Cornerstone Financial Solutions, Inc.
An Independent Firm

Tax Report

QUARTER 4, 2016

10 THINGS TO REVIEW BEFORE YEAR-END

1. Guesstimate your tax rates
2. Review your retirement savings options
3. Consider Roth IRA conversions
4. Review your capital losses and gains
5. Consider "bunching" your deductions
6. Check if your Social Security is taxable
7. Maximize your charitable giving
8. Consider PATH Act extenders
9. Determine if your 2016 and 2017 income will differ dramatically
10. Review tax strategies with your tax preparer

Year-End Tax Planning for 2016

One of the many benefits of working with the professionals at Cornerstone is that our Wealth Advisors can help identify tax savings opportunities and strategies that coordinate with your investment portfolio. The goal of this report is to share strategies that could be effective if considered and implemented before year-end.

The election of Donald Trump to serve as the 45th President of the United States brings forward some proposals that were announced on the campaign trail, but these are far from being law and will not affect 2016 tax returns. Despite all the uncertainty surrounding future tax rules, there are many year-end tax moves that focus on income and expenses you can make to lessen your tax liability.

The Protecting Americans from Tax Hikes Act (PATH Act) passed in late 2015 changed, revised and also made permanent some tax breaks that were previously in need of extension. To the extent that income or expenses can be moved or recognized in either 2016 or 2017 can make a difference for many investors. Year-end tax planning is often about determining the best year to earn additional income or to incur more tax deductions. Now is the time to focus on how to optimize your situation between these two years.

Remember that every situation is different and not all strategies will be appropriate for you. Please discuss all tax strategies with your tax preparer before making any final decisions.

Income Tax Rates for 2016

Tax brackets have changed slightly for 2016. For example, for the 2015 tax year, the top of the 15% federal income tax bracket for married couples filing jointly was $74,900. In 2016, that figure was increased to $75,300. Below is a table of federal income tax rates for 2016.

FEDERAL TAX RATES		SINGLE		HEAD OF HOUSEHOLD		MARRIED FILING SEPARATELY		MARRIED FILING JOINTLY / QUALIFYING WIDOW OR WIDOWER	
Ordinary Income	*Long Term Capital Gains and Qualified Dividends*	*Taxable Income Over*	*To*	*Taxable Income Over*	*To*	*Taxable Income Over*	*To*	*Taxable Income Over*	*To*
10%	0%	$0	$9,275	$0	$13,250	$0	$9,275	$0	$18,550
15%	0%	$9,276	$37,650	$13,251	$50,400	$9,276	$37,650	$18,551	$75,300
25%	15%	$37,651	$91,150	$50,401	$130,150	$37,651	$75,950	$75,301	$151,900
28%	15%	$91,151	$190,150	$130,151	$210,800	$75,951	$115,725	$151,901	$231,450
33%	15%	$190,151	$413,350	$210,801	$413,350	$115,726	$206,675	$231,451	$413,350
35%	15%	$413,351	$415,050	$413,351	$441,000	$206,676	$233,475	$413,351	$466,950
39.6%	20%	$415,051	—	$441,001	—	$233,476	—	$466,951	—

Source: www.irs.gov

Consider Your Retirement Savings Options

If you have earned income or are working, retirement savers should consider contributing to retirement plans. This is an ideal time to make sure you maximize your intended use of retirement plans for 2016 and start thinking about your strategy for 2017. Here are some retirement plan highlights:

HIGHER 401(K) CONTRIBUTION LIMITS. The elective deferral (contribution) limit for employees who participate in 401(k), 403(b), most 457 plans, and the federal Thrift Savings Plan is $18,000. The catch-up contribution limit for employees aged 50 and over who participate in 401(k), 403(b), most 457 plans, and the federal Thrift Savings Plan is an additional $6,000 ($24,000 total). Contributions must be made in 2016.

IRA CONTRIBUTION LIMITS UNCHANGED. The limit on annual contributions to an IRA remains unchanged at $5,500. The additional catch-up contribution limit for individuals aged 50 and over is not subject to an annual cost-of-living adjustment and remains $1,000. IRA contributions can be made all the way up to the April 17, 2017 filing deadline.

HIGHER IRA INCOME LIMITS. The deduction for taxpayers making contributions to a traditional IRA is phased out for singles and heads-of-household who are covered by a workplace retirement plan and have modified adjusted gross incomes (AGI) of $61,000 and $71,000 for 2016. For married couples filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phase-out range is $98,000 to $118,000 for 2016. For an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered, the deduction is phased out in 2016 as the couple's income reaches $184,000 and completely at $194,000 for 2016. For a married individual filing a separate return who is covered by a workplace retirement plan, the phase-out range is $0 to $10,000 for 2016. Keep in mind, if your earned income is less than your eligible contribution amount, your maximum contribution amount equals your income.

INCREASED ROTH IRA INCOME CUTOFFS. The AGI phase-out range for taxpayers making contributions to a Roth IRA is $184,000 to $194,000 for married couples filing jointly in 2016. For singles and heads-of-household, the income phase-out range is $117,000 to $132,000 in 2016. For a married individual filing a separate return, the phase-out range is $0 to $10,000 for 2016. If your earned income is less than your eligible contribution amount, your maximum contribution amount equals your income.

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LARGER SAVER'S CREDIT THRESHOLD. The AGI limit for the saver's credit (also known as the Retirement Savings Contribution Credit) for low- and moderate-income workers is $61,500 for married couples filing jointly, $46,125 for heads-of-household and $30,750 for all other filers.

BE CAREFUL OF THE IRA "ONE ROLLOVER" RULE. IRA investors were always limited to one rollover per year, per IRA. Investors are still limited to only one rollover from ALL of their IRAs to another in any 12-month period. A second IRA-to-IRA rollover in a single year could result in income tax becoming due on the rollover, a 10% early withdrawal penalty, AND a 6% per year excess contributions tax as long as that rollover remains in the IRA. While individuals can only make one IRA rollover during any one-year period, there is no limit on trustee-to-trustee transfers. Multiple trustee-to-trustee transfers between IRAs and conversions from traditional IRAs to Roth IRAs are allowed in the same year.

ROTH IRA CONVERSIONS. Some IRA owners are considering converting part or all of their traditional IRAs to a Roth IRA. This is never an easy decision. Roth IRA conversions can be helpful, but they can also create immediate tax consequences and can bring additional rules and potential penalties. It is best to run the numbers and calculate the most appropriate strategy for your situation.

Review Your Capital Gains and Losses

Looking at your investment portfolio can reveal a number of different tax-saving opportunities. Start by reviewing the various sales you have realized so far this year on stocks, bonds, and other investments. Then review what's left and determine whether these investments have an unrealized gain or loss. (Unrealized means you still own the investment and haven't yet sold it, versus realized, which means you've actually sold the investment.)

KNOW YOUR BASIS. In order to determine if you have unrealized gains or losses, you must know the tax basis of your investments, which is usually the cost of the investment when you bought it. However, it gets trickier with investments that allow you to reinvest your dividends and/or capital gain distributions.

CONSIDER LOSS HARVESTING. If your capital gains are larger than your losses, "loss harvesting" may be an option. This means selling certain investments that will generate a loss. You can use an unlimited amount of capital losses to offset capital gains.

However, you are limited to only $3,000 of net capital losses if married filing jointly ($1,500 if married filing separately) that can offset other income, such as wages, interest and dividends. Any remaining unused capital losses can be carried forward into future years indefinitely.

BE AWARE OF THE "WASH SALE" RULE. If you sell an investment at a loss and then buy it right back, the IRS disallows the deduction. The "wash sale" rule says you have to wait at least 30 days before buying back the same security in order to be able to claim the original loss as a deduction. However, while you cannot immediately buy a substantially identical security to replace the one you sold, you can buy a similar security—perhaps a different stock in the same sector. This strategy allows you to maintain your general market position while utilizing a tax break.

SELL WORTHLESS INVESTMENTS. If you own an investment that you believe is worthless, ask your tax preparer if you can sell it to someone who isn't related for a minimal amount, say $1, to show that it is, in fact, worthless. The IRS often disallows a loss of 100% because they will usually argue that the investment has to have at least some value.

ALWAYS DOUBLE-CHECK BROKERAGE FIRM REPORTS. If you sold a stock in 2016, the brokerage firm will report the basis on an IRS Form 1099-B in early 2017. Unfortunately, sometimes there are problems when reporting your information, so we suggest you double-check these numbers to make sure that the basis is calculated correctly and does not result in a higher amount of tax than you need to pay.

Zero Percent Tax on Long-Term Capital Gains

You may qualify for a 0% capital gains tax rate for some or all of your long-term capital gains realized in 2016. The strategy is to figure out how much long-term capital gain you might be able to recognize to take advantage of this tax break.

The 0% long-term capital gains tax rate is for taxpayers who end up in the 10% or 15% ordinary income tax brackets, which is up to $37,650 for single filers and $75,300 for joint filers (See chart pg. 2). If your taxable income goes above this threshold, then any excess long-term capital gains will be taxed at a 15% capital gains tax rate and/or 20% capital gains tax rate, depending on how high your taxable income is for the year.

NOTE: *The 0%, 15% and 20% long-term capital gains tax rates only apply to capital assets (such as marketable securities) held longer than one year. Anything held one year or less is considered short-term capital gain and is taxed at ordinary income tax rates.*

If you are eligible for the 0% capital gains tax rate, it might be a good time to consider selling some appreciated investments to take advantage of it. Sell just enough so your gain pushes your income to the top of the 15% tax bracket, then buy new shares in the same company. The "wash sale" requirement to wait 30 days does not apply for gains. With "gains harvesting," you can actually sell the stock and buy it back in the same day. Of course, there could be transaction costs such as commissions and other brokerage fees. At the end of the day you will have the same number of shares, but with a higher cost basis. Please remember, you must also review your state income tax rules to determine whether or not these gains will be tax-free at the state level.

If you're ineligible for the 0% capital gains tax rate, but you have adult children in the 0% bracket, consider gifting appreciated stock to them. Your adult children will pay a lot less in capital gains tax than if you sold the stock yourself and gifted the cash to them. Make sure the Kiddie Tax doesn't apply - e.g. students up

Itemized Deductions and Exemptions

Taxpayers are entitled to take either a standard deduction or itemize their deductions on IRS Form 1040, Schedule A. Itemized deductions include mortgage interest, certain types of taxes, charitable contributions, and medical expenses. Unfortunately, itemized deductions are subject to several limitations. For example, in 2016, medical expenses are deductible only to the extent that they exceed 10% of AGI this year. However, if you or your spouse are over 65, the deduction limit is still at 7.5% until December 31, 2016.

CONSIDER "BUNCHING" YOUR DEDUCTIONS. Many taxpayers don't have enough itemized deductions to reduce their taxes more than if they take the standard deduction. If you find you often miss the threshold by only a small amount per year, it may be best to "bunch" your deductions every other year, taking a standard deduction in the alternate years. The standard deduction for 2016 is $6,300 for singles, $6,300 for married persons filing separate returns, $9,300 for heads of households and $12,600 for married couples filing jointly.

Medicare Tax on Investment Income

In 2016, a 3.8% Medicare surtax on net investment income remains in place for wealthy taxpayers. The 3.8% Medicare surtax is on top of ordinary income and capital gains taxes, meaning long-term capital gains and qualified dividends may be subject to taxes as high as 23.8%, while short-term capital gains and other investment income (such as interest income) could be taxed as high as 43.4%.

The Medicare surtax is imposed only on net investment income and only to the extent that total Modified Adjusted Gross Income (MAGI) exceeds $200,000 for single individuals and $250,000 for taxpayers filing joint returns. The chart attached shows which types of income are subject to this new Medicare tax.

TYPE OF INCOME	SUBJECT TO 3.8% MEDICARE CONTRIBUTION TAX?	
	Yes	*No*
Interest and dividends	✓	
Capital gains	✓	
Royalties and net rental income	✓	
Installment sales proceeds	✓	
Gain from the sale of personal residence of the IRC 121 exclusion	✓	
Passive income from S corporations	✓	
Passive activity income	✓	
Income from a trade or business that trades in financial instruments or commodities	✓	
Non-passive income from S corporations		✓
Wages		✓
Income from qualified pension, profit-sharing and stock bonus plans		✓
Social security income		✓
Tax-exempt interest		✓

Source: The Essential Planning Guide to the Income & Estate Tax Increases

For those of you who are subject to this Medicare surtax, some of these strategies will take time to implement so now is a good time to review your situation. For example, you might consider investing in tax-advantaged vehicles such as tax-exempt bonds, qualified retirement accounts or cash value life insurance policies (assuming that the cost of acquisition and maintenance does not exceed the tax savings) or converting passive real estate activities to active interests.

Taxation of Social Security Income

Social Security income may be taxable, depending on the amount and type of other income a taxpayer receives. If a taxpayer only receives Social Security income, this income is generally not taxable (and it is possible that the taxpayer might not even need to file a federal income tax return).

If a taxpayer receives other income in addition to Social Security income, then up to 85% of the Social Security income could be taxable. There is a "floor" ($32,000 married filing jointly; $0 married filing separately; $25,000 all other taxpayers) whereby a portion of Social Security benefits become taxable and that the 85% inclusion kicks in once provisional income goes above a "ceiling" ($44,000 married filing jointly; $0 married filing separately; $34,000 all other taxpayers). For married taxpayers filing a joint return and for married persons filing separately who do not live apart from their spouses for the whole year, the "provisional income" threshold is $0. A complicated formula is necessary to determine the amount of Social Security income that is subject to income tax. (We suggest using the worksheet in IRS Publication 915 to make this determination.)

Finally, it is important to note that Social Security income is included in the calculation of Modified Adjusted Gross Income (MAGI) for purposes of calculating the 3.8% Medicare surtax on "net investment income" (as discussed earlier). Therefore, taxpayers having significant net investment income might have more reason to defer Social Security benefits.

Year-End Charitable Giving

This is a great time of the year to clean out your garage and give your items to charity. Remember that you can only write off these donations to a charitable organization if you itemize your deductions. You can find estimated values for your donated clothing at http://turbotax.intuit.com/personal-taxes/itsdeductible/.

Send cash donations to your favorite charity by December 31, and be sure to hold on to your canceled check or credit card receipt as proof of your donation. If you contribute $250 or more, you also need a written acknowledgment from the charity.

If you plan to make a significant gift to charity this year, consider gifting appreciated stocks or other investments that you have owned for

more than one year. Doing so boosts the savings on your tax returns. Your charitable contribution deduction is the fair market value of the securities on the date of the gift, not the amount you paid for the asset, and therefore you avoid having to pay taxes on the profit.

Do not donate investments that have lost value. It is best to sell the asset with the loss first and then donate the proceeds, allowing you to take both the charitable contribution deduction and the capital loss. Also remember, if you give appreciated property to charity, the unrealized gain must be long-term capital gain in order for the entire fair market value (FMV) to be deductible. (The amount of the charitable deduction must be reduced by any unrealized ordinary income, depreciation recapture and/or short-term gain.)

The laws allowing taxpayers age 70 ½ and older to transfer up to $100,000 directly from their IRA over to a charity, satisfying all or part of the required minimum distribution (RMD), were made permanent in 2015. If you want to do this please make sure it is done before year-end.

Popular PATH Act Permanent Extenders

AMERICAN OPPORTUNITY TAX CREDIT. The PATH Act made the American Opportunity Tax Credit (AOTC) permanent. The AOTC is equal to 110% of the first $2,000 of qualified tuition and related expenses, plus 25% of the next $2,000 of qualified tuition and related expenses.

TEACHERS' CLASSROOM EXPENSE DEDUCTIONS. The PATH Act permanently extended the above-the-line deductions of up to $250 for elementary and secondary school administrators' and teachers' classroom expenses. Eligible educators (such as teachers, administrators and others) may claim this above-the-line deduction in lieu of a miscellaneous itemized deduction.

STATE AND LOCAL SALES TAX DEDUCTION. The PATH Act made permanent the itemized deduction for states and local general sales taxes. That deduction may be taken in lieu of state and local income taxes when itemizing deductions.

PATH Act Extenders Expiring at the End of 2016

TUITION FOR FEE DEDUCTIONS. The PATH Act extended the above-the-line deduction for qualified tuition and related expenses for two years for expenses paid before January 1, 2017. The maximum amount of the tuition and fee deductions is $4,000 for an individual whose AGI for the tax year does not exceed $65,000 ($130,000 in the case of a joint return) or $2,000 for other individuals whose AGI does not exceed $80,000 ($160,000 in the case of a joint return).

MORTGAGE INSURANCE PREMIUM DEDUCTIONS. The PATH Act extended the treatment of qualified mortgage insurance premiums as qualified residence interest proactively for two years, to apply to amounts paid or accrued through 2016 and not properly allocable to a period after December 31, 2016.

President Elect Trump Tax Positions

While campaigning for the position of President, Donald Trump shared some views of his tax position. President-elect Trump stated that comprehensive tax reform to significantly lower individual and business tax rates was one of his top priorities. According to CCH's Tax Briefing, his proposals included a simpler tax system with 3 tax brackets: 12, 25 and 33%. He also shared that he would recommend no change in capital gains rates and a repeal of the 3.8% Medicare Tax.

Another item discussed was capping deductions at $100,000 for single filers and $200,000 for joint returns. Many experts feel that tax reform will advance in 2017. Remember, ideas and proposals are far from actual laws, but with a Republican Senate and House, change is considered possible and as things become finalized we will keep you updated.

Other Year-End Tax Strategies and Ideas

MAKE USE OF THE ANNUAL GIFT TAX EXCLUSION. You may gift up to $14,000 tax-free to each person in 2016. These annual exclusion gifts do not reduce your lifetime gift tax exemption.

NOTE: *The annual exclusion gift is doubled to $28,000 per recipient for joint gifts made by married couples or when one spouse consents to a gift made by the other spouse.*

HELP SOMEONE WITH MEDICAL OR EDUCATION EXPENSES. There are opportunities to give unlimited tax-free gifts when you pay the provider of the services directly. The medical expenses must meet the definition of deductible medical expenses. Qualified education expenses are tuition, books, fees, and related expenses but not room and board. You can find the detail qualifications in IRS Publications 950 and the instructions for IRS Form 709, which are available for free at www.irs.gov.

CONTRIBUTE TO A 529 PLAN ON BEHALF OF A BENEFICIARY. This qualifies for the annual gift-tax exclusion. Withdrawals (including earnings) used for qualified education expenses (tuition, books, and computers) are income tax free. The tax law even allows you to give the equivalent of five years' worth of contributions up front with no gift-tax consequences. Non-qualifying distribution earnings are taxable and subject to a 10% tax penalty.

MAKE GIFTS TO TRUSTS. These gifts often qualify for the annual exclusion ($14,000 in 2016) if the gift is direct and immediate. A gift that meets all the requirements removes the property from your estate. The annual exclusion gift can be contributed for each beneficiary of a trust. We are happy to review the details with your estate planning attorney.

IF POSSIBLE, PREPARE A TAX PROJECTION FOR 2016 AND 2017 to determine if you will have a change in your tax situation. Then consider the following strategies:

IF YOUR INCOME IS HIGHER THIS YEAR THAN YOU EXPECT FOR NEXT YEAR, CONSIDER...	IF YOUR INCOME IS LOWER THIS YEAR THAN YOU EXPECT FOR NEXT YEAR, CONSIDER...
Deferring income and accelerating deductions	*Accelerating income and deferring deductions*
Asking to receive bonuses next year instead of this year.	Asking to receive bonuses this year instead of next year.
Holding off on selling any investments with capital gains (especially those that are short-term) that you cannot offset until next year.	Selling any investments with capital gains if you are in the 0% (or maybe even 15%) capital gains rates.
Holding off any IRA distributions you can until January if your tax rate will be lower next year.	Accelerating, if possible, any necessary IRA distributions this year if your tax rate will be higher next year.
Pre-paying any deductible bills like property tax (if possible) this year.	Deferring the payment of any deductible bills like property (if possible) to next year.
If applicable, paying your fourth state-estimated tax payment in December, rather than in January. This works well for taxpayers who will itemize their deductions and who aren't subject to the alternative minimum tax.	

It is important to note that some itemized deductions (such as state income taxes, real estate taxes and miscellaneous itemized deductions) are not allowed when computing the Alternative Minimum Tax (AMT). If you are subject to the AMT, it is often best to delay payment on the disallowed deductions and push them off until 2017 or later tax years (when AMT is no longer an issue). It is always possible you might be able to use the deductions next year. Therefore, we suggest that you talk with your tax preparer about AMT prior to using any of the deduction and exemption strategies we have mentioned.

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