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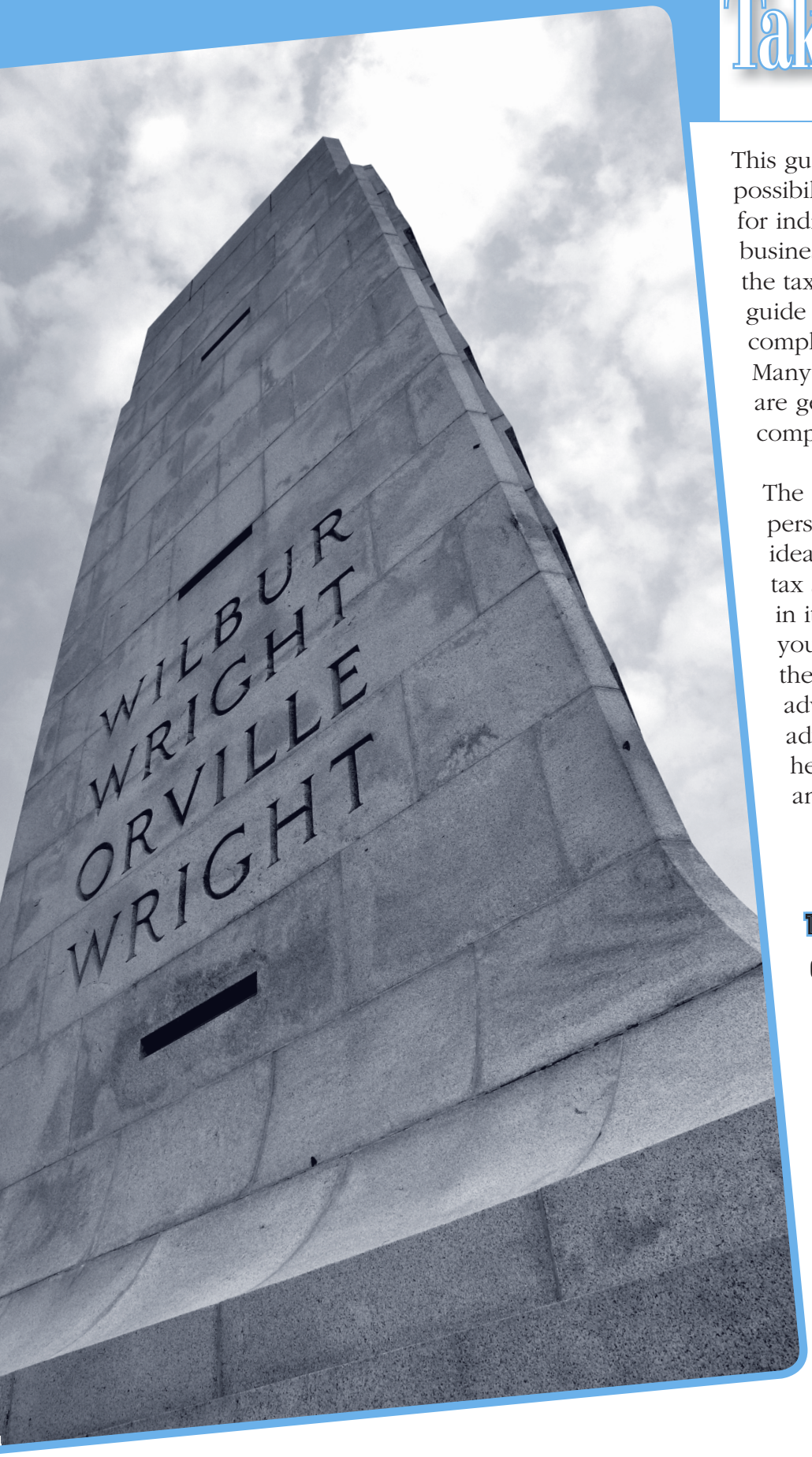
2016 2017 Tax & Financial Planning

A Year-Round, Year-End Guide

Contents

Taking Flight



This guide describes tax-saving possibilities and strategies for individuals, families and businesses, but because of the tax law's complexity, no guide of this length can be complete and exhaustive. Many simple suggestions in it are generalizations covering complex subjects.

The guide will help you gain perspective and bearings, with ideas for where to look for tax savings. The information in it should be tailored to your circumstances. To apply the information to your best advantage, consult with your advisor. Together we can help you plot your journey and take flight.

The Wright Brothers

Orville and Wilbur Wright chose Kitty Hawk, North Carolina, as the place to test their flying machine because of that location's reputation for strong winds. The first flight lasted a mere 12 seconds but the fourth flight of the day was in the air for 59 seconds. That day, December 17, 1903, marked the first time a heavier-than-air machine under the control of a pilot flew. After the last flight, the brothers sent a telegram to their father in Ohio relating their success and asking him to inform the press of their achievement.

Quick Reference

Above-the-line Deductions (even if you don't itemize)

- portion of self-employment tax
- health insurance for self-employeds and 2% or greater owners of S Corps (limits apply)
- performers' expenses
- contributions by self-employeds to Keogh, SEP and SIMPLE plans, Medical Savings Accounts (MSAs), and Health Savings Accounts (HSAs)
- certain job-based moving costs
- surrendered jury pay
- up to $2,500 of student loan interest
- eligible IRA contributions
- alimony paid
- eligible HSA contributions
- up to $4,000 for eligible college expenses (based on AGI)
- teachers' supplies and professional development costs up to $250

Fully Deductible (not subject to the 2%-of-AGI limit)

- estate tax on income heirs inherit, including estate taxes on IRAs, Keoghs, 401(k)s, and savings bonds
- amortizable bond premiums
- impairment-related job expenses of the handicapped
- gambling losses to the extent of winnings

Included in Income

Wages; salaries; fees; tips; commissions; gain on sale of some real estate, securities, and other property; alimony received and separate-maintenance payments; annuities (to the extent the return exceeds investment) and pensions; gambling winnings (gambling losses to extent of winnings are deductible); business profits; net rental income; interest received; dividends; royalties; prizes and awards; some fringe benefits; income from an interest in an estate or trust; up to 85% of Social Security benefits—see pg. 20; net hobby income; barter income; strike benefits; unemployment compensation; sick pay.

Not Included in Income (generally)

Gifts and inheritances; interest from certain state and municipal bonds (or received by mutual funds that hold them); gain up to $500,000 on sale of primary residence (under certain conditions); employer-paid health coverage for immediate family; accident- and health-insurance proceeds; scholarships and fellowships to a degree candidate if used for certain purposes; returns of capital; federal income tax refunds; interest on eligible Education Savings Bonds; employer reimbursements for business expenses (that you don't deduct); some or all of Social Security benefits—see pg. 20; workers' compensation for sickness or injury; child support; veteran benefits; welfare; life-insurance proceeds (estate tax may apply); child's investment income up to $1,050.

At A Glance—2016

Personal exemption	$4,050
Phaseout of personal exemptions and itemized deductions starts (AGI)	
• MFJ	$311,300
• HH	$285,350
• Single	$259,400
• MFS	$155,650
Standard mileage rate	
• business use	54¢
• medical & moving	19¢
• charitable	14¢
Taxable wage base	
• Social Security tax	$118,500
• Medicare	no limit
Social Security earnings limit	
• Age 62 to 66	$15,720
• Turn age 66 in 2016	$41,880
• Age 66 and older	no limit
2016 contribution limits	
• 401(k)s	$18,000
additional catch-up amount	$6,000
• IRAs (traditional and Roth)	$5,500
additional catch-up amount	$1,000
Automatic exemption from federal estate tax	$5,450,000

Terms and Acronyms

Filing Status Acronyms – MFJ (married/filing jointly); **HH** (head of household); **MFS** (married/filing separately).
Deduction – reduces the amount of your income on which your tax liability is determined.
Above-the-line Deduction – directly reduces your gross income. Eligible deductions (see opposite page) are taken on the first page of your tax return *above the bold solid line.* You can take above-the-line deductions regardless of whether you take the Standard Deduction or itemize your deductions.
Phaseout Range - the income range in which the credit or deduction gradually decreases to zero.
Adjusted Gross Income (AGI) – the difference between your gross income and your adjustments to income (eligible above-the-line deductions). It's a benchmark to determine if you can take certain deductions—e.g., IRA contributions, medical expenses (7.5%- or 10%-of-AGI), and miscellaneous expenses (2%-of-AGI).
Modified Adjusted Gross Income (MAGI) – determined by adding back certain deducted or excluded items to your AGI. For many taxpayers, AGI and MAGI are the same or very close.
Required Minimum Distribution (RMD) – the amount the owner of a traditional IRA (not a Roth IRA) must withdraw each year upon reaching age 70½. SEPs, SIMPLEs, 401(k)s, Roth 401(k)s, and other employer-sponsored retirement plans are also subject to RMDs.
Credit – lowers your tax liability by the amount of the credit.
Refundable Tax Credit – paid to you even if the credit amount is more than the tax you owe.

The Medicare Surtaxes

There are two Medicare surtaxes that affect some higher-income individuals. The first is a 3.8% surtax applied to certain unearned income and assessed on the lesser of net investment income or the excess of MAGI over: $250,000 (MFJ); $200,000 (Single and HH); $125,000 (MFS). Net investment income includes: interest, dividends, capital gains, annuities, royalties, and passive rental or business income (generally). It does not include tax free interest, distributions from retirement plans, pension plans, or deferred-pay plans. Investment expenses can be deducted from investment income thereby reducing the amount subject to the surtax. Trusts and estates with AGI above $12,400 and undistributed net investment income could also be subject to the surtax.

Example: Mary and Lou are a couple with combined 2016 wages of $300,000 (Mary's salary = $170,000; Lou's = $130,000). They also have $50,000 of net investment income (NII) bringing their MAGI to $350,000. The surtax is applied to the lesser of NII or MAGI over the threshold for MFJ ($250,000).

Step 1:	*Step 2:*	*Step 3:*	*Step 4:*
$300,000 combined wages + 50,000 NII $350,000 MAGI	$350,000 MAGI - 250,000 threshold $100,000 MAGI excess	compare MAGI excess ($100,000) to NII ($50,000)—which is less?	3.8% Medicare surtax applied to $50,000 = $1,900 tax owed

The second surtax is a 0.9% tax applied to earned income (Medicare wages and self-employment income) above: $250,000 (MFJ); $200,000 (Single and HH); $125,000 (MFS). Employers are required to withhold the surtax once the employee's wages exceed $200,000. Taxpayers will calculate the actual tax due on their income tax returns. Let's assume their combined Medicare wages are $320,000. Mary and Lou will be subject to the second surtax as well.

$320,000 combined Medicare wages
-250,000 threshold
$ 70,000 excess

0.9% Medicare surtax applied to $70,000 = $630

Couples take note: if each spouse makes less than $200,000 but your combined wages will exceed $250,000, you may face underwithholding of your taxes. Consider revising your W-4s to have more tax withheld.

You and Your Family

What's New for 2016

- **Several tax breaks are now permanent: tax deductions for state and local sales taxes vs. state income taxes; a $250 above-the-line deduction for teachers' supplies and professional development costs; and tax-free IRA distributions up to $100,00 to charity for those age 70½ and older.**
- **The above-the-line deduction for college tuition has been extended through 2016.**
- **The 2016 Income Tax Rates, Standard Deductions, personal exemption information, and limits on itemized deductions are shown on the back inside cover.**
- **The non-refundable adoption tax credit is applicable to expenses up to $13,460 (also the exclusion for company-paid adoption aid). Special rules apply for adoptions of special needs children. The phaseout range for the credit is AGI $201,920–$241,920.**
- **Estimated tax: to avoid underpayment penalties in 2016 you must prepay (in a timely manner) 100% of your 2015 taxes (110% of them if your 2015 AGI was more than $150,000) or 90% of 2016 taxes.**
- **The Foreign Earned Income exclusion rises to $101,300. The maximum housing exclusion is $14,182; high-cost foreign areas may have higher limits.**

Education

- **Claiming tax-free interest on EE Bonds and Series I bonds used for higher education expenses is subject to higher MAGI phaseouts: $116,300–$146,300 (MFJ); $77,550–$92,550 (Single and HH).**
- **The American Opportunity Tax Credit is now a permanent tax break.**

Medical

- **The penalty for not having qualifying health insurance coverage will continue to increase over the next several years. See the discussion on pages 9 and 10.**
- **Long-term-care premiums remain potentially deductible within limits: $390 for age 40 and younger; $730 for those age 41–50; $1,460 for age 51–60; $3,900 for age 61–70; and those age 71 and older can deduct up to $4,870 per person. The limit on tax-free payouts rises to $340 per day.**

Green Energy Credits

- **The 30%-of-cost credit continues through 2019 for alternative energy systems (such as solar water heaters, geothermal heat pumps, and wind turbines). Principal residences and second homes qualify whether new construction or existing homes. The credit will begin to phase out in 2020 and expire in 2022.**
- **Federal tax credits for energy efficient home improvements have been extended through 2016. If the credit was taken in any previous year, it counts against the credit's $500 lifetime cap. Available for primary residences only. Possible improvements (must meet certain energy standards): high efficiency heating and cooling; water-heaters; exterior doors, windows, roofs.**

Alternative Minimum Tax (AMT)

AMT Risk Factors

- large unreimbursed employee business expenses
- exercising incentive stock option (ISOs) gains
- living in states with high state and/or real estate taxes
- large miscellaneous deductions
- large number of personal exemptions (big families)
- taking large capital gains

If your tax is higher under the AMT rules than under the regular tax, you must pay the AMT. Annual adjustments based on inflation occur automatically for AMT exemption amounts. For 2016 the new exemptions are: $83,800 (MFJ and surviving spouses); $53,900 (Single and HH); and $41,900 (MFS). The AMT has only two rates (26% and 28%) and allows fewer deductions than the regular tax. Many ordinary tax write-offs are not allowed: personal exemptions, the Standard Deduction, state and local income taxes, sales and real estate taxes, and some medical expenses.

Children and Dependents

To claim a child as a dependent you may not need to pay over half of the child's support, so long as the child doesn't either (complex rules apply). There are rules on age, living in the same house, and close relationship. There is a uniform definition of "qualifying child" for HH filing status, the child care credit, and the earned

income credit (EIC). The definition of a "qualifying child" includes the provision that the child must be younger than you in order to claim a dependency exemption. You may be able to claim an unrelated child as a dependent under certain conditions. If you have a "qualifying relative," you may be able to take a dependency exemption but you can't claim head-of-household status, the child tax credit, the earned income credit, or the dependent care credit (unless the person is disabled).

If you claim a person as a dependent, no one else, not even that person, can claim the exemption, but you get no exemption for anyone with 2016 income (excluding Social Security and tax-exempt income) over $4,050 except your spouse or a child under age 19 (under 24 if a full-time student).

It's possible that the assets of a "special needs" child who requires care may disqualify him or her for government aid. Consider setting up a special needs trust charged with supplementing, rather than replacing, government aid. If you establish a larger trust, such as a 2503(c) trust, include a "special needs" clause that kicks in if a child becomes disabled. (Laws on special needs trusts vary from state to state.)

Whether or not a dependent child needs to file a tax return depends on several factors—how much income and what type of income (earned, unearned or a combination) the child has. A return must be filed if: 1) the child's earned income from a job exceeds the Standard Deduction—$6,300 in 2016; 2) the child's unearned income (interest, dividends, investment income) exceeds $1,050; or 3) the child's gross income (the combined earned and unearned income) exceeds the larger of $1,050 or the child's earned income (up to $5,950) plus $350. You can report and pay a child's tax on your return if you and the child meet certain requirements.

Child-Related Credits

These child-related credits reduce income tax liability dollar for dollar for qualifying taxpayers.

- Adoption Credit. This non-refundable credit can be taken on up to $13,460 of expenses (also the exclusion for company paid adoption aid). Special rules apply for adoptions of special needs children. The phaseout range for the credit is AGI $201,920–$241,920. Couples must file jointly to claim the credit and all claims substantiated.
- Earned Income Tax Credit (EITC). This refundable credit is for low- to moderate-income working taxpayers whose income falls below certain thresholds.

# Qualifying Children	Max Credit	Max Earned Income Individual	MFJ
3 or more	$6,269	$47,955	$53,505
2	$5,572	$44,648	$50,198
1	$3,373	$39,296	$44,846
0	$506	$14,880	$20,430

- Child Tax Credit. If you have one or more qualifying dependent children younger than age 17 as of year-end, you may qualify for a credit of up to $1,000 per child. Phaseout of the credit starts at MAGI: $110,000 (MFJ), $75,000 (Single and HH), $55,000 (MFS).
- Child and Dependent Care Credit. You might claim a tax credit for costs of caring for a child up to age 13 or disabled dependent. The cost of summer day camps may count toward the credit but overnight camps do not. The credit range is 35% to 20% of qualifying expenses up to $3,000 for one child or $6,000 for more than one. A taxpayer with income less than $15,000 gets the full 35% credit. For those earning more than $15,000, the credit phases down until it hits 20% for those earning more than $43,000. Employer provided dependent-care assistance reduces the qualifying expenses dollar-for-dollar. For a married couple, the claimed expenses can't exceed the earnings of the lower-earning spouse. The caregiver can even be a relative, such as a grandparent, but not a dependent. To claim the credit the credit you must report the caregiver's name, address, tax ID

Odds and Ends

- The first U.S. commercial passenger service began in 1914 with a regularly scheduled flight between St. Petersburg and Tampa, Florida.
- English is the international language of flight for pilots and air traffic controllers.
- An average 747 has 150 to 175 miles of wiring.
- Many airlines require the pilot and co-pilot to eat different meals as a precaution against food poisoning.
- One major airline saved $40,000 by removing one olive from each salad served in first class.
- On a three hour flight, the body can lose up to 1.5 quarts of water.
- The average service life of a passenger jet is 30–35 years.

number, and total amount paid. If you use a Flexible Spending Account (FSA) to pay dependent care costs for two or more children, you can still claim the dependent care credit if your expenses exceed what can be paid through the FSA. The first $5,000 could be run through the FSA, with the remaining $1,000 eligible for the dependent care credit.

Children and Investments

The kiddie tax was introduced years ago to keep parents from shifting investments to a child to take advantage of the child's lower tax rate. A child is subject to the kiddie tax if the child is 1) under age 18, 2) age 18 whose earned income does not exceed one-half his/her support or 3) age 19–23 and a full-time student whose earned income does not exceed one-half his/her support. The child's income can be reported on the parent's return if the child's gross income is only from interest, dividends, and capital gain distributions, and is more than $1,050 but less than $10,500. The first $1,050 of a child's investment income (interest, dividends, etc.) is tax-free, and the next $1,050 is taxed at the child's tax rate. If a child subject to the kiddie tax has investment income greater than $2,100, the excess is taxed at the parent's marginal rate and could reduce the parent's credits and deductions tied to AGI.

Transferring investment assets to younger children may still be a good idea if they are in a low income tax bracket. You can transfer $14,000 (or $28,000 with your spouse) to each child this year without gift tax implications. The child owns the assets, however, which could be a barrier to financial aid if the child goes to college. If you shift assets to your children, they are treated as having held the assets since you acquired them.

Children age 19 and older may pay no capital gains tax on long-term gains up to the difference between their other taxable income and $37,650 this year. Up to $$37,650 of this other income is taxed at a maximum income tax rate of 15% (or 10% if under $9,275), so shifting income-producing S Corp stock or appreciating stocks to them may make sense.

If you are a business owner, consider paying a child or grandchild reasonable summer job wages for a few years (bona fide services must be performed). If the child is under age 18, Social Security or Medicare taxes may not be due. Deduct the salary and put the wages into a Roth IRA in the child's name. The child can't deduct the contributions, but his or her tax bracket is probably low. If you give the child the money for the contribution, it counts toward the $14,000 annual gift tax exclusion, but even a single payment can grow into a nice retirement nest egg down the road.

Education Credits

Two credits are available to help with the cost of higher education. Marrieds who wish to take either of them must file jointly and claim the student as a dependent. Students can claim these credits if their parents don't take personal exemptions for them, even if the parents paid the college tuition. Students subject to the kiddie tax must have some income tax liability to offset. Eligible tuition expenses do not include any covered by grants, scholarships, and employer-assistance programs, and must be incurred on behalf of the taxpayer, spouse, or dependent. The student must be at least a half-time student for at least one academic period in the year. You can take either credit in a year you take tax-free distributions from a Coverdell Education Savings Account but not for the same expenses. Tuition paid in December for a course that begins the next Spring counts toward this year's credit.

Tax Credit	Maximum Benefit	Qualified Expenses	2016 AGI Phaseouts	Notes
American Opportunity Tax Credit	$2,500 tax credit per student per year 100% of first $2,000 spent 25% of second $2,000 spent (Credit is 40% refundable; not subject to AMT)	Tuition, fees, and course materials (conditions apply)	Single and HH $80,000–$90,000 MFJ $160,000–$180,000	Usable for first 4 years of college
Lifetime Learning Tax Credit	$2,000 tax credit 20% of first $10,000 spent	Tuition and fees	Single and HH $55,000–$65,000 MFJ $111,000–$131,000	Usable for undergrad and graduate education and courses to gain/improve skills

Other Education-Related Tax Benefits

Those who have student loans forgiven may not have to pay tax on the waived debt if they work in public service jobs or teach in schools in low-income areas for 120 months, and make regular loan payments during that time. This rule applies to loans first made by the government or by private lenders that are later consolidated into federal loans. Information on federal loan forgiveness programs can be found at studentaid.ed.gov.

Tax Benefit	Maximum Benefit	Qualified Expenses	2016 Income Phaseouts	Notes
Tuition and Fees Deduction	$4,000 above-the-line deduction; Reduced to $2,000 in income phaseout band	Tuition and fees	Single and HH $65,000–$80,000 MFJ $130,000–$160,000	• Undergrad + graduate • Can't claim deduction and educ credit in same year • MFS cannot claim • Taxpayer who can be claimed as dependent by another is not eligible for deduction
Student Loan Interest Deduction	$2,500 above-the-line deduction	Student loan interest	Single and HH $65,000–$80,000 MFJ $130,000–$160,000	Person obligated to make loan payment must be/ have been at least half-time student in degree program
Employer Tuition Assistance	$5,250 exclusion from income per student	Tuition, fees, books, supplies, equipment	None	
Scholarships	Excluded from income	Tuition, fees, books, supplies, equipment	None	Student must be degree candidate

Paying for Education

It's never too early to prepare for the potentially high cost of educating your children.

Education Plan	Tax Benefit	Qualified Expenses	2016 Income Phaseouts	Notes
529 College Savings Plans	Earnings are tax-free for qualified expenses. Earnings portion of a non-qualified distribution is taxed at the distributee's rate and may be subject to a 10% tax penalty.	Tuition, fees, books, supplies and equipment, computers, expenses for special needs services. Room and board if enrolled at least half-time.	None	• Undergrad + graduate • Beneficiary can be changed but monies must be used for college expenses
Coverdell ESA	$2,000 non-deductible contribution limit per year but earnings are tax-free.	Books, supplies, equipment. Higher educ: room and board if enrolled at least half-time. Payments to a Qualified Tuition Plan (529 Plan)	Single and HH $95,000–$110,000 MFJ $190,000–$220,000	• K–12 at private and parochial schools • Undergrad + graduate • Available for use until child reaches age 30 • Can take distribution in same year as educ credit, but not to cover same expenses
Education Bonds	Tax-free interest on Series EE bonds issued after Dec. 31, 1989, and all Series I bonds.	Tuition and fees Rollover into a 529 plan or Coverdell ESA	Single and HH $77,550–$92,550 MFJ $116,300–$146,300	• Income limits apply when bonds are cashed • Bonds must be in parent's name; child must be beneficiary, not co-owner • Purchaser must be age 24 or older

- Contributions to 529s are generally excluded from a donor's estate, making these a great way to reduce an estate and the potential for taxes on it. You can deduct from your estate in the first year the first five years' worth of gifts to a child's prepaid tuition account in a 529 plan so $70,000 can exit the estate (or up to $140,000 for a couple) in the first year for each child. Each state puts limits and conditions on its plans, but your advisor can help you find the best one for you.
- Parents and others (perhaps a relative) can establish Coverdell accounts for children under age 18. The non-deductible funds can grow and be used tax-free to pay tuition and other costs up to the time the child reaches age 30.

Financial Aid

Most colleges use federal guidelines to determine the need-based aid for which your child may be eligible. (Criteria for colleges that use their own formulas may vary from what is discussed here.) Several factors determine the amount of the aid: the "cost of attendance" for the college in question; the money provided from outside sources (such as scholarships or tuition paid directly by a relative); and the "expected family contribution" (EFC). The information you provide each year on the Free Application for Federal Student Aid (FAFSA) is used to calculate your EFC. The college then uses that figure to calculate the amount of federal student aid you are eligible to receive through loans, grants, and/or work-study programs.

The EFC formula considers several financial pools: 2.5%–5.64% of the parents' assets and 22%–47% of the parents' income (minus certain allowances for both); 20% of the student's assets; 50% of the student's income (minus certain allowances). If you have multiple children in college at the same time, this is taken into consideration. Some assets, such as retirement accounts and home equity, are not included in the financial pool. 529 account balances may be included in parents' assets but tax-free distributions from a 529 plan are not included in parents' income. If you have a child going to college next year, your assessment for aid will be based on this year's tax return. Consider minimizing your earned income, fully funding your retirement accounts, accelerating investment losses, and adjusting investments to hold down interest and dividend income.

Job Hunting

If you are unemployed and/or looking for a job in the same line of work, keep a record of your job-hunting expenses. They are potentially deductible to the extent all your miscellaneous itemized deductions exceed 2% of your AGI. If you're looking for your first job, you can't deduct the expenses, but if you're moving to get to your first job, and the job is at least 50 miles away from your previous home, some moving costs may be deductible "above-the-line." You can deduct certain costs of getting yourself, your family, and goods to the new area, and this includes parking fees, tolls, and 19¢ per mile. See page 22 for additional information on moving expenses.

Household Workers

The wages of a household worker (such as housekeeper, gardener, cook, babysitter) are subject to a "Nanny Tax" once the worker's wages reach the $2,000 threshold for paying Social Security tax. Any employee under the age of 18 any time during 2016 and in school is exempt as well as your spouse, your child under age 21, and a parent (conditions apply). You may also owe federal unemployment tax (FUTA) if you paid/pay more than a total of $1,000 to all your domestic workers for any quarter in 2015 or 2016. Employers can increase their own withholding or estimated tax to cover the taxes on a household worker. IRS Publication 926, Household Employer's Tax Guide, has detailed information and can be found at irs.gov.

Divorce

Because of the potentially complicated and financially significant implications of divorce, always consult with your tax, financial, and legal advisors for comprehensive advice.

Liquid assets are good to take from a divorce, but with up to $500,000 in gain on a primary home sale potentially tax exempt, a house can also be attractive, even though it generates maintenance and property tax bills and no income. An ex-spouse no longer residing in a house who helps to pay the mortgage cannot deduct the interest. Always have your tax advisor check out tax issues.

Before a child reaches the age of majority (18 years), the custodial parent must waive the right to exemptions before a non-custodial parent can claim them. Any conditions in the divorce agreement can cancel the non-custodial parent's

claim to the dependency exemption if the custodial parent hasn't signed Form 8332 to waive his or her right to it.

"Innocent spouses" are protected after a divorce against collection of tax for mistakes made on a joint return. Many spouses are eligible, and executors can assert claims for deceased spouses, or pursue claims filed before death. To qualify you must be at least legally separated from the other and not have lived together for the past 12 months.

Transferring assets in a divorce must normally occur within six years but more time may be allowed. The transfer triggers no gain or loss for the recipient until the asset is sold. Alimony paid is deductible; alimony received is taxable. Child support is neither. Post-divorce payments on a marital home can qualify as alimony.

Medical Expenses

The threshold for deducting medical expenses is 10%-of-AGI for singles under age 65 and for MFJ in which both filers are under 65. If one of the filers is age 65 or older, the threshold drops to 7.5%-of-AGI for 2016 only. In general, medical expenses are deductible to the extent they exceed the 10% or 7.5% thresholds, and large medical insurance premiums put many over the threshold. Premiums deducted from Social Security benefits, or paid from certain benefit plans, count for purposes of exceeding the 10% or 7.5% threshold. Other deductions: capital improvements to your home needed for medical reasons (get a statement from your doctor); medical expenses paid directly to the provider for relatives who meet dependency requirements; cosmetic surgery that improves the body's functioning.

Prescription drugs are fully deductible. Flexible Spending Accounts (FSAs), Health Saving Accounts (HSAs), and Health Reimbursement Arrangements (HRAs) cannot reimburse workers for unprescribed over-the-counter drugs. Only prescriptions and insulin are reimbursable. Medicare Part B and D payments are deductible as medical expense deductions. Costs of physician-prescribed weight loss plans and prescriptions to treat obesity, or prescribed in connection with another malady, are deductible under the percentage-of-AGI rule. The cost of diagnosing (e.g., pregnancy test kits, electronic body scans, or annual physicals), preventing, or treating a specific disease may be deductible. Refundable entry fees to continuing care facilities are not deductible, but a deduction is okay for the medical related portion of non-refundable monthly fees. The medical mileage rate for 2016 is 19¢.

You may be able to deduct medical expenses you pay for a parent for whom you pay more than half the support, even if the parent lives separately. Long-term-care insurance may be especially valuable in protecting the parent's house and other assets. You might buy the insurance for the parent and possibly deduct all or some of the cost.

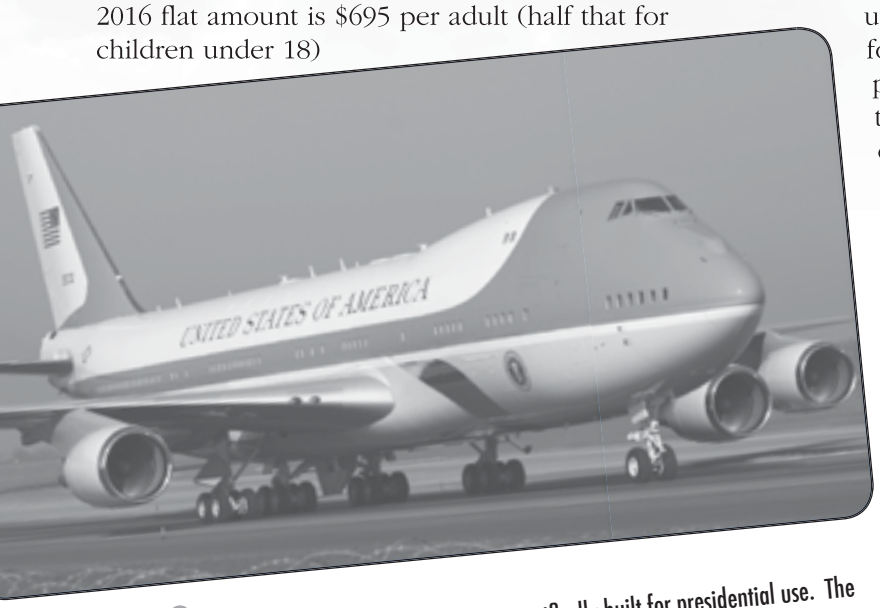
Health Insurance

Individuals must have minimum essential health insurance each month of the year for themselves and their dependents or risk paying a penalty. Most people already have qualifying coverage which can be obtained through employers, private plans, or the Health Insurance Marketplace (also known as the Marketplace or Exchange). Medicare or Medicaid also qualify.

The Flight Attendant
United Airlines was the first airline to hire stewardesses in the late 1930s. They were required to be registered nurses so passengers with air sickness could be properly treated. Early hiring practices required the stewardesses to take oaths not to marry or have children which could be reasons for dismissal. Long hours and wages of about $1 per hour were the norm.

There are some exceptions to paying the penalty under certain circumstances. A refundable premium tax credit (based on a sliding scale) to help cover the premiums may be available contingent upon one's household income and the number of people in the household; however, the credit is only for insurance purchased through the Marketplace.

The penalty imposed for not having minimum essential health insurance is the greater of a flat amount or an income-based formula. The 2016 flat amount is $695 per adult (half that for children under 18) capped at $2,085 per family. The income-based penalty is 2.5% of the household income above the person's tax filing threshold. This penalty calculation, however, is also capped—at the cost of a bronze level plan available through the Marketplace. Healthcare.gov provides more detailed information regarding the health insurance coverage mandate.



Air Force One
President Kennedy was the first president to fly in a jet specifically built for presidential use. The two planes in use today are highly customized 747s. They can refuel midair, have unlimited range, and are equipped with advanced secure communications equipment. There are 4,000 sq. feet of floor space on three levels, an extensive Presidential suite, and a medical suite that can also function as an operating room. A doctor is on board at all times.

Self-employeds can buy medical insurance in their own names (rather than that of the business) but cannot aggregate profits from more than one business when calculating the deduction. The premiums are fully deductible.

Flexible Spending Accounts (FSAs)

There are several types of FSAs but the medical expense FSA and the dependent care FSA are the most common. Medical FSAs allow employees to pay some health care expenses with pre-tax dollars. The tax savings can be substantial. Deductibles, co-pays, and coinsurance are reimbursable expenses as well as doctor-prescribed drugs and insulin. Some over-the-counter items may also be eligible. Employers can set a maximum contribution limit to their plans, although contributions are capped at $2,550 per year per participant on medical FSAs. Plans can allow employees to carry over up to $500 to the next year without forfeiture or offer a 2½ month grace period to spend remaining funds. If the plan has an extension option, it can only have one option available, not both; however, the employer is not required to offer either. If both spouses work, each can have their own Medical FSA each capped at $2,550 per year.

Dependent Care FSAs can be used to pay certain expenses for dependents. Often this means child care for children under age 13, but care for mentally or physically handicapped children of any age as well as elderly dependents may also be eligible. Contributions are limited to $5,000 for singles and MFJ; $2,500 for MFS. Note that married working couples have a combined cap of $5,000, even if each has a separate account.

Health Reimbursement Arrangements (HRAs)

If your employer offers HRAs, you can withdraw funds tax-free to pay medical expenses (only) for yourself, your spouse and dependents. Unused sick leave can go into the HRA when the employee retires, but tax is payable if the employee could have taken cash. If a beneficiary other than an employee's spouse or dependent receives an HRA's funds after an employee's death, all reimbursements under the plan become taxable.

Health Savings Accounts (HSAs)

HSAs help workers, their spouses, and dependents who have health insurance policies with high deductibles (HDHP). Coverage under a disability, dental, vision, or long-term-care plan is okay. Some states require policies to pay certain

expenses in full or part. Refer to the chart below for information on limits.

Neither contributions nor withdrawals used to pay medical costs are taxed, but other distributions are taxed—and penalized 20%, except after age 65 or for death or disability. If you set up an HSA by December 1, you can put in the maximum contribution for the whole year.

You can carry over HSA balances from year to year, or roll over an old Medical Savings Account into an HSA if you do so within 60 days. You can roll IRA funds into an HSA—once, up to the maximum annual contribution. A one-time transfer from an IRA to an HSA can make tax sense if after-tax contributions were made to the IRA. Making a medical payment from an HSA after an IRA rollover saves you tax and a 10% penalty on early distributions from the IRA. HSAs can be tapped to pay Medicare Part D premiums if the owner is age 65 or older, but withdrawals to pay them for a spouse are taxed as income and hit with a penalty if the account owner is under age 65. HSAs can be used to pay premiums for COBRA coverage for a spouse or dependent (or medical premiums for them if they're unemployed). Employers can open HSAs and contribute to them if they include all eligible workers. The contributions are then tax-free to the employees and free from payroll and income taxes.

High Deductible Health Plan	Self-Only Coverage		Family Coverage	
	2016	2017	2016	2017
Minimum Deductible	$1,300	$1,300	$2,600	$2,600
Contribution Limit*	$3,350	$3,400	$6,750	$6,750
Maximum Out-of-Pocket	$6,550	$6,550	$13,100	$13,100

*Those age 55 by year-end can add another $1,000.

Charitable Gifts

The deduction for charitable contributions is usually limited to 50% of your AGI. The limit falls to 30% for gifts to private charities and gifts of appreciated stock. First deduct gifts that qualify for the 50% limit, then other gifts. In general, there's a five-year carryover for gifts you can't deduct this year. The IRS website (www.irs.gov) has a database, updated monthly, of charities eligible to receive deductible contributions.

You can deduct the full market value of capital assets you donate to charities without paying taxes on their appreciation (limited to 30% of AGI). Don't donate loss property. Sell it first (so you can take the loss on your taxes) and donate the proceeds (so you can take the charitable deduction). Tax-free direct transfers up to $100,000 to an eligible charity by IRA holders age 70½ and older has been reinstated as a permanent tax break.

All monetary donations, regardless of amount, must be substantiated through bank records or written communications from the charity. Gifts under $250 get no deduction without a canceled check, a bank record, or a receipt with the charity's name and the amount of the gift. The only exception is for a contribution of less than $250 to a charitable remainder trust. For gifts of $250 or more, the charity's receipt must contain additional information: 1) a statement that no goods or services were provided in return for the contribution or 2) a description and estimate of the value of any goods or services that were provided. If you receive something in return for your donation, you have to reduce your deduction by its value. Incomplete information from the charity can invalidate the tax deduction. For donations made via payroll deductions, a pay stub or W-2 with donated amounts, and a pledge card with the charity's name may do. It may be a good idea to make all donations via checks.

Donations made to charities via check by year-end can be deducted in the current year, regardless of when the check clears. Donations made with credit cards have specific rules. If using a retail store credit card, the deduction can be taken only in the year you pay the bill. Donations via a bank credit card, however, can be deducted in the year that the charge was made even if the bill is paid in the following year. This is important for year-end contributions.

Clothing and household goods that are not in good used condition need an appraisal if you claim a deduction of more than $500. For items in good used condition or better, you need an appraisal if the item is valued at more than $5,000. Items of low value (e.g., socks) can't be deducted. Credit card rebates you donate to charity are deductible, but if the gift is $250 or more you need a receipt from the charity documenting the date and amount. You can deduct out-of-pocket costs you incur while doing work for a charity and 14¢ per mile you drive for charity. Note: if you donate more than $500 in non-cash contributions, you must attach Form

8283 to your tax return. The IRS is flagging returns that do not comply.

The rules on donations to charities of autos, boats, and planes are strict. If the donor claims the value of an item exceeds $500, there must be a written acknowledgment. If the charity sells the gift without rehabbing or using it, the donor's deduction cannot exceed the selling price (with a few exceptions). A charity need not sell a vehicle in 2016 for the donor to take a deduction for the year; the vehicle only needs to be transferred this year.

There are several additional tools, such as charitable remainder trusts and charitable lead trusts, which may be useful for your charitable giving objectives. Consult with your estate planning and tax advisors to determine their applicability to your situation.

Casualty Losses

Casualty losses on personal assets are claimed as itemized deductions. The floor for casualty losses in regions not declared disaster areas remains $100 per loss event. The balance is deductible to the extent it exceeds 10% of AGI. (If you have more than one loss event for the year, the balances above $100 for each are totaled and the excess above 10% of AGI is deductible.) Repair costs due to corrosive drywall are eligible as a casualty loss in the year of payment, but slow damage, as from rust or insects, is not. Gain on insurance proceeds for personal property lost in a declared disaster is not taxed. You can take a 2016 declared-disaster loss on your 2016 or (amended) 2015 return; choose the year of lower AGI.

Insurance reimbursements for living expenses are taxable to the extent they exceed actual expenses in the year the owner receives the funds or moves back into the house, whichever is later. Insurance payments also taxed: for a destroyed house and not spent to replace the house within two years (four years in disaster areas); and for items listed in separate schedules of the policy and not reinvested in the house or similar items.

Compensation

You can convert compensation to a tax-advantaged form, such as no-extra-cost-to-the-employer services (e.g., free standby flights for airline employees), working-condition fringe benefits, employee discounts, or de minimis fringe benefits. Some types of noncash compensation are taxable—e.g., employer-provided automobile for personal use or employer aid for education not directly job-related or job-required. Also, stock options: the difference between the stock's fair market value and the option price is "income" when the option is exercised, but a special rule delays the tax on incentive stock options (ISOs) until the stock is sold or exchanged. Even ordinary stock options let you speculate on the stock, while ISOs benefit from the low rate on capital gain. Certain conditions must be met to receive favorable tax treatment on ISOs. If you receive restricted stock or options from your employer or exercise ISOs, consider making a Section 83(b) election within 30 days. With respect to stock, the election lets you use long-term capital gains rates on the difference between the sales price and your basis when you sell the stock; with respect to ISOs, it lets you pay lower AMT. Firms must report to the IRS ISOs exercised in 2016 as well as employee stock purchase plans.

Severance pay is fully taxable and severance paid to employees laid off as part of a reduction in workforce is subject to payroll taxes. An ex-employer's continued payment of health and accident benefits is not taxable. An ex-employee who pays his or her own COBRA health premiums can deduct them to the extent they and other medical expenses exceed 10% (or 7.5%) of AGI. Outplacement services are a tax-free benefit if not paid in cash, but state unemployment benefits are taxable.

Investments

Gains realized from sales of investments are taxed at either ordinary or capital gains tax rates. Several factors determine which rate is applicable: the type of asset, the holding period of the asset before selling, and your income tax bracket. Profits from assets held short-term—12 months or less—are subject to ordinary income tax rates as short-term gains. Gains from assets held longer than a year, however, are long-term gains and taxed at reduced rates. There are some exceptions as shown in the chart below.

Long-held assets that are sold benefit from a 0% long-term capital gains rate for those with taxable income below the 25% income tax bracket (the 2016 threshold for MFJ is $75,300). If your taxable income is close to the threshold but not below it, try to lower your taxable income to take advantage of the 0% rate. For instance, maximize deductible retirement plan contributions and, if you itemize, make sure you are taking all allowable deductions. The 0% rate also creates tax planning opportunities.

Capital Gains Tax

Income Tax Bracket	Capital Gains Rate
- 10% and 15%	0%
- 25% through 35%	15%
- 39.6%	20%
Exceptions	
- Section 1250 real property	up to 25%
- Qualified small business stock	28%
- Collectible	28%

Dividends you receive from investments are either ordinary dividends or qualified dividends. Ordinary dividends are taxed at ordinary income tax rates. Qualified dividends are taxed at the long-term capital gains rates. At year-end the dividend payer will provide information regarding which dividends are "qualified." Dividends received from a regulated investment company (RIC) or real estate investment trust (REIT) may also qualify for the reduced capital gains rates under special rules.

Try to plan your sales to take full advantage of gain and loss offsets (although tax considerations shouldn't necessarily dominate your investment moves). Any capital losses you incur this year offset your gains and up to $3,000 of other income. Net losses greater than $3,000 carry over to defray capital gains or other income in later years. To limit the tax on your capital gains, plan and correctly "net" (i.e., offset) your long- and short-term gains and losses. First net your short-term losses and gains then apply any excess loss against your net long-term capital gain. If you have a net long-term capital loss, you can apply it (and losses carried forward from earlier years) against any net short-term capital gain.

Deductions for margin interest (up to the amount of your net investment income) are increased by taking short-term gains. Long-term gains aren't investment income for this purpose unless you forego taking the capital gains rate on them (so also for qualified dividends). Investment interest is deductible up to the total of investment income, and you can carry forward the excess undeducted interest to later years. Low-bracket taxpayers and older investors who may lose the investment-interest carryover at death might elect to have capital gains taxed as ordinary income.

Gains on real property, to the extent depreciation was claimed on it, may be taxed as high as 25%. If you inherit property from a decedent, generally you'll be able to classify its sale as a long-term transaction. Like-kind exchanges of business or investment property may also delay tax on any gain until you dispose of the property you receive. Collectibles held longer than one year are taxed at 28%.

Many expenses connected with investments qualify as miscellaneous itemized deductions (subject to the 2%-of-AGI floor): office rent; legal fees; accounting and secretarial fees; certain travel expenses (not to conventions or meetings); investment-related newsletters, books, etc.; long-distance phone calls; postage; travel to your broker's office; custodial IRA fees paid out of separate funds; fees to financial planners or managers; and rental fees for safe-deposit

Rules of Thumb

- If you have realized capital losses larger than your realized capital gains plus $3,000, consider selling more capital gain property.
- If your realized gains exceed your losses, consider selling more loss property to reduce tax on the gains.
- If your deductions for this year exceed your income, don't realize any more losses—they'll be unusable this year (and if they're non-capital they may not be eligible for carryover to later years).

boxes. Brokers' and mutual fund commissions are generally deducted by adding them to the basis to reduce capital gain upon sale.

- An individual whose return fails to flag a "reportable transaction" (tax shelter) is subject to a minimum $5,000 penalty.
- Net investment income could be subject to the 3.8% Medicare surtax for some higher-income individuals. Refer to the discussion of the surtax on page 3.
- Profits up to $500,000 for couples or $250,000 for singles upon the sale of a principal residence are exempt from tax under certain conditions. (See Real Estate chapter.)

The 2016 Kiddie Tax: Certain children's unearned income over $2,100 is taxed at the parent's marginal rate. A child is subject to this "kiddie tax" if the child is 1) under age 18, 2) age 18 whose earned income does not exceed one-half his/her support or 3) age 19–23 and a full-time student whose earned income does not exceed one-half his/her support. Many such kids will get no advantage from the 0% capital gains rate. Shifting capital-gain property, however, especially if slated for sale before 2017, to other family members in the lower income tax brackets might save tax. Grandparents who wish to help grandchildren pay for college, take note, especially if the grandchildren are age 19 and over and escape the kiddie tax. Tax savings could be significant if the child sells stock at a 0% capital gains rate.

FDR
Franklin D. Roosevelt was the first sitting president to use air travel for official business. The historic flight took place in January 1943 on the Pan Am Dixie Clipper departing from Miami. Roosevelt flew to meet Winston Churchill in Casablanca for a WW II strategy meeting. The trip was secret and circuitous resulting in a 4 day journey with stops for refueling and rest time for the passengers.

Other Considerations

- Don't sell stocks to pay a tax bill. It's usually a bad idea and if they have appreciated, you are generating more taxable income.
- Remember to use the correct basis for stocks or assets you inherit.
- Keep your "buy and hold" stocks in your taxable account and stocks you may hold for shorter periods (as well as high-yield fixed income securities and CDs) in your tax-deferred account.
- The "wash sale" rule disallows losses on stocks and bonds if you re-buy substantially identical securities (or funds) within 30 days of the sale. Caution: if you sell a mutual fund within 30 days of a reinvested dividend, you could inadvertently violate the rule.
- Owners of worthless securities (but not of worthless partnerships) have seven years to file retrospective claims for tax refunds.
- The penalties for tax-shelter investments the IRS deems lack economic substance are stiff—up to 40%.
- Bond interest is taxable at regular rates that can reach 39.6% and, when interest rates rise, bond and bond mutual fund values generally fall. Municipal bonds may be good investments for high-incomers, especially in high-tax states.

Mutual Funds

If you sell a mutual fund this year, remember to add to your original cost basis all subsequent reinvested interest, dividends, capital gains distributions and sales charges. This could greatly reduce your reported gain or increase your reported loss.

Those who are long term investors in mutual funds and reinvest dividends and capital gains

should remember to include these in the cost basis of shares. An alternative is to take the dividends in cash, and thus keep your original cost basis, while reducing paperwork. Funds usually tell you your average basis for all your shares, including those bought by reinvesting dividends. Mutual funds must report the cost basis of shares purchased after 2011.

There are several ways to figure the cost basis of shares, and they all become complex when investors reinvest dividends and capital gains and sometimes sell shares. The average-cost method is most popular and most fund groups use it to provide cost figures to clients. Although the most flexible method to minimize taxes is to designate specific shares, it requires careful recordkeeping. Another option is first-in, first-out. Once you select a method, you must stick with it.

Capital gain distributions from mutual funds increase your net capital gain for the year. Long-term gains of mutual funds qualify for the capital gains tax rates. Non-qualified dividends of interest and short-term gain, however, are taxed at ordinary income tax rates. If you see such gains coming, try to offset them by selling securities with values currently below your basis in them. You might even sell an extra $3,000 of loss securities, so as to deduct the losses and reduce your taxes, and use the proceeds from the sales to update and reposition your portfolio.

You may have paid foreign taxes if you invested in international mutual funds. If so, a dollar-for-dollar foreign tax credit may be available to you. Your fund should be able to tell you how much foreign tax was paid on each share.

- Mutual fund shareholders whose only gains are from fund payouts can avoid Schedule D. Form 1099-Div will tell you which portion of gain qualifies for what treatment.
- You can swap one fund for another to lock in a loss while keeping exposure to the same asset class. Don't wait until year-end to capture losses; you can sell at any time.
- If you buy a mutual fund that is about to pay a dividend, including capital gains dividends, you'll pay tax on the payout without enjoying any increase in your wealth (share prices drop by amounts paid out). Wait to buy until after the record date for payment. If a fund's value has fallen, selling before the payout record date will provide a loss that can offset gains elsewhere, and you avoid taxes on the payouts.
- A mutual fund is "tax efficient" if its returns show up as appreciation in the share price, not as taxable distributions. Such funds often use a buy-and-hold strategy, although buying and selling actively provides more chances to offset gains with losses. A fund with large unrealized losses may be a buy, because, when realized, the losses will offset gains. A fund can lose value and still allocate gains taxable to you.

Passive Activities

Some investment activities are defined as "passive" to prevent their use as tax shelters for other types of income. Passive activities are of two types: 1) the owner (often limited partnerships or S Corporations) does not "materially participate" and 2) any rental activity (irrespective of the level of participation) for which payment is mainly for the use of tangible property. (There are a few exceptions.) Passive activity investments do not include stocks and bonds. The Real Estate chapter describes an exception to the passive-loss restrictions for those who actively participate in renting real estate.

Calendar year filers must report new groupings or changes in how passive activities are grouped. The reporting rules are intended to keep filers from playing games to deduct losses. The grouping rules are important because if two or more activities are grouped as one, the disposition of an activity will not trigger any suspended passive losses until all the others are disposed of.

Passive losses you can't deduct this year can be carried forward and deducted when you dispose of the entire activity or have passive income to offset them. Any interest owners receive on loans to passive activities is treated as portfolio income, and can't be used to offset passive losses—except that interest earned on loans owners make to partnerships or S Corps with passive activities (such as rental realty) is passive income to the owners. The owners need not have a 10% share in the S Corp or partnership to use this break.

To reduce your passive-activity interest expense, reduce your debt in a rental activity or convert the debt to home-equity debt, the interest on which may be deductible. (Use the proceeds from a home-equity loan to repay passive-activity loans.

Retirement

What's New for 2016

- **The option to make direct tax-free payouts of up to $100,000 to eligible charities from IRAs by taxpayers age 70½ or older has been made permanent. The distribution counts toward the owner's RMD.**
- **The definition of a highly compensated employee remains unchanged at $120,000. The definition of a key employee in a top-heavy plan remains $170,000.**

The sooner you start setting aside money for retirement, the longer your money can grow and benefit from the power of interest compounding. For example, let's say you are 25 years of age and contribute $2,000 each year to a retirement account until the age of 65. (Total contributions = $80,000.) Assuming a 6% rate of return, your nest egg would be worth $309,500. Compare that to a 30 year old who begins to save, contributing $2,500 each year for 35 years at the same 6% rate of return. (Total contributions = $87,500.) His nest egg at age 65 years is only $278,550 although his total contributions were higher. That's the power of interest compounding. There are many retirement saving vehicles, the most common of which are discussed in this chapter. The chart on page 18 provides a snapshot of the plans.

Retirement plan contributions can offer two large tax benefits: they can 1) potentially reduce your AGI and current income tax and 2) grow faster than your other assets because they're sheltered from tax until withdrawn. (Roth-type accounts are notable exceptions; withdrawals are generally not taxed.) Take advantage of your employer's plan especially if it features an employer match (which is free money for you once it is vested) or you qualify for catch-up contributions (age 50 or older).

If you have stock from your company in your retirement plan, find out its "cost basis" now; this number will help determine your later taxes and affect how you should take distributions. Employee contributions to pension plans can be rolled over into another plan via a trustee-to-trustee transfer. Non-spousal as well as spousal beneficiaries can roll over a decedent's interest in a qualified plan under strict rules. Consult with your advisor.

If you retire before the age of 55, you may incur a 10% penalty on early plan distributions. The penalty is avoided if you are 55 in the year you retire. The separation date, not the distribution date, is the key factor. This exception does not pertain to early distributions (before age 59½) from IRAs.

Low- and moderate-income taxpayers may benefit from the "saver's credit" on the first $2,000 contributed to retirement plans. In order to qualify, AGI cannot exceed: $61,500 (MFJ); $46,125 (HH); and $30,750 (Single and MFS). The credit amount (10% to 50%) is tied to AGI. Maximum credit: $2,000 for MFJ, $1,000 for Single and all others. Taxpayers who are younger than 18 years, full-time students, or claimed as a dependent on another's return cannot take the credit. The credit is trimmed if the taxpayer took a distribution from a plan or IRA the same year or the two previous years.

Individual Retirement Accounts (IRAs)

You must have earned income in order to contribute to an IRA. (Exception: MFJ—only one spouse needs earned income in order to contribute to a spousal IRA and one for yourself.) You cannot contribute more than your earned income or the contribution limit of $5,500, whichever is less. Wages, salaries, tips, and net earnings from self-employment are considered earned income. Parents can make contributions to IRAs for their dependents, but the dependent must have earned income equal to or greater than the contribution amount. Those age 70½ and older cannot contribute to an IRA.

If neither you nor your spouse is covered by a qualified employer-sponsored plan, you can each contribute to an IRA and jointly exclude from

RMD Schedule For IRAs

Age	Years*	Age	Years*
70	27.4	85	14.8
71	26.5	86	14.1
72	25.6	87	13.4
73	24.7	88	12.7
74	23.8	89	12.0
75	22.9	90	11.4
76	22.0	91	10.8
77	21.2	92	10.2
78	20.3	93	9.6
79	19.5	94	9.1
80	18.7	95	8.6
81	17.9	96	8.1
82	17.1	97	7.6
83	16.3	98	7.1
84	15.5	99	6.7

*Distribution span in years

To get a year's RMD, divide the sum of the prior year's Dec. 31 balances in your plan(s) by the distribution span for your age.

current tax up to $11,000 (or $13,000 if both are age 50 or older) of current income, even if one spouse does not work. (Spouses cannot contribute more than their combined earned incomes.) If either spouse participates in a qualified employer-sponsored plan, contribution deductibility is subject to MAGI limits (see chart).

If ineligible for a deductible IRA contribution (or over the AGI limit for a Roth IRA), you can still make non-deductible contributions. Non-deductible IRAs are a good place for after-tax dollars if you trade in and out of stocks and mutual funds: you can buy and sell without paying taxes.

Is My IRA Contribution Deductible?

Plan at Work	Filing Status	2016 Modified AGI	IRA Deduction up to Contribution Limit
You're covered by retirement plan at work	Single and HH	$61,000 or less $61,000–$71,000 $71,000 or more	Full Partial None
	MFJ	$98,000 or less $98,000–$118,000 $118,000 or more	Full Partial None
Neither you nor your spouse is covered by retirement plan at work	Single and HH	No limits	Full
	MFJ	No limits	Full
You're not covered by retirement plan at work but your spouse is	MFJ	$184,000 or less $184,000–$194,000 $194,000 or more	Full Partial None
	MFS	Special rules apply	

You can temporarily withdraw funds from an IRA for 60 days without penalty, but if you exceed that time limit you pay tax and penalty on the funds as of the day of withdrawal. You can make only one such temporary withdrawal in any 12 month period regardless of the number of IRAs you have. (All your IRAs will be aggregated and treated as one for this event.)

A 10% penalty plus regular income tax applies to premature withdrawals (before age 59½) from IRAs unless you are disabled, but you can avoid the penalty by withdrawing the funds in equal periodic payments (conditions apply). The penalty is also waived if the early withdrawal is used for: medical expenses in excess of 7.5%- or 10%-of-AGI; health insurance premiums (conditions apply); certain education-related expenses; or up to $10,000 for the purchase of a first house. Unemployed persons who receive unemployment benefits for 12 consecutive weeks can tap their IRAs (in the year the benefits are paid or the following year) penalty free to pay for health insurance. All early distributions are subject to income tax.

Required minimum distributions (RMDs) are required once the owner of a traditional IRA reaches age 70½. The first RMD can be delayed until April 1 of the year after turning 70½. For each year thereafter, the deadline is December 31. The RMD amount is determined by 1) the previous-year year-end IRA balances and 2) a life-expectancy schedule provided by the IRS (see chart on page 16). Non-spousal heirs can stretch the IRA over their lifetimes but must start RMDs in the year following the owner's death. Tax will be due on withdrawal of the deductible contributions and earnings.

Be sure to amend your IRA forms if your beneficiary dies or there is a divorce. If the IRA passes to the estate, unintended taxation and flexibility issues may result. Heirs may be able to claim an itemized deduction, not reduced by 2% of AGI, for the part of an estate tax bill due to the IRA.

Roth IRAs

Contributions to Roth IRAs are made with after-tax money and, therefore, are not deductible. Eligibility to contribute to Roths is subject to modified AGI limits as shown in the chart on page 18. The greatest benefits of Roth IRAs may be in transferring wealth to heirs. A Roth IRA is not subject to RMDs during the owner's lifetime, contributions are allowable at any age (even beyond age 70½), and may provide far more to a beneficiary than other plans. Assets in the account for five years can pass to heirs without current income tax. Non-spousal beneficiaries of a Roth IRA have to take minimum distributions (which are tax-free) but can stretch them out over a lifetime. In the meantime, the Roth continues to enjoy tax-free growth.

A Roth can grow into a large sum for a child who has earned income. The parent can fund the account but the contribution amount cannot exceed the child's earned income.

Although contributions to a Roth IRA are non-deductible, you can withdraw the contributions

without tax or penalty. So keep track of your Roth contributions. After five years you may be able to withdraw earnings early (before age 59½) without penalty for your first purchase of a house ($10,000 limit), for education, or because of disability. After five years and age 59½, you can withdraw all of the Roth for any reason. The five year period starts with the tax year of the first conversion or contribution.

Conversions to Roth IRAs: Traditional IRAs can be converted to Roth IRAs and the latter back to traditional IRAs. If you convert a traditional IRA to a Roth, watch out for a 10% penalty on withdrawals in the first five years, even if you take out funds you converted tax free. Usually the penalty is on taxable withdrawals, but the whole withdrawal is subject to the penalty unless you've turned 59½, are disabled, or have elected to take a series of equal distributions from the Roth. A conversion can make sense if your personal tax rate will be higher or the same in the future.

If you convert a traditional IRA to a Roth IRA and want to put the funds into different types of investments, consider using a different Roth for each type. If any of the investments declines in value later in the year you can unconvert that portion until as late as the filing date plus extensions without paying income tax on it. It's usually not a good idea to use part of the distribution in a conversion to pay the taxes due. Better to have enough cash on hand to pay the tax; you don't want to limit the Roth's ability to grow.

Switching to a Roth from a traditional IRA can make more of seniors' Social Security benefits taxable in that year, and the increase in income could cause loss of some tax breaks. Try to schedule the conversion in a year your income dips or you have investment losses. Upper-incomers may have to pay a surcharge on their Medicare Part B premiums, and Roth conversion income counts toward the AGI trigger point. Even lower-income seniors who convert might see more of their Social Security benefits taxed, but at least they won't have to take minimum

Plan		Contribution Limits 2016	2017	Pros	Cons	Use
IRA	individual age 50+ add'l	$5,500 $1,000	Indexed to inflation $1,000	Tax-deferred savings	Withdrawals not tax-free; participation in employer plan affects contribution deductibility	For individuals
Roth IRA	individual age 50+ add'l	$5,500 $1,000	Indexed to inflation $1,000	Earnings and withdrawals tax-free; flexible distribution	No up-front deduction; contribution eligibility phases out at MAGI Single and HH $117,000–$132,000 MFJ $184,000–$194,000	For individuals
myRA	individual age 50+ add'l	$5,500 $1,000	Indexed to inflation	No minimum to open; risk-free; will not decline in value	No up-front deduction; contribution eligibility phases out at MAGI Single and HH $117,000–$132,000 MFJ $184,000–$194,000	For individuals to jump start saving for retirement
SIMPLE IRA	individual age 50+ add'l	$12,500 $3,000	Indexed to inflation	High contribution limit; employer must match	Withdrawals not tax-free	For small businesses-less than 100 employees
SEP		Employer can pay in lesser of $53,000 or 25% of compensation		High contribution limits	Withdrawals not tax-free	For self-employeds and their employees
401(k)	individual age 50+ add'l	$18,000 $6,000	Indexed to inflation	Tax-deferred contri-butions and growth; employer match not taxed to owner	Employee withdrawals only allowed under limited conditions	Employer sponsored
Roth 401(k)	individual age 50+ add'l	$18,000 $6,000	Indexed to inflation	Earnings and withdrawals tax-free; employer can match	No up-front tax deferral	Employer sponsored

distributions from the Roth and any withdrawals will be tax free.

A conversion must meet certain conditions and the taxation on the conversion can be complex. Always consult with your advisor before making a conversion to determine if it is right for you.

myRAs

The myRA is a Roth IRA backed by the U.S. Treasury meaning it is risk free and won't decline in value. It is designed to jumpstart retirement saving for wage earners without access to retirement plans at work. Contributions can be made via regular (after-tax) automatic deductions from paychecks; through direct deposits from a bank account; or with tax refunds. Contributions can be made for 30 years or until the account balance reaches $15,000. When either limit has been reached, the account must be rolled into a private-sector Roth IRA, although the funds can be moved to another Roth IRA prior to reaching these limits.

The rules for myRAs are like those for regular Roth IRAs. Contributions can be withdrawn at any time without tax or penalty. The interest earned can be withdrawn if the owner is age 59½ and the account has been opened for at least five years. Under certain conditions the interest can be withdrawn early (before age 59½) without penalty for the purchase of new home, education, or disability. Visit myRA.gov for enrollment information.

401(k) and ROTH 401(k) Plans

401(k) plans are excellent tax-saving vehicles, especially if your employer matches your contributions because the matches are not income to you; however, no unrealized losses, even on after-tax contributions, are deductible. Know the rules of your 401(k). If an employee cashes out of a 401(k) and doesn't roll over within 60 days, federal, state and local taxes are due on the entire amount withdrawn, and possibly a 10% early-withdrawal penalty. Consider borrowing from your 401(k) rather than cashing out. If a departing employee has a balance below $5,000 in a company 401(k) or pension plan, the company can opt to evict the employee from the plan.

The usual "distribution" or withdrawal choices from a company plan are a lump-sum or an annuity. Many who leave their jobs take a cash distribution from their 401(k)s rather than rolling the funds over into their IRA or a new employer's plan. This can be a serious mistake. If you roll over a lump-sum distribution to an IRA within 60 days, tax is deferred.

Rules enacted in 2015 provide that disbursements from a 401(k) made at the same time are treated as a single distribution even if sent to multiple destinations. As a result, if your plan contains pre-tax and after-tax amounts, you can transfer (through direct rollovers only) the pre-tax portion to a traditional IRA and the after-tax portion to a Roth IRA. Partial distributions must still include a proportional share of the pre-tax and after-tax amounts in the plan.

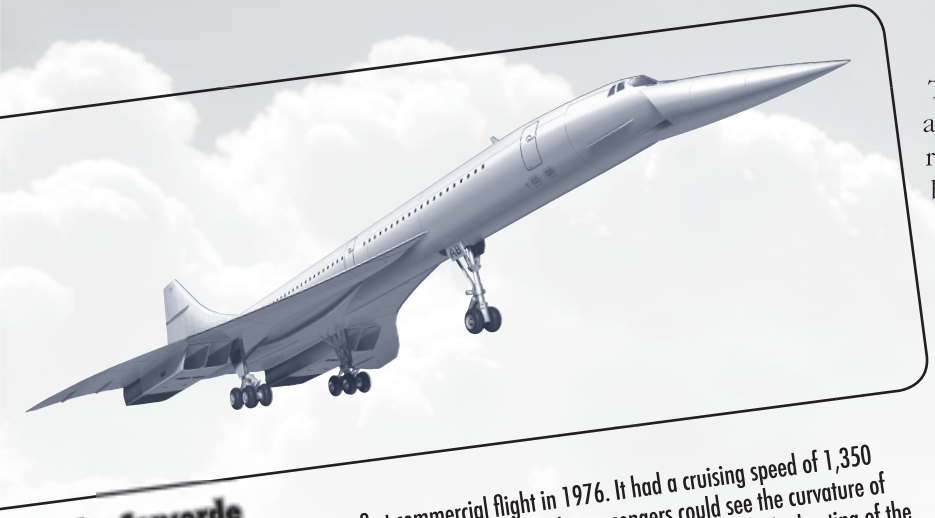
The value of unpaid leave can possibly be transferred to an employee's 401(k) or profit sharing plan annually. This can help employees with vacation that can't be carried over. If the plan allows, the value of unused leave can be contributed when the employee leaves the company.

Non-spousal heirs can take payouts over their lifetimes if they properly roll the 401(k) into their own IRAs. There are strict rules so see your advisor. They still face a deadline, however: to beat the five-year rule, and get lifetime payouts, the heir must transfer the 401(k) to an IRA within a year after the 401(k) owner dies.

The Roth 401(k) combines the features of traditional 401(k)s and Roth IRAs. There's no up-front deduction for the contributions. The limits are the same as for regular 401(k)s and include catch-ups, but withdrawals are tax-free after age 59½. If the earnings are large or tax rates at the withdrawal date are high, the tax benefit will be invaluable. There are no income limits for eligibility for Roth 401(k)s, which is great for highly-paid employees. The contribution limits apply to all your 401(k)s, so you can't put $18,000 (or $24,000 for those age 50 and older) into both a regular and a Roth 401(k), but you can divide your contribution between the two types in any year. Which type is better? When you contribute to a regular 401(k), you get a current deduction and delay paying taxes on those assets until retirement. For young people, if their retirement tax rate will be higher than now, the Roth 401(k) may be better for them. If the reverse is true, the deductible 401(k) may be better. The main variables for deciding between regular and Roth 401(k)s are your tax brackets today and those estimated at the time you'll withdraw.

Qualified Plans

There are two basic kinds of qualified plans: defined contribution and defined benefit. Self-employment income can be sheltered from tax



The Concorde
The Concord supersonic jet made its first commercial flight in 1976. It had a cruising speed of 1,350 mph and a cruising altitude of up to 60,000 ft. At that altitude, passengers could see the curvature of the Earth. The jet was 204 feet in length but stretched six to 10 inches in flight due to the heating of the airframe. Incredibly, a ton of fuel per minute was required during takeoff. The British Concorde flew its fastest transatlantic flight of 2 hours 52 minutes and 59 seconds from New York to London in 1996.

with either type. The contribution limit to defined contribution plans remains the lesser of $53,000 or 100% of eligible compensation, and can be based on up to $265,000 in salary. The maximum annual payout for defined benefit plans remains $210,000. Defined-benefit-type plans that provide a fixed amount per year have dwindled because of their complexity.

Simplified Employee Pension Plans (SEPs) and SIMPLES

SEPs let employers make deductible contributions to the IRAs of employees and avoid much paperwork. All eligible employees must be covered but there's no waiting period for vesting. Businesses with no more than 100 employees can have a SIMPLE plan, to which an employee can contribute this year up to $12,500 of pre-tax wages (plus another $3,000 if age 50 or older). Employer matches must be made by the due date of the return plus extensions. Contributions to a SIMPLE have an earlier deadline than for an IRA: one month after year-end. SEPs are easily converted to Roths, but there are restrictions on conversions of SIMPLEs.

Social Security Benefits

Social Security benefits are generally not taxed if they are the only income source for the year. If you have earned income or large investment income, up to 85% of benefits may be taxable depending on the amount of income and your filing status. Tax-exempt income also figures into the calculation of the taxability of benefits.

The 2016 earnings test (not applicable for individuals at full retirement age) for Social Security benefits remains unchanged from 2015: a charge of $1 for every $2 that earnings exceed $15,720 if below full retirement age; a charge of $1 for every $3 that earnings exceed $41,880 if full retirement age is reached in 2016 (for earnings made in the months prior to the month you reach full retirement age). Full retirement age depends on the year you were born (see chart). The test applies to each person, not to couples. Beneficiaries who work continue to pay Social Security and Medicare payroll taxes, even if they work only part-time and the pay is not enough to raise their benefits. Social Security beneficiaries may withdraw an application for retirement benefits but only once per lifetime and only within 12 months of their first Social Security payment. Any benefits received prior to the withdrawal must be repaid.

Social Security Retirement Age Schedule

YEAR OF BIRTH	FULL RETIREMENT AGE
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

Other Retirement Considerations

You may want to investigate state taxation and its implications for you if you're deciding where to live in retirement. Take into account the state income tax rate, state taxation of retirement benefits and Social Security, state and local property taxes, state estate taxes, and state sales tax. These can vary widely from state to state and could have a measurable impact on your finances.

Real Estate

What's New for 2016

- **The deduction for Private Mortgage Insurance (PMI) premiums on a qualified residence remains in effect through 2016.**
- **The exclusion of up to $2 million of debt forgiveness on a primary home has also been reinstated through 2016.**
- **Recapture of the $7,500 first-time homebuyer's credit continues for those who bought a house between April 9 and Dec. 31, 2008, and took the credit: $500 must be added to this year's taxes. You can track the repayments you have made to date on the IRS website (www.irs.gov). Enter First Time Homebuyer Credit Account Look Up in the search engine.**

Home Sales

The rules for home sales remain unchanged this year. Gain of up to $500,000 on the sale of a principal residence by a married couple remains potentially exempt from tax; for singles, $250,000. Surviving spouses have two years following a spouse's death to sell a primary home and claim the $500,000 exclusion. A taxpayer who owned and used the property as a principal residence for a cumulative two years during the five years preceding the sale can claim this exclusion once in any two-year period, for any number of periods. To qualify for a full exclusion, either spouse can meet the ownership requirement but both must meet the use requirement. Unmarried co-owners of a house each can exclude $250,000 if they meet the other requirements.

You may get partial relief if your home must be sold due to job changes, bad health, or unforeseen circumstances, even if the two-year use and residency tests aren't met. The use requirement is reduced to one year (out of five) prior to the sale if the homeowner has to move to a nursing home. You can apply these rules retroactively to sales in which you didn't claim eligible relief.

Be sure to keep accurate records of what you paid for your home, as well as the costs of eligible improvements to it. Upon the sale of your home, such "basis" amounts will be compared to the sales proceeds to determine any potential taxable gain. If the gain is above the exemption amount ($500,000/$250,000), the excess could be subject to capital gains tax, and, for some high-incomers, the Medicare surtax.

Home Loans

Mortgage points paid on the purchase of a main residence (whether paid in cash or financed over the life of the loan) are deductible as long as the cash down payment at least equals the cost of the points. You can deduct points on a refinanced loan evenly over the term of the loan. Refinancing the loan for a second time triggers the deduction of the remaining balance of points from the prior refinancing. If you sell a residence while amortizing the points, any points not yet deducted are written off in full. State and local transfer taxes on a house purchase are not deductible but can be added to the tax basis and reduce the realized gain when you sell the house.

Pulling cash out in a home refinancing can create AMT problems. If the mortgage balance increases as a result when you're refinancing a primary residence or a second home, interest on the excess portion is added back to income under the AMT. (Exception: when the extra proceeds are used to improve a first or second home.)

Interest on the first $1,000,000 of home acquisition debt (to buy, build, or substantially improve a main or second residence) is deductible. (For mortgages dated before Oct. 13, 1987, all interest is deductible.) Interest on

Most Traveled Airport

Atlanta's Hartfield Jackson airport was ranked as the world's most-traveled passenger airport for 2015, a distinction it has held for 18 years. More than 100 million travelers passed through its gates. According to the FAA, there are approximately 7,000 aircraft in the air over the United States at any given time.

a Home Equity loan up to $100,000 secured by a residence is deductible, with deductibility of amounts above that dependent on the use of the proceeds. If you borrow more than $1,000,000 to buy your primary home, the next $100,000 may qualify as home equity debt.

Runways
Runways are configured based on the degrees on a compass; North is 0 degrees; East 90 degrees; South 180 degrees; West 270 degrees. A runway's compass direction is written in a shorthand format and indicated by a large painted number at the end of the runway. The numbers at each end are directional opposites. The longest runway in the world is in Tibet, 18,044 feet in length (3.42 miles). Longer runways are needed at airports with higher altitudes in order to give the planes the speed and thrust needed to take off. North America's longest runway is in Denver, Colorado, measuring 16,000 ft. (3.30 miles).

Keep in Mind

- You can tap a traditional IRA (penalty-free but not tax-free) up to $10,000 to buy a first home. A Roth IRA can be tapped (tax-free and penalty-free) for up to $10,000 for a first home purchase if it has been open for five years. You can tap a 401(k) only by borrowing from it.
- If you withdrew from IRAs for a failed first-home purchase, you have 120 days to roll the money back to an IRA without tax or penalty—twice the time allowed for a standard IRA distribution. The withdrawal is treated as a rollover subject to the new one-per-year rollover limit for multiple IRAs.
- The time limits associated with tax-free exchanges of real estate are strictly enforced.
- The property tax on your home depends on the tax assessor's valuation. Make sure your house valuation is in sync with current market values.

Moving Expenses

Some moving costs may be an above-the-line deduction from gross income if you have a job-related move. Deductible moving costs are those for a professional mover, rented moving van, moving a mobile home, and travel and lodging en route as long as the new job is 50 miles farther than the old job from the old house. (If the mover had no full-time pre-move job, the new job must be at least 50 miles from the old house.) There are also strict requirements for periods of work after the move. The nondeductible expenses of moving can be large, so bargain with your employer for reimbursement of as many of these as possible. Reimbursements to cover moving expenses that are not "qualified" are reportable as income, so try to get the taxes reimbursed as well. The standard mileage rate in 2016 for moving is 19¢. If you move to a new state, you will likely owe income tax in both states. Consult with your tax advisor for proper allocation of your income.

Rental Investments

A rental activity in which the payment is for use of tangible property is generally "passive." Losses from this type of activity can generally offset only gains from such activities, including profits from sales of the properties. Losses unusable this year can be carried forward to years when you have passive-activity income. The only other way to use suspended losses is to dispose of the entire activity. The depreciation period for nonresidential real property is 39 years for most property placed in service after May 12, 1993. That for residential rental property is 27½ years.

Exception: If you "actively" participate in renting real estate (i.e., you are at least a 10%-owner and deeply involved in its operation), you can currently deduct up to $25,000 of your net passive rental real estate losses. The deduction is reduced by $1 for every $2 of AGI in the phaseout range: $100,000–$150,000 (MFJ). Losses from fire, storm, theft, or such calamities don't count toward the $25,000 limit, nor is gain

from the insurance proceeds passive income. MFS filers can't take this loss deduction unless the couple lived apart for the entire tax year; otherwise, the landlord must spend over half his or her time materially participating in realty and put in more than 750 hours per year to deduct such losses.

Note: income from a passive activity may be subject to the 3.8% Medicare surtax if you do not materially participate in the operation and you meet the AGI thresholds. (See the discussion on page 3 regarding the surtax.)

You can deduct up to $25,000 of rental expenses in excess of rental income if your vacation home qualifies as a rental property. If you're close to the limit, consider reducing your time at the home to take a full deduction. If you expect to qualify for the full deduction next year, postpone repair and maintenance expenses.

Repairs to a rental property can be deducted for the year when made, but improvements must be depreciated over many years. The rules distinguishing one from the other can be complicated. To keep these types of work separate, do them at different times and get them billed separately, if possible by different contractors. If you convert to rental use a house that has lost value since you bought it, only the drop in value after the conversion will be deductible when you sell.

Vacation Homes

The tax details of owning a vacation home can be complex so guidance from your tax advisor can help you take advantage of potential benefits available to you. In simple terms, if you rent your vacation home for less than 15 days a year, the rental income is tax-free and you can deduct interest and property tax payments (and casualty losses) on the house, but not rental expenses, for the entire year. If you rent your vacation home out for 15 days or more during the year, and personal use does not exceed the larger of 14 days or 10% of the rental days, you must include the rent in income. Days spent maintaining and repairing the home don't count as personal use. There is no deduction for depreciation, utilities, or repairs unless interest and taxes allocated to rental are less than rental income. If you occupy the house for more time, this is use of a personal residence and not part of a passive activity. Use by you, your family or relatives (even if they pay fair rent—except when the house is their main home) is "personal."

There's a restriction on converting a vacation home to a primary residence and later sold: a portion of any profit may be subject to tax, based on the time when the house was a second home or a rental to the total time you owned it.

Although the gains on a sale of a primary home may enjoy an exemption from tax as discussed on page 21, gains on sales of second homes do not. Consequently, any gain could be subject to the 3.8% Medicare surtax if your income exceeds the MAGI thresholds for the surtax: $250,000 (MFJ); $200,000 (Single and HH); $125,000 (MFS). See the discussion of the surtax on page 3.

Home Offices

Home office expenses are potentially deductible if you have no other fixed location where you perform essential business activities. A home office must be your principal place of business for important business functions, where you meet with customers, or located in a separate structure on your property. It must be used regularly and exclusively for business. You cannot deduct more than the net income from the business but any excess can be carried over to next year.

There are two methods for taking this deduction. A simplified method reduces paperwork and recordkeeping and may be used as an alternative to calculating, allocating, and substantiating actual expenses. Under the simplified method the deduction is capped at $1,500 ($5 per square foot up to 300 square feet). Depreciation cannot be claimed and allowable mortgage interest and real estate taxes are claimed as itemized deductions. Business expenses unrelated to the home office (e.g., supplies and advertising) remain deductible.

When using the regular method, you must first deduct from the income the business portion of your mortgage interest and real estate taxes and business expenses unrelated to the home office. Only then do you deduct home-office expenses and depreciation on the business portion of your house. In a sale of your home, gain on the office part may be taxable and depreciation may have to be recaptured.

Taking the home office deduction can be an audit flag. Know and follow the rules for a valid deduction.

Estate Planning

What's New for 2016

- **The Estate Tax exclusion has risen to $5.45 million as has the lifetime gift tax exclusion. Up to $148,000 in gifts to a spouse who is not a U.S. citizen are excludable.**
- **The five-year deferral, for installment payments of estate tax when a closely-held business makes up over 35% of an estate, continues. For estates of decedents dying in 2016, the 2% interest rate applies on up to $592,000 in deferrals.**
- **The Generation Skipping Tax (GST) exemption amount is $5.45 million with a top rate of 40%.**
- **The annual exclusion for gifts remains $14,000.**
- **Trusts and estates could be subject to the 3.8% Medicare surtax. The surtax applies to the lesser of undistributed net investment income or the excess of AGI over $12,400.**
- **The special use valuation of qualifying real property limit rises to $1,110,000.**
- **Executors must timely report the basis of inherited assets to heirs and the IRS. Exception: estates that file an estate tax return solely to elect portability.**
- **Heirs who inherit assets subject to basis reporting must report the basis and new owner to the IRS if the inherited assets are later gifted to relatives.**

When it comes to estate planning, one size does not fit all. Carefully consider your circumstances and always discuss your situation with your financial, tax, and legal advisors.

Estate Planning - The Basics

Regardless of the size of your estate or what your net worth is, make sure you have these basic estate planning documents.

Wills - Having a will is a must. A will outlines to whom or where your assets are distributed upon your demise according to your wishes. If you pass away without a will ("intestate"), the settlement of the estate may prove costly for heirs, and the disposition of your assets may not reflect what you intended. Each state has its own rules for the distribution of assets for those who die intestate. As part of a will, you choose an executor to pay any final expenses and taxes before distributing your assets. You also can name a guardian for your minor children or other dependents. Some assets, such as retirement accounts and life insurance policies, bypass a will completely and are distributed directly to the assigned beneficiaries. As events in your life change (births, marriages, deaths, divorce, etc.), make sure your will is kept up to date.

Beneficiary Designations - Important! As noted above, your provisions in a will do not generally supersede the beneficiary designations you make in trust agreements, insurance policies, bonds, bank accounts, and retirement and profit-sharing plans, which can represent most of an estate. These designations usually trump a will, so keep them up to date. Even better, make sure your will and such designations agree. The joint owner of joint bank, brokerage, or mutual fund accounts will automatically inherit the account upon your death.

*Power of Attorney * Health Care Directive * Living Will* - Choosing a trusted person to handle your financial and legal affairs should you become incapacitated is an important element of your planning. This person may or may not be someone in your family. Your choice must be made while you are still of sound mind. Without a power of attorney, a court-supervised guardianship or conservatorship may be assigned to handle your assets.

A Health Care Directive designates someone to make medical decisions on your behalf if you are unable to do so. Going hand in hand with that is a living will which expresses your wishes concerning life-sustaining procedures.

More Detailed Planning

Some estates require more comprehensive estate planning and often involve the application of large insurance policies within complex legal trusts. The size of your federally taxable estate can be easy to misjudge. The taxable estate includes home equity, retirement accounts, foreign assets, and proceeds from life insurance. To reduce the size of your estate, transfer assets early through planned gifts and other devices.

An executor must generally file an income tax return for the decedent on April 15 following

the year of death even if no federal estate tax is due. Executors are liable for any unpaid estate tax and income tax, and often wait to distribute until the IRS agrees on its tax status. One of an executor's main roles is to determine the market value of all the estate's assets on the date of the death, so that the heirs will know the stepped-up basis of the assets received.

Couples are still entitled to two exclusions ($5.45 million each for those who die in 2016), and any of a deceased spouse's exclusion that is unused can pass to the other. This exclusion portability (as it is known) means in effect the exclusion amount for a couple is now $10.9 million thereby adding another option to traditional estate planning strategies. The executor who handles the first deceased's estate must explicitly transfer the unused exclusion to the survivor by filing a timely federal estate tax return even if no tax is due.

If the portability option is not utilized, one spouse can still pass (outright or in trust) an unlimited amount to the other without estate tax. Such assets are subject to potential estate tax when the surviving spouse passes them on to heirs. If one spouse passes everything directly to the other, they effectively get only one exclusion. To secure two exclusions, they can set up two asset pools: one pool, valued at the exclusion amount, passes to children or others; the remaining assets are passed under the marital deduction to the surviving spouse, who can later use another exclusion amount. Yet in other cases trusts such as an "AB" or "by-pass trust" may be desired.

As baby boomers transfer assets to children, the children must decide how to receive them. One method is an "inheritor's trust" to receive even small inheritances. Trust income, however, may be taxed as high as 39.6% for income above $12,400. Seek help from your advisor.

Consider these other ways to save more of the assets if you are in line to inherit part or all of an estate:

- You can value an estate's assets either as of the date of death or six months later. (If an estate tax return is filed, it is due nine months after the date of death.) Check the value on both dates and try to use the date that produces the least estate tax.
- If an estate tax return is not filed, the basis of property you inherit is stepped up to its market value on the date of death.
- If the estate's executor is a beneficiary, he/she should consider collecting executor's fees and deduct them from the estate. The executor's income tax rate may be far lower than the tax rate on the estate.
- If the inheritance will put your own estate over the exclusion amount, you can renounce your share through a disclaimer and pass it on directly to later generations.
- If you inherit an IRA, ask the estate executor for any Form 8606s that were attached which track non-deductible contributions. The IRS exacts a penalty for failure to file them.

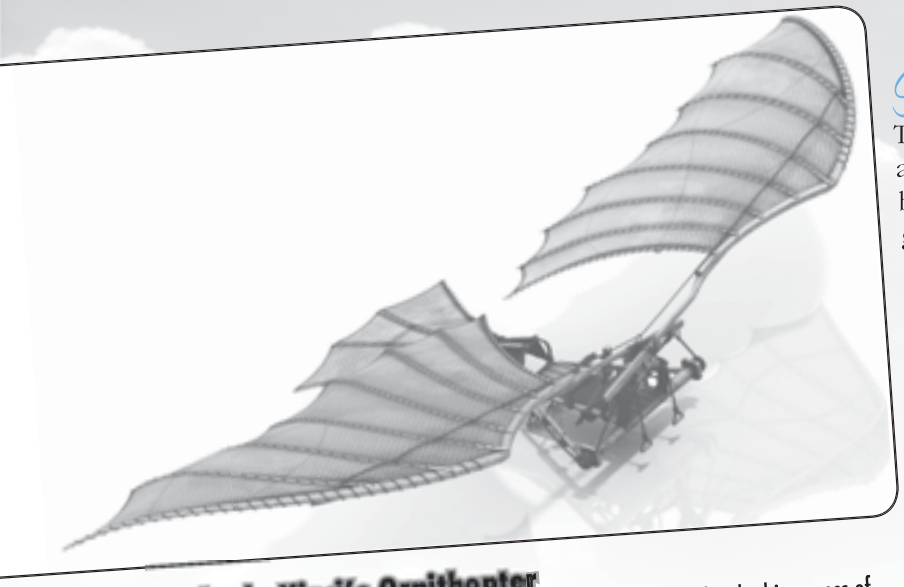
Winglets

Have you ever noticed the perpendicular tips on the wings of many airplanes? These "winglets" reduce the drag on the plane resulting in better fuel economy, range, and speed. The design of the winglet varies depending on the type of airplane. The earliest winglets appeared in the 1970s on smaller jets; those for larger aircraft were seen in the 1990s. Improving winglet design for even better efficiencies is an ongoing pursuit.

Trusts

Trusts are another useful tool for estate planning. Trusts have many features and variations: e.g., they can be established before or after you die. If you set up a trust now and make it irrevocable, the assets you donate to it are out of your estate. (There are gift tax implications, however.)

Some trusts used in estate planning include: Living trusts; "Wealth-replacement trusts"; QTIPS; By-pass trusts (although these became less useful when exemptions became portable). Discuss with your advisor which option might be right for you.



Leonardo da Vinci's Ornithopter
Leonardo da Vinci made the first real studies of flight in the 1480s. He sketched in excess of 100 drawings illustrating his theories. His "ornithopter" (derived from the Greek words for bird and wing) was a design to show how man could fly. This design was one of his earliest studies on flight.

In lieu of a life-insurance trust, you could have your child buy a policy on your life, or you could transfer an existing policy to the child. (Such a transfer is subject to the "three year rule", i.e. if you die within three years of the transfer, estate tax may be due.) As a gift, the transfer counts toward your $5.45 million lifetime gift tax exemption. You might give your child enough money each year to pay the premiums (which could possibly not exceed the tax-free gift limit).

Other Planning Considerations

- The power to make gifts must be explicitly authorized by a document conveying power of attorney. Problems can result if the document is silent about making gifts.
- Roth IRAs, Roth 401(k)s, and 529 college savings plans can be useful in estate planning. 529 plans offer some unique opportunities: withdrawals are tax-free if used for authorized purposes; contributions may not be subject to gift tax, are usually excluded from the donor's estate, and may be deductible on the state return; and you might be able to shelter as much as $70,000 (or $140,000 with your spouse) from gift tax.
- A non-citizen spouse is not eligible for the marital deduction. If the estate is more than the exemption amount, professional counsel could help find possible solutions.

Gifts and Gift Tax

The lifetime gift tax exclusion amount rises to $5.45 million. As baby boomers and their parents age, gift-giving becomes an important tax saving tool. Annually each person can give $14,000 free of gift tax to each of an unlimited number of people, or a couple can give away $28,000 if both spouses agree. Up to $148,000 of gifts to a non-citizen spouse are excludable. Gifts from foreign persons have to be reported if they exceed certain thresholds; penalties for failing to report can be high. Gifts of securities must be endorsed and delivered by year-end. Gifts paid to schools for tuition or to health-care providers for medical expenses or for medical insurance on behalf of a donee are not subject to the $14,000/$28,000 limit. Prepayments of tuition paid directly to a school get an unlimited exclusion, and reduce the donor's estate because they are not taxable gifts.

Recipients in lower tax brackets who receive gifts will pay lower income tax on the earnings of some assets, and any gain in donated property stays out of your estate. The best gifts are those with the highest chance of appreciation. If the assets are still in your estate when you die, their tax basis is stepped up but they could be subject to estate tax far higher than the capital gains rate. If you exceed the $14,000/$28,000 limit, you must report the excess to the IRS (on Form 709) including transfers of real estate for little or no payment—usually to family—if they exceed the limit. You pay no gift tax, however, if you haven't used up your lifetime exclusion, and many never will. Neglecting to attach past gift tax returns (709s) to an estate tax return is an audit trigger. Taxable gifts are added back to the estate, and use of the lifetime gift tax exclusion reduces the estate tax exclusion by that amount.

If you transfer realty to a relative for little or no consideration, make certain you report the gift. The IRS is searching property records to uncover unreported gifts.

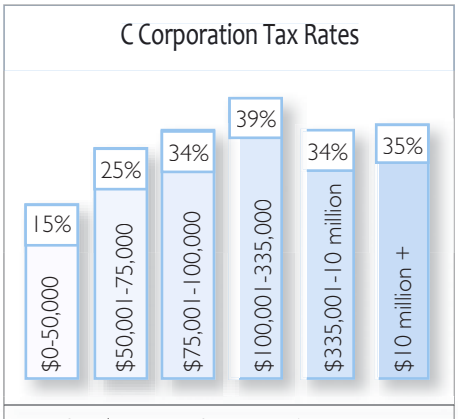
Business

What's New for 2016

- **The expanded work opportunity tax credit (WOTC), extended through 2019, now includes the hiring of the long-term unemployed.**
- **The new markets tax credit has been extended through 2016.**
- **The 15 year recovery period for qualified leasehold, restaurant, and retail property is now a permanent provision.**
- **The enhanced conservation easement tax incentive has been reinstated and made permanent.**
- **The R&D credit is now permanent and can be used against the AMT or payroll taxes for certain businesses.**
- **Section 179 deductions are now permanent and will be indexed to inflation in future years. 2016 limits: $500,000 limit until $2,000,000 in qualifying new and used assets, as well as computer software, are placed in service by year-end.**
- **Extended through 2017: 50% bonus depreciation. It will drop to 40% in 2018; 30% in 2019.**
- **The per-diems for high-cost areas have risen to $275 ($207 lodging, $68 meals and incidentals). Elsewhere the per diems are $185 ($128 lodging, $57 meals and incidentals). Self-employeds on travel can use these rates for meals and incidentals only. Lodging expenses must be substantiated separately.**
- **The 30% credit for businesses installing qualified solar energy property remains through 2016.**

Business Structures and Taxes

Businesses can be structured in several ways and choosing the right structure at the onset is important. Changing the business structure later could have tax consequences. Although C Corporations pay only 15% on taxable income of less than $50,000, individual tax rates can be more favorable in many cases so operating as a sole proprietorship, partnership, or S Corporation may make sense. Consult with your advisor about which structure is the best for your business.



The first $50,000 of taxable income is taxed at 15%, the next $25,000 at 25%, etc. An extra 3% surtax applies to income between $15 million and $18 1/3 million. A Personal Service Corp. pays 35% tax on all income.

Structure	Definition	Taxes	Liability
Sole Proprietorship	Someone who owns an unincorporated business by himself/herself	Profits/losses included on owner's individual tax return	Owner generally not protected
Partnership	Relationship between two or more persons who join to operate business or trade	Profits/losses pass through to each partner's individual tax return	General partners: unlimited Limited partners: to the extent of the investment
Limited Liability Company (LLC)	Structure allowed by state statute; not a classification for federal tax purposes	LLC must file corporation, partnership or sole proprietorship federal tax return	Limited
S Corporation	Corporation that passes income, losses, deductions, and credits through to shareholders	Because of pass through to shareholders' tax returns, double taxation on corporate income avoided	Limited for shareholders
C Corporation	Entity that conducts business, realizes net income or loss, pays taxes, and distributes dividends	Taxed on earnings; shareholders taxed on dividends received	Limited for shareholders

Business Credits and Deductions

The many credits and deductions available to businesses each year can result in substantial tax savings. Consult with your advisor regarding those that are applicable to your business.

Business expenses must be "ordinary" (common) and "necessary" (helpful and appropriate) in your type of business to qualify as deductions. You can increase your deductions by paying attention to what you do near year-end. For example, buy non-inventoriable supplies before year-end and accelerate repairs into this year; reduce or defer year-end income; delay shipping until next year; make sales on consignment or approval. For cash basis businesses, defer billing for services until the next month or quarter and advance into 2016 payments you expect to make in 2017 for expenses such as maintenance, office supplies, and advertising.

Keep in mind that the deduction for business meals and entertainment is 50% of eligible expenses, with receipts required for expenditures above $75. Be certain to document each expense, including the place, people in attendance, and the business focus of the discussion. You need an itemized bill for lodging; a credit card receipt is not enough.

Suggestion—hold a company party during the holidays. Limits on deductions for meals and entertainment don't apply if the party isn't limited to highly-compensated employees. Another idea: instead of buying your client a meal (only 50% deductible), give a gift certificate (100% deductible) to his or her favorite restaurant.

Tangible Property Regulations

The regulations for tangible property effective for tax years beginning in 2014 have created a framework to determine whether certain costs are currently deductible or must be capitalized and depreciated. Incidental materials, supplies, and routine maintenance can be expensed rather than depreciated under strict new guidelines. The regulations will likely require new recordkeeping methods and certain election statements in order to be compliant. A thorough review of your situation with your advisor is prudent.

Vehicles

Taxpayers can either claim vehicle deductions based on actual costs (such as fuel, insurance, and repairs) or use the standard mileage rate of 54¢ in 2016 for business driving. The standard rate can be used for hired vehicles such as taxis as well as leased cars and for valuing an employee's use of a company car. It cannot be used for more than four vehicles used simultaneously (such as a fleet). Business-related parking and tolls remain deductible when using the standard mileage rate. The mileage rate can't be used if you claimed depreciation or expensing on the vehicle. Employees have income for personal use of company cars. The 2016 maximum fair market value (FMV) for employer-provided vehicles using the cents-per-mile valuation rule: $15,900 passenger auto; $17,700 truck or van.

When you depreciate a business vehicle, you must indicate what percentage of the annual use was for business. Claiming 100% business usage can be an audit flag. Make sure your records for business use of a car are written and contemporaneous or the deduction could be disallowed.

Depreciation Schedule Luxury Vehicles Placed in Service 2016

	Cars	Light Trucks/Vans
First Year	$3,160*	$3,560*
Second Year	$5,100	$5,700
Third Year	$3,050	$3,350
Fourth Year +	$1,875	$2,075

* plus $8,000 bonus depreciation, if applicable.

Employer-Provided Benefits

IRS Publication 15-B provides information regarding the taxability of workplace fringe benefits and the related withholding rules.

Health Care – Employers with an average of at least 50 "full-time equivalent" (FTE) employees in calendar year 2015 must offer health insurance coverage to at least 95% of its full-time workers and their dependents in 2016. Employers who do not offer coverage or whose coverage does not meet minimum value and affordability standards will face penalties. Businesses that are required to report employee insurance data should keep worker health coverage forms for at least three years.

Small employers who pay at least 50% of

the health insurance premiums for employee coverage may be eligible for a tax credit providing the insurance is purchased through the Small Business Health Options Program (SHOP) in the Marketplace. The credit amount works on a sliding scale; the smaller the business/non-profit, the larger the credit. An employer with fewer than 25 FTE employees qualifies for some credit if the annual wages paid average no more than $51,800. A full 50% credit goes only to small employers with 10 or fewer FTEs paid annual average wages of $25,900 or less. Qualifying non-profits can get a refundable credit of up to 35%. Even if your small business did not owe tax during the year, the credit can be carried forward or back to other tax years. Premium expenses in excess of the credit can be deducted. For tax years beginning in 2014, the credit is available for no more than two consecutive taxable years.

Beware! Employers who reimburse employees for their individual health insurance premiums (known as Employer Payment Arrangements) or pay the premiums on the employee's behalf will be subject to hefty penalties. Strict rules apply. Compliance with the Affordable Care Act (ACA) provisions can be complex so consult with your advisors for guidance.

Commuter Benefits – The allowances for mass transit as well as parking increase to $255. The benefit for bicycle commuters remains $20 per month when a bike is used for a substantial part of the commute.

Flex Plans – Medical and Dependent Care FSAs can be offered. Employers with medical flex plans: Note! The full amount an employee elects to have taken out of pay for the year must be available at the start of the year. The employer is liable for any amount needed that has not yet been paid in, and the employee need not pay it back if he/she leaves the job before year-end. Dependent Care FSAs, however, are not "pre-funded." The employee can only access whatever funds have been paid in through payroll deductions.

Qualified Retirement Plans

The Retirement Plans Navigator is an IRS guide to retirement plans for small businesses. It compares contribution limits, filing rules, and operational requirements for the various types. Small employers may be eligible for a credit for the start-up costs of a pension plan. Employers must put small ($5,000 or less) payouts from retirement plans into an IRA if a departing employee fails to specify a payout option. If this is done prudently, the employer is not liable for subsequent losses.

Plane Windows

In the 1950s one of the earliest commercial planes, the de Havilland Comet, experienced several tragic crashes. Engineers were at a loss to explain the cause but the mystery was eventually solved. One of the contributing factors was the design of the windows. The pressurization of the cabin concentrated stresses on the corners of the rectangular windows causing them to crack and break apart. To ensure that the stresses were distributed over the entire surface, the windows were redesigned with circular shapes.

myRA – If an employee is not eligible for your employer-sponsored plan or you don't offer a retirement plan, this may be a good option. Contributions can be made with after-tax dollars through payroll deductions with direct deposits to the employee's myRA. Employers do not administer employee accounts, contribute to them, or match.

401(k) – Employers have discretion whether to match employee contributions. Participants can decide how much to contribute (with before tax dollars) through salary deductions. Contribution limits are high, and the plan must be offered to all eligible employees, not just owners and managers.

Roth 401(k) – Firms can offer Roth 401(k)s but must amend earlier 401(k)s to add this feature. The IRS has a model amendment firms can use. Contributions are made with after-tax dollars. The

high contribution limit and tax free withdrawals make this an attractive option. Disadvantages of Roth 401(k)s: non-discrimination and minimum-distribution (after age 70½) rules apply, and employer matches may not be tax favored so keep contributions to regular and Roth 401(k)s segregated. Employers must permit non-spousal IRA rollovers.

SEP (Simplified Employee Pension) – Employers contribute directly to employees' IRAs and avoid much paperwork and reports to the IRS. All eligible employees must be covered. An employer's contribution can't exceed the lesser of 1) 25% of the employee's compensation or 2) $53,000.

SIMPLE – Must include employees who earn $5,000 or more. Employers must make contributions of either 2% of pay or match employee contributions up to 3% of salary, and all eligible employees must be covered. If you have low amounts of self-employment income (for instance, $25,000 or less), a SIMPLE may be just right for you; otherwise, consider a 401(k) or SEP.

Compensation

C Corporations – If you own a small C Corporation in a lower tax bracket, you might save on taxes by taking out more as low-taxed dividends and less as salary. (Not in Personal Service Corporations—they pay a flat 35% rate.) If the IRS thinks your C Corp salary is too high, it may reclassify some of it as a dividend. Profitable C Corps should pay at least some dividends each year. Make clear that bonuses are tied to performance.

S Corporations – Owners: make sure you pay yourself a reasonable salary. If the IRS thinks you take too little in salary from an S Corp, it may reclassify some profits as compensation, on which you'll have to pay payroll taxes.

Deferred compensation plans can deduct payments of benefits to charities, whether or not the benefits are taxable to the payees. (Charities are often contingent beneficiaries if a primary beneficiary dies or disclaims his or her share.)

Employees with leave or vacation pay they are about to forfeit can use the vacation days by year-end or have the cash equivalent placed in their 401(k) accounts. Because they are not allowed to receive cash for it, the IRS says the contributions are free of income and FICA taxes. Make sure highly-paid employees don't have a disproportionate percentage of extra contributions. When employers contribute the dollar value of unused sick leave for retiring employees and buy additional medical coverage for them, the benefits are tax free so long as the workers cannot elect to take cash instead.

Biplane
The planes used in the early days of flight were biplanes, planes with two wings, one above the other. Biplanes were easy to maneuver and were structurally sound but were limited in speed due to the drag produced by the two wings and bracing. As engines became lighter and more powerful, the monoplane began to replace the biplane.

Miscellaneous

If you make more than 40% of your 2016 asset purchases (excluding buildings) in the last quarter, regular depreciation on all 2016 purchases is figured on the mid-quarter basis, so assets bought near year-end get less current year depreciation. This is a complex area; seek professional advice.

Be certain that assets are ready for business use before year-end or they may not qualify for this year's expensing.

If your C Corporation is close to break even for the year, try to achieve a small profit. Why? If the company reports a loss for 2016, it must pay 100% of its year 2017 tax bill through estimated payments to avoid an underpayment penalty. If it owes $1 in tax for 2016, it need pay only $1 in estimated taxes for 2017 to avoid a penalty.

In many cases owners of Limited Liability Companies will owe SECA (self-employment) taxes if they are personally liable for the LLC's debts, can sign contracts for the firm, work for an LLC that provides professional services, or work more than 500 hours a year. Talk to your advisor about your situation.

Farmers

Farmers and ranchers in many drought stricken states have an extended period of time to replace livestock and defer tax on any gains from forced sales. Normally tax is deferred on the extra gains from such sales and the livestock must generally be replaced within four years. If the drought continues, additional extensions may be authorized by the IRS. Eligible counties as designated by the National Drought Mitigation Center can be found on the IRS website.

"Conservation reserve" payments (to keep tillable land idle) are subject to SECA tax as self-employment income (and might cause the farmer to lose Social Security benefits even if the farmer is retired or not engaged in farming). Cost-sharing payments to farmers who adopt conservationist practices are free of income and SECA taxes.

Tips For Small Business

The Small Business and Self-Employed Tax Center at irs.gov is a resource available to you. It provides the tax basics of running a business, videos and webinars, and other online tools and educational products.

The IRS continues to focus on misclassifications of workers as contractors (and violations of fringe benefit and executive pay rules). If you have workers you claim are contractors, give them 1099 forms at year-end. Employees get W-2s. Firms that voluntarily correct misclassifications may be allowed to pay lower penalties. Not so if already under audit.

Is your small business legally obliged to make the premises disabled accessible? Many renovation costs qualify for the disabled access credit, which reduces the business's tax bill dollar for dollar. The first $250 of renovation expenses is excluded; then there's a 50% credit for the first $10,000 of qualified expenses, for a maximum credit of $5,000.

Sole proprietors, partnerships and S Corps can expense new equipment under Section 179 only to the extent they have taxable income, not to show a loss. Unused Section 179 expense can be carried over to future years.

A married couple who jointly owns an unincorporated business may be able to elect not to be treated as a partnership and instead file tax returns as two sole proprietors. Conditions apply.

Keep complete payroll tax records for at least four years.

Adding Spouse to Payroll 2016

Without spouse on payroll	Eligible owner's income	$180,000
	Spouse	-0-
	Family Income	$180,000
	401(k) deferral (1)	$18,000
	Age 50 catch-up (1)	$6,000
	Total 401(k) deferrals	$24,000
With spouse on payroll	Eligible owner's income	$155,000
	Spouse	$25,000
	Family Income	$180,000
	401(k) deferral (2)	$36,000
	Age 50 catch-up (2)	$12,000
	Total 401(k) deferrals	$48,000

Business owners who want to set aside as much as they can for retirement may want to consider adding their spouse to the payroll before year-end. The extra FICA tax paid on the income shifted to the spouse is more than offset by the additional 401(k) contributions.

Extra FICA tax paid on $25,000 income to spouse: (15.3% Co & employee) $3,825

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2016 Income Tax Rates

	Taxable Income		Tax Rate	Total Tax			Phaseout Range of Personal Exemptions
	Over	But not over		Tax is	Plus	Of the amount over	
Married/Filing Jointly (MFJ)	$0	$18,550	10%	$0	10%	$0	
	$18,550	$75,300	15%	$1,855.00	15%	$18,550	
	$75,300	$151,900	25%	$10,367.50	25%	$75,300	
	$151,900	$231,450	28%	$29,517.50	28%	$151,900	$311,300–$433,800
	$231,450	$413,350	33%	$51,791.50	33%	$231,450	
	$413,350	$466,950	35%	$111,818.50	35%	$413,350	
	$466,950		39.6%	$130,578.50	39.6%	$466,950	
Head of Household (HH)	$0	$13,250	10%	$0	10%	$0	
	$13,250	$50,400	15%	$1,325.00	15%	$13,250	
	$50,400	$130,150	25%	$6,897.50	25%	$50,400	
	$130,150	$210,800	28%	$26,835.00	28%	$130,150	$285,350–$407,850
	$210,800	$413,350	33%	$49,417.00	33%	$210,800	
	$413,350	$441,000	35%	$116,258.50	35%	$413,350	
	$441,000		39.6%	$125,936.00	39.6%	$441,000	
Single	$0	$9,275	10%	$0	10%	$0	
	$9,275	$37,650	15%	$927.50	15%	$9,275	
	$37,650	$91,150	25%	$5,183.75	25%	$37,650	
	$91,150	$190,150	28%	$18,558.75	28%	$91,150	$259,400–$381,900
	$190,150	$413,350	33%	$46,278.75	33%	$190,150	
	$413,350	$415,050	35%	$119,934.75	35%	$413,350	
	$415,050		39.6%	$120,529.75	39.6%	$415,050	
Married/Filing Separately (MFS)	$0	$9,275	10%	$0	10%	$0	
	$9,275	$37,650	15%	$927.50	15%	$9,275	
	$37,650	$75,950	25%	$5,183.75	25%	$37,650	
	$75,950	$115,725	28%	$14,758.75	28%	$75,950	$155,650–$216,900
	$115,725	$206,675	33%	$25,895.75	33%	$115,725	
	$206,675	$233,475	35%	$55,909.25	35%	$206,675	
	$233,475		39.6%	$65,289.25	39.6%	$233,475	
Estates & Trusts	$0	$2,550	15%	$0	15%	$0	
	$2,550	$5,950	25%	$382.50	25%	$2,550	
	$5,950	$9,050	28%	$1,232.50	28%	$5,950	
	$9,050	$12,400	33%	$2,100.50	33%	$9,050	
	$12,400		39.6%	$3,206.00	39.6%	$12,400	

Personal Exemption $4,050

2016 Standard Deduction

	Under Age 65	Age 65 and older	
Married/Filing Jointly	$12,600	$13,850 $15,100	(one spouse) (both spouses)
Head of Household	$9,300	$10,850	
Single	$6,300	$7,850	
Married/Filing Separately	$6,300	$7,550	

Blind taxpayers get an extra $1,250 if married; $1,550 if single or head of household.

Itemized Deductions

Reduced for high-incomers but cannot lose more than 80% of your deductions. Phaseout starts at AGI:

MFJ $311,300 HH $285,350 Single $259,400 MFS $155,650

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