can expect that significant tax reforms will be debated, and perhaps enacted, in the near future. But the greatest impact on year-end tax planning in 2016 will likely derive from what happened late last year, not what will happen next year.

In the waning days of 2015, Congress passed the Protecting Americans from Tax Hikes (PATH) Act, which was promptly signed into law. This new federal legislation reinstated dozens of favorable tax provisions that had expired, many of them retroactive to the beginning of 2015. In some cases, the new law made often-extended tax breaks permanent, with certain modifications. The changes included in the PATH Act provide both individual and business taxpayers with a clearer picture about the optimal tax moves to make before the end of this year.

Furthermore, other developments occurring the last few years—such as a series of new cases, rulings and IRS regulations—could affect your year-end tax decisions. Finally, you might be able to benefit from various other tax-saving opportunities previously written into the Internal Revenue Code.

Keeping all that in mind, we have prepared the following **2016 Year-End Tax-Planning Letter**. For your convenience, the letter has been divided into three sections:

\*Individual Tax Planning

\*Business Tax Planning → *New laws in effect, please read all the way through.*

\*Financial Tax Planning

Be aware that the concepts discussed in this letter are intended to provide only a general overview of year-end tax planning. It is recommended that you review your personal situation with a tax professional.

## INDIVIDUAL TAX PLANNING

### Alternative Minimum Tax

Despite some recent favorable changes, the alternative minimum tax (AMT) continues to impact millions of unsuspecting taxpayers each year. The calculation for determining AMT liability involves inclusion of technical adjustments and tax preference items, such as add-backs for certain deductions, and subtraction of an exemption amount. After comparing the AMT result to your regular tax, you effectively pay the higher of the two.

The exemption amount for 2016 is \$53,900 for single filers and \$83,800 for joint filers. However, these amounts are reduced for high-income taxpayers. For 2016, the reduction equals 25 cents for each dollar of AMT income above \$119,700 for single filers and \$159,700 for joint filers.

**YEAR-END MOVE:** Have your personal situation assessed. Depending on the results, you may shift certain tax preference items or deductions to 2017 to reduce AMT liability for 2016.

There are just two AMT rates: 26% on AMT income up to \$186,300 in 2016 and 28% on AMT income above that threshold. Note that the top AMT rate is lower than the top regular income tax rate of 39.6%.

**Tip:** If you are normally in a high tax bracket and expect to pay the AMT in 2016, but not in 2017, you might decide to accelerate taxable income into this year. Accordingly, the extra income will be taxed at the 26% or 28% AMT rate in 2016, as opposed to being taxed at a higher rate in 2017. Consider all the relevant factors.

### Charitable Donations

Generally, you can deduct the full amount you donate to qualified charitable organizations, as long as you meet the strict substantiation requirements spelled out in the tax law. However, be aware that other limits may apply to charitable deductions, including the “Pease rule” (see page 3).

**YEAR-END MOVE:** Absent extenuating circumstances, increase your charitable gifts before 2017. However, be sure to meet the strict record-keeping requirements in the law. For instance, a written acknowledgment from the charity is required for monetary gifts of \$250 or more.

Furthermore, if you donate property held for longer than one year, you can generally deduct an amount equal to the property’s fair market value (FMV). Otherwise, the deduction is limited to your “basis” (generally, the cost), in the property. Note that additional rules may apply to gifts of property. For instance, the annual deduction for gifts of property generally cannot exceed 30% of your adjusted gross income (AGI).

If you plan to donate securities to a charity, it is often advantageous to give assets that have appreciated in value over time. As a result, you can deduct the FMV of the securities while the appreciation remains untaxed forever.

**Tip:** If you donate by credit card late in December, you can still write off the donation on your 2016 return—even if you do not actually pay the credit card charge until 2017.

### **Pease and PEP Rules**

Two recent tax law changes can reduce the tax benefits available to high-income taxpayers, but timely year-end action may minimize the consequences.

1. **Pease rule:** Under this rule, named for the congressman who initially introduced the legislation, most itemized deductions—including those claimed for charitable donations, gifts, state and local taxes, and mortgage interest—are reduced by 3% of the excess above an annual threshold based on your filing status (not to exceed 80% of total deductions).

2. **PEP rule:** The personal exemption phaseout (PEP) rule generally reduces personal exemptions by 2% for every \$2,500 of AGI (or a fraction thereof) above the Pease rule thresholds.

**YEAR-END MOVE:** Analyze your exposure to the Pease and PEP rules. In some cases, you may be able to lower your AGI or shift deductions to your tax advantage. For example, you might postpone large charitable gifts to next year to avoid a reduction under the Pease rule in 2016.

The thresholds for the Pease and PEP rules are shown below.

| <b>Filing status</b>      | <b>Threshold for 2016</b> |
|---------------------------|---------------------------|
| Single                    | \$259,400                 |
| Joint                     | \$311,300                 |
| Married filing separately | \$155,650                 |
| Head of household         | \$285,350                 |

**Tip:** Certain itemized deductions—typically, those with built-in floors—are not affected by the Pease rule. However, all personal exemptions, including those claimed for dependents, are subject to the PEP rule.

### **Medical and Dental Expenses**

For 2016, you may deduct only unreimbursed medical and dental expenses exceeding 10% of your AGI. For taxpayers who are age 65 or older, the threshold is 7.5% of AGI.

Usually, you have no control over when medical or dental expenses occur. At other times, however, you may be able to schedule elective expenses, such as arranging physical examinations or dental cleanings, to your benefit.

**YEAR-END MOVE:** Move non-emergency expenses into the optimal tax year for claiming deductions. For instance, if you are near or have already surpassed the AGI threshold this year, you could accelerate elective expenses into 2016. Otherwise, you might as well delay expenses to 2017, when at least you will have a chance at a deduction.

For this purpose, count unreimbursed medical and dental expenses paid for your immediate family, as well as other tax dependents such as an elderly parent or in-law. Paying these expenses may help you qualify for a deduction or boost an existing write-off.

**Tip:** Under current law, this is the last year in which taxpayers who are age 65 or older will benefit from the lower 7.5%-of-AGI floor. It is set to increase to 10%-of-AGI in 2017.

### **Education Expenses**

The tax law provides certain tax benefits to parents of children in college, but within limits. Thanks to the PATH Act, you can choose between a tax credit and a deduction in 2016.

**YEAR-END MOVE:** When appropriate, pay qualified expenses for next semester by the end of the year. Generally, the costs will be eligible for either tax break in 2016, even though the semester does not begin until 2017. Thus, you may be able to increase your credit or deduction amount.

Typically, you may benefit from either the American Opportunity Tax Credit (AOTC) or the Lifetime Learning Credit (LLC). The enhanced maximum AOTC of \$2,500, permanently preserved by the PATH Act, can be claimed for qualified expenses of each student. Conversely, the maximum LLC is \$2,000 and is available only on a per-family basis. Thus, the AOTC is usually preferable to parents.

Both credits are subject to phaseouts based on modified adjusted gross income (MAGI). Similarly, the tuition deduction is either \$4,000 or \$2,000, based on your MAGI. The deduction is completely phased out at a MAGI of \$80,000 for single filers and \$160,000 for joint filers.

**Tip:** The tuition deduction, which has expired and been extended several times, was revived by the PATH Act. It is currently scheduled to expire again after 2016.

### **Miscellaneous**

\*You may deduct annual state sales taxes (based on an IRS table or actual receipts) in lieu of deducting state and local income taxes. This alternative deduction, which had expired and been revived several times in the past, was made permanent by the PATH Act.

\*In some cases, you may consolidate outstanding personal debts into home equity debt. Interest on personal debts is not tax deductible, but you can generally deduct mortgage interest paid on the first \$100,000 of home equity debt in most states, no matter how the proceeds are used.

\*Prepay state and local taxes when it suits your needs. For instance, if property taxes are due on January 1, 2017, a payment in December may increase your 2016 deduction.

\*Miscellaneous expenses, including unreimbursed employee business expenses, are deductible only in excess of 2%-of-AGI. As with medical and dental expenses, you might arrange to pay qualified expenses (e.g., tax assistance fees) before 2017 to boost your deduction for 2016.

\*Generally, you may claim a dependency exemption for a child under age 19, or a full-time student under age 24, if you provide more than half of the child's annual support. If needed, you might be extra-generous with support around the holidays to clear the half-support mark.

\*The PATH Act restores the 10% residential energy credit, capped at \$500, for energy-saving improvements, but only for those made through 2016.

\*You may be liable for an estimated tax penalty if you fail to pay the required tax during the year. But you can avoid the penalty by paying enough to satisfy a "safe harbor" of 90% of current tax liability or 100% of the previous year's tax liability (110% if your AGI was above \$150,000).

## **BUSINESS TAX PLANNING**

### **Accelerated Filing Deadlines for Forms W-2, W-3, and Form 1099-MISC**

New for 2016, the deadline for filing both electronic and paper Forms W-2 to employees and to the Social Security Administration (SSA) is January 31, 2017. Previously, the deadline was the end of February to file paper Forms W-2 with the SSA and until the end of March to make electronic filings. The January 31 deadline also applies to Forms W-2AS, W-2GU, W-2VI, W-3, and W-3SS.

If you are filing any Forms 1099-MISC and reporting an amount in Box 7, Nonemployee Compensation, the deadline for filing these forms has also been moved up to January 31, 2017. If you are not reporting an amount in Box 7, the deadline remains February 28 for paper filings and March 31 for electronic filings.

### **Change in Return and Extension Due Dates for C Corporations and Partnerships**

In general, C corporations with tax years ending in 2016 now have an extra month to file their federal income tax returns. Such returns are due by the 15<sup>th</sup> day of the fourth month following the close of the tax year, rather than the 15<sup>th</sup> day of the third month following the close of the tax year. Thus, 2016 calendar-year C corporation federal income tax returns are due April 18, 2017, due to April 15 falling on a Saturday and Monday, April 17 being Emancipation Day in the District of Columbia.

A special rule exempts C corporations with fiscal years ending on June 30 from this change until tax years beginning after December 31, 2025. Thus, the filing deadline for such corporations remains September 15 until 2026 (when it will change to October 15).

Partnerships with tax years ending in 2016 are now required to file their federal income tax returns by the 15<sup>th</sup> day of the third month following the close of the tax year, rather than the 15<sup>th</sup> day of the fourth month following the close of the tax year. Thus, 2016 calendar-year partnership federal income tax returns are due March 15, 2017

Along with the changes in tax return deadlines, many of the automatic extension periods have also changed. For calendar year C corporations, the new rules provide for a five-month automatic extension. The extension period is a month shorter, but results in the same

September 15 extended deadline for a calendar year C corporation because of the new due date for C corporation returns (i.e., April 15).

For fiscal year C corporations with tax years ending on dates other than June 30, the length of automatic extensions remains unchanged at six months. For fiscal year C corporations with tax years ending on June 30, a special seven-month automatic extension applies for tax years beginning after 2015 and ending before 2026.

While partnerships were previously allowed a five-month extension of time in which to file their tax returns, they are now allowed a six-month extension so that the extended due date is the same as under prior law (i.e. September 15).

The filing deadline for S corporation returns remains unchanged, meaning that partnerships and S corporations will now share the same due dates.

### Section 179 Deductions

Under Section 179 of the tax code, a business may currently deduct, or “expense,” the cost of qualified new or used property placed in service during the year, up to an annual limit. The maximum deduction is phased out on a dollar-for-dollar basis above an annual threshold.

The maximum Section 179 deduction was scheduled to be slashed from \$500,000 to \$25,000 after 2014, but the PATH Act permanently preserves the generous higher allowance, retroactive to 2015, with future inflation indexing. The table below lists the maximum Section 179 allowances in recent years.

| Tax year  | Deduction limit | Phaseout threshold |
|-----------|-----------------|--------------------|
| 2007      | \$125,000       | \$500,000          |
| 2008–2009 | \$250,000       | \$800,000          |
| 2010–2015 | \$500,000       | \$2 million        |
| 2016      | \$500,000       | \$2.01 million     |

**YEAR-END MOVE:** Maximize the tax benefits for buying qualified property. As long as the property is placed in service this year, the cost is deductible on your 2016 tax return. Depending on your situation, you might amend your 2015 return to recover Section 179 benefits for last year.

Note that the Section 179 deduction cannot exceed the taxable income from all your business activities. This could limit your deduction for 2016.

**Tip:** Depreciation deductions may still be available for costs that cannot be expensed under Section 179. For these purposes, the Section 179 deduction is claimed first.

### Depreciation Deductions

Generally, a business may claim depreciation deductions for qualified property over a cost recovery period, based on the Modified Accelerated Cost Recovery System (MACRS). In addition, the PATH Act preserves the 50% “bonus” depreciation for qualified property

placed in service from 2015 through 2017. This bonus depreciation deduction is now scheduled to decrease to 40% in 2018 and 30% in 2019 before expiring.

**YEAR-END MOVE:** Your business should cash in on this tax break while it can. Factor in all the tax ramifications for your business before purchasing property at the end of the year.

Note that bonus depreciation may be claimed in conjunction with Section 179 (see above). However, unlike deductions claimed under Section 179, bonus depreciation is not available for used property.

**Tip:** MACRS deductions are generally reduced if business property (other than real estate) placed in service during the last quarter of the year—the period spanning October 1 through December 31—exceeds 40% of the cost of assets placed in service during the entire year.

### **Small Employer Health Insurance Credit**

Under the Affordable Care Act (ACA), the health care legislation enacted in 2010, a qualified small business may be eligible for a credit if it pays for health insurance coverage for its employees. For 2016, the business must have 25 or fewer full-time employees or full-time equivalents (FTEs) with average annual wages of less than \$51,800. The credit is eliminated if either of these two limits is exceeded.

**YEAR-END MOVE:** Be careful to observe the limits for claiming the credit. However, be aware that sole proprietors, partners in a partnership, 2%-or-more owners of S corporations and 5%-or-more business owners, as well as their family members, do not count as full-time employees for this purpose. This rule may give your business some added flexibility.

Currently, the credit is equal to 50% of the nonelective contributions made on behalf of employees. Prior to 2014, it was limited to 35% of those contributions.

**Tip:** To qualify for a credit in 2016, an employer must obtain health insurance through the Small Business Health Options Program (SHOP). The SHOP Marketplaces are similar to the individual health insurance exchanges established by states.

### **Business Bad Debts**

Even in the best of times, your business may have difficulty collecting payments for certain goods or services it has provided. At the very least, however, the business should be able to salvage some tax relief on its 2016 tax return.

**YEAR-END MOVE:** Step up collection efforts at the end of the year. For instance, you may issue a series of dunning letters to debtors asking for payment or hire a collection agency. If you are still unable to collect the unpaid amounts after making a concerted effort, you can generally write them off as business bad debts.

Generally, business bad debts are deducted from taxable income in the year they become worthless. To qualify as a business bad debt, a loan or advance must have been created

or acquired in connection with your business operation and result in a loss to the business entity if it cannot be repaid.

**Tip:** Keep detailed records of all your collection activities—including letters, telephone calls, e-mails and collection agency work. This documentation can help support your position claiming worthlessness of the debt if the IRS ever challenges the bad-debt deduction claimed on your 2016 return.

### **Miscellaneous**

\*Purchase routine business supplies before the end of the year. As a general rule, your company can deduct the costs in 2016, even if the supplies are not used until 2017.

\*Losses claimed by S corporation shareholders are limited to the basis in the stock plus outstanding debt. Thus, you might decide to make a capital contribution or loan money to the corporation before year-end to increase your basis for loss-deduction purposes.

\*A company may deduct 100% of business travel costs and 50% of entertainment and meal expenses. To increase your current deduction, accelerate trips planned for 2017 into 2016. Note that a company can deduct 100% of the cost of a holiday party as long as the entire workforce is invited.

\*If you buy a heavy-duty SUV or van for business, you might claim a first-year deduction of up to \$25,000. The usual “luxury car” limits do not apply to certain heavy-duty vehicles.

\*As a general rule, repairs are currently deductible, while capital improvements must be depreciated over time. Based on guidelines established by recent regulations, plan accordingly. For instance, take care of minor repairs before next year to increase your deduction for 2016.

\*An accrual-basis company operating on a calendar tax year may deduct bonuses in 2016 if it pays them within two and a half months of the close of the tax year (but not bonuses for certain business owners). Conversely, employees are not taxed on the bonuses until 2017, when they are received.

\*Comply with the employer mandate for health insurance under the ACA. The shared responsibility requirement was extended in 2016 to businesses with between 50 and 99 full-time employees or FTEs. Also, be aware that penalties for failures have increased.

## **FINANCIAL TAX PLANNING**

### **Capital Gains and Losses**

The tax law requires investors to use net capital gains and losses from securities sales to offset each other. If you have an excess loss for the year, it may offset up to \$3,000 of ordinary income before being carried over to the next year. A net long-term capital gain is taxed at a maximum rate of 15% or 20% if you are in the top ordinary income tax bracket of 39.6%. Short-term capital gains are taxed at ordinary income rates.



**YEAR-END MOVE:** Examine your investment portfolio. Depending on the results, you might “harvest” capital losses to offset gains realized earlier in the year or harvest capital gains that will be partially or wholly absorbed by prior losses.

Be aware of even greater preferential tax treatment for long-term capital gains. Notably, a 0% rate applies to taxpayers in the lowest two regular income tax brackets of 10% and 15%, such as a young child. And, even if capital gains push you into a higher tax bracket, you still benefit from the 0% rate on the portion of the gains up to the top of the income threshold for the 15% tax bracket.

**Tip:** Under the “kiddie tax,” unearned income above \$2,100 realized by a child under age 19, or a dependent full-time student under age 24, is generally taxed at the parents’ top tax rate. Keep an eye on this threshold.

### **Net Investment Income Tax**

An additional 3.8% tax applies to the lesser of your net investment income (NII) or the amount by which your modified adjusted gross income (MAGI) exceeds \$200,000 for single filers and \$250,000 for joint filers. (These amounts are not indexed for inflation.) The definition of NII includes interest, dividends, capital gains and income from passive activities, but not Social Security benefits, tax-exempt interest, and distributions from qualified retirement plans and IRAs.

**YEAR-END MOVE:** Reduce your exposure to the NII tax in 2016. For instance, depending on your situation, you might use one or more of the following techniques:

\*Add municipal bonds (“munis”) to your portfolio. Interest income from munis does not count as NII, nor is it included in the calculation of MAGI.

\*Establish a charitable remainder trust (CRT). With a CRT, you qualify for a current tax deduction while the income is sheltered from the NII tax.

\*Become active in a passive activity. For example, if you own a business and meet the tax law requirements for material participation, the business income may be exempted from the NII tax.

\*Consider an investment in a tax-deferred annuity that “leapfrogs” your highest-earning years when the NII tax is likely to apply.

**Tip:** Of course, these decisions should not be made in a vacuum. Coordinate tax-saving strategies with other aspects of your financial and investment plans.

### **Estate and Gift Taxes**

Estate-tax planning has gone down a long and winding path. Legislation enacted in 2001 gradually increased the estate-tax exemption, while severing it from the lifetime gift exemption, and reduced the top estate-tax rate. Then the estate tax was repealed entirely, but only for 2010, after which it was reinstated. Currently, as shown by the following table, the tax

law provides a reunified estate- and gift-tax exemption of \$5 million (indexed to \$5.45 million in 2016) and a top 40% estate-tax rate.

| <b>Tax year</b> | <b>Maximum estate-tax exemption</b> | <b>Top estate-tax rate</b> |
|-----------------|-------------------------------------|----------------------------|
| 2002            | \$1 million                         | 50%                        |
| 2003            | \$1 million                         | 49%                        |
| 2004            | \$1.5 million                       | 48%                        |
| 2005            | \$1.5 million                       | 47%                        |
| 2006            | \$2 million                         | 46%                        |
| 2007–2008       | \$2 million                         | 45%                        |
| 2009            | \$3.5 million                       | 45%                        |
| 2010            | Not applicable                      | Repealed                   |
| 2011            | \$5 million                         | 35%                        |
| 2012            | \$5.12 million                      | 35%                        |
| 2013            | \$5.25 million                      | 40%                        |
| 2014            | \$5.34 million                      | 40%                        |
| 2015            | \$5.43 million                      | 40%                        |
| 2016            | \$5.45 million                      | 40%                        |

**YEAR-END MOVE:** Update your estate plan to reflect existing law. For instance, wills and trusts may be revised to accommodate the rule allowing portability of the estate-tax exemption.

Under the “portability” provision for a married couple, the unused portion of the estate-tax exemption of the first spouse to die may be carried over to the estate of the surviving spouse. This tax break is now a permanent part of the tax code.

**Tip:** The annual gift-tax exclusion allows you to give up to \$14,000 to a recipient in 2016 (\$28,000 for joint gifts by a married couple) without any gift tax, thereby reducing your taxable estate.

### **Miscellaneous**

\*Sell real estate on the installment basis. For payments over two years or more, you can defer tax until payment is received. Also, this method may effectively reduce the overall tax liability.

\*Under the “wash sale rule,” you cannot deduct a loss on securities sales if you acquire substantially identical securities within 30 days. The simplest way to avoid this result is to wait at least 31 days before you repurchase the same or similar securities.

\*Contribute up to \$18,000 to a 401(k) in 2015 (\$24,000 if age 50 or older). If you clear the 2016 Social Security wage base of \$118,500 and promptly allocate the payroll tax savings to the 401(k), you can increase your deferral with no further reduction in your take-home pay.

\*Invest in passive income generators (PIGs). Generally, you can only use losses from passive activities (e.g., most real estate investments) to offset income from passive activities, with limited exceptions. With a PIG, you can absorb more of your passive activity losses.

\*The PATH Act permanently preserves the tax exclusion for distributions from an IRA to a qualified charity by taxpayers age 70½ or older. The limit is \$100,000 per taxpayer.

\*New temporary regulations could have a major impact on valuations of transfers of business interests for estate- and gift-tax purposes. Arrange a consultation as soon as possible if this might affect you.

## **CONCLUSION**

This year-end tax-planning letter is based on the prevailing federal tax laws, rules and regulations. Of course, it is subject to change, especially if major tax-reform provisions are enacted before the end of the year.

Finally, remember that this letter is intended to serve only as a general guideline. Your personal circumstances will likely require a careful examination. We will be glad to schedule a meeting with you to provide assistance with all your tax-planning needs.

Very truly yours,

*Simpson & Company, P.C.*