Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

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Time to Start Thinking About Year-End Tax Moves

With year-end just around the corner, it is time to think about those last-minute actions you can take to improve your tax situation for 2016. Year-end tax planning is probably something you will want to deal with before the holiday season crush arrives.

There are numerous steps that can be taken before January 1 to save a considerable amount of tax. Not all actions recommended in this article will apply to your particular situation, but you will likely benefit from many of them.

Maximize Education Tax Credits – If you qualify for either the American Opportunity or Lifetime Learning education credits, check to see how much you will have paid in qualified tuition and related expenses in 2016. If it is not the maximum allowed for computing the credits, you can prepay 2017 tuition as long as it is for an academic period beginning in the first three months of 2017. That will allow you to increase the credit for 2016. This technique is especially helpful when a student has just started college in the fall.

Roth IRA Conversions – If your income is unusually low this year, you may wish to consider converting some or all of your traditional IRA into a Roth IRA. The lower income results in a lower tax rate, which provides you an opportunity to convert to a Roth IRA at a lower tax amount.

Don't Forget Your Minimum Required Distribution – If you are over 70.5 years of age and have not taken your 2016 required minimum distribution from your IRA or qualified retirement plan, you should do that before December 31 to avoid possible penalties. If you turned 70.5 this year, you may delay your 2016 distribution until the first quarter of 2017, but that will mean a double distribution in 2017 that will be taxed.

Advance Charitable Deductions – If you regularly tithe at a house of worship or make pledges to other qualified charities, you might consider pre-paying part or all of your 2017 tithing or pledge, thus advancing the deduction into 2016. This can be especially helpful to individuals who marginally itemize their deductions, allowing them to itemize in one year and then take the standard deduction in the next. If you are age 70.5 or over, you can also take advantage of a direct IRA-to-charity transfer, which will count toward your RMD and may even reduce the taxes on your Social Security income.

Maximize Health Savings Account Contributions – If you become eligible to make health savings account (HSA) contributions late this year, you can make a full year's worth of deductible HSA contributions even if you were not eligible to make HSA contributions earlier in the year. This opportunity applies even if you first become eligible in December.

Prepay Taxes – Both state income and property taxes are deductible if you itemize your deductions and you are not subject to the AMT. Prepaying them advances the deductions onto your 2016 return. So if you expect to owe state income tax, it may

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Little-Known Tactic Increases Child Care Credit

When both spouses in a married couple are jointly involved in the operation of an unincorporated business (generally a Schedule C), it is fairly common – but incorrect – for all of that business's income to be reported as just one spouse's income, even when they both work in the business.

In such cases, the spouse not taking credit for his or her portion of the earned income loses out on the chance to accumulate his or her own eligibility for Social Security benefits. In addition, to claim a child care credit, both spouses on a joint return must have earned income (or imputed income if one of the spouses is a full-time student or is disabled), so unless the spouse not including a portion of the income from the joint business has another source of earned income, the couple will not be allowed a child care credit.

There are ways to remedy this situation, however. One option is to file a partnership return for the activity, in which case each spouse will receive a K-1 that reports his or her share of the net profit. An approach that avoids the necessity of filing a partnership return, and that is probably less complicated, is a qualified joint-venture election, in which each spouse elects to file a separate Schedule C for his or her respective share of the business. This gives both spouses self-employed income for the purposes of the self-employment tax and for claiming the child care credit.

A qualified joint venture refers to any joint venture involving the conduct of a trade or business if:

(1) The only members of the joint venture are husband and wife,

(2) Both spouses materially participate in the trade or business, and

(3) Both spouses elect to apply this rule.

Generally, to meet the material participation requirement, each spouse will have to participate in the activity for 500 hours or more during the tax year.

If the net income from the business exceeds the annual cap on income subject to the Social Security tax, the combined self-employment tax for the spouses with split Schedule Cs will exceed what a single spouse would have paid if he or she had filed a single Schedule C.

An additional benefit when filing split Schedule Cs is the opportunity for both spouses to participate in IRAs and self-employed retirement plans.

De Minimis Expense Election Required Before Year-End

Small businesses can adopt an accounting procedure that allows them to expense, rather than to capitalize, the purchase (cost) of tangible business property. Generally, the maximum that can be expensed under this provision is whatever amount the business decides between $1 and $2,500 per item or per invoice. So if you have not adopted the accounting procedure, you have until December 31, 2016, to do so for 2017. (The rules require that the accounting procedure be in place as of the beginning of the business's tax year.) In addition, and even if your business may have already adopted an accounting procedure, an annual election is required to be included with your 2017 tax return to apply the accounting procedure to 2017. This can be used for computers, printers, tools, etc., rather than the Sec 179 expense allowance, which recaptures as income if the item is disposed of early.

WARNING – Latest IRS Scam

There are reports of taxpayers receiving bogus CP-2000 notices, which duplicate the look of official IRS notices that demand immediate payment. To the untrained eye, they look like real IRS notices. The fake notices ask that payments be made to the Internal Revenue Service (IRS), not to the United States Treasury, as the real ones do. Scams are rampant, and like all of the recent ones, they rely on a taxpayer's fear of the IRS to steal your money. Don't be a victim. Always allow this office to review any notice or other communication you receive before acting on it. You can view a copy of the phony notice at:

https://www.calt.iastate.edu/sites/default/files/files-page/SCAMletter.pdf

(Time to Start Thinking About Year-End Tax Moves Cont'd...)

be appropriate to increase your state withholding tax at your place of employment or make an estimated tax payment before the close of 2016, and if you are paying your real property taxes in installments, pay the next installment before year-end.

Pay Tax-deductible Medical Expenses – If you have outstanding medical or dental bills, paying the balance before year-end may be beneficial, but only if you already meet the 10% (7.5% if age 65 and over) of AGI floor for deducting medical expenses, or if adding the payments would put you over the AGI threshold. You can even use a credit card to pay the expenses, but if you won't be paying off the full balance on the card right away, do so only if the interest expense on the credit card is less than the tax savings. You might also wish to consider scheduling and paying for medical expenses such as glasses, dental work, etc., before the end of the year.

Take Advantage of the Annual Gift Tax Exemption – You can give $14,000 to each of an unlimited number of individuals without paying gift tax each year, but you can't carry over unused amounts from one year to the next. (The gifts are not tax deductible.)

Avoid Underpayment Penalties – If you are going to owe taxes for 2016, you can take steps before year-end to avoid or minimize the underpayment penalty. The penalty is applied quarterly, so making a fourth-quarter estimated payment only reduces the fourth-quarter penalty. However, withholding is treated as paid ratably throughout the year, so increasing withholding at the end of the year can reduce the penalties for the earlier quarters.

There are additional factors to consider for a number of the strategies suggested above, and you are encouraged to contact this office prior to acting on any of the advice to ensure that you will benefit given your specific tax circumstances.

Year-End Investment Moves

If you invest in publicly traded securities, here are a couple of tax-saving possibilities you shouldn't forget to consider before year-end.

Zero Capital Gains Rate – If you are having a low-income year, there may be a way for you to take advantage of it. There is a zero long-term capital gains rate for those taxpayers whose regular tax brackets are 15% or less. This may allow you to sell some securities that you have owned for more than a year and actually pay no tax or very little.

Offset Gains with Losses – At this time of year, you should review your portfolio with an eye to offset gains with losses and to take advantage of the $3,000 ($1,500 for married taxpayers filing separately) of allowable annual capital loss allowance. Any losses in excess of those amounts are carried forward to future years. However, keep in mind that if you replace a security that you sell for a loss either 30 days before or after the date of sale, it will be considered a wash sale, and the loss cannot be used on your return and instead adjusts the basis of the replacement security.

Liberal Expensing Limits Can Create Major Year-End Tax Savings

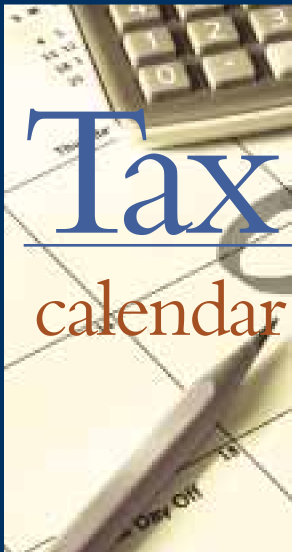
Businesses seeking to increase deductions by acquiring machinery and equipment before year-end have an impressive array of tools to work with:

- Generous, up to $500,000, expensing under IRC Sec. 179,
- A liberal, up to $2,500, expensing safe harbor for small businesses, and
- First year 50% bonus depreciation.

The bonus depreciation also applies to leasehold improvements, which include the cost of interior qualified improvements to non-residential property after the building is placed in service. In addition, the IRC Sec 179 expense deduction is allowed for qualified leasehold property, qualified restaurant property and qualified retail improvements.

On top of that, the Sec 179 allowance applies to off-the-shelf software and air conditioning units (but not residential rental air conditioning).

Armed with these tools, and careful planning, a small business has the opportunity to legally manipulate the taxable profit of the business. However, to accomplish that end, all the machinery, equipment and improvements must be purchased and placed in service before the end of the year. If you need assistance in planning this strategy, please call this office.



Tax calendar

Nov. 2016 – Apr. 2017

November-December 2016: It's time for 2016 year-end and 2017 tax planning. Please call for an appointment.

December 31, 2016: Last day to pay deductible expenses for 2016. This doesn't apply to IRA, SEP, or Keogh contributions, which can be made after December 31, 2016.

- Last day to set up a Keogh Retirement Account if you plan to make a 2016 contribution. [1]
- For individuals who turned 70½ during 2015 or in a prior year, this is the last day to withdraw the required minimum distribution (RMD) from their IRA for 2016. [1]
- Last day for small business owners to establish an accounting procedure allowing them to elect up to a $2,500 de minimis expense deduction for 2017.

January 1, 2017: The first day for 2017 health insurance coverage. Unless exempt, individuals and families without qualified coverage may incur penalties on their 2017 tax returns.

January 17, 2017: Fourth-quarter 2016 federal individual estimated tax payment is due, unless the 2016 return is filed by January 31, 2017, and the entire balance due is paid with the return.[3]

January 31, 2017: The Open Enrollment period for purchasing 2017 health care coverage through a Marketplace ends. If you don't enroll in a 2017 plan by January 31, 2017, you can't enroll in a health insurance plan through a Marketplace for 2017 unless you qualify for a Special Enrollment Period.

January 31, 2017: Deadline for businesses to provide 1099-MISCs (nonemployee compensation payments - box 7) and W-2s to the people they paid during 2016. This is also the due date[3] for filing these forms with the government. The 1099-MISC forms are required if the business paid $600 or more for the services of individuals (other than employees) during the year.

February 28, 2017: This is the deadline for filing paper 2016 Forms 1099 (other than 1099-MISC forms that were due January 31, 2017).

March 1, 2017: This is the last day for a farmer or fisherman who owed, but did not pay, estimated tax by January 17, 2017, to file a 2016 calendar-year income tax return to avoid a late payment penalty.

March 15, 2017: Due date[2] for filing 2016 calendar year partnership returns or request an extension. [3]

March 31, 2017: If filed electronically, this is the deadline for filing 2016 Forms 1099 (other than 1099-MISC forms that were due January 31, 2017).

April 1, 2017: This is the last day for taxpayers who turned 70½ during 2016 to withdraw their IRA RMD for 2016.

April 15, 2017 : For individuals with an interest in, or a signature authority over a foreign financial account, this is the due date[2] for filing form FinCEN 114 (FBAR) with the U.S. Government or to file an extension.

April 18, 2017: Deadline for -

- Individuals to file a 2016 federal income tax return or request a filing extension.[3]
- Fiduciaries of estates and trusts to file a 2016 calendar-year income tax return or request an extension.
- Paying the first installment of the 2017 federal individual estimated tax.[3]
- The first installment of the 2016 defined benefit pension plan contributions.

(1) This is a Saturday. Many financial institutions are not open on weekends; make arrangements in advance. (2) This is an earlier due date than prior years. (3) Some states have different due dates.

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Since You Asked...

You Asked: I am a working mother. My child attends kindergarten in the morning and goes to an after-school care program for the remainder of the day. What portion of my expenses for kindergarten and after-school care can be used toward the child care credit?

Answer: Per IRS regulations, expenses for programs at the level of kindergarten and above aren't employment related and thus don't count toward child care expenses. However, those same regulations do allow expenses for before- and after-school care of a child in kindergarten or a higher grade (up to age 13), as well as nursery, preschool, or similar programs below the kindergarten level.

You Asked: A local amateur baseball league has approached my company about sponsoring one of the teams. The uniforms will include the name of my firm. They claim the sponsor's expenses are tax-deductible. Is that true?

Answer: Marketing that is intended to portray your business positively can be deducted. Such marketing creates a long-term potential for business and falls within the "ordinary and necessary" requirements of the tax code. Examples of such marketing include costs associated with sponsoring local youth sports teams, distributing samples of your business's product, and prizes offered by your business in a contest. As long as your marketing expenses can be reasonably related to the promotion of your business, they can be deducted.

You Asked: I am a partner in a partnership, and I incur some unreimbursed expenses attributable to the partnership. Where do I deduct those expenses?

Answer: The correct way is for the partnership to reimburse you. But, IRS instructions indicate where you are not reimbursed and the partnership agreement requires you to be responsible for your own expenses, you deduct them on Schedule E, Part II. Do not adjust the numbers on the K-1 because the IRS matches those, and Form 8082 – Notice Of Inconsistent Treatment – must then be filed.

You Asked: I recently purchased a car that I use 63% of the time in my business, and I have been taking the standard mileage rate as a business expense. I also have a consumer loan on the car. Is there any way to deduct that interest?

Answer: Normally, consumer loan interest is not deductible, but to the extent that it applies to business it is deductible as a business expense. In your case, 63% of the interest would be a business expense.