1919 INVESTMENT COUNSEL

It's the End of 2016 - Is There Anything Left to Do This Year?

December 2016

The end of the year is upon us and it is time to evaluate your tax situation and most importantly, determine if you have done everything you can to save on taxes.

Before implementing any of the tax savings strategies listed below, it is important for you to understand your individual tax situation. Not all strategies work for everyone and some may even cause a taxpayer to be subject to more tax. Also listed below are a number of reminders regarding deductions and additional taxes.

Couples with $250,000[1] or greater of income are subject to paying additional Medicare taxes through the Net Investment Income Tax. This tax imposes a Medicare tax of 3.8% on investment income such as dividends and capital gains. A married couple with wage income of $250,000 is also subject to a 0.9% Medicare payroll tax.

Personal and dependency exemptions begin to phase out when a married couple has $311,300[2] of income. Itemized deductions begin to phase out at this same income level. There are some itemized deductions[3] that are not affected by the phase out and for most individuals, the charitable deduction[4] is not subject to the phase out.

Most importantly, you should be aware of Alternative Minimum Tax ("AMT"). AMT is a parallel tax calculation that disallows certain itemized deductions such as state and local income taxes in calculating tax due. If AMT is higher than the regular tax, the taxpayer pays the higher AMT tax.

1. Defer Income and Accelerate Deductions

If you have the ability to defer income to next year, you should consider doing so. Large items of income such as bonuses and year-end incentives may push you into a higher tax bracket subjecting all or a portion of the amount to tax at your highest income tax rate.

In addition, below the line deductions or itemized deductions, may reduce your tax. Deductions such as state and local income tax[5], charitable deductions and medical expenses reduce income subject to tax for most people.

[1] Modified Adjusted Gross Income ("MAGI")
[2] Adjusted Gross Income ("AGI")
[3] Deductions such as medical expenses, investment interest expense and casualty and theft losses do not phase out.
[4] The charitable deduction is only phased out if a taxpayer has no other itemized deductions such as state income tax, mortgage interest and real property tax to reduce.
[5] Before accelerating certain deductions, you should know if those deductions will increase the amount of AMT.

2. Charitable Giving

Giving to charity is a terrific way to end the year. While the charitable deduction[6] is currently not subject to the phase-out, tax reform is a stated priority for President-elect Trump, and income tax deductions are likely to be a top item of discussion. Proposals that are currently under consideration include the possibility of capping itemized tax deductions, including the charitable deduction. As a result, assuming charitable intent exists, it may prove more tax-advantageous to donate to charity in 2016 than in subsequent years.

There are a number of ways to make charitable gifts and reduce your tax liability at the same time.

- **Gifts of Cash** – Most individuals make charitable gifts by writing a check to their favorite charities. However, this may not always be the most optimal route – see "Gifts of Stock or Other Appreciated Property" below.

  Limitation: Cash gifts are limited to 50% of an individual's AGI[7].

- **Gifts of Personal Property** – Another popular method of charitable giving is the donation of clothing and household goods.

  Limitations: Such gifts of property are limited to 30% of AGI and it should be noted that an appraisal is required for any one item with a value of $500 or more.

- **Gifts of Stock or Other Appreciated Property** – An often overlooked method of giving, donating appreciated securities rather than selling the assets and donating the cash proceeds, is one of the most tax-efficient ways to give and be able to give more.

  If appreciated securities with embedded long-term gains are donated to a charity rather than sold, the donor is no longer responsible for the capital gains taxes associated with those securities (see note about limits that apply below) and the charitable organization is not subject to capital gains taxes when they ultimately sell those assets. As a result, the donor both saves on paying capital gains tax and is able to donate more to a charity since the donation is gross and not net of the associated capital gains tax.

  Similarly, if the cost basis of an asset is missing or difficult to determine, this asset may be an ideal candidate for a charitable contribution since only the current fair market value of the asset is required.

  Limitation: A taxpayer is permitted to deduct the fair market value of stock or other appreciated property up to 30% of AGI.

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[6] The charitable deduction is only phased out if the taxpayer has no other itemized deductions such as state income tax, mortgage interest and real property tax to reduce.

[7] To the extent that a gift exceeds 50% (or 30%) of an individual's AGI, the deduction is carried forward to the following tax year. The deduction may be carried forward for up to 5 years.

- **Donor Advised Fund ("DAF")** – A taxpayer who establishes a DAF receives a current (in the tax year in which it was made) charitable deduction (subject to the limitations for cash and stock gifts) for the fair market value of property contributed to the DAF; however, the funds can be distributed to charitable organizations in future years. It isn't too late for last minute donors to establish a DAF[8]. An account can be set up and funded within a matter of hours. Given the incoming administrations talk of possibly limiting the charitable deduction, 2016 is an especially attractive year in which to consider establishing and /or making additional contributions to a DAF.

  Similarly, DAFs are particularly attractive in high-income years because any contribution to a DAF (each of which is structured as a 501(c)(3)) is considered a charitable deduction in the year in which it is made as opposed to the year in which the monies are distributed to the ultimate charitable beneficiary(ies).

- **Qualified Charitable Distribution** – A taxpayer who is in Required Minimum Distribution status ("RMD") may contribute up to $100,000 from his/her IRA. The donation must be made directly from the IRA custodian to the qualified charity. The donor is not entitled to a charitable deduction for the amount going to charity; however, he/she would not include the amount in ordinary income.

As a best practice, one should always receive a receipt from the charity for the donation at the time the gift is made.

1. Maximize Contributions to your Retirement Plan or IRA

Now is the time to make sure that you have made the maximum contributions to your 401(k), IRA or other retirement plan. For the 2016 year, an individual can contribute up to $18,000 to a 401(k) with an additional $6,000 if the individual is age 50 or older – for a total of $24,000 (if 50 or older).

The maximum contribution to an IRA this year is $5,500 with an additional $1,000 for individuals who are 50 or older[9].

2. Contribute to a 529 Plan for a Child or Grandchild

If your state offers an income tax deduction for contributions to 529 education plans, consider making contributions now for children and grandchildren.

3. Prepare for Capital Gain Distributions

In December, most mutual funds announce year-end capital gain distributions. You can prepare for the distributions by taking tax losses to off-set the gains.

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[8] Fidelity, Vanguard and many charitable organizations maintain DAFs for donors.
[9] Contributions to IRA are subject to income limitations and the availability of other retirement plans to the individual.

4. Harvest Capital Losses

   If you have capital gains from the sale of securities or other appreciated property, review your holdings now to determine if you have losses to off-set the gains. Remember too that capital losses can be carried forward to future tax years until used.

Always coordinate with your advisors to ensure you and they are working in concert with one another, especially when it comes to tax planning and tactical year-end maneuvers.

2017 and Beyond

What does the future hold? Given the outcome of the election resulted in a Republican Congress and a Republican President, we believe that there will be changes to the tax laws in the coming years.

Throughout the presidential campaign and since being elected, President-Elect Trump has commented on a number of changes he would like to see made to the tax law, such as:

- Repeal the Estate Tax
- Leave the Capital Gains rates unchanged
- Have only 3 income tax brackets – 12%, 25% and 33%
- Repeal the AMT
- Give families an above the line deduction (before the calculation of AGI) for childcare expenses

No one is certain at this time which of the above changes, if any, will be enacted or when they would be put in place if they were passed by Congress. We will continue to closely follow the ongoing discussion and debate around U.S. tax law during the President-Elect’s term in office and update you as necessary. We here at 1919 Investment Counsel are always available to discuss these issues or others involving your account at any time.

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