Wealth Planning Services

Tax Update # 40: 2016 Year-End Individual Income Tax Planning

Year-end 2016 brings planning opportunities and challenges, and there is much for taxpayers and their tax advisors to consider in taking action before 2016 ends. This summary explores some of the **2016 year-end income tax planning opportunities available to individual taxpayers.** Of course, every taxpayer's situation is unique and a year-end planning strategy, whether for an individual, family, or business, should be customized in consultation with a qualified professional. Harbour Capital Advisors (HCA) stands ready to assist clients with year-end planning issues and opportunities.

Moreover, year-end tax planning is complicated by what the new Administration and Congress could do next year. During his campaign, President-elect Trump outlined a number of tax proposals for individuals and businesses. Keep in mind, however, that what is proposed by an Administration and/or Congress and what legislation ultimately looks like can differ dramatically, especially when (i) Congress and the new Administration may have differing views on what tax reform should look like and (ii) a 60-vote supermajority (to override filibuster) in the Senate on a given bill may be difficult to obtain (which may not be necessary if "reconciliation" is utilized). However, during his campaign, President-elect Trump called for, among other things:

- Reducing the number of individual income tax brackets and lowering the individual income tax rates for most taxpayers (with a new rate structure of 12, 25, and 33 percent)
- Repealing the alternative minimum tax (AMT)
- Limiting itemized deductions and increasing the standard deduction
- Eliminating the head-of-household filing status and all personal exemptions
- Repealing the Federal estate and gift tax (and introducing a "carryover basis" rule for inherited assets of more than $10 million)
- Lowering the corporate tax rate to 15 percent (from 35 percent)
- Sharing the corporate rate break with owners of "pass through" entities on reinvested profits
- Doubling the Code Sec. 179 small business expensing election to $1 million
- Allowing repatriation of corporate profits held offshore at a one-time tax rate of 10 percent
- Repealing the Affordable Care Act (ACA) (including presumably the ACA's tax-related provisions)

Given that it is too early to predict what legislation will look like and when it will pass, this summary focuses instead on current law (as scheduled for 2016 and 2017). For a summary of business income tax-savings opportunities, please request a copy of our separate **Tax Update # 41: 2016 Year-End Business Income Tax Planning**. For a summary of estate and gift tax-savings opportunities, please request a copy of our separate **Tax Update # 42: 2016 Year-End Estate and Gift Tax Planning**. Note that all tax information contained herein is general in nature, is provided for informational and educational purposes only, and should not be construed as legal or tax advice.

General Filing Requirements

Income tax returns can be filed as married filing jointly, head of household, single, and married filing separately. A married couple, which includes legally-recognized same-sex marriages, may elect to file one return reporting combined income, computing the tax liability using the tax tables or rate schedules for "Married Persons Filing Jointly." A joint return may be filed even though one spouse has neither gross income nor deductions. If one spouse has died during the year, the survivor may file a joint return for that year. Certain married persons who do not elect to file a joint return may be entitled to use the lower head-of-household tax rates. Generally, in order to qualify as a head of household, you must not be a resident alien, you must satisfy certain marital status requirements, and you must maintain a household for a qualifying child or another dependent if you are entitled to a dependency deduction for the taxable year for such person.

Basic Numbers You Need To Know

Since many tax benefits are tied to (or limited by) adjusted gross income (AGI), a key aspect of tax planning is to estimate both 2016 and 2017 AGI. Also, when considering whether to accelerate or defer income or deductions, you should be aware of the impact on AGI and your ability to maximize deductions that are tied thereto. Your 2015 tax return and 2016 pay stubs and other income- and deduction-related materials are a good starting point for estimating AGI.

2016 individual income tax brackets are as follows:

Tax Rate	Single Filers	Married Filing Jointly or Qualifying Widow(er)	Married Filing Separately	Head of Household	Trusts and Estates
10%	Up to $9,275	Up to $18,550	Up to $9,275	Up to $13,250	
15%	$9,276 - $37,650	$18,551 - $75,300	$9,276 - $37,650	$13,251 - $50,400	Up to $2,500
25%	$37,651 - $91,150	$75,301 - $151,900	$37,651 - $75,950	$50,401 - $130,150	$2,501 - $5,950
28%	$91,151 - $190,150	$151,901 - $231,450	$75,951 - $115,725	$130,151 - $210,800	$5,951 - $9,050
33%	$190,151 - $413,350	$231,451 to $413,350	$115,726 - $206,675	$210,801 - $413,350	$9,051 - $12,400
35%	$413,351 - $415,050	$413,351 to $466,950	$206,676 - $233,475	$413,351 - $441,000	
39.6%	$415,051 or more	$466,951 or more	$234,476 or more	$441,001 or more	$12,401 or more

2017 individual income tax brackets are as follows:

Tax Rate	Single Filers	Married Filing Jointly or Qualifying Widow(er)	Married Filing Separately	Head of Household	Trusts and Estates
10%	Up to $9,325	Up to $18,650	Up to $9,325	Up to $13,350	
15%	$9,326 - $37,950	$18,651 - $75,900	$9,326 - $37,950	$13,351 - $50,800	Up to $2,550
25%	$37,951 - $91,900	$75,901 - $153,100	$37,951 - $76,550	$50,801 - $131,200	$2,551 - $6,000
28%	$91,901 - $191,650	$153,101 - $233,350	$76,551 - $116,675	$131,201 - $212,500	$6,001 - $9,150
33%	$191,651 - $416,700	$233,351 to $416,700	$116,676 - $208,350	$212,501 - $416,700	$9,151 - $12,500
35%	$416,701 - $418,400	$416,701 to $470,700	$208,351 - $235,350	$416,701 - $444,550	
39.6%	$418,401 or more	$470,701 or more	$235,351 or more	$444,551 or more	$12,501 or more

Note that, because the highest rate for estates and trusts starts at a relatively low level of taxable income ($12,401 in 2016 and $12,501 in 2017), executors and trustees should consider making distributions, where allowed, to beneficiaries before year-end, which generally will pass that amount of taxable income through to those beneficiaries and bypass tax at the comparatively high estate/trust level.

An additional 0.9 percent Medicare tax is imposed on wages, compensation, and self-employment earnings above a threshold amount. Once the threshold is reached, the tax applies to all wages that are currently subject to Medicare Tax, to the Railroad Retirement Tax Act, or to the Self-Employment Compensation Act. The threshold amounts are as follows:

Filing Status	Threshold Amount
Married Filing Jointly (Combined Income)	$250,000
Married Filing Separately	$125,000
Single, Head of Household, Qualifying Widow(er)	$200,000

IRA and Retirement Savings Rules

Tax-saving opportunities continue for retirement planning due to the availability of Roth IRAs and other retirement savings incentives.

Traditional IRAs: The deadline for 2016 IRA contributions (whether traditional or Roth) is April 17, 2017. Individuals who are not active participants in an employer pension plan may make deductible contributions to an IRA. For 2016 and 2017, the annual contribution limit for an IRA is $5,500. For 2016 and 2017, a $1,000 "catch-up" contribution is allowed for taxpayers age 50 or older by the close of the taxable year, making the total limit $6,500 for these individuals. Individuals who are active participants in a qualified plan offered by an employer also may make deductible contributions to an IRA, but their contributions are limited in amount depending on their AGI. For 2016, the AGI phase-out range for deductibility of IRA contributions is between $61,000 and $71,000 of modified AGI for single persons (including heads of households) and between $98,000 and $118,000 of modified AGI for married filing jointly. For 2017, the AGI phase-out range for deductibility of IRA contributions is between $62,000 and $72,000 of modified AGI for single persons (including heads of households) and between $99,000 and $119,000 of modified AGI for married persons filing jointly. Above these ranges, no deduction is allowed.

In addition, an individual will not be considered an "active participant" in an employer plan simply because the individual's spouse is an active participant for part of a plan year. Thus, you may be able to take the full deduction for an IRA contribution regardless of whether your spouse is covered by a plan at work, subject to a phase-out if your joint modified AGI is between $184,000 and $194,000 for 2016 and between $186,000 and $196,000 for 2017. Above these ranges, no deduction is allowed.

Spousal IRA: For 2016 and 2017, if an individual files a joint return and has less compensation than a spouse, the IRA contribution is limited to the lesser of (i) $5,500 plus age 50 catch-up contributions or (ii) the total compensation of both spouses reduced by the other spouse's IRA contributions.

Roth IRA: This type of IRA permits nondeductible contributions of up to $5,500 a year (for both 2016 and 2017). Earnings grow tax-free, and distributions are tax-free provided that no distributions are made until more than five years after the first contribution and the individual has reached age 59.5. Distributions may be made earlier in the event of the individual's disability or death. The maximum contribution is phased out in 2016 for persons with AGI above certain amounts: $184,000 to $194,000 for married taxpayers filing jointly, $117,000 to $132,000 for single taxpayers (including heads of households), and $0 to $10,000 for married taxpayers filing separately who lived with the spouse during the year. The maximum contribution is phased out in 2017 for persons with AGI above certain amounts: $186,000 to $196,000 for married taxpayers filing jointly, $118,000 to $133,000 for single taxpayers (including heads of households), and $0 to $10,000 for married taxpayers filing separately who lived with the spouse during the year.

Roth IRA Conversion Rule: Funds in a traditional IRA (including SEPs and SIMPLE IRAs), §401(a) qualified retirement plan, §403(b) tax-sheltered annuity, or §457 government plan may be rolled over into a Roth IRA, provided certain requirements are met. Such a rollover, however, is treated as a taxable event, and you will pay tax on the amount converted to the extent that it exceeds your tax basis in the original account (reported on Form 8606 in the case of an IRA). No penalties will apply if all the requirements for such a transfer are satisfied. For 2016 and 2017, taxpayers will be able to make Roth IRA conversions without regard to their AGI. Also, if you already made a conversion earlier this year, you have the option of undoing the conversion (known as a "recharacterization"). This is a useful strategy if the investments have gone down in value so that if you were to do the conversion now, your taxes would be lower. This is a complicated calculation, however, so you should consult with us if you wish to explore a recharacterization further.

In addition, for 2016 and 2017, if your §401(k) plan, §403(b) plan, or governmental §457(b) plan has a qualified designated Roth contribution program, a distribution to an employee (or a surviving spouse) from an account under the plan that is not a designated Roth account is permitted to be rolled over into a designated Roth account under the plan for the individual; provided, however, that such a rollover is treated as a taxable event, and you will pay tax on the amount converted to the extent that it exceeds your tax basis in the account that is not a designated Roth account. Other rules related to employer plan account Roth conversions are similar to those for Roth IRA conversions.

401(k) Contribution: The §401(k) elective deferral limit is $18,000 for 2016 and 2017. If your §401(k) plan has been amended to allow for catch-up contributions for 2016 and you will be 50 years old by December 31, 2016, you may contribute an additional $6,000 to your §401(k) account in 2016, for a total maximum contribution of $24,000 ($18,000 in regular contributions plus $6,000 in catch-up contributions). The catch-up amount will remain at $6,000 in 2017.

SIMPLE Plan Contribution: The SIMPLE plan deferral limit is $12,500 for 2016 and 2017. If your SIMPLE plan has been amended to allow for catch-up contributions for 2016 and you will be 50 years old by December 31, 2016, you may contribute an additional $3,000. The catch-up amount will remain at $3,000 in 2017.

Catch-Up Contributions for Other Plans: If you will be 50 years old by December 31, 2016, you may contribute an additional $6,000 to your §403(b) plan, SEP, or eligible §457 government plan. The catch-up amounts will remain at $6,000 in 2017.

Saver's Credit: A nonrefundable tax credit is available based on the qualified retirement savings contributions to an employer plan made by an eligible individual. For 2016, only taxpayers filing joint returns with AGI of $61,500 or less, head of household returns with AGI of $46,125 or less, or single returns (or separate returns filed by married taxpayers) with AGI of $30,750 or less are eligible. For 2017, only taxpayers filing joint returns with AGI of $62,000 or less, head of household returns with AGI of $46,500 or less, or single returns (or separate returns filed by married taxpayers) with AGI of $31,000 or less are eligible. The amount of the credit is equal to the applicable percentage (10% to 50%, based on filing status and AGI) of qualified retirement savings contributions up to $2,000 ($4,000 if married filing jointly).

Required Minimum Distributions: For 2016 and 2017, taxpayers age 70.5 by the end of the relevant year must take their required minimum distribution from IRAs or defined contribution plans (§401(k) plans, §403(a) and (b) annuity plans, and §457(b) plans that are maintained by a governmental employer).

Maximize Retirement Savings: In many cases, employers will require you to set your 2017 retirement contribution levels before January 2017. If you did not elect the maximum 401(k) contribution for 2016, you can increase your amount for the remainder of 2016 to lower your AGI in order to take advantage of some of the tax breaks described above.

Deferring Income to 2017

If you expect your marginal tax rate to be the same or lower in 2017, you may benefit by deferring income into 2017 (and accelerating deductions into 2016). Some ways to defer income include:

Delay Billing: If you are self-employed and on the cash basis, delay year-end billing to clients so that payments will not be received until 2017.

Interest and Dividends: Interest income earned on Treasury securities and bank certificates of deposit with maturities of one year or less is not includible in income until received. To defer interest income (and assuming that your investment program otherwise calls for such investments), consider buying short-term bonds or certificates that will not mature until next year. If you have control as to when dividends are paid, arrange to have them paid to you after the end of the year.

Accelerating Income into 2016

On the other hand, you may want to try to accelerate income (and defer deductions), if you expect your marginal tax rate to be higher in 2017. If accelerating income will be beneficial, here are some ways to accomplish this:

Accelerate Collection of Accounts Receivable: If you are self-employed and report income and expenses on a cash basis, issue bills and attempt collection before the end of 2016. Also see if some of your

clients or customers might be willing to pay for January 2017 goods or services in advance. Any income received using these steps will shift income from 2017 to 2016.

Year-End Bonuses: If your employer generally pays year-end bonuses after the end of the current year, ask to have your bonus paid to you before the beginning of 2017.

Retirement Plan Distributions: If you are over age 59.5 and you participate in an employer retirement plan or have an IRA, consider making any taxable withdrawals before 2017. You may also want to consider converting a traditional IRA to a Roth IRA, as discussed above.

Other Income: Other types of income over which individuals may have control of timing include consulting or other self-employment income and U.S. Treasury Bill income.

Deduction Planning: Individuals

Deduction timing is also an important element of year-end tax planning. Deduction planning is complicated, however, by factors such as AGI levels and filing status. If you are a cash-method taxpayer, remember to keep the following in mind:

Deduction in Year Paid: An expense is only deductible in the year in which it is actually paid. Under this rule, if your marginal tax rate is going to increase in 2017, it is usually a smart strategy to postpone deductions (where possible) until 2017.

Payment by Check: Date checks before the end of the year and mail them before January 1, 2017 if you want to be able to take the deduction in 2016.

Promise to Pay: A promise to pay or providing a note does not permit you to deduct an expense. But, you can take a deduction if you pay with money borrowed from a third party. For example, if you pay by credit card in 2016, you can take the deduction even though you don't pay the credit card bill until 2017.

AGI Limits: For 2016 and 2017, the overall limitation on itemized deductions (Pease limitation) applies for taxpayers whose AGI exceeds certain limits detailed in the table below. Moreover, under the personal exemption phase-out (PEP), the total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each $2,500 ($1,250 for married couples filing separate returns) or portion thereof by which the taxpayer's adjusted gross income exceeds the limits detailed in the table below.

2016 Pease Limitations on Itemized Deductions		
Filing Status	**Income Threshold**	
Single	$259,400.00	
Married Filing Jointly	$311,300.00	
Head of Household	$285,350.00	
2016 Personal Exemption Phase-out		
Filing Status	**Phase-out Begin**	**Phase-out Complete**
Single	$259,400.00	$381,900.00
Married Filing Jointly	$311,300.00	$433,800.00
Head of Household	$285,350.00	$407,850.00

2017 Pease Limitations on Itemized Deductions		
Filing Status	**Income Threshold**	
Single	$261,500.00	
Married Filing Jointly	$313,800.00	
Head of Household	$287,650.00	
2017 Personal Exemption Phase-out		
Filing Status	**Phase-out Begin**	**Phase-out Complete**
Single	$261,500.00	$384,000.00
Married Filing Jointly	$313,800.00	$436,300.00
Head of Household	$287,650.00	$410,150.00

In addition, certain deductions may be claimed only if they exceed a percentage of AGI: 10% for medical expenses (7.5% for certain older taxpayers until December 31, 2016, at which point the 10% threshold is scheduled to apply to all taxpayers), 2% for miscellaneous itemized deductions, and 10% for casualty losses.

Standard Deduction Planning: Deduction planning is also affected by the standard deduction. For 2016 returns, the standard deduction is $12,600 for married taxpayers filing jointly, $6,300 for single taxpayers, $9,300 for heads of households, and $6,300 for married taxpayers filing separately. For 2017 returns, the standard deduction is $12,700 for married taxpayers filing jointly, $6,350 for single taxpayers, $9,350 for heads of households, and $6,350 for married taxpayers filing separately. If your itemized deductions are relatively constant and are close to the standard deduction amount, you will likely obtain little or no benefit from itemizing your deductions each year. But simply taking the standard deduction each year means you lose the benefit of your itemized deductions. To maximize the benefits of both the standard deduction and itemized deductions, consider adjusting the timing of your

deductible expenses so that they are higher in one year and lower in the following year (otherwise known as "bunching"). You can do this by paying in 2016 deductible expenses, such as mortgage interest due in January 2017.

Medical Expenses: For 2016, medical expenses, including amounts paid as health insurance premiums, are deductible only to the extent that they exceed 10% of AGI (7.5% for taxpayers age 65 or older). Beginning on January 1, 2017, the 10% threshold will apply to all taxpayers, including those age 65 or older.

State Taxes: If you anticipate a state income tax liability for 2016 and plan to make an estimated payment, consider making the payment before the end of 2016, provided you can still avoid AMT exposure. Note that the option to elect to deduct, as an itemized deduction, state and local sales taxes instead of state and local income taxes expired at the end of 2014 but was reinstated retroactively and permanently by Congress at the end of 2015.

Charitable Contributions: Consider making your charitable contributions by the end of the year. This will give you use of the money during the year and simultaneously permit you to claim a deduction for that year. You can use a credit card to charge donations in 2016 even though you will not pay the bill until 2017. A mere pledge to make a donation is not deductible, however, unless it is paid by the end of the year. Note, however, for claimed donations of cars, boats, and airplanes of more than $500, the amount available as a deduction will depend significantly on what the charity does with the donated property, not just the fair market value of the donated property. If the organization sells the property without any significant intervening use or material improvement to the property, the amount of the charitable contribution deduction cannot exceed the gross proceeds received from the sale.

To avoid capital gains and still maximize your deductions, you may want to consider donating long-term appreciated property to charity. For example, subject to certain exceptions, gifts of long-term appreciated marketable securities to a public charity can be deducted at their fair market value on the date of the gift, subject to a 50%-of-AGI deduction limitation. Any overage may be carried forward for up to five additional tax years. And none of the inherent capital gains should be realized. So, if your AGI is $500,000 and you want to contribute your $60,000 of IBM stock (that you purchased years ago and which has a tax cost basis of $10,000) to a public charity (*e.g.,* the American Red Cross), you should be able to do so without running into the 50%-of-AGI limitation and while avoiding recognition of the inherent long-term capital gain.

Regarding charitable contributions, please remember the following rules: (1) no deduction is allowed for charitable contributions of clothing and household items if such items are not in good used condition or better; (2) the IRS may deny a deduction for any item with minimal monetary value; and (3) the restrictions in (1) and (2) do not apply to the contribution of any single clothing or household item for which a deduction of $500 or more is claimed if the taxpayer includes a qualified appraisal with his or her return. Taxpayers run the risk of having deductions for charitable contributions, regardless of the amount, denied, unless the donor maintains a cancelled check, bank record, or receipt from the donee organization showing the name of the donee organization and the date and amount of the contribution.

A special provision, made permanent in 2016, gives taxpayers the ability to distribute tax-free to charity up to $100,000 from a traditional or Roth IRA maintained for an individual who has reached age 70.5.

Other Expenses: Other types of expenses over which individuals may have control of timing include property taxes, mortgage interest, and margin interest. Note, however, that prepaid expenses can be deducted only in the year to which they relate. For example, you can prepay (by Dec. 31) property taxes due next year that relate to this year and deduct the payment on this year's return; but you generally cannot prepay property taxes that relate to next year and deduct the payment on this year's return.

Education and Child Tax Benefits

Child Tax Credit: A tax credit of $1,000 per qualifying child under the age of 17 is available on this year's return. In order to qualify for 2016, the taxpayer must be allowed a dependency deduction for the qualifying child (who must be younger than the taxpayer). The credit is phased out at a rate of $50 for each $1,000 (or fraction of $1,000) of modified AGI exceeding the following amounts: $110,000 for married taxpayers filing jointly; $55,000 for married taxpayers filing separately; and $75,000 for all other taxpayers. A portion of the credit may be refundable. For 2016 and 2017, the threshold earned income level to determine refundability is set by statute at $3,000.

Credit for Adoption Expenses: For 2016, the adoption credit limitation is $13,460 ($13,570 in 2017) of aggregate expenditures for each child, except that the credit for an adoption of a child with special needs is deemed to be $13,460 in 2016 ($13,570 in 2017) regardless of the amount of expenses. The credit ratably phases out for taxpayers whose income is between $201,920 and $241,920 in 2016 (between $203,540 and $243,540 in 2017).

American Opportunity Tax Credit and Lifetime Learning Credit: The maximum American Opportunity tax credit for 2016 and 2017 is $2,500 (100% on the first $2,000, plus 25% of the next $2,000) for qualified tuition and fees paid on behalf of a student (*i.e.,* the taxpayer, the taxpayer's spouse, or a dependent) who is enrolled on at least a half-time basis. The credit is available for the first four years of the student's post-secondary education. For 2016 and 2017, the credit is phased out at modified AGI levels between $160,000 and $180,000 for joint filers and between $80,000 and $90,000 for other taxpayers. Forty percent of the credit is refundable, which means that you can receive up to $1,000 even if you owe no taxes. The term "qualified tuition and related expenses" includes expenditures for "course materials" (books, supplies, and equipment needed for a course of study whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance). One way to take advantage of the credit for 2016 is to prepay the spring 2017's tuition. In addition, if your child's books for the spring semester are known, those can be bought and the costs qualify for the credit.

The Lifetime Learning credit maximum in 2016 and 2017 is $2,000 (20% of qualified tuition and fees up to $10,000). A student need not be enrolled on at least a half-time basis so long as he or she is taking post-secondary classes to acquire or improve job skills. As with the American Opportunity tax credit, eligible students include the taxpayer, the taxpayer's spouse, or a dependent. For 2016, the Lifetime Learning credit is phased out at modified AGI levels between $111,000 and $131,000 (between $112,000 and $132,000 for 2017) for joint filers and between $55,000 and $65,000 (between $56,000 and $66,000 for 2017) for single taxpayers.

Coverdell Education Savings Account: For 2016 and 2017, the aggregate annual contribution limit to a Coverdell education savings account is $2,000 per designated beneficiary. The limit is phased out for individual contributors with modified AGI between $95,000 and $110,000 and joint filers with modified AGI between $190,000 and $220,000. The contributions to the account are non-deductible, but the earnings grow tax-free.

Student Loan Interest: You may be eligible for an above-the-line deduction for student loan interest paid on any "qualified education loan." The maximum deduction is $2,500. The deduction is phased out at a modified AGI level between $130,000 and $160,000 for 2016 (between $135,000 and $165,000 for 2017) for joint filers and between $65,000 and $80,000 for individual taxpayers for 2016 and 2017.

Kiddie Tax: For 2016 and 2017, the kiddie tax applies to: (1) children under 18; (2) 18-year-old children who have unearned income in excess of the threshold amount, do not file a joint return, and have earned income, if any, that does not exceed one-half of the amount of the child's support; and (3) children between the ages of 19 and 23 if, in addition to the above rules, they are full-time students. For 2016 and 2017, the first $1,050 of unearned income that a child or college student earns will be offset by the $1,050 standard deduction (assuming the child has no earned income), and the next $1,050 of such unearned income will be taxed at the child's tax rate. All of the child's unearned income in excess of $2,100 is taxed at the parent's tax rate.

Energy Incentives

Residential Energy Efficient Property Credit: Through December 31, 2016, tax incentives are available to taxpayers who install certain energy-efficient property, such as photovoltaic panels, solar water heating property, fuel cell property, small wind energy property, and geothermal heat pumps. The credit for photovoltaic panels and solar water heating property has been extended for property placed in service through December 31, 2021. A credit is available for the expenditures incurred for such property up to a specific percentage, except that a cap applies for fuel cell property. The property purchased cannot be used to heat swimming pools or hot tubs. If you have made improvements to your home or plan to do so by the end of 2016, please contact us and/or your tax accountant to discuss the amount of the credit for which you may qualify.

Investment Planning

The following rules apply in 2016 and 2017:

- Capital gains on property held one year or less (and non-qualified dividends) are taxed at an individual's ordinary income tax rate at the Federal level.
- Capital gains on property held for more than one year (and qualified dividends) are taxed at a maximum Federal rate of 20% (0% if an individual is in the 10% or 15% marginal tax bracket; 15% for individuals in the 25%, 28%, 33% and 35% brackets).

[Qualified dividends include dividends received from domestic and certain foreign corporations.]

A 3.8% net investment income surtax is levied on certain unearned income. The tax is levied on the lesser of net investment income or the amount by which modified AGI exceeds certain dollar amounts ($250,000 for joint returns and $200,000 for individuals). Investment income is: (1) gross income from interest, dividends, annuities, royalties, and rents (other than from a trade or business); (2) other gross income from any business to which the tax applies; and (3) net gain attributable to property other than property attributable to an active trade or business. Investment income does not include distributions from certain qualified retirement plans or amounts subject to self-employment tax. This rule applies mostly to passive businesses and the trading in financial instruments or commodities. With this additional tax, the maximum net long-term capital gains (and qualified dividend) tax rate at the Federal level is 23.8% in 2016 and 2017.

Timing of Sales: You may want to time the sale of assets so as to have offsetting capital losses and gains. Capital losses may be fully deducted against capital gains and also may offset up to $3,000 of ordinary income ($1,500 for married filing separately). In general, when you take losses, you must first match your long-term losses against your long-term gains and short-term losses against short-term gains. If there are any remaining losses, you may use them to offset any remaining long-term or short-term gains, and then up to $3,000 (or $1,500) of ordinary income. HCA will, by early December, report short-term and long-term realized and unrealized gains and losses in taxable accounts managed by HCA so as to provide clients with information that may be helpful in addressing year-end tax planning issues.

Social Security: Depending on the recipient's modified AGI and the amount of Social Security benefits, up to 85% of Social Security benefits may be taxed. To reduce the percentage, it may be beneficial to defer receipt of other retirement income. One way to do so is to elect to receive a lump sum distribution from a retirement plan and to roll that distribution into an IRA. Alternatively, it may be beneficial to accelerate income so as to reduce the percentage of your Social Security taxed in 2017 and later years. HCA stands ready to assist with such an acceleration-v.-deferral analysis.

Health Care Planning

Individual Mandate: Under PPACA, there is an “individual mandate” requiring individuals and their dependents to (i) have health insurance that is “minimum essential coverage” or (ii) pay a penalty (unless exempt). Many individuals already have qualifying coverage, which can be obtained through the individual market, an employer-provided plan or coverage, a government program such as Medicare or Medicaid, or an “exchange.” For lower-income individuals who obtain health insurance through such an exchange, a premium tax credit and cost-sharing reductions may be available to offset the costs.

Health Care Savings Accounts: The 2016 annual deduction limit for contributions to an HSA for an individual with self-only coverage under a high-deductible health plan (HDHP) will be $3,350 ($3,400 for 2017). For an individual with family coverage under an HDHP in 2016 and 2017, the limit will be $6,750. For 2016 and 2017, an HDHP will need to have an annual deductible that is not less than $1,300 for self-only coverage or $2,600 for family coverage. In addition, for 2016 and 2017, the annual out-of-pocket expenses (deductibles, copayments, and other amounts, but not premiums) may not exceed $6,550 for self-only coverage or $13,100 for family coverage. For 2016 and 2017, individuals age 55 and older who are covered by an HDHP can make additional “catch-up” contributions each year until they enroll in

Medicare. By statute, the catch-up contribution limit for individuals who will attain age 55 or older in the 2016 and 2017 taxable year will be $1,000.

Annual contributions to health flexible spending arrangements (health FSAs) are capped at $2,550 for 2016 ($2,600 for 2017). Any salary reductions in excess of the caps will subject an employee to tax on distributions from the health FSA. Cafeteria plans can now be amended to allow up to $500 of unused amounts remaining at the end of a plan year in a health FSA to be paid or reimbursed to plan participants for qualified medical expenses incurred during the following plan year, subject to certain exceptions.

Long-term Care Insurance Premiums: Long-term care insurance premiums qualify as deductible "medical care" costs up to certain limits for a taxable year. The applicable inflation-adjusted limits for 2016 and 2017 are:

Age Attained Before End of Taxable Year	Deductible Premium Limit (2016)	Deductible Premium Limit (2017)
40 or less	$390	$410
More than 40 but not more than 50	$730	$770
More than 50 but not more than 60	$1,460	$1,530
More than 60 but not more than 70	$3,900	$4,090
More than 70	$4,870	$5,110

Self-Employed Health Insurance Premiums: Self-employed individuals are allowed to claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses, and dependents as an above-the-line deduction, without regard to the general 10%-of-AGI floor.

Alternative Minimum Tax

The alternative minimum tax (AMT) exemption amounts for 2016 are: (1) $83,800 for married individuals filing jointly and for surviving spouses; (2) $53,900 for unmarried individuals other than surviving spouses; and (3) $41,900 for married individuals filing a separate return. The exemption amounts for 2017 are: (1) $84,500 for married individuals filing jointly and for surviving spouses; (2) $54,300 for unmarried individuals other than surviving spouses; and (3) $42,250 for married individuals filing a separate return. Also, for 2016 and 2017, nonrefundable personal credits can offset an individual's regular tax and AMT, and capital gains will be taxed at the lower favorable rates noted above for AMT purposes.

Some of the standard year-end planning ideas will not reduce tax liability if you are subject to the AMT, since different rules apply. Due to the complexity of the AMT, you may want to request that HCA analyze your potential AMT exposure.

Conclusion

While we are getting very close to the end of the year, there is still time to implement strategies to minimize your 2016 tax liability. If you have questions about topics reviewed above or other tax planning matters, please contact Hunter Payne at 703.992.6485.

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