Year-end tax planning guide

Moves to make now to help you save later

By Donna H. Laubcher, CPA

The last few months of the year are usually when you get a better idea of your income and deductions for the entire year, so you'll want to add one more thing to your to do list – tax planning. Now is the time to make those final moves that could save you taxes.

Protecting Americans from Tax Hikes Act (PATH Act)

The PATH Act, passed in late 2015, permanently extended a number of tax incentives that you can now work into your year-end planning without worry that they're only temporary:

American Opportunity Tax Credit. This credit is equal to 100% of the first $2,000 you spend on qualified tuition and related expenses, plus 25% of the next $2,000 of qualified tuition and related expenses.

Teachers' classroom expense deduction. If you're a teacher, administrator or other eligible educator, you can take this above-the-line deduction of up to $250 for classroom expenses instead of a miscellaneous itemized deduction.

State and local sales tax deduction. You can take this itemized deduction for state and local general sales taxes instead of an itemized deduction for state and local income taxes.

Exclusion for direct charitable donation of IRA funds. This exclusion from gross income of qualified charitable distributions for those 70 ½ or older covers distributions of up to $100,000 from traditional or Roth IRAs – $100,000 for each spouse on a joint return.

On the flip side, some tax incentives are expiring at the end of this year unless they're renewed by Congress:

Tuition and fees deduction. You can take this above-the-line deduction for qualified tuition and related expenses for expenses you have already paid this year or are planning to pay before January 1, 2017. The maximum amount you can deduct is $4,000 for individuals with an adjusted gross income (AGI) for the year of $65,000 or less ($130,000 for a joint return), or $2,000 if your AGI is between $65,001 and $80,000 (between $130,001 and $160,000 for a joint return).

Mortgage insurance premium deduction. The PATH Act extended the treatment of qualified mortgage insurance premiums as qualified residence interest retroactively for two years, to apply to amounts paid or accrued through 2016, and not properly allocable to a period after December 31, 2016.

Life events

Major life events – marriage, divorce, having a baby, a death, retirement or a new job – all impact your tax planning.

Marital status. Your marital status for the entire year is determined on December 31, so if you're planning a New Year's Eve wedding, you'll be counted as married for 2016 for tax purposes.

Dependents. If you've had or are having a child this year, you are entitled to a full $4,050 personal exemption, a full $1,000 child credit and up to a $3,000 child care credit if eligible – all subject to AGI limits.

Retirement. If you retired this year or you're getting ready to retire this year, there are three key strategies you'll want to keep in mind for your year-end planning:

- **Required minimum distributions (RMD).** If you're 70 ½ or older, there are rules that outline annual amounts you need to start taking from certain retirement accounts.
- **Roth conversions/reconversions.** If you've converted a traditional IRA to a Roth IRA, the 10% additional tax on early distributions does not apply. However, the amount converted is taxable in the year of the conversion.
- **Roth conversions.** Once a Roth IRA has been re-characterized back to a (new) traditional IRA, the (new) traditional IRA can be reconverted to a Roth IRA, subject to certain eligibility requirements.

Also, don't forget that you need to apply for Medicare by the time you're 65 or a penalty will apply to the amount you pay for Medicare premiums.

Alternative Minimum Tax (AMT)

Always a suggestion to consider for year-end is the timing of your income and deductions. While the mantra may be to accelerate deductions into the current year and see what income you can push into the following year, you always need to consider AMT. Deductions that can affect AMT are state and local income tax payments, including withholdings and estimated tax payments; real estate tax payments; and miscellaneous itemized deductions that are subject to 2% of your adjusted gross income such as investment fees and unreimbursed employee business expenses. Income items can also cause AMT. The interest income from private activity municipal bonds and passive activity differences with "regular" tax. The annoying thing about AMT and regular tax is that you get to compute both and then pay the highest amount.

Charitable Donations

You can deduct charitable donations for both regular tax and AMT. If you make large, non-cash donations, you may need other documentation before they can be deducted such as an appraisal or a signed form from the charity to attach to your tax return.

Capital Gains

If you have large capital gains that have been realized during the year, you may want to look at your portfolio to see if there are any unrealized losses you can harvest before the end of the year to offset your capital gains. Just be aware that if the stock you sold at a loss is a stock you really like, you can't buy it back within 30 days and count the loss on your tax return. That would be considered a wash sale and the loss will be disallowed.

Also be aware that mutual fund investments tend to have capital gain dividends at the end of the year that you may not have been anticipating in your income earlier in the year. This can also affect your AGI.

Net Investment Income Tax (NIIT)

Single taxpayers and heads of household with a modified AGI of over $200,000 and married taxpayers filing jointly with a modified AGI of over $250,000 may owe the 3.8% NIIT in addition to other taxes. This is tax on your interest income, dividend income, capital gain income and passive activity income.

Identity Theft

While more than 70 call center workers were recently arrested in India for allegedly carrying out tax-related scams, you still need to be on alert for fraudsters trying to steal your information and your money. We've had a number of clients during the past several years that have been notified, when they've tried to e-file their tax returns, that a tax return had already been filed under their Social Security number. The IRS then requires a separate form (Form 14309) when this happens and may also determine that the taxpayers need an identity theft pin number. Just be aware that if you are issued one of these pin numbers, the IRS issues a new one every year in December and you need to get that pin to your tax preparer.

More or less tax in 2017?

With a newly elected President and Congress, we will all now be waiting with bated breath to see the impact of the new administration's tax policies for 2017 – as well as tax reform. Who knows how quickly any changes will happen and you always have to be ready to adjust, even as late as December 31, if necessary. Only time will tell if you'll be paying more or less tax in 2017, but as always, enlist the help of your CPA. Tax planning can be complicated. You don't want to overlook or mess up anything, so please let us help.

Donna H. Laubscher, CPA, Partner, specializes in tax and accounting services for individuals and businesses. You can reach her at (480) 483–1170 or DonnaL@hhcpa.com.