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Last Minute '16 Tax Planning

As the end of the year approaches, it is a good time to think of planning moves that will help lower your tax bill for this year and possibly the next. There are factors that compound the planning challenge this year including, overall economic uncertainty and Congress' failure to act on a number of important tax breaks.

The following is a list of possible actions that may help you save tax dollars, if you act before year-end. Not all actions will apply, but you may benefit from one or more items.

Realize losses on stock: Realize losses on stock to offset gains or use to reduce taxable income, while substantially preserving an investment position. This can be done several ways; for example, you can sell the original holding, and then buy back the same securities at least 31 days later.

Postpone income: Postpone income until 2017 and accelerate deductions into 2016 to lower your 2016 tax bill. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2016 that are phased out over varying levels of adjusted gross income (AGI). These include child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2016. For example, this may be the case where a person's marginal tax rate is much lower this year than it will be next year or where lower income in 2017 will result in a higher tax credit for an individual who plans to purchase health insurance on a health exchange and is eligible for a premium assistance credit.

Consider Recharacterizing: If you converted assets in a traditional IRA to a Roth IRA earlier in the year and the assets in the Roth IRA account declined in value, you could wind up paying a higher tax than is necessary if he or she leaves things as is. Taxpayers can back out of the transaction by recharacterizing the conversion—that is, by transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA via a trustee-to-trustee transfer. You can later reconvert to a Roth IRA.

Defer a bonus: It may be advantageous to try to arrange with your employer to defer a bonus that may be anticipated until early 2017.

Consider using a credit card: Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2016 deductions even if you do not pay the credit card bill until after the end of the year.

Consider increasing withholding: If you expect to owe state and local income taxes when filing a return next year, you should consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2016 if you won't be subject to alternative minimum tax (AMT) in 2016.

Estimate the effect of any year-end planning: Estimate the effect of any year-end planning moves on the AMT for 2016, keeping in mind that many tax breaks allowed for purposes of calculating regular taxes are disallowed for AMT purposes. These include the deduction for state property taxes on a residence, state income taxes, miscellaneous itemized deductions, and personal exemption deductions. (If you are at least age 65 or your spouse is at least 65 as of the close of the tax year, deductions for medical expenses are calculated in a more restrictive way for AMT purposes than for regular tax purposes.)

Apply a bunching strategy: You may be able to save taxes this year and next by applying a bunching strategy to "miscellaneous" itemized deductions, medical expenses and other itemized deductions.

Consider accelerating medical procedures or expenses: For 2016, the "floor" beneath medical expense deductions for those ages 65 or older is 7.5% of adjusted gross income (AGI). Unless Congress changes the rules, this floor will rise to 10% of AGI next year. Taxpayers age 65 or older who can claim itemized deductions this year, but won't be able to next year because of the higher floor, should consider accelerating discretionary or elective medical procedures or expenses (e.g., dental implants or expensive eyewear).

Pay contested taxes: You may want to pay contested taxes (if otherwise deductible) to be able to deduct them this year while continuing to contest them next year.

Settle insurance damage: Taxpayers may want to settle an insurance or damage claim in order to maximize a casualty loss deduction this year.

Think twice before delaying 2016 RMD's: Required Minimum Distributions (RMD's) from IRAs must begin by April 1 of the year following the year taxpayers reach age 70½[1]. Taxpayers should think twice before delaying 2016 distributions to 2017, as bunching income into 2017 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2017 if you will be in a substantially lower bracket that year.

Increase FSA: Increase the amount set aside for next year in an employer's health flexible spending account (FSA) if you set aside too little for this year.

HAS contribution: If you are eligible in December of 2016 to make a health savings account (HSA) contribution, you can make a full year's worth of deductible HSA contributions for 2016.

Make energy saving improvements: If you are thinking of installing energy saving improvements to a home, such as certain high-efficiency insulation materials, you should do so before the close of 2016. You may qualify for a "nonbusiness energy property credit" that won't be available after this year, unless Congress reinstates it.

Make gifts: Gifting can also be a sound tax-savings strategy, you can donate cash and other assets. However, 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. You get the deduction for the gift subject to certain limitations, and you eliminate the capital gains tax.

These are just some of the year-end steps that can be taken to save taxes. You may want to consult a legal or tax advisor regarding any legal or tax information as it relates to your personal circumstances.

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

[1] That start date also applies to company plans, but non-5% company owners who continue working may defer RMDs until April 1 following the year they retire. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. Although RMDs must begin no later than April 1 following the year in which the IRA owner attains age 70½, the first distribution calendar year is the year in which the IRA owner attains age 70½. Thus, if you turn age 70½ in 2016, you can delay the first required distribution to 2017, but if you does, you will have to take a double distribution in 2017—the amount required for 2016 plus the amount required for 2017.

CRN-1663168-121316