Time to Start Thinking About Year-End Tax Moves

Article Highlights:

- Maximize Education Tax Credits
- Roth IRA Conversions
- Minimum Required Distribution
- Advance Charitable Deductions
- Maximize Health Savings Account Contributions
- Prepay Taxes
- Pay Tax-deductible Medical Expenses
- Take Advantage of the Annual Gift Tax Exemption
- Avoid Underpayment Penalties

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 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% of AGI floor for deducting medical expenses, or if adding the payments would put you over the 10% 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. See the "Seniors Beware" article if you or your spouse is age 65 and over.

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.