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Talking Taxes

Historically, many people don't think about taxes until they're facing the April 15 deadline. But by then, it's too late to do any productive planning.

One of the best ways to save on income taxes is to max out your 401(k). You can contribute up to $18,000 into your 401(k) in 2016 and if you are over age 50, you can make an additional "catch-up" contribution of $6,000. But this is just the beginning. At the end of the year, you should also review with your financial planner the "nuts-and-bolts" things that can impact taxes: estimated tax payments, the sale of a residence, distributions from qualified plans or IRAs, as examples.

In addition, reviewing your estate plan with your financial advisor before the end of the year may help reveal some additional tax-reduction strategies appropriate to your situation.

For example, one thing that could help save taxes is to shift passive income-producing assets like rental real estate to a family limited liability corporation (LLC) or a family limited partnership (FLP).

Gifting can also be a sound tax-savings strategy. Instead of giving cash to a charity, consider gifting appreciated assets. You don't have to pay any tax on the gain—and neither does the charity. So you get the deduction for the gift subject to certain limitations, and you eliminate the capital gains tax.

The "Stealth" Tax
Under the so-called "stealth" tax, you lose parts of certain deductions—medical expenses; interest on second mortgages; state and local taxes; and charitable gifts, among them—once your adjusted gross income reaches a certain level.

One of the things you can do that may help avoid the AMT is to exercise your employee stock options wisely. There are two types of employee stock options: incentive stock options (ISOs) and nonqualified stock options, with the tax implication being the biggest difference between them. While nonqualified stock options are taxed as ordinary income when they are exercised (then if you exercise and hold the stock for a year, you can pay capital gains tax on the appreciation), ISOs are subject to the AMT when they're exercised.

The highest federal income tax rate is 39.6%; the highest AMT is 28%. In tax preparation, your income is run through both calculations and you pay whichever one is higher. (So if your federal tax is $90,000 and the AMT is $100,000, you pay $90,000 federal tax and $10,000 for AMT.) To be strategic about taxes, try to balance your ordinary federal income tax with your AMT tax amount. If you can increase your ordinary income on one side, say by exercising nonqualified stock options, it may leave room to exercise ISOs on the AMT side without incurring AMT penalties.

Think About the Future

The popular 529 college savings plans have emerged as terrific college funding planning tool for families who can front-load up to five years' worth of contributions per child. Under a special election, a 529 account owner can choose to front-load up to $70,000 per beneficiary, or $140,000 for married couples, into the college savings plan without generating a taxable gift—assuming no other gifts are made to the beneficiary over the five-year timeline.

I hope this information is helpful. If you would like to discuss any of the items and how they could apply in your situation, please call us at 301-585-4700

Sincerely,

Eric Bailey

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