December 12, 2016

Dear Clients and Friends,

We look forward to assisting you with your 2016 tax returns. Now is an excellent time to consider tax planning and wealth preservation strategies in advance of the close of 2016.

Below are some year-end tax planning strategies to consider, along with an update on tax law changes, tax rates and regulations that may impact you.

**Year-End Tax Planning Strategies**

* Capital gains planning, including capital loss harvesting, and contributions to tax-deferred accounts (retirement savings or flexible spending accounts) can play an important role in your year-end tax planning strategy.
* Testing your current tax position to determine if you should make estimated payments or are subject to the Alternative Minimum Tax should be a part of your year-end review.
* Review your current withholding to determine if estimated tax payments should be made.
* Prepay your January 2017 mortgage in December 2016 to maximize your 2016 mortgage interest deduction.
* Pay your entire property tax bill, including installments due in year 2017, by year-end. This does not apply to mortgage escrow accounts.
* Pay a state estimated tax installment in December instead of the January due date. However, make sure the payment is based on a reasonable estimate of your state tax.
* Consider funding a Health Savings Account if you meet the eligibility requirements.
* Establish a Roth IRA. Taxpayers whose income exceeds the Roth IRA AGI limitation can benefit from the “Backdoor Roth IRA” contribution.
* Defer recognition of gain on sales of investment property and/or business through installment sales or like-kind exchanges.
* Prepay deductible expenses, such as medical expenses and charitable donations, by credit card to claim deductions without using immediate cash.
* Acceleration of expenses and/or deferral of income can often provide an immediate cash tax benefit.
* Accelerating income into 2016 is a good idea for taxpayers who anticipate being in a higher tax bracket next year or whose earnings are close to threshold amounts ($200,000 for single or $250,000 for married filing jointly) that make them liable for additional Medicare Tax or Net Investment Income Tax.
* If your company grants stock options, you may want to exercise the option or sell stock acquired by exercise of an option this year if you think your tax bracket will be higher in 2016. Exercise of the option is often but not always a taxable event; sale of the stock is almost always a taxable event.
* Bunching "threshold" expenses, such as medical and dental expenses and miscellaneous itemized deductions. For example, you might pay medical bills and dues and subscriptions in whichever year they would do you the most tax good.

Note: Threshold expenses are deductible only to the extent they exceed a certain percentage of adjusted gross income (AGI). By bunching these expenses into one year, rather than spreading them out over two years, you have a better chance of exceeding the thresholds and maximizing your deduction.

Please note that taxpayers who paid Alternative Minimum Tax may need to modify certain strategies mentioned above.

**Noteworthy 2016 Tax Changes and Regulations**

Many of the tax changes affecting individuals and businesses for 2016 were related to the Protecting Americans from Tax Hikes Act of 2015 (PATH) that modified or made permanent numerous tax breaks (the "tax extenders"). The PATH Act contains key tax provisions for businesses and individuals alike, including permanently expanding Section 179 of the Internal Revenue Code; extending the availability of “bonus-depreciation”; modifying key business tax credits; extending several energy tax credits through 2016; and incentivizing charitable giving.  The PATH act brings some level of complication, as certain provisions were only extended through 2016 and are set to expire at the end of this year while others were extended through 2019.

President-elect Trump has proposed large tax cuts for many people. Here are some proposed tax changes:

* Reduce seven federal tax brackets to three with rates of 12 percent, 25 percent and 33 percent. The top rate would fall from 39.6 percent to 33 percent.
* Increase the standard deduction from $6,300 to $15,000 for single filers and from $12,600 to $30,000 for married couples filing jointly while ending personal exemptions.
* Cap itemized deductions at $100,000 for single filers and $200,000 for married couples filing jointly.
* Eliminate the 3.8 percent tax on net investment income on people who have a modified adjusted gross income of over $200,000 for single filers and $250,000 for married couples filing jointly.
* Repeal the alternative minimum tax and the estate tax.

Please keep in mind that the above points are only proposals and have not been passed in to law.

**Personal Exemptions**  
The personal and dependent exemption for tax year 2016 is $4,050, up $50 from 2015.

**Standard Deductions**   
The standard deduction for married couples filing a joint return or qualifying widow/widower in 2016 is $12,600, same as 2015. For singles and married individuals filing separately, the standard deduction is $6,300, same as 2015.  For heads of household, the standard deduction is $9,300, up $50 from 2015.

The additional standard deduction for blind people and senior citizens in 2016 is $1,250 for married individuals and $1,550 for singles and heads of household.

**Pease and PEP (Personal Exemption Phaseout)**  
Pease (limitations on itemized deductions) and PEP (personal exemption phase-out) limitations were made permanent by the American Taxpayer Relief Act (indexed for inflation) and affect taxpayers with income at or above $259,400 for single filers and $311,300 for married filing jointly in tax year 2016.

**Income Tax Rates**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Tax Rate** | **Single** | **Married Filing Jointly or Qualifying Widow / Widower** | **Married Filing Separately** | **Head of**  **Household** |
| 10% | $0 to $9,275 | $0 to $18,550 | $0 to $9,275 | $0 to $13,250 |
| 15% | $9,276 - $37,650 | $18,551 - $75,300 | $9,276 - $37,650 | $13,251 - $50,400 |
| 25% | $37,651 - $91,150 | $75,301 - $151,900 | $37,651 - $75,950 | $50,401 - $130,150 |
| 28% | $91,151 - $190,150 | $151,901 - $231,450 | $75,951 - $115,725 | $130,151 - $210,800 |
| 33% | $190,151 - $413,350 | $231,451 - $413,350 | $115,726 - $206,675 | $210,801 - $413,350 |
| 35% | $413,351 - $415,050 | $413,351 - $466,950 | $206,676 - $233,475 | $413,351 - $441,000 |
| 39.6% | Over $415,051 | Over $466,951 | Over $233,476 | Over $441,001 |

**Alternate Minimum Tax**

It is important not to overlook the effect of any year-end planning moves on AMT for 2016 and 2017. Items that may affect AMT include deductions for state property taxes and state income taxes, miscellaneous itemized deductions, and personal exemptions. Please call or email if you're not sure whether AMT applies to you.

**Note:** AMT exemption amounts for 2016 are as follows:

* $53,900 for single and head of household filers,
* $83,800 for married people filing jointly and for qualifying widows or widowers,
* $41,900 for married people filing separately

**Long Term Capital Gains**  
In 2016 taxpayers in the lower tax brackets (10 and 15 percent) pay zero percent on long-term capital gains. For taxpayers in the middle four tax brackets the rate is 15 percent and for taxpayers whose income is at or above $415,050 ($466,950 married filing jointly), the rate for both capital gains and dividends is capped at 20 percent.

**Adoption Credit**  
In 2016 a nonrefundable credit of up to $13,460 is available for qualified adoption expenses for each eligible child.

**Child and Dependent Care Credit**  
If you pay someone to take care of your dependent (defined as being under the age of 13 at the end of the tax year or incapable of self-care) in order to work or look for work, you may qualify for a credit of up to $1,050 or 35 percent of $3,000 of eligible expenses.

For two or more qualifying dependents, you can claim up to 35 percent of $6,000 (or $2,100) of eligible expenses. For higher income earners the credit percentage is reduced, but not below 20 percent, regardless of the amount of adjusted gross income.

**Child Tax Credit**  
For tax year 2016, the child tax credit is $1,000. The credit is phased out for those with higher incomes.

**Earned Income Tax Credit (EITC)**   
For tax year 2016, the maximum earned income tax credit (EITC) for low and moderate income workers and working families increased to $6,269, up from $6,242 in 2015. The maximum income limit for the EITC increased to $53,505, up from $53,267 in 2015 for married filing jointly. The credit varies by family size, filing status and other factors, with the maximum credit going to joint filers with three or more qualifying children.

**Education Expenses**

In 2016, there are several different tax credits or deductions that may apply depending on the type of expense.

**American Opportunity Tax Credit**   
For 2016, the maximum American Opportunity Tax Credit that can be used to offset certain higher education expenses is $2,500 per student, although it is phased out beginning at $160,000 adjusted gross income for joint filers and $80,000 for other filers.

**Lifetime Learning Credit**  
A credit of up to $2,000 is available for an unlimited number of years for certain costs of post-secondary or graduate courses or courses to acquire or improve your job skills. For 2016, the modified adjusted gross income threshold at which the lifetime learning credit begins to phase out is $108,000 for joint filers and $54,000 for singles and heads of household.

**Coverdell Education Savings Account**  
You can contribute up to $2,000 a year to Coverdell savings accounts in 2016. These accounts can be used to offset the cost of elementary and secondary education, as well as post-secondary education.

**Employer Provided Educational Assistance**  
In 2016, as an employee, you can exclude up to $5,250 of qualifying post-secondary and graduate education expenses that are reimbursed by your employer.

**Student Loan Interest**  
In 2015 you can deduct up to $2,500 in student-loan interest. The deduction begins to phase out if your modified adjusted gross income is larger than $130,000 for joint filers and $65,000 for singles and heads of household.

**Residential Energy Efficient Property Tax Credits**

The Residential Energy Efficient Property Credit is available through the end of 2016 to individual taxpayers to help pay for qualified residential alternative energy equipment, such as solar hot water heaters, solar electricity equipment and residential wind turbines. In addition, taxpayers are allowed to take the credit against the alternative minimum tax (AMT), subject to certain limitations.

Qualifying equipment must have been installed on or in connection with your home located in the United States.

Geothermal pumps, solar energy systems, and residential wind turbines can be installed in both principal residences and second homes (existing homes and new construction), but not rentals. Fuel cell property qualifies for the tax credit only when it is installed in your principal residence (new construction or existing home).

The tax credit is 30 percent of the cost of the qualified property, with no cap on the amount of credit available, except for fuel cell property.

Generally, labor costs can be included when figuring the credit. Any unused portions of this credit can be carried forward. Not all energy-efficient improvements qualify so be sure you have the manufacturer's tax credit certification statement, which can usually be found on the manufacturer's website or with the product packaging.

**What's included in this tax credit?**

* **Geothermal Heat Pumps.** Must meet the requirements of the ENERGY STAR program that are in effect at the time of the expenditure.
* **Small Residential Wind Turbines.** Must have a nameplate capacity of no more than 100 kilowatts (kW).
* **Solar Water Heaters.** At least half of the energy generated by the "qualifying property" must come from the sun. The system must be certified by the Solar Rating and Certification Corporation (SRCC) or a comparable entity endorsed by the government of the state in which the property is installed. The credit is not available for expenses for swimming pools or hot tubs. The water must be used in the dwelling. Photovoltaic systems must provide electricity for the residence and must meet applicable fire and electrical code requirement.
* **Solar Panels (Photovoltaic Systems).** Photovoltaic systems must provide electricity for the residence and must meet applicable fire and electrical code requirement.
* **Fuel Cell (Residential Fuel Cell and Microturbine System).** Efficiency of at least 30 percent and must have a capacity of at least 0.5 kW.

**Charitable Contributions**

Cash and property can be donated to a charity. You can generally take a deduction for the fair market value of the property; however, for certain property, the deduction is limited to your cost basis. While you can also donate your services to charity, you may not deduct the value of these services. However, you may also be able to deduct charity-related travel expenses and some out-of-pocket expenses.

Keep in mind that a written record of your charitable contributions--including travel expenses such as mileage--is required in order to qualify for a deduction. A donor may not claim a deduction for any contribution of cash, a check or other monetary gift unless the donor maintains a record of the contribution in the form of either a bank record (such as a cancelled check) or written communication from the charity (such as a receipt or a letter) showing the name of the charity, the date of the contribution, and the amount of the contribution.

Contributions of appreciated property (i.e. stock) provide an additional benefit because you avoid paying capital gains on any profit.

**Investment Gains and Losses**

This year, and in the coming years, investment decisions are likely to be more about managing capital gains than about minimizing taxes per se. For example, taxpayers below threshold amounts in 2016 might want to take gains; whereas taxpayers above threshold amounts might want to take losses.

If your tax bracket is either 10 or 15 percent (married couples making less than $75,300 or single filers making less than $37,650), then you might want to take advantage of the zero percent tax rate on qualified dividends and long-term capital gains. If you fall into the highest tax bracket (39.6 percent), the maximum tax rate on long-term capital gains is capped at 20 percent for tax years 2013 and beyond.

Minimize taxes on investments by judicious matching of gains and losses. Where appropriate, try to avoid short-term capital gains, which are usually taxed at a much higher tax rate than long-term gains--up to 39.6 percent in 2016 for high-income earners (over $415,050 for single filers and $466,950 married filing jointly). Where feasible, reduce all capital gains and generate short-term capital losses up to $3,000.

**Mutual Fund Investments**

Before investing in a mutual fund, ask whether a dividend is paid at the end of the year or whether a dividend will be paid early in the next year but be deemed paid this year. The year-end dividend could make a substantial difference in the tax you pay.

**Additional Medicare Tax**

Taxpayers whose income exceeds certain threshold amounts ($200,000 single filers and $250,000 married filing jointly) are liable for an additional Medicare tax of 0.9 percent on their tax returns, but may request that their employers withhold additional income tax from their pay to be applied against their tax liability when filing their 2016 tax return next April.

High net worth individuals should consider contributing to Roth IRAs and 401(k) because distributions are not subject to the Medicare Tax.

If you're a taxpayer close to the threshold for the Medicare Tax, it might make sense to switch Roth retirement contributions to a traditional IRA plan, thereby avoiding the 3.8 percent Net Investment Income Tax as well (more about the NIIT below).

**Net Investment Income Tax (NIIT)**

The Net Investment Income Tax, which went into effect in 2013, is a 3.8 percent tax that is applied to investment income such as long-term capital gains for earners above certain threshold amounts ($200,000 for single filers and $250,000 for married taxpayers filing jointly).

Short-term capital gains are subject to ordinary income tax rates as well as the 3.8 percent NIIT. This information is something to think about as you plan your long-term investments. Business income is not considered subject to the NIIT provided the individual business owner materially participates in the business.

**Gift Tax**

The federal gift and estate tax exemption, which is currently set at $5.45million in 2016. ATRA set the maximum estate tax rate set at 40 percent.

For many, sound estate planning begins with lifetime gifts to family members. In other words, gifts that reduce the donor's assets subject to future estate tax. Such gifts are often made at year-end, during the holiday season, in ways that qualify for exemption from federal gift tax.

Gifts to a donee are exempt from the gift tax for amounts up to $14,000 a year per donee.

**Retirement Plan Contributions**

Maximizing your retirement plan contributions. If you own an incorporated or unincorporated business, consider setting up a retirement plan if you don't already have one. It doesn't actually need to be funded until you pay your taxes, but allowable contributions will be deductible on this year's return.

If you are an employee and your employer has a 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan, taxpayers can contribute a maximum amount ($18,000 for 2016), plus an additional catch-up contribution of $6,000 if age 50 or over, assuming the plan allows this and income restrictions don't apply.

If you are employed or self-employed with no retirement plan, you can make a deductible or non-deductible (dependent on income levels) contribution of up to $5,500 a year to a traditional IRA (deduction is sometimes allowed even if you have a plan). Further, there is also an additional catch-up contribution of $1,000 if age 50 or over.

**Retirement Savings Contribution Credit**  
In 2016, the AGI limit for the saver's credit (also known as the retirement savings contributions credit) for low-and moderate-income workers is $61,500 for married couples filing jointly, $46,125 for heads of household, and $30,750 for married individuals filing separately and for singles.

**Affordable Care Act Tax Provisions**

An individual shared responsibility payment may be required if you and all of your dependents do not have minimum essential coverage and don’t have an exemption.  The individual shared responsibility payment amount is the greater of a percentage of your household income or a flat dollar amount.

An individual will owe 1/12th of the annual payment for each month the individual or their dependent(s) don’t have either coverage or an exemption.

For 2016, the annual payment amount is:

* The greater of:
  + 2.5 percent of the individual’s household income that is above the tax return filing threshold for the filing status, limited to the total yearly premium for the national average price of a Bronze plan sold through the Marketplace, or
  + The individual’s (or family's) flat dollar amount, which is $695 per adult and $347.50 per child, limited to a family maximum of $2,085.

**Health Savings Accounts**

Consider setting up a health savings account (HSA). You can deduct contributions to the account, investment earnings are tax-deferred until withdrawn, and amounts you withdraw are tax-free when used to pay medical bills.

In effect, medical expenses paid from the account are deductible from the first dollar (unlike the usual rule limiting such deductions to the excess over 10 percent of AGI). For amounts withdrawn at age 65 or later, and not used for medical bills, the HSA functions much like an IRA.

To be eligible, you must have a high-deductible health plan (HDHP), and only such insurance, subject to numerous exceptions, and must not be enrolled in Medicare. For 2015, to qualify for the HSA, your minimum deductible in your HDHP must be at least $1,300 for single coverage or $2,600 for a family.

**Flexible Spending Accounts (FSA)**  
FSAs are limited to $2,550 per year in 2016 and apply only to salary reduction contributions under a health FSA. The term "taxable year" refers to the plan year of the cafeteria plan, which is typically the period during which salary reduction elections are made.

Specifically, in the case of a plan providing a grace period (which may be up to two months and 15 days), unused salary reduction contributions to the health FSA for plan years beginning in 2012 or later that are carried over into the grace period for that plan year will not count against the $2,550 limit for the subsequent plan year.

Employers may allow employees to carry over into the next calendar year up to $500 in their accounts, but aren't required to do so.

**Social Security Benefits**

All Social Security benefit recipients should receive Form SSA-1099 from the Social Security Administration, which shows the total amount of benefits.  Please let us know if you have questions regarding the taxability of your Social Security Benefits.

**Tips for Recently Married or Divorced Taxpayers**

Newlyweds and the recently divorced should ensure the name on their tax return matches the name registered with the Social Security Administration (SSA).

**Local Taxes**

Please note that the TAXPAYER is responsible for determining if there are any local taxes owed.  The TAXPAYER is responsible for letting Papajcik Brothers Tax LLC know that a municipality or county will be assessing taxes. We are happy to work with you to make this determination, but the facts are very case specific. Please let us know if your residence or your workplace might cause you to be subject to local taxes.

**Businesses**

Whether you file as a corporation or sole proprietor, below is what business owners need to know about tax changes for 2015.

**Standard Mileage Rates**  
The standard mileage rates in 2015 are as follows: 54 cents per business mile driven, 19 cents per mile driven for medical or moving purposes, and 14 cents per mile driven in service of charitable organizations.

**Health Care Tax Credit for Small Businesses**  
Small business employers with 25 or fewer full-time-equivalent employees (average annual wages of less than $52,000 in 2016) may qualify for a tax credit to help pay for employees' health insurance. The credit is up to 50 percent (35 percent for non-profits).

**Section 179 Expensing**  
The Section 179 expense deduction was made permanent at $500,000 by the PATH Act. For equipment purchases, the maximum deduction is $500,000 of the first $2.01 million of qualifying equipment placed in service during the current tax year. The deduction is phased out dollar for dollar on amounts exceeding the $2 million threshold amount (indexed for inflation) and eliminated above amounts exceeding $2.5 million. In addition, Section 179 is now indexed to inflation in increments of $10,000 for future tax years.

The 50 percent bonus depreciation has been extended through 2019. Businesses are able to depreciate 50 percent of the cost of equipment acquired and placed in service during 2015, 2016 and 2017. However, the bonus depreciation is reduced to 40 percent in 2018 and 30 percent in 2019. The standard business depreciation amount is 24 cents per mile.

**Work Opportunity Tax Credit (WOTC)**

The Work Opportunity Tax Credit has been modified and enhanced for employers who hire long-term unemployed individuals (unemployed for 27 weeks or more) and is generally equal to 40 percent of the first $6,000 of wages paid to a new hire. This tax credit has been extended through 2019.

**SIMPLE IRA Plan Contributions**  
Contribution limits for SIMPLE IRA plans remain at $12,500 for persons under age 50 and $15,500 for persons age 50 or older in 2016. The maximum compensation used to determine contributions increases to $265,000.

Please contact us if you need help making estimated tax payments, understanding which deductions and tax credits you are entitled to.  We are always available to assist you.  Each individual tax return is different, so please don't hesitate to reach out and ask questions.  We look forward to assisting you with your 2016 taxes.

If you think someone else could benefit from our services, please forward this email with my contact information.  Referrals are the best compliment you can pay our firm and it is the primary way we grow.  I very much appreciate it.