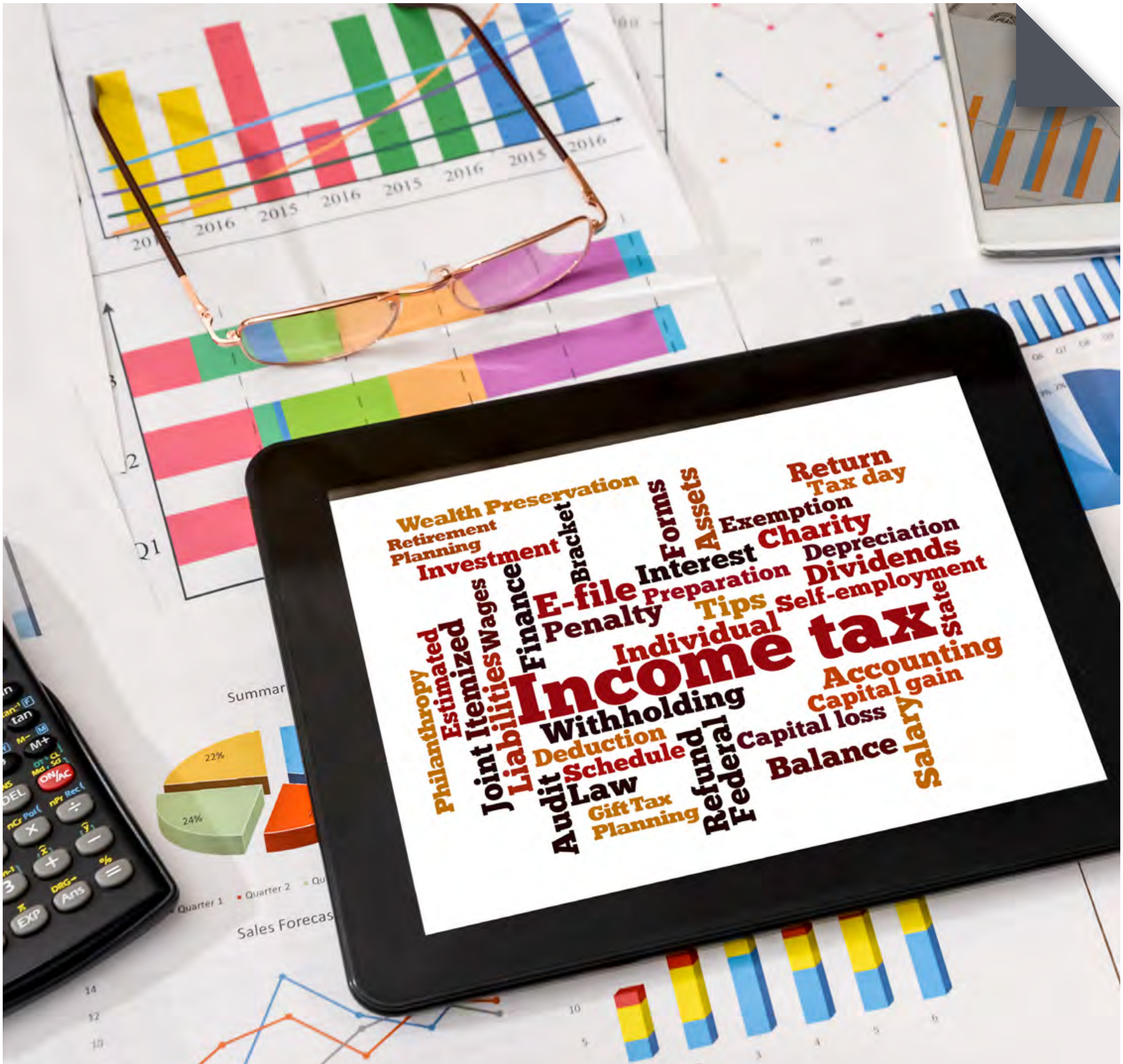

2017 personal tax guide

and tax tips for 2016

EisnerAmper LLP
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INTRODUCTION:
2017 POISED FOR TAX LAW CHANGES

As we begin a new year, we find the higher tax regime resulting from the passage of the American Taxpayer Relief Act of 2012 ("ATRA") continues into 2017. The top federal ordinary income tax rate is at 39.6%, while the top federal long-term capital gains rate is at 20%. The top alternative minimum tax remains at 28%. The top estate and gift tax rate remains at 40% and a $5.49 million gift, estate, and generation-skipping tax exclusion (as adjusted for inflation) is in effect.

The enactment of the Protecting Americans from Tax Hikes Act of 2015 ("PATH") extended many of the tax incentives and credits for businesses and individuals, some on a permanent basis. The Patient Protection and Affordable Care Act ("ACA") continues to impose a 0.9% Health Insurance Tax on earned income for higher income individuals and a 3.8% Medicare Contribution Tax on net investment income. The tax is imposed on the lesser of (a) net investment income, such as interest income, dividends, capital gains and passive income less expenses directly attributable to the production of such income and (b) the excess of modified adjusted gross income over a specified dollar amount ($250,000 for joint filers or a surviving spouse, $125,000 for married filing separately and $200,000 for other taxpayers).

That being said, the election of Donald J. Trump as the 45th president of the United States appears to make tax reform likely in 2017. During the 2016 presidential campaign, tax-related proposals included the following: lower and consolidated individual income tax rates, a cap on itemized deductions, elimination of the personal exemptions and head of household filing status, expansion of tax breaks for families, repeal of the alternative minimum tax, repeal of the Affordable Care Act and elimination of the 3.8% net investment income tax, ordinary income tax treatment of carried interest, reduction of the corporate income tax rate and elimination of the corporate alternative minimum tax, 15% flat rate on pass-through income retained within a business, and repeal of the estate and gift tax. It is also important to note that these proposals may change after President-Elect Trump assumes office. The new administration and the GOP-controlled Congress might move quickly with a package of tax cuts before the summer. We will certainly keep you updated on any new tax reform legislation that is presented.

At the same time, legislation, court decisions and IRS regulations issued in 2016 will impact 2017 and beyond. Here are some of the highlights:

- In March 2016, President Obama signed the Trade Facilitation and Trade Enforcement Act of 2015, which included an increase in the penalty for failure to file a return for returns required to be filed in calendar years after 2015.

- In August 2016, the IRS issued proposed regulations changing the estate tax valuation regime under IRC section 2704. The proposed regulations addressed certain abuses relating to the valuation of interests of corporations and partnerships for estate, gift, and generation-skipping transfer tax purposes with the treatment of lapsing rights and restrictions on liquidation when determining value in intra-family transfers.

- In September 2016, the IRS issued final regulations explaining that marriage for federal tax purposes encompasses both opposite-sex and same-sex marriages. The proposed regulations follow the Supreme Court's decision on same-sex marriage in *Obergefell.*

- In October 2016, the IRS issued final debt-equity IRC section 385 regulations, which establish threshold documentation requirements that must be satisfied for certain related-party interests in a corporation to be treated as debt, and treat as stock certain related-party instruments that normally would be considered debt. While the final regulations tone down the reach of earlier regulations, there is still concern over the broad potential for debt/equity reclassification.

- In December 2016, President Obama signed the 21st Century Cures Act, allowing certain small businesses to use qualified small business health reimbursement arrangements without having imposed penalties for failure to satisfy market reforms under the ACA.

- Congress did not take up before the end of 2016 the extenders which expired at December 31, 2016. These extenders related to energy, higher education tuition and fees deduction, mortgage

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debt forgiveness tax relief and private mortgage insurance deductibility. These extenders may become part of tax reform legislation in 2017.

- The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 changed the filing due dates of many tax returns, effective for the 2016 tax returns due in 2017. We have included in our guide a new Appendix E, which highlights these new changes.

- The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 also mandated reporting to assure that a beneficiary's basis in certain property acquired from a decedent be consistent with the value of the property for estate tax purposes. Because executors were not prepared to comply with this requirement, the IRS had issued several extensions of the initial filing. Final regulations confirmed that no further extensions beyond June 30, 2016 would apply to the initial reporting and that the rule going forward requires reporting within 30 days of filing Form 706.

The international arena still continues to be of concern to many individuals and families. The global threat of terrorism, the confrontation with Russia over hacking U.S. systems and the Ukraine, BREXIT and the EU, and perennial hot spots such as North Korea, China's economic slowdown, the Panama Papers, inversions and global M&A continue to be significant issues.

Many families with wealth are concerned about their children's and grandchildren's future, and wonder what can be done to sustain and grow their wealth in these uncertain times. With the many law changes cited above, the likelihood of new tax reform legislation and the current economic and geopolitical conditions, it is extremely important that you pay attention to your financial position so that you can achieve your financial goals. Specific items such as retirement planning, managing cash flow, financing the cost of your children's college education and transferring your family's wealth to the next generation should be top-of-mind in 2017. Indeed, 2017 will most certainly be a pivotal year for taxes and tax planning.

We have written this guide to provide you with a tool to identify opportunities to minimize tax exposure, accomplish your financial goals, and preserve your family's wealth. The guide includes all major law changes through January 1, 2017. The best way to use this guide is to identify areas that may be most pertinent to your unique situation and then discuss the matter with your tax advisor. As always, our tax professionals will be pleased to discuss any of the ideas in this guide or any other planning opportunities which might apply to your personal situation.

This guide is meant not only to assist with the preparation of your 2016 income tax returns, but also to plan for 2017 and beyond. Because of the real possibility that tax reform impacting 2017 may be enacted after the publication of this guide, please be sure to check in with us before proceeding with any tax planning transactions.

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This tax guide highlights tax planning ideas that may help you minimize your tax liability. This guide does not constitute accounting, tax, or legal advice, nor is it intended to convey a thorough treatment of the subject matter. The best way to use this guide is to identify those issues which could impact you, your family, or your business and then discuss them with your tax advisor.

The discussion in this guide is based on the Internal Revenue Code as amended through January 1, 2017. Future legislation, administrative interpretations, and judicial decisions may change the advisability of any course of action. Because of periodic legislation changes, you should always check with your tax advisor before implementing any tax planning ideas.

Any tax advice contained in this publication (including any attach–ments) is not intended for and cannot be used for the purpose of (i) avoiding penalties imposed by the Internal Revenue Code or (ii) promoting, marketing, or recommending any transaction or matter addressed herein.

tax planning strategies

In addition to saving income taxes for the current and future years, effective tax planning can reduce eventual estate taxes, maximize the amount of funds you will have available for retirement, reduce the cost of financing your children's education, and assist you in managing your cash flow to help you meet your financial objectives.

Tax planning strategies can defer some of your current year's tax liability to a future year, thereby freeing up cash for investment, business, or personal use. This can be accomplished by timing when certain expenses are paid, or controlling when income is recognized. Tax planning allows you to take advantage of tax rate differentials between years. However, if tax rates rise in a subsequent year, extra caution may be necessary. If monitored properly, tax planning can also help you minimize, or even prevent, the impact of the alternative minimum tax ("AMT") and preserve the tax benefit of many of your deductions.

The key things you should understand as you look for ways to minimize your taxes are:

- Residents of states with high income and property taxes, such as New York, California, Connecticut, Pennsylvania and New Jersey, are most likely to be subject to the AMT.
- The current top long-term capital gains tax rate is 20%. Including the additional 3.8% Medicare Contribution Tax on net investment income, the top long-term capital gains rate could be 23.8% and the top short-term capital gains tax rate could be as much as 43.4%.
- Under current law, the complex netting rules have the potential effect of making your long-term capital gains subject to short- term rates, so you must carefully time your security trades to ensure that you receive the full benefit of the lowest capital gains tax rate.
- There may be limitations on the deductibility of your itemized deductions ("Pease" provision) and on the allowable amount of your personal exemptions provision ("PEP") based on your adjusted gross income ("AGI"). Various phaseouts that reduce your deductions and/or exemptions can increase your tax liability and your effective tax rate.
- Consider the impact that the additional Medicare Contribution Tax on net investment income will have on your particular tax situation. Certain direct and indirect expenses, such as margin interest and state taxes, may decrease the surtax and it may make sense to prepay these expenses, even if you are projected to be in the AMT.
- Gift and estate taxes can reduce the amount your beneficiaries will receive by 40% to 50%, depending on which state you are resident of at date of death. However, there are planning techniques and strategies available to maximize the amount of wealth that is preserved for your family.

TAX PLANNING GOALS

Proper tax planning can achieve the following goals:

- Reduce the current year's tax liability.
- Defer the current year's tax liability to future years.
- Reduce any potential future years' tax liabilities.
- Maximize the tax savings from allowable deductions.
- Minimize the effect of the AMT on this year's tax liability.
- Maximize tax savings by taking advantage of available tax credits.
- Maximize the amount of wealth that stays in your family.
- Minimize capital gains tax.
- Minimize the Medicare Contribution Tax on net investment income.
- Avoid penalties for underpayment of estimated taxes.
- Increase availability of cash for investment, business or personal needs by deferring your tax liability.
- Manage your cash flow by projecting when tax payments will be required.
- Minimize potential future estate taxes to maximize the amount left to your beneficiaries and/or charities (rather than the government).
- Maximize the amount of money you will have available to fund your children's education as well as your retirement.

YEAR-END TAX PLANNING TIPS

Tax Tip 1 provides a snapshot of key strategies geared toward helping you achieve your planning goals. It includes ideas to help you reduce your current year's tax as well as ideas to reduce any potential future taxes. While this chart is not all inclusive, it is a good starting point to help you identify planning ideas that might apply to your situation. Keep in mind that many of the strategies involve knowing what your approximate income, expenses and tax rates will be for the current and subsequent years and then applying the applicable tax law for each year to determine the best path to follow. Implementation of many of these ideas requires a thorough knowledge of tax laws, thoughtful planning and timely action.

Timing when you pay deductible expenses and when you receive income (to the extent you have control) can permanently reduce your taxes — especially if you are subject to the AMT in one year but not another. Timing expenses and income can also defer some of your tax liability to next year (or even later years) giving you, rather than the government, use of your money.

To gain the maximum benefit, you need to project, as best you can, your tax situation for the current and subsequent years. This will help you identify your tax bracket for each year and determine whether the AMT will likely affect you in either or both years. Your year-to-date realized long- and short-term capital gains and losses should be included in your projections. Be sure to consider prior-year loss carry forwards (if any). Based on these results, you can decide what steps to take prior to year-end. You will be able to decide whether or not you should prepay deductions and defer income, defer expenses and accelerate income, realize capital losses, or lock in capital gains.

Tax Tip 2 offers basic guidance for deciding when to prepay or defer deductible expenses and when to defer or collect taxable income.

Tax Tip 3 offers steps to follow relating to realized capital gains and/or losses, and the type of gains and losses you should trigger.

STEPS TO TAKE IF THE AMT APPLIES EITHER THIS YEAR OR NEXT

As a general rule, if your year-end projection indicates that you will be in the AMT, it is very important that you do not pay any of the following expenses prior to the end of the year, as they are not deductible in computing your AMT and you will not receive a tax benefit from the deduction:

- State and local income taxes
- Real estate taxes
- Miscellaneous itemized deductions such as investment expenses and employee business expenses

Conversely, if you are not projected to be in the AMT in the current year, you should try to prepay as many of the above expenses as possible to receive the maximum tax benefit. Keep in mind, though, that the more you prepay, the more likely you will end up in the AMT.

EXPENSES YOU CAN PREPAY

Here are the most common deductible expenses you can easily prepay by December 31, if appropriate:

Charitable Contributions
You can deduct charitable gifts of cash and tangible personal property, such as clothing and household goods, up to 50% of your AGI and charitable gifts of appreciated capital gain properties up to 30% of your AGI.

State and Local Income Taxes
If you are not in the AMT this year, you can prepay before December 31 your fourth-quarter estimated state tax payment due on January 15 of the following year, as well as any state income tax you project will be due on April 15 of the following year. You will gain the benefit of a tax deduction in the current year and protect those deductions that could be lost if you fell into the AMT next year. Prepaying these taxes will probably outweigh any lost earnings on the use of the funds. However, be careful that the prepayment itself doesn't put you into the AMT. Prepayment of state income taxes may also reduce the Medicare Contribution Tax to the extent that such taxes are allocated against any investment income. As a result, you may wish to consider such prepayment even if it puts you into the AMT.

Real Estate Taxes
Like state and local income taxes, prepaying next year's real estate taxes prior to year-end can be an especially beneficial strategy should you end up subject to the AMT next year, but not in the current year.

Miscellaneous Itemized Deductions
Miscellaneous itemized deductions are deductible for regular income tax purposes only if they exceed, in the aggregate, 2% of your AGI. Bunching these deductions to gain the most favorable tax result may be a viable strategy, as a tax benefit is received if you are not subject to the AMT. Investment expenses may also reduce the Medicare Contribution Tax on net investment income.

tax tip

1 KEY TAX PLANNING STRATEGIES

Situation	Planning idea	Detailed discussion
Your regular tax rate will be the same or lower next year and the AMT will not apply in either year.	• Prepay deductions. • Defer income.	Page 7 Page 10
Your regular tax rate will increase next year and the AMT will not apply in either year.	• Defer deductions. • Accelerate income, but only if the tax rate increase warrants accelerating tax payments.	Page 10
The regular tax rate applies this year and is higher than the AMT rate that you expect will apply next year.	• Prepay deductions, especially if they are not deductible against the AMT and would therefore be lost next year. These deductions include state and local income taxes, real estate taxes, and miscellaneous itemized deductions such as investment fees. • Defer income.	Page 25
This year you are in the AMT and next year you will be subject to a higher regular tax rate.	• Defer deductions, especially those not allowed against the AMT that would be lost this year. • Accelerate income.	Page 23
You have net realized capital losses this year or loss carryforwards from last year.	• Consider recognizing capital gains by selling appreciated securities to offset realized losses and loss carryforwards, thereby locking in the appreciation.	Page 11
You have net realized capital gains this year.	• Sell securities with unrealized losses to offset the gains — if market conditions justify it. • Use a bond swap to realize losses. • Consider tax implications of netting rules. • Avoid wash sale rules. • Consider the implications of the Medicare Contribution Tax on net investment income.	Page 11 Page 38 Page 35 Page 38 Page 18
You are contemplating purchasing new business equipment.	• Accelerate the purchases into 2016 to take advantage of section 179 deductions available this year. (Qualified purchases must be placed in service in 2016.)	Page 28
Your miscellaneous deductions will be reduced due to the limitation based on 2% of your AGI.	• Bunch these deductions into a single year, thereby increasing the deductible amount. Make sure you avoid the AMT. To the extent that these deductions are investment expenses they can reduce the Medicare Contribution Tax on net investment income.	Page 12
A penalty for underpayment of estimated taxes will apply.	• Withhold additional amounts of tax from your wages before December 31. • Prepay fourth quarter estimates due January 15 and increase the payment amount, if necessary. • Have withholding taken out of your retirement plan distribution.	Page 21
You want to diversify a concentrated low-basis stock position and avoid paying taxes currently.	• Consider using a charitable remainder trust that will allow you to sell the stock in exchange for an annuity. This will allow you to defer the tax while benefiting a charity of your choice.	Page 66

tax tip

1 KEY TAX PLANNING STRATEGIES

Situation	Planning idea	Detailed discussion
You have incentive stock options that you can exercise.	• Consider exercising your options to start the long-term holding period, but only if the spread between the market price of the stock and the exercise price will not put you into the AMT.	Page 42
Your passive activity losses exceed your passive income.	• Dispose of an activity that is generating passive losses in order to deduct the suspended loss on that activity. However, consider the impact of the Medicare Contribution Tax on net investment income on net passive income.	Page 53
You would like to make significant charitable contributions.	• Donate appreciated securities you have held for more than one year. • Consider establishing a charitable trust or a private foundation, or take advantage of a donor-advised fund. • Consider donating partial interests in certain assets such as a conservation easement, remainder interest in real estate or art work to a museum.	Page 63 Page 65 Page 64
You need funds for personal use, such as improvements to your home in excess of the mortgage limitations or to pay tax liabilities.	• Sell marketable securities with little or no appreciation to fund your needs, and then use margin debt to purchase replacement securities. The interest on the debt will be deductible, subject to investment interest limitations. The interest may also reduce the Medicare Contribution Tax on net investment income. • Take distributions, if available, from partnerships, limited liability companies, or S corporations on income that you have already paid taxes on. Be sure you have sufficient tax basis and are "at risk" in the entity.	Page 72 Page 30
You want to take advantage of the tax-deferred nature of retirement accounts.	• Maximize your contributions to your retirement accounts and take advantage of the best plans available to you prior to December 31.	Page 76
You expect the value of your IRA to appreciate over time, and you want to position your IRA now so that there will be little or no tax impact when you or your beneficiaries take distributions later.	• Consider converting your traditional IRA into a Roth IRA in the current year. However, this will cause a current tax liability, since the converted amount is subject to income tax in the year of the conversion.	Page 79
You have a sizeable estate and want to protect your assets from estate tax.	• Make gifts of $14,000 to each individual in 2016, and again in 2017. • Pay beneficiaries' tuition and medical expenses directly to the providers. • Use your lifetime gift tax exclusion of $5.45 million effective for 2016, $5.49 million effective for 2017; for subsequent years, the exclusion will be indexed for inflation.	Page 85
You want to transfer assets to your designated beneficiaries during your lifetime.	• Create a grantor retained annuity trust ("GRAT"). • Set up a family limited partnership ("FLP") or family limited liability company ("FLLC"). • Make loans to your beneficiaries at minimum required interest rates.	Page 88 Page 88 Page 87
You want to provide for your children's and/or grandchildren's qualified education costs.	• Establish and fund a 529 plan that can grow tax-free as long as you use the funds to pay qualified education expenses.	Page 97

Mortgage Interest

Consider prepaying your mortgage payment for next January in the current year in order to accelerate the deduction.

Margin Interest

Be sure to pay any margin interest before December 31, since interest accrued at year-end is only deductible if actually paid. This may also reduce the Medicare Contribution Tax on net investment income.

Business Equipment

You could accelerate the purchases of business equipment before the end of 2016 to take advantage of expensing allowances, subject to certain limitations. To qualify, the property must be placed in service in the year of the intended deduction. Certain deductions taken in 2015 were at the more beneficial levels, as the deduction for Qualified Leasehold Improvements is no longer available for tax years ending after December 31, 2015.

INCOME YOU CAN ACCELERATE OR DEFER

Timing income can be more difficult than timing deductions, but here are some types of income that you may be able to control the timing of receipt so you can gain the advantage of having the income taxed in a year that you are in a lower tax bracket.

Cash Salaries or Bonuses

If you anticipate your current year's income tax rate to be lower than next year's rate, you can accelerate salary or bonuses into the current year. You would need to determine if there are strict limitations on amounts that can be accelerated. However, if next year's rate is lower than your current year's rate, it may make sense to defer such income until next year provided the income is not constructively received (made available to you in the current year).

tax tip 2

AMT TAX PLANNING STRATEGIES

	You will not be in the AMT this year or next year and next year's tax rate		You are in the AMT*		
Nature of deduction or income	**will be the same as the current year or will decrease**	**will increase**	**only this year**	**this year and next year**	**only next year**
Charitable contributions, mortgage interest, investment interest and self-employed expenses	Prepay	Defer	Defer	Prepay	Prepay
State and local income taxes, real estate taxes, and miscellaneous deductions that are not deductible if you are in the AMT	Prepay	Defer	Defer	Defer	Prepay
Income such as bonuses, self-employed consulting fees, retirement plan distributions, and net short-term capital gains (unless you have long-term losses offsetting the gains)	Defer	Collect	Collect	Defer	Defer
Miscellaneous itemized deductions bunched (not deductible for the AMT) into a single year to exceed the 2% AGI income floor	Prepay	Defer	Defer	Defer	Prepay

Legend: *Prepay before the end of the current year/Defer into next year or later/Collect before the end of the year*

**The chart assumes your regular tax rate on ordinary income is higher than the maximum AMT rate of 28%.*

Consulting or Other Self-Employment Income

If you are a cash-basis business and you anticipate your current year's tax rate to be lower than next year's rate, you can accelerate income into the current year. Otherwise, you would want to defer such income.

Retirement Plan Distributions

If you are over age 59½ and your tax rate is low this year, you may consider taking a taxable distribution from your retirement plan even if it is not required, or consider a Roth IRA conversion.

The law that allowed tax-free distributions from individual retirement accounts ("IRAs") to public charities made by individuals age 70½ of up to $100,000 has been made permanent. The provision allows an individual to exclude the distribution from income; thereby reducing the limitations based on a percentage of AGI and also reducing state taxable income.

Capital Gains

The following ideas can lower your taxes this year:

- If you have unrealized net short-term capital gains, you can sell the positions and realize the gains in the current year if you expect next year's tax rate to be higher. This may be a good strategy if the gain will be taxed at the AMT rate of 28% this year but at 39.6% next year (exclusive of the additional Medicare Contribution Tax). Only consider this strategy if you do not otherwise intend to hold the position for more than 12 months, making it eligible for the long-term capital gain rate of 20%, exclusive of the additional Medicare Contribution Tax. However, you may be able to apply the netting rule which may result in the offsetting of long-term losses to short-term gains, resulting in a tax savings of 39.6% rather than 20%.

- Review your portfolio to determine if you have any securities that you may be able to claim as worthless, thereby giving you a capital loss before the end of the year. A similar rule applies to bad debts.

- Consider a bond swap to realize losses in your bond portfolio. This swap allows you to purchase similar bonds and avoid the wash sale rule while maintaining your overall bond positions.

- Similarly, you may consider selling securities this year to realize long-term capital gains that may be taxed at the more favorable rate this year, and then buying them back to effectively gain a step-up in basis. Since the sales are at a gain, the wash sale rules do not apply.

Real Estate and Other Non-Publicly Traded Property Sales

If you are selling real estate or other non-publicly traded property at a gain, you would normally structure the terms of the arrangement so that most of the payments would be due next year. You can use the installment sale method to report the income. This would allow you to recognize only a portion of the taxable gain in the current year to the extent of the payments you received, thereby allowing you to defer much of that tax to future years.

tax tip 3

YEAR-END CAPITAL GAINS AND LOSSES

If you have	Consider taking these steps
Both short-term and long-term losses	Sell securities to recognize unrealized gains, preferably if held short-term, up to the amount of your losses less $3,000.
Long-term gains in excess of short-term losses	Take losses equal to the net gain, plus $3,000. Use long-term loss positions first, then short-term loss positions.
Both short-term and long-term gains, or short-term gains in excess of long-term losses	Take losses equal to the net gain, plus $3,000. Use long-term loss positions first to gain the benefit of offsetting short-term gains (taxed at a rate as high as 39.6% plus 3.8% Medicare Contribution Tax on net investment income).
Worthless securities and bad debts	Identify these securities and debts and take the necessary steps to ensure that the losses are deductible in the current year, by having the proper substantiation.

Note: *If you are married filing separately substitute $1,500 for $3,000 in the above tip.*

U.S. Treasury Bill Income
If you have U.S. Treasury Bills maturing early next year, you may want to sell these bills to recognize income in the current year if you expect to be in a lower tax bracket this year than next year.

BUNCHING DEDUCTIONS

Bunching miscellaneous itemized deductions from two different years into a single year may allow you to exceed the 2% AGI limitation that applies to these deductions. If you have already exceeded the 2% floor, or will do so by prepaying some of next year's expenses now, prepay the following expenses by December 31 (assuming you will not be in the AMT this year):

Investment Expenses
These include investment advisory fees, custody fees, and investment publications. Such expenses may also reduce the Medicare Contribution Tax on net investment income.

Professional Fees
The most common of these fees relate to income, gift, and estate tax planning; tax return preparation; accounting; and legal expenses (to the extent deductible).

Unreimbursed Employee Business Expenses
These include business travel, meals, entertainment, vehicle expenses and publications, all exclusive of personal use. You must reduce expenses for business entertainment and meals (including those while away from home overnight on business) by 50% before the 2% floor applies.

Medical Expenses
These expenses are deductible only if they exceeded 10% of your AGI (also 10% for AMT purposes). The threshold is 7.5% of AGI for any tax year beginning before January 1, 2017 for taxpayers who have attained age 65 before the close of such year. Therefore, bunching unreimbursed medical expenses into a single year could result in a tax benefit. Medical expenses include health insurance and dental care. If you are paying a private nurse or a nursing home for a parent or other relative, you can take these expenses on your tax return even if you do not claim the parent or relative as your dependent, assuming you meet certain eligibility requirements.

ADJUST YEAR-END WITHHOLDING OR MAKE ESTIMATED TAX PAYMENTS

If you expect to be subject to an underpayment penalty for failure to pay your current-year tax liability on a timely basis, consider increasing your withholding and/or make an estimated tax payment between now and the end of the year in order to eliminate or minimize the amount of the penalty.

UTILIZE BUSINESS LOSSES OR TAKE TAX-FREE DISTRIBUTIONS

It may be possible to deduct losses that would otherwise be limited by your tax basis or the "at risk" rules. Or, you may be able to take tax-free distributions from a partnership, limited liability company or S corporation if you have tax basis in the entity and have already been taxed on the income. If there is a basis limitation, consider contributing capital to the entity or making a loan under certain conditions. See further discussion in the chapter on business owners.

PASSIVE LOSSES

If you have passive losses from a business in which you do not materially participate that are in excess of your income from these types of activities, consider disposing of the activity. The tax savings can be significant since all losses become deductible when you dispose of the activity. Even if there is a gain on the disposition, you can receive the benefit of having the long-term capital gain taxed at 23.8% inclusive of the Medicare Contribution Tax with all the previously suspended losses offsetting ordinary income at a potential tax benefit of 43.4% inclusive of the Medicare Contribution Tax.

INCENTIVE STOCK OPTIONS

Review your incentive stock option plans ("ISOs") prior to year-end. A poorly timed exercise of ISOs can be very costly since the spread between the fair market value of the stock and your exercise price is a tax preference item for AMT purposes. If you are in the AMT, you will have to pay a tax on that spread, generally at 28%. If you expect to be in the AMT this year but do not project to be next year, you should defer the exercise. Conversely, if you are not in the AMT this year, you should consider accelerating the exercise of the options; however, keep in mind to not exercise so much as to be subject to the AMT.

ESTATE PLANNING

If you have not already done so, consider making your annual exclusion gifts to your beneficiaries before the end of the year. You are allowed to make tax-free gifts of up to $14,000 per year, per individual ($28,000 if you are married and use a gift-splitting election, or $14,000 from each spouse if the gift is funded from his and her own separate accounts). By making these gifts, you can transfer substantial amounts out of your estate without using any of your lifetime exclusion. Also, try to make these gifts early in the year to transfer that year's appreciation out of your estate. The annual exclusion for gifts in 2017 remains unchanged at $14,000. You could gift $14,000 to an individual in 2016 and another $14,000 to the same individual in 2017 and not incur any gift taxes. Again, this benefit is doubled if you are married and use the gift-splitting election. Furthermore, because of the increased lifetime gift exclusion, you may wish to make additional gifts to fully utilize such exclusion of $5.45 million each ($10.9 million for married couples) in 2016. The 2017 lifetime gift exclusion has been increased to $5.49 million each ($10.98 million for married couples). When combined with other estate and gift planning techniques such as a grantor retained annuity trust, tax planning strategies may enable you to avoid estate and gift taxes and transfer a great deal of wealth to other family members (who may be in a lower income tax bracket or may need financial assistance).

TAX STRATEGIES FOR BUSINESS OWNERS

Timing of Income and Deductions

If you are a cash-basis business and expect your current year's tax rate to be higher than next year's rate, you can delay billing until January of next year for services already performed in order to take advantage of the lower tax rate next year. Similarly, even if you expect next year's rate to be the same as this year's rate, you should still delay billing until after the year-end to defer the tax to next year. Alternatively, if you expect to be in a higher tax bracket next year, or if you expect to be in the AMT this year, you can accelerate billing and collections into the current year to take advantage of the lower tax rates.

You also have the option to prepay or defer paying business expenses in order to realize the deduction in the year that you expect to be subject to the higher tax rate. This can be particularly significant if you are considering purchasing (and placing in service) business equipment. If you are concerned about your cash flow and want to accelerate your deductions, you can charge the purchases on the company's credit card. This will allow you to take the deduction in the current year when the charge is made, even though you may not actually pay the outstanding credit card bill until after December 31.

Business Equipment

Tax benefits are available for immediate deduction of business equipment purchased and placed in service in 2016. The amount allowable for full deduction in 2016 under Section 179 is $500,000 if property placed in service does not exceed $2,000,000. The 50% bonus depreciation is currently available for 2016 on Qualified Improvement Property, however, 50% bonus depreciation is no longer available on Qualified Leasehold Improvements.

Business Interest

If you have debt that can be traced to your business expenditures — including debt used to finance the capital requirements of a partnership, S corporation or LLC involved in a trade or business in which you materially participate — you can deduct the interest "above-the-line" as business interest rather than as an itemized deduction. The interest is a direct reduction of the income from the business. This allows you to deduct all of your business interest, even if you are a resident of a state that limits or disallows all of your itemized deductions.

Business interest also includes finance charges on items that you purchase for your business (as an owner) using the company's credit card. These purchases are treated as additional loans to the business, subject to tracing rules that allow you to deduct the portion of the finance charges that relate to the business items purchased. Credit card purchases made before year-end and paid for in 2017 are allowable deductions in 2016 for cash basis businesses.

CONCLUSION

Now, more than ever, effective planning is crucial if one is to achieve certain financial goals and realize tax savings.

tax rate overview

The effective rate of federal tax on income ranges from 0% to 56%.

As a result of the American Taxpayer Relief Act of 2019 ("ATRA"), the Bush-era tax cuts were extended and made permanent for married taxpayers with taxable income below $466,950 in 2016 ($470,700 in 2017) and single taxpayers with income below $415,050 in 2016 ($418,400 in 2017). These amounts will be adjusted for inflation in the future.

The rate of tax you pay on your income — as well as the benefit you receive from your deductions — can vary from no tax at all to a rate of approximately 56% depending on many factors, including:

- What is the nature of your income? Is it ordinary income, qualifying dividend income or net long-term capital gain income?
- Are you losing the advantage of the lower long-term capital gains rate because of netting rules?
- Are you subject to the AMT?
- Are you subject to the Medicare Contribution Tax on net investment income?
- Are you subject to the Medicare Wage Surcharge?
- Is any of your income subject to self-employment tax?
- How much of your miscellaneous itemized deductions and total itemized deductions are being limited?
- Are your personal exemptions being phased out?
- Is any of your income eligible to be excluded from your taxable base?
- Are credits available to offset your tax?

The most common federal tax rates (exclusive of the Medicare Contribution Tax on net investment income) are:

- 20% for net long-term capital gains and qualified dividends for taxpayers in the 39.6% tax bracket, such as for married taxpayers with 2016 taxable income over $466,950 ($415,050 for single filers).
- 28% for ordinary income subject to the AMT.
- For 2016, 39.6% maximum rate for ordinary income, including short-term capital gains for married taxpayers with taxable income over $466,950 ($470,700 in 2017) and $415,050 for single filers ($418,400 in 2017).
- The top rate for the first $118,500 of wages earned in 2016 ($127,200 in 2017) is approximately 48% and 56% for self-employment income. The portion of Social Security FICA tax that employees pay remains unchanged at 6.2% on the first income listed herein (12.4% for self-employed individuals). The Medicare portion of the FICA tax remains unchanged at 1.45% on all income earned for employees. For the self-employed, the rate is 2.9% of all self-employment income. Also, there is the additional 0.9% additional Medicare tax paid by those earning more than $200,000 ($250,000 for married taxpayers and $125,000 for married taxpayers filing separately).

ORDINARY INCOME RATES

Ordinary income primarily includes wages, business and self-employment income, interest income, nonqualifying dividend income, taxable retirement plan distributions, rental income, taxable Social Security benefits, alimony, and your distributive share of ordinary income passing through to you from a partnership, LLC or S corporation.

Net short-term capital gains are subject to the same rate as ordinary income and, therefore, could be taxed at a rate as high as 43.4%, inclusive of the Medicare Contribution Tax on net investment income. Chart 1 shows the different tax brackets that apply to ordinary income in 2016 and 2017 for married filing jointly and single taxpayers.

CAPITAL GAIN AND DIVIDEND INCOME RATES

Long-term capital gains and qualified dividend income are eligible to be taxed at lower maximum tax rates than ordinary income. This is discussed in detail in the chapter on capital gains and losses. But here are the basic rules:

Net long-term capital gains are taxed at a maximum rate of 20% (if your taxable income exceeds certain thresholds) for both the regular tax and the AMT — with several notable exceptions to be discussed in the chapter on capital gains and losses. In some cases, the former 15% rate may still apply. To benefit from long-term capital gains treatment, you must have held the asset for more than 12 months. There is an additional 3.8% Medicare Contribution Tax on net investment income, including net long-term capital gains.

For 2016, dividends received from most domestic corporations and qualified foreign corporations are taxed at the same 15% rate that applies to net long-term capital gains (20% for married taxpayers with taxable income over $466,950 ($470,700 in 2017) and $415,050 ($418,400 in 2017) for single filers). Dividends that do not qualify for the preferential rate of 15% (or 20%), such as dividends from a money market fund or nonqualified foreign corporations, are subject to the higher ordinary income tax rates. There is an additional 3.8% Medicare Contribution Tax on net investment income that will also apply to dividend income.

chart 1

2016 AND 2017 FEDERAL TAX RATE SCHEDULES

2016 FEDERAL TAX RATE SCHEDULES

Taxable Income	Base Tax	Marginal Tax Rate (Tax on Next Dollar)
Married Filing Jointly or Qualifying Widow(er)		
$ 0	$ 0	10%
18,550	1,855.00	15%
75,300	10,367.50	25%
151,900	29,517.50	28%
231,450	51,791.50	33%
413,350	111,818.50	35%
466,950	130,578.50	39.6%
Single		
$ 0	$ 0	10%
9,275	927.50	15%
37,650	5,183.75	25%
91,150	18,558.75	28%
190,150	46,278.75	33%
413,350	119,934.75	35%
415,050	120,529.75	39.6%

2017 FEDERAL TAX RATE SCHEDULES

Taxable Income	Base Tax	Marginal Tax Rate (Tax on Next Dollar)
Married Filing Jointly or Qualifying Widow(er)		
$ 0	$ 0	10%
18,650	1,865.00	15%
75,900	10,452.50	25%
153,100	29,752.50	28%
233,350	52,222.50	33%
416,700	112,728.00	35%
470,700	131,628.00	39.6%
Single		
$ 0	$ 0	10%
9,325	932.50	15%
37,950	5,226.25	25%
91,900	18,713.75	28%
191,650	46,643.75	33%
416,700	120,910.25	35%
418,400	121,505.25	39.6%

Note: *See Appendix B for detailed 2016 tax rate schedules, including tax rates for married taxpayers filing separately and taxpayers filing as head of household. See Appendix C for detailed 2017 tax rate schedules, including tax rates for married taxpayers filing separately and taxpayers filing as head of household.*

ALTERNATIVE MINIMUM TAX

Ordinary income subject to the AMT is taxed at a maximum rate of 28%. As mentioned above, the 15% or 20% rate on net long-term capital gains and qualified dividends also applies to the AMT. While the AMT rate on ordinary income is lower than the highest regular tax rate of 39.6%, it usually applies to a higher taxable income base and frequently results in a greater tax. This is especially true if you live in a state with high income tax rates and high real estate taxes, and/or you have significant investment expenses in excess of 2% of your AGI, since these deductions are not allowed in computing your AMT. See the chapter on the AMT for a more detailed discussion.

KIDDIE TAX

The unearned income of a child under age 19, or a full-time student under age 24, is generally taxed at the parents' tax rate. This is designed to lessen the effectiveness of intra-family transfers of income-producing property that would shift income from the parents' higher marginal tax rate to the child's generally lower tax rate. For 2016 and 2017, the first $1,050 of the child's unearned income is tax-free. The next $1,050 for 2016 (and 2017) is taxed at the child's marginal rate. Any excess of unearned income above $2,100 is then taxed at the parents' marginal rate (assuming the parents' rate is higher than the child's). To the extent that the child has earned income such as wages, that income is taxed at the child's marginal rate. Unearned income such as net long-term capital gains and qualifying dividend income is eligible for the preferential tax rate of 15% or 20% to the extent that rate applies to the parents' income. The child may also be subject to the Medicare Contribution Tax on net investment income (see below).

EMPLOYMENT TAXES

Your wages and self-employment income are also subject to Social Security and Medicare taxes. The amount of income subject to the Social Security tax is limited (see Chart 2), but all earned income is subject to the Medicare Contribution Tax.

If you are self-employed, your share of Social Security and Medicare taxes almost doubles because you pay both the employer's and employee's portions of these taxes. As a result, for 2016, the federal effective tax rate on self-employment income can be as high as 56% on the first $118,500 of such income, compared to about 48% for income from wages (after including your employee share of Social Security and Medicare taxes). The reason there is not a greater spread is primarily because you receive a deduction against AGI for 50% of the self-employment tax you pay.

chart 2

SOCIAL SECURITY AND MEDICARE TAXES FOR 2016 AND 2017

Maximum Income Subject to Tax			Tax Rates/Maximum Tax Cost	
			Employer and Employee Portion	Self-Employed
Social Security	**2016**	$118,500	6.2%/$7,347 each	12.4%/$14,694
	2017	$127,200	6.2%/$7,886.40 each	12.4%/$15,772.80
Medicare	**2016**	No limit	1.45%/No limit 2.35%/No limit**	2.678%/No limit* 3.578%/No limit**
	2017	No limit	1.45%/No limit 2.35%/No limit**	2.678%/No limit* 3.578%/No limit**

** The tax rate is actually 2.9%, but only 92.35% of self-employment income is subject to the Medicare Tax.*

***Includes 0.9% Hospital Insurance Tax for amounts above certain income thresholds.*

MEDICARE WAGE SURTAX

An additional 0.9% Hospital Insurance Tax applies to earned income. This tax applies to wages and/or self-employment income in excess of $250,000 for married couples filing joint returns, $125,000 for married filing separate returns and $200,000 for all other taxpayers. The threshold amounts are not indexed for inflation.

MEDICARE CONTRIBUTION TAX ON NET INVESTMENT INCOME

The Health Care and Education Reconciliation Act of 2010 provided for a 3.8% tax on net investment income of higher income taxpayers for years beginning in 2013.

The additional 3.8% tax will apply if your AGI (with certain modifications) is in excess of $250,000 for a joint return (and qualifying widow(er) with dependent child), $200,000 if single, and $125,000 if married filing separate. The tax will apply to the lesser of your net investment income or your AGI in excess of the applicable threshold amounts stated above. Net investment income includes interest, dividends, capital gains, annuities, royalties, rents, income from passive business activities and income from trading in financial instruments or commodities. The amount of gross investment income may be reduced by expenses associated with earning that income. Such expenses include directly allocable state and local taxes, investment advisory fees (over 2% of AGI), and investment interest expenses.

The maximum federal tax rate on long-term capital gains and qualified dividends will be 23.8% (20% plus 3.8% additional Medicare Contribution Tax on net investment income). The threshold amounts are not indexed for inflation.

ITEMIZED DEDUCTIONS AND PERSONAL EXEMPTIONS

Reduction of miscellaneous itemized deductions
You must reduce certain miscellaneous itemized deductions by 2% of your AGI. The deductions subject to the 2% disallowance include investment advisory fees, unreimbursed employee business expenses, professional dues and subscriptions, tax return preparation fees and deductible legal expenses.

Reduction of itemized deductions
For 2016, the reduction of itemized deductions affects married taxpayers with AGI over $311,300 ($313,800 in 2017) and single taxpayers with AGI over $259,400 ($261,500 in 2017). Certain itemized deductions are to be reduced by the lesser of 3% of the amount by which AGI exceeds a certain limit or 80% of the itemized deductions subject to the reduction rules.

Personal exemptions
The personal exemption amount ("PEP") for 2016 (and 2017) is $4,050 for each of your qualifying dependents. The 2016 PEP begins to phase out for married taxpayers with AGI over $311,300 ($313,800 in 2017) and single taxpayers with AGI over $259,400 ($261,500 in 2017). It completely phases out for married taxpayers at $433,800 for 2016 ($436,300 in 2017) and for single taxpayers at $381,900 for 2016 ($384,000 in 2017).

FOR 2016 AND BEYOND

PATH permanently extended the option to claim an itemized deduction for state and local general sales tax in lieu of an itemized deduction for state and local income taxes, effective for taxable years beginning after December 31, 2014. A taxpayer may either deduct the actual amount of sales tax paid in a tax year or, alternatively, deduct an amount prescribed by the IRS.

estimated tax requirements

A penalty will apply if a taxpayer fails to make sufficient estimated tax payments during the year. The appropriate combination of quarterly estimated tax payments and withholdings on wages (and certain other income) can enable the taxpayer to avoid this penalty. Proper tax planning may help you minimize the required estimated tax payments and avoid the underpayment penalty.

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AVOIDING THE PENALTY

You will not owe the penalty for the underpayment of estimated taxes if the amount of taxes you pay (through withholding and/or timely paid estimated tax payments) is the lesser of:

- 90% of the actual tax shown on your current year's tax return, or
- 110% of the tax on your prior year's tax return based on a safe harbor exception (100% if the AGI on your prior year's return was $150,000 or less, or $75,000 if married filing separately), or
- 90% of your actual tax for the current year based on the annualized income installment method (see Tax Tip 4).

The penalty is determined on a quarterly basis combining the withholding tax and timely paid quarterly estimated taxes. You may still owe the penalty for an earlier due date shortage, even if you pay the tax in later quarters to make up the underpayment. It may be possible to avoid this situation by using the annualized income installment method (see Tax Tip 4). Alternatively, you may increase withholding taxes to be applied evenly throughout the year.

WHAT'S NEW FOR 2016 AND 2017?

When estimating your income tax liability, make sure to consider the following changes commencing for tax years beginning in 2016 and 2017:

- **Tax rates remained stable.** For 2016 and subsequent years the individual income tax rates will remain at 10, 15, 25, 28, 33, 35 and 39.6% for ordinary income. The top rate for long-term capital gains and qualified dividends will remain at 20%. The applicable threshold amounts for the 2016 top tax rates are: $466,950 for married filing jointly; $441,000 for head of household; $415,050 for single; and $233,475 for married filing separately. The 2017 applicable thresholds are $470,700 for married filing jointly; $444,550 for head of household; $418,400 for single; and $235,350 for married filing separately.
- **Personal exemption phaseouts increased.** For tax years beginning in 2016, the personal exemption amount is increased to $4,050 (remains at $4,050 in 2017) for taxpayers with AGI at or below $311,300 if married filing jointly ($313,800 in 2017); $285,350 if head of household ($287,650, in 2017); $259,400 ($261,500, in 2017) if single, or $155,650 ($156,900 in 2017) if married filing separately. The personal exemption amount for taxpayers with AGI above these amounts may be reduced.
- **AMT exemption amount increased.** The AMT exemption amount, which is indexed annually for inflation, has increased to $53,900 in 2016 for single taxpayers, $83,800 for married filing jointly and $41,900 if married filing separately. For 2017, the amounts are $54,300 for singles, $84,500 for married filing jointly, and $42,250 for married filing separately.
- **Increase in employee's share of payroll tax.** For 2016, employee's wages up to the Social Security limitation of $118,500 were withheld at the rate of 6.2%. For 2017, the Social Security limitation is increased to $127,200. There is no change in Medicare withholding.
- **Lifetime learning credit income limits increased.** For 2016, in order to claim the maximum lifetime learning credit, modified AGI must be less than $55,000 ($111,000 if married filing jointly). Modified AGI above these levels gradually phases out the credit, with no credit available for AGI in excess of $65,000 ($131,000 for married joint filers). For 2017, the amount is increased to $56,000 ($112,000 if married filing jointly).

tax tip

4 USE THE ANNUALIZED INCOME INSTALLMENT METHOD TO REDUCE YOUR QUARTERLY ESTIMATES AND ELIMINATE THE UNDERPAYMENT OF ESTIMATED TAX PENALTY

The annualized income installment method is a pay-as-you-go method to calculate the required quarterly estimated tax payments.

You may receive income, such as business income, bonuses and capital gains, unevenly throughout the year. If you expect to earn more income in the latter part of 2017 than in the first months of the year, or pay deductible expenses earlier in the year, you can reduce your quarterly estimated tax payments by paying the tax based on actual quarterly tax projections. This method provides a way to pay less estimated tax than the safe harbor method based on 110% (or 100% if applicable) of your actual prior year tax for the quarter with lower income. If your income changes in a subsequent quarter, you may increase or decrease the future estimated tax payments accordingly.

You can also use the annualized income method to reduce a potential penalty on your 2017 return. If the safe harbor exception based on 110% of your 2016 tax or 90% of your actual 2017 tax does not eliminate the penalty, you can still use the annualized income method when preparing your 2017 return to reduce or eliminate the penalty.

- **Tax benefits extended.** Some special tax incentives known as "extenders" had expired after 2014. However, these provisions have been reinstated retroactively for 2015 and beyond as a result of PATH.

  1. IRA distributions to a qualified charitable organization. Up to a maximum of $100,000 per taxpayer will be tax free if the distribution from an IRA account to a public charity is made by a taxpayer age 70½ or older. This special distribution will satisfy the minimum distribution requirements. This provision has been made permanent and is effective for distributions made in taxable years beginning after December 31, 2014.

  2. Work Opportunity tax credit for unemployed veterans extended through taxable years beginning on or before December 31, 2019.

  3. Deduction for qualified tuition and related expenses extended through December 31, 2016.

  4. Nonbusiness energy credits extended through December 31, 2016.

  5. Exclusion from income the cancellation of indebtedness of up to $2 million on a qualified principal residence extended through December 31, 2016.

OTHER TAX CONSIDERATIONS

- **Additional Medicare Tax on Earned Income.** A 0.9% additional Medicare tax applies to Medicare wages and self-employment income. This additional Medicare tax applies to income over the threshold of $250,000 for married filing jointly and $200,000 for any other filing status ($125,000 for married filing separately).

- **Net Investment Income Tax (NIIT).** There is a surtax of 3.8% on the lesser of net investment income or the excess of modified AGI over the threshold amount. The threshold amount is $250,000 for joint filers or a surviving spouse ($125,000 for married filing separately) and $200,000 for any other filing status.

YEAR-END PLANNING ACTIONS

If your year-end planning indicates that you have already met the 90% test, you may not need to pay some or all of your fourth quarter estimated tax installment.

If you realize before year-end that you may owe the penalty for underpayment of estimated tax, you can still reduce or eliminate your penalty by taking one or more of the following actions:

- **Pay more tax through salary or other withholdings.** Since any tax paid through withholdings will be treated to have been paid evenly throughout the year, an individual may increase his or her withholding tax before year-end to minimize the underpayment tax penalty attributable to a prior quarter. There are several ways to achieve this:

  1. Increase your W-2 withholding tax for the remaining pay periods this year.

  2. Withhold more than the required bonus rate of 25% (39.6% rate if the bonus exceeds $1 million) at year-end.

  3. Withhold tax from pension or IRA distributions if you are qualified to do so.

- Increase your estimated tax payment to eliminate the penalty for the fourth quarter.

- Lower your taxable income (if otherwise desirable) by using the year-end tax planning strategies presented in this guide to reduce the quarterly underpayment.

- Eliminate or mitigate the underpayment by using the annualized income installment method.

Caution: *If you withdraw money from an IRA and have taxes withheld, you will need to replenish the IRA within 60 days with the gross amount withdrawn, not just the net amount (i.e., assuming you still want the money in a tax-deferred retirement account).*

As part of year-end planning, you should consider the current penalty rates. If the penalty rates are relatively low (which has been the case in recent years) and the cash can be invested at higher rates, it may be more cost efficient to just pay the penalty.

STATE TAX CONSIDERATIONS

The foregoing discussion of tax planning suggestions may also apply to state and local income tax penalties.

alternative minimum tax

The AMT was designed to prevent wealthy taxpayers from using tax loopholes to avoid paying taxes. Because historically the exemption from the AMT had not been automatically adjusted for inflation and certain common deductions were not allowed in computing the AMT, millions of middle class taxpayers were finding themselves subject to the AMT. However, Congress provided some annual relief in the recent past by installing "AMT patches" which increased the AMT exemption.

ATRA permanently increased the AMT exemption beginning in 2012 and provided for indexing of the exemption for 2013 and beyond. Since ATRA increased income tax rates for certain taxpayers beginning in 2013, fewer people may be subject to the AMT while paying a higher overall rate. Proper planning requires a 2-year analysis in order to determine the true benefits you can achieve.

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WHAT TRIGGERS THE AMT?

The AMT is computed separately from your regular tax. Using your regular taxable income as a starting point, adjustments are made to arrive at your alternative minimum taxable income ("AMTI"). Many deductions and tax credits that are used to calculate your regular tax are not deductible or allowable in computing AMTI. So, even though the AMT maximum tax rate is less than the regular maximum tax rate, your AMT liability may be higher than your regular tax. You will pay the higher of the regular tax or the AMT.

Chart 3 shows most of the adjustments necessary to calculate your AMTI. As the chart illustrates, certain deductions, such as state and local income taxes and real estate taxes, are not deductible when computing your AMTI. Other deductions, such as depreciation on business property, may be different for regular tax and AMT purposes. And some forms of income are exempt for regular tax purposes but taxable for AMT purposes. One example is the exercise of incentive stock options to the extent the fair market value exceeds the exercise price.

Tax Tip 5 demonstrates the high cost of being in the AMT.

Tax Tip 6 explains how state taxes on long-term capital gains and qualified dividends may trigger the AMT.

PRIVATE ACTIVITY BOND INTEREST

Tax-exempt interest on specified private activity bonds issued in 2009 and 2010 are no longer an item of tax preference and, therefore, not subject to the AMT. However, the interest on such bonds issued before 2009 and after 2010 is still subject to the AMT.

AMT RATES

For 2016, the 28% maximum tax rate applies to ordinary AMTI in excess of $186,300 for joint returns and unmarried individuals ($187,800 for 2017) and $93,150 if married filing separately ($93,900 for 2017) net of any allowable exclusion. Ordinary AMTI of $186,300 or less is subject to a tax rate of 26%. Net long-term capital gains and qualified dividends are taxed at the same maximum 20% rate for both the AMT and regular tax beginning in tax year 2013.

AMT EXEMPTION

Beginning in 2013, the exemption amount is indexed for inflation. For 2016, you are allowed an AMT exemption of up to $83,800 ($84,500 for 2017) if married filing jointly, $53,900 ($54,300 for 2017) if filing single or head of household or $41,900 ($42,250 for 2017) if married filing separately. Exemptions are fully phased out for taxpayers when their AMTI reaches $498,900 (married filing jointly), $337,900 (single or head of household) or $249,450 (married filing separately).

Be advised that while you are in the AMT exemption phase out range, your marginal AMT tax rate can be as high as 35%.

PLANNING FOR AMT SCENARIOS

Tax planning can help you determine whether or not you will be subject to the AMT. This can enable you to take steps to reduce your overall tax liability. Using Chart 3 to guide you, here are 3 possible AMT scenarios to plan for:

You are subject to the AMT in the current year, but don't expect to be next year:

- Defer until the following year any deductions that are not deductible for AMT purposes. Avoid the pitfall of automatically prepaying your state income taxes before the end of the year.
- Taxpayers with large itemized deductions that are disallowed for AMT but considered a direct expense that can be deducted when computing net investment income may want to consider taking such deductions in the current year, even if in the AMT. Expenses such as state and local taxes paid, investment fees, etc. are directly allocable to net investment income and can be used to lower the 3.8% surtax even if the deductions are not allowed for AMT purposes.
- Accelerate ordinary income into the current year to benefit from the lower AMT rate.
- Realize net short-term capital gains this year to benefit from the lower AMT rates, unless these gains will offset short-term losses next year or would otherwise be held long term.
- Delay exercising any incentive stock options ("ISOs") since you could wind up paying the AMT on the spread between the fair market value and the exercise price. If you already exercised the options, consider a disqualifying disposition as discussed in the chapter on stock options. Also, see the rule discussed later in this chapter that may offer some credit relief for the AMT resulting from the exercise of ISOs.

tax tip

5 THE HIGH COST OF THE AMT

Failing to consider the AMT and incorrectly timing the payment of some of your deductions can be costly. Let's say that before December 31, 2016, you paid the following expenses:

- $15,000 state estimated fourth quarter tax payment (due January 15, 2017),
- $10,000 in real estate taxes (not due until January, 2017), and
- $20,000 in charitable contributions that you could have delayed until 2017.

Income	Regular Tax After Year-End Payments	AMT
Earned income	$ 200,000	$ 200,000
Qualifying dividends	25,000	25,000
Long-term capital gains	175,000	175,000
Total income	**$ 400,000**	**$ 400,000**
Deductions		
State & local income taxes	$ 100,000	$ 0
Real estate taxes	20,000	0
Mortgage interest	50,000	50,000
Contributions	40,000	40,000
Investment advisory fees	25,000	0
Disallowance of advisory fees (2% of AGI)	(8,000)	0
3% AGI Floor	(2,661)	0
Net itemized deductions	**$ 224,339**	**$ 90,000**
Personal exemptions (married with 2 children) (after phaseouts)	4,536	0
Taxable income	**$ 171,125**	**$ 310,000**
Federal tax	**$ 14,374**	**$ 35,287**
Medicare Contribution Tax on net investment income	5,054	5,054
Total federal tax (including Medicare Contribution Tax on net investment income)	**$ 19,428**	**$ 40,341**

Because you must pay the higher of the two taxes, your tax will be $40,341 — that's $20,913 of AMT tax in excess of your regular tax. Therefore, you lost the full benefit from the prepayment of your state estimated tax and real estate taxes, as well as some of the benefit of prepaying charitable contributions.

You are not subject to the AMT in the current year and will be taxed at the regular tax rate of 39.6% but expect to be subject to the AMT next year:

- Prepay deductions that are not deductible for AMT purposes to get the full tax benefit in the current year rather than lose the tax benefit next year.
- Prepay your fourth-quarter state and local income tax estimate by December 31, as well as any projected remaining balance due on your current year's state/local income tax return that you would otherwise pay on April 15 of the following year.
- Prepay deductions that are deductible against the AMT, such as charitable contributions, to gain the benefit of the higher ordinary tax rate in the current year.
- Defer ordinary income, such as bonuses if possible, to the following year to take advantage of the lower AMT rate.
- Review your ISO awards to determine if you can exercise any shares before the end of the year. The exercise will be tax-free this year up to the extent of the break-even point between your regular tax and the AMT. In the following year, any exercises will result in an AMT liability based on the fair market value of the shares at the time of exercise over the exercise price.

You are not subject to the AMT in either year:

- You have avoided the AMT, but you still want to reduce your regular tax liability in the current year. Turn to the chapter on tax planning strategies for year-end planning ideas that can minimize your tax exposure.

AMT CREDIT CAN REDUCE FUTURE TAXES

If you pay the AMT, you may be entitled to a tax credit against your regular tax in a subsequent year. You qualify for an AMT credit based on "deferral items" that contributed to your AMT liability. The most common deferral items are depreciation adjustments, passive activity adjustments and the tax preference on the exercise of ISOs. Other deductions, such as state and local income taxes and investment fees, are called exclusion items. You cannot get an AMT credit from these deductions. The AMT illustrated in Tax Tip 5 would not create an AMT credit since none of the adjustments are deferral items.

The reason a deduction is classified as a deferral item is because over time you will end up with the same total deductions for both regular tax and AMT purposes. As an example, a depreciation difference is a deferral item if it is calculated using a different asset life and method for AMT purposes then used for regular tax purposes. However, over the life of the asset the total depreciation will be the same under either tax computation. Special rules apply for bonus depreciation. See the chapter on business owners and depreciation deductions.

tax tip

6 LONG-TERM CAPITAL GAINS AND QUALIFYING DIVIDEND INCOME CAN PUT YOU INTO THE AMT

Long-term capital gains and qualifying dividend income can cause you to be subject to the AMT, even though both are taxed at the maximum tax rate of 20% for regular tax purposes and for the AMT. The reason for this is that when you pay state and local taxes on the income, which reduces your regular tax liability, these taxes are not deductible in computing your AMT. Therefore, your AMT taxable income is higher than your regular taxable income.

As an example, let's say you file a joint return and your income only included a long-term capital gain of $600,000 and, as a New York City resident, your state and city income tax was $60,000. Ignoring all other deductions, exemptions, phaseouts and rate differentials, your regular taxable income would be $540,000 after the $60,000 deduction. At the maximum tax rate of 20%, your regular tax would be $108,000. Your AMT liability would be $120,000 ($600,000 taxed at the same maximum rate of 20%) because you are not allowed a deduction for state and local income taxes. Therefore, you would pay the higher of the 2 taxes (an additional cost of $12,000). Keep in mind that not all of the long-term capital gains (regular or AMT) will be taxed at the 20% rate, since there is also a 15% rate applied up to certain income thresholds.

If you find yourself in this tax situation, avoid paying your state and local income taxes in the year of the sale. To the extent possible, consider deferring the payments until next year if there is a possibility that you will not be in the AMT and you may therefore receive a federal tax benefit.

Keep in mind that if you are subject to the Medicare Contribution Tax on net investment income, consideration should be given to paying expenses that are allocable in arriving at net investment income even if they are not deductible for AMT purposes.

chart 3

AMT VS. REGULAR TAX

Description	Deductible in Computing: Regular Tax	Deductible in Computing: AMT	Taxable for AMT Only	Other AMT Differences
State and local income taxes (non-business)	▪			
Real estate taxes (personal)	▪			
Qualified Motor Vehicle Tax (State or local sales tax or excise tax on purchase)	▪			
Investment interest expense	▪	▪		
Charitable contributions	▪	▪		
Investment advisory fees	▪			
Employee business expenses (W-2)	▪			
Mortgage interest on:				
• Qualified acquisition and equity debt up to $1,000,000 used to buy, build, or improve your residence	▪	▪		
• Equity debt (up to $100,000) not used to improve your residence	▪			
Note: *Interest on acquisition debt in excess of $1 million and equity debt over $100,000 is not deductible as mortgage interest, but the debt is subject to the interest tracing rules to determine if deductible as interest on other debt, such as investment interest.*				
Medical expenses in excess of 10% of AGI*	▪	▪		
Exercise of incentive stock options (to the extent the fair market value exceeds the exercise price)			▪	
Depreciation (subject to different AMT rules)				▪
Gain or loss on disposition of certain assets, including sale of small business stock				▪
Passive activity adjustments				▪
Interest on private activity bonds issued before 2009 and after 2010				▪
Net operating losses (subject to different AMT rules)				▪

**For regular tax purposes, the medical expense threshold is 7.5% for any tax year beginning after December 31, 2012 and before January 1, 2017 for taxpayers who have attained age 65 for close of such year. The threshold increases to 10% for all beginning January 1, 2017.*

business owner issues and depreciation deductions

Individuals who are owners of a business, whether as sole proprietors or through a partnership, limited liability company or S corporation, have specific tax planning opportunities available to them.

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TAX ADVANTAGES FOR BUSINESS OWNERS

A self-employed individual, or owner of an operating business through a partnership, LLC, or S corporation, may have additional tax planning opportunities available. Unlike a salaried employee, a self-employed person's business deductions can offset AGI, rather than be characterized as itemized deductions, subject to various limitations and disallowances.

TIMING OF INCOME AND DEDUCTIONS

If you are in a cash-basis business, you can delay billing until January of the following year for services already performed, thereby deferring the tax until next year. Alternatively, if you expect to be in a higher tax bracket in the following year, or if the AMT applies in the current year but is not expected to apply in the following year, you can accelerate billing and collections into the current year to take advantage of the lower tax rate.

Similarly, you can prepay or defer paying business expenses so the deduction occurs in the year you expect to be subject to the higher tax rate. This choice can be particularly significant if you are considering purchasing (and placing in service) business equipment, as the next section addresses. If cash flow is a concern, you can accelerate the business's deductions by charging them on a credit card. This method allows you to take a deduction in the current year, when the charge is made, even though you may actually pay the bill containing those credit card charges in January of the following year. (The credit card rule only applies where the seller of the goods/services is different from the credit card company.)

Another advantage of deferring income or prepaying expenses is the opportunity to defer the 2.9% Medicare component of self-employment taxes. If the total of self-employment income plus wages is below $118,500 in 2016 ($127,200 in 2017), you can also reduce the Social Security tax.

Caution: *It is important to consider the impact of the imposition of the additional 3.8% Medicare Contribution Tax on net investment income and the 0.9% Health Insurance Tax on earned income.*

BUSINESS EQUIPMENT

Effective for tax years beginning after December 31, 2014, PATH permanently extends the Section 179 small business expensing limitations to $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property during the taxable year exceeded $2,000,000. These amounts are indexed annually for inflation.

Qualified property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. PATH treats air conditioning and heating units placed in service in tax years beginning after 2015 as eligible for expensing.

Special rules, which prior to 2015 allowed expensing for computer software and qualified real property (e.g., qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property) have been extended permanently.

Observation: *The basis of property for which a section 179 election is made is reduced by the amount of the section 179 deduction. The remaining basis of the asset is depreciable under the normal rules.*

The 15-year straight line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements has also been extended.

BONUS DEPRECIATION

PATH extends bonus depreciation for property acquired and placed in service from 2015 through 2019 (with an additional year for certain property with a longer production period). The bonus depreciation percentage is 50% for property placed in service during 2015, 2016 and 2017 and phases down, with 40% in 2018 and 30% in 2019.

Bonus depreciation is available for eligible property, such as qualified improvement property and computer software, with a recovery period of less than 20 years.

Under the new rules, qualified improvement property includes the interior portion of the building which is non-residential real estate placed in service after the year the building was first placed in service. The qualified improvement cannot enlarge the building, nor can it be an elevator, escalator or internal framework. The remaining portion of the qualified improvement property would be eligible for 39-year depreciation or 15-year depreciation provided it also met the test to be qualified real property.

Taxpayers can continue to elect to accelerate the use of AMT credits in lieu of bonus depreciation.

BUSINESS INTEREST

If you have debt traced to business expenditures — including debt used to finance the capital requirements of a partnership, S corporation or LLC involved in a trade or business in which you materially participate — you can deduct the interest as a business expense, rather than an itemized deduction. Business interest also includes finance charges on items that an owner purchases for the business using a credit card. These purchases are treated as additional loans to the business, subject to tracing rules which permit a deduction of that portion of the finance charges relating to the business items purchased.

The interest is a direct reduction of the business's income and the full deduction of business interest is permitted. Taxpayers should keep in mind that state laws concerning the deductibility of business interest expense may differ.

HOME OFFICE DEDUCTIONS

If you use part of his home for business, you may be able to deduct the business portion of the costs of running your home, such as real estate taxes, mortgage interest, rent, utilities, insurance, painting, repairs and depreciation. The home office deduction is available to both renters and homeowners, but is subject to an overall limitation that will prevent you from deducting a net loss from your business resulting from your home office deductions.

Generally, you must meet 2 requirements to qualify for the home office deduction:

- You must regularly use part of your home exclusively for a trade or business. Incidental or occasional business use is not regular use. "Exclusive use" means a specific area of your home is used only for trade or business activities.

- The home office must be your principal place of business. This requirement can be satisfied if the home office is used for the administrative or management activities of a business and there is no other fixed location where you can conduct these activities.

If you deduct depreciation for a home office in your principal residence, your ability to fully use the taxable gain exclusion on the sale of the principal residence will be limited because the portion of the gain attributable to your home office is not eligible for this exclusion. See the discussion in the chapter on principal residence sale and rental.

Expenses that are deductible only because the home is used for business (such as the business portion of home insurance and utilities) are limited to the gross income derived from the use of the home. Unused deductions are carried over to the subsequent year but are subject to limitations calculated on that year. Expenses which would have been otherwise deductible, such as real estate taxes and qualified home mortgage interest, are not subject to these limitations.

Taxpayers can choose a simplified option to calculate the home office deduction. The requirements for the deduction remain the same for both methods, but the recordkeeping and calculation is simplified. Under the streamlined option, the standard deduction is $5 per square foot used for the business, up to a maximum of 300 square feet; home-related itemized deductions are claimed in full on Schedule A; and there is neither depreciation nor depreciation recapture for any year the simplified option is used. The taxpayer may elect either the simplified method or the regular method for a taxable year on a timely filed original federal income tax return (including extensions). Once selected, a taxpayer may not change the method for a particular year but may use a different method in a subsequent year.

START-UP EXPENSES

The amount of capitalized business start-up expenses eligible for deduction in the year the active business commences (rather than amortization over 180 months) is $5,000, reduced (but not below zero) by the amount the start-up expenses exceed $50,000. Expensing is automatic and no longer requires a formal election. Nevertheless, taxpayers wishing to elect out must affirmatively choose to capitalize the costs on a timely filed federal income tax return (including extensions). The election either to deduct or to capitalize start-up costs is irrevocable and applies to all of the taxpayer's start-up costs. Capitalized start-up costs must be amortized over 180 months.

ORGANIZATION COSTS

A taxpayer may expense up to $5,000 of organization costs (reduced by amount which exceeds $50,000). The excess must be amortized over 180 months. Expensing is automatic and no formal election is necessary. Affirmatively electing to amortize the organization costs on a timely filed return (including extensions) will be considered "opting out" of the expense election.

SELF-EMPLOYED HEALTH INSURANCE DEDUCTION

As a self-employed individual, you can deduct 100% of the health insurance premiums you pay for yourself, your spouse, your dependents, and any of your children under the age of 27 as of the end of the tax year. This deduction applies if you are a general partner in a partnership, a limited partner receiving guaranteed payments, or a more-than-2% shareholder who receives wages from an S corporation. You can also deduct the premiums paid for eligible long-term care insurance policies as self-employed health insurance subject to certain limitations. Medicare premiums also qualify for this deduction.

Note: *These rules only apply for any calendar month in which the taxpayer is not otherwise eligible to participate in any subsidized health plan maintained by any employer of yours or of your spouse, or any plan maintained by any employer of your dependent or your under-age-27 child.*

UTILIZE BUSINESS LOSSES OR TAKE TAX-FREE DISTRIBUTIONS

If you have an interest in a partnership, LLC or S corporation, you can deduct losses from the entity only to the extent that you have tax basis and are "at-risk" for the losses. If you have a loss from any of these entities which may be limited, you may want to make a capital contribution (or a loan) before year-end to enable deduction of the loss. Nevertheless, those losses may still be subject to and limited by the passive activity loss rules. For further information, see the chapter on passive and real estate activities.

You can take tax-free distributions from a partnership, LLC or S corporation if you have tax basis in the entity and have already been taxed on the pass-through income. Since you are taxed on your share of the income of pass-through entities, regardless of whether or not distributions were made, you may have paid tax in a prior year, or will pay in the current year, on income that you have not received. Therefore, you can take a distribution without paying additional tax, if funds are available and the entity permits such distributions, to the extent of your tax basis and at-risk amount in the entity. However, there are certain special considerations for distributions from S corporations.

SELF-EMPLOYMENT TAX

Your net earnings from self-employment are subject to Social Security and Medicare taxes. As a self-employed individual, your share of these taxes is almost doubled since you pay both the employer's and employee's portions of these taxes. However, if you are also a salaried employee, any wages will offset the portion of your self-employment earnings subject to the Social Security tax.

The self-employment tax rate is 15.3%, which consists of 12.4% Social Security tax and 2.9% Medicare tax. The maximum amount of combined 2016 wages and self-employment earnings subject to the 12.4% Social Security tax is $118,500 ($127,200 in 2017). There is no limitation on self-employment income subject to the 2.9% Medicare tax. An additional 0.9% Hospital Insurance tax (which, combined with the 2.9% Medicare tax, will total 3.8%) will be imposed on self-employment income in excess of $250,000 for joint returns, $125,000 for married taxpayers filing separate returns and $200,000 in all other cases. See the chapter on tax rate overview.

Because of these taxes, the federal effective tax rate on self-employment income can be as high as 56%, compared to approximately 48% for wage income (after including your employee's share of Social Security and Medicare taxes). The reason the spread is not greater is primarily because you receive a deduction against AGI for 50% of the self-employment tax paid. For further information, see the chapter on tax rate overview.

PENSION AND PROFIT SHARING PLANS

Rules governing contributions to, and distributions from, retirement plans are very complex, so an entire chapter is dedicated to this discussion. You should refer to that chapter for more specific information, including various plan restrictions.

NET OPERATING LOSS CARRYBACKS

Net operating losses can be carried back 2 years and carried forward 20 years.

Note: *A taxpayer can elect to relinquish the carryback period if a timely election is filed. Taxpayers whose losses are de minimis or who expect to be in a higher tax bracket in future years may benefit from this election.*

REPORTING REQUIREMENTS FOR EMPLOYEE STOCK PURCHASE PLANS AND ISOs

Corporations are subject to certain reporting requirements related to employee stock purchase plans and incentive stock options. See the chapter on stock options, restricted stock, and deferred compensation plans.

FINAL REPAIR/CAPITALIZATION REGULATIONS

The IRS released the final "repair regulations" which affected tax years beginning on or after January 1, 2014. These regulations distinguished the circumstances under which business owners must capitalize costs from those in which they can deduct expenses for acquiring, maintaining, repairing, and replacing tangible property.

The final regulations included an expensing rule which provides a safe harbor for taxpayers to deduct certain amounts paid to acquire or produce tangible property. If the company has an Applicable Financial Statement ("AFS") and a written accounting policy for expensing amounts paid or incurred for such property, up to $5,000 per invoice can be deducted. Therefore, taxpayers should have had this written policy in place by the end of 2015 in order to qualify for 2016 and beyond. Elections are made on an annual basis.

Note: *The AFS is defined as an audited financial statement.*

There are certain relief provisions applicable to smaller businesses. As of January 1, 2016, a company without an AFS may deduct up to $2,500 per item or invoice as long as it has a written expensing policy in place at the beginning of the tax year.

In addition, taxpayers should consider whether to adopt the $200 safe harbor expensing rule for materials and supplies.

Caution: *The specific facts and circumstances of each business taxpayer will dictate which safe harbors, tax return elections and accounting method changes might be required or appropriate. Some elections require a simple attachment to the business's tax return; others may necessitate the filing a Form 3115 as a change of accounting method.*

New for 2016

In December 2016, the IRS extended the 5-year eligibility limitation waiver for certain automatic changes of accounting made to comply with these regulations. Specifically, the IRS extended the liberal waiver rule for one year beginning before January 1, 2017. A transition rule now generally allows taxpayers whose non-automatic consent requests were pending on December 20, 2016 to switch to the automatic consent procedures.

AFFORDABLE CARE ACT

The Patient Protection and Affordable Care Act of 2010 ("ACA"), along with the Health Care and Education Reconciliation Act, represents the most significant regulatory overhaul of the U.S. health care system since the passage of Medicare and Medicaid in 1965.

ACA was enacted to increase the quality and affordability of health insurance through the use of mandates, subsidies and insurance exchanges. The following are the major considerations of the ACA:

- Large Employer Mandate

The ACA requires that an applicable large employer pay an excise tax if:

1. The employer fails to offer its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan and any full-time employee is certified to the employer as having a premium assistance tax credit or cost-sharing reduction; or
2. The employer offers its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan, but the plan is either underfunded or too expensive. Also, at least one or more full-time employee is certified as having a premium assistance tax credit or cost-sharing reduction.

The Premium Assistance Tax Credit was designed to help offset the cost of health insurance coverage obtained through the marketplace.

An applicable large employer is defined as one that employs within one calendar year an average of at least 50 full-time employees (including full-time equivalent employees). A full-time employee for every calendar month is an employee who has an average of at least 30 hours of service per week or at least 130 hours of service during the calendar month. For example, 40 full-time employees employed 30 or more hours per week on average plus 20 employees employed 15 hours per week on average are equivalent to 50 full-time employees. Seasonal workers are taken into account under special rules in determining the number of full-time employees. Seasonal workers are workers who perform services on a seasonal basis, including retail workers employed exclusively during the holiday season.

- Employer and Insurer Reporting

The ACA generally requires applicable large employers to file an information return which reports the terms and conditions of the employer-provided health care coverage for its full-time employees. Other parties, such as health insurance plans, have similar reporting requirements.

The reporting began in the first quarter of 2016. Separate from this rule, the ACA requires employers with 250 or more employees to provide the cost of the applicable employer-sponsored coverage on the employee's Form W-2, "Wage and Tax Statement." Employers should be aware that the 2015 good faith exception to missing or incorrect date on Forms 1094-C and 1095-C has terminated; therefore, they should be consider reliable reporting alternatives for 2017.

- Small Business Health Care Tax Credit

The ACA provides a tax credit to encourage eligible small employers to provide health insurance coverage to their employees. An eligible taxpayer can claim the Code Section 45B credit for 2 consecutive years beginning with the first tax year on or after 2014. A taxpayer may claim the credit for tax years beginning in 2010 through 2013 without those years counting towards the 2-consecutive-year period.

An eligible small employer is one with no more than 25 full-time equivalent employees who earn an average annual wage not exceeding $52,000 in 2016 (this number is indexed for inflation). The employer must also have a qualifying arrangement in which it pays a uniform percentage of not less than 50% of the premium cost of a qualified health plan that it offers to its employees through a small business health options program ("SHOP") marketplace.

The maximum credit is 50% of the premiums paid for small business employers and 35% for small tax-exempt employers. Small business employers can carry the credit back or forward and are permitted to deduct the premiums paid in excess of the credit as a business expense.

• Individual Mandate

Beginning January 1, 2014, individuals must carry minimum essential coverage for each month or make a "shared responsibility payment" (penalty) with his or her tax return. Minimum essential coverage is that from an employer-sponsored plan, coverage obtained through a state or federal marketplace, Medicare, Medicaid, most student health plans or other similar plans.

For 2016, the penalty is the greater of $695 or 2.5% of taxable income. There is a family maximum penalty of $2,085. The 2016 amounts will be adjusted for inflation.

Planning Opportunity: *By January 1, 2017, employers facing the increased costs of health insurance coverage must have decided if they would "pay or play." In other words, they must have chosen either to meet the minimum essential coverage requirements, or incur a penalty. Business owners should consider their company's entire employee compensation package, including the cost-effectiveness of their retirement plans, and perhaps revamping their entire compensation strategy to obtain and retain human capital.*

The 21st Century Cures Act was enacted in December 2016 and generally allows small businesses to continue to offer health-reimbursement arrangements to employees without violating market reforms under the ACA and risking an excise tax of $100 per day per affected participant.

LEGISLATION AFFECTING 2016

The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 was signed into law on July 31, 2015 and changed tax return due dates and extensions for tax years beginning after December 31, 2015, impacting the 2017 filing season. For C corporations, the new due date is the 15th day of the 4th month following the end of the tax year. For calendar year C corporations, the new due date will be April 15. Generally, a 6-month extension will be granted. C corporations with a June 30 year-end maintain the September 15 due date until 2026. For partnerships, the new due date is the 15th day of the 3rd month following the end of the year, or March 15 for a partnership with a calendar year-end. Partnerships will be granted a 6-month extension, so the extended due date will be September 15. S corporations' original due date of March 15 remains unchanged.

PATH includes a new requirement requiring employers to file their copies of Form W-2 with the Social Security Administration by January 31, 2017. The new January 31 filing deadline also applies to certain Forms 1099-MISC reporting non-employee compensation such as payments to independent contractors. Only one 30-day extension is available to file Form W-2 by submitting Form 8809 before January 31, but it is not automatic.

The Bipartisan Budget Act of 2015 was signed into law on November 2, 2015. The law removed the automatic ACA registration to new employees (if over 200 in number). It also repealed the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") and the electing large partnership ("ELP") rules for audit and legal procedures for partnerships. The law reduces the audit process for partnerships from 3 audit systems to one streamlined system, moves IRS audit adjustments from partner level to the partnership level, and provides for an option to elect out if there are 100 or fewer partners. Partnership agreements may need to be amended to reflect the impact of this legislation.

PATH permanently extends the rules reducing to 5 years (rather than 10 years) the period for which an S corporation must hold its assets following conversion from a C corporation to avoid the tax on built-in gains. In general, corporate-level built-in gains tax, at the higher marginal rate applicable to corporations (currently 35%), is imposed on an S corporation's net realized built-in gain that arose prior to the conversion of the C corporation to an S corporation and is recognized by the S corporation during the recognition period.

New for 2017

In October 2016, the IRS issued final regulations on IRC section 385 which pertains to debt-equity rules. The regulations establish threshold documentation requirements that must be satisfied for certain related-party interest in a corporation to be treated as debt, and treat as stock certain related-party instruments that would otherwise be classified as debt. The regulations were intended to tone down the broad reach of the earlier imposed regulations.

capital gains and dividend income

Managing capital gains and losses can help you save taxes, defer taxes and obtain the highest after-tax yield on your assets. This planning is very critical when considering the various tax rates since the rate on short-term capital gains can be as high as 43.4% (including the 3.8% Medicare Contribution Tax for certain taxpayers) compared to the long-term capital gain rate of 23.8% (including the 3.8% Medicare Contribution Tax for certain taxpayers).

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CAPITAL GAIN TAX RATES

As a result of the ACA, an additional 3.8% Medicare Contribution Tax may be imposed on your net investment income depending upon your tax bracket. For more information on how this tax is computed, see the chapter on tax rate overview. As Chart 4 illustrates, for 2016 and thereafter, many different tax rates can apply to capital gains, but the most important rates to remember are the maximum tax rates of 39.6% on net gains from assets held 12 months or less (short-term) and 20% on most assets held more than 12 months (long-term). However, the actual rate of tax you pay on the sale of a capital asset can depend on more than just how long you have held the asset, including:

- Type of property sold.
- The AMT rate of 28% on assets held short-term.

chart 4

CAPITAL GAIN TAX RATES

	39.6%	28%	25%	20%*	15%	0%
Short-Term Rate (Holding period 12 months or less)						
Regular tax purposes	▪					
AMT purposes		▪				
Long-Term Rate (Holding period greater than 12 months)						
Regular tax purposes				▪	▪	
AMT purposes				▪	▪	
Exceptions to the 20% tax rate on property held more than 12 months						
Collectibles, such as artwork & precious metals		▪				
Gain attributable to depreciation on real property			▪			
Gains otherwise taxable at the 10% or 15% ordinary tax rate						▪
Gain attributable to depreciation on tangible personal property	▪					

Taxpayers are liable for the additional 3.8% Medicare Contribution Tax on net investment income if their Modified Adjusted Gross Income ("MAGI") exceeds the threshold amount for the applicable filing status:**

Filing Status	Threshold Amount
Married Filing Joint & Qualifying Widow(er)	$ 250,000
Single & Head of Household	$ 200,000
Married Filing Separate	$ 125,000

**The 20% tax rate applies to taxpayers with income above certain threshold amounts ($466,950 for married filing jointly; $441,000 for head of household; $415,050 for single filers; and $233,475 for married filing separately).*
***MAGI is AGI increased by the net income excluded from foreign income under Internal Revenue Code Section 911(a).*

tax tip

7 USE THE NETTING RULE TO GET THE BEST RESULTS

Assume you determine that your year-to-date net capital gains are $240,000, made up of short-term losses of $160,000 and long-term gains of $400,000. In 2016, your capital gains tax would be $48,000 ($240,000 of excess long-term gains at 20%). You also have assets with an unrealized short-term gain of $150,000 that you would like to sell, but are reluctant to pay the short-term capital gain rate of 39.6%. Since gains are netted, if you realized the gain you would have net capital gains of $390,000 (short-term losses of $10,000 and long-term gains of $400,000). Your capital gains tax would be $78,000 ($390,000 of excess long-term gains at 20%). So your tax increase would be $30,000 ($78,000 less the original tax of $48,000). You actually paid the long-term rate of 20% on the additional short-term gain of $150,000.

Note: *The above example is exclusive of the Medicare Contribution Tax, and also assumes that the top rates apply.*

- A netting rule that can flip the actual rate from 20% to 39.6% on long-term gains (and the reverse for short-term gains) since you must net excess losses from one holding period against the gains of the other holding period (see Tax Tip 7).
- 28% rate on the sale of collectibles, such as artwork and precious metals (including ETFs that invest in precious metals).
- Sale of real estate that is subject to depreciation recapture at a maximum rate of 25%.
- Exclusion and rollover provisions on the sale of certain assets.
- Capital loss limitations that only allow you to deduct $3,000 of losses in excess of gains against ordinary income, such as wages and interest income. (If married filing separately, the limit for each individual is $1,500.) It should be noted that net capital losses cannot reduce other categories of income in calculating the Medicare Contributions Tax.

YEAR-END TRADING STRATEGIES

If you have unrealized capital gains or losses, you should refer to Tax Tip 3 in the chapter on tax planning strategies to help you decide whether to take additional gains or losses before the end of the year. But as this tip illustrates, the exact nature of your gains and losses will dictate which stock positions you should consider selling.

COMPUTING YEAR-TO-DATE REALIZED GAINS AND LOSSES

Before determining which year-end strategy to use, it is important to compute your year-to-date realized gains and losses. Make sure you consider the following when determining your year-to-date realized gains and losses:

Trade date

The trade date, not the settlement date, determines the holding period and the year you recognize gain or loss on the sale of publicly traded securities, except for short sales closed at a loss.

Excess capital losses

Only $3,000 of capital losses in excess of capital gains can reduce your ordinary income per year ($1,500 if you are married filing separately). Excess losses are carried forward indefinitely (but not back) until used. Capital loss carryforwards are terminated when the taxpayer dies; however, you can carry back some losses on Section 1256 contracts against prior years' income from similar contracts.

Mutual fund distributions

Dividends paid by mutual funds typically include long-term capital gain distributions that are taxed as capital gains rather than dividend income. Many funds make their largest distributions in December, so make sure you consider them when computing your year-to-date net capital gain or loss. Short-term capital gain distributions and non-qualifying dividends, such as from money market constant dollar funds, are treated as dividend income subject to the ordinary income tax rates. However, mutual funds paying out qualifying dividends in 2016 and beyond are subject to rates of 15% or 20%. The 3.8% Medicare Contribution Tax rate also applies.

Note: *Absent unusual circumstances, and strictly from an income tax perspective, it is usually inadvisable to buy mutual funds shortly before an announced dividend distribution (see below).*

Pass-through entities

Gains and losses from pass-through entities, such as partnerships, S corporations, and LLCs, are taxable to you whether or not you actually receive a cash distribution. You will need to determine your projected share of any distributable capital gains and losses from any entities in which you are an owner or investor.

Mark-to-market assets
Capital gains and losses on mark-to-market assets such as S&P Index options and regulated futures contracts should also be considered when determining your year-to-date capital gains and losses. For the tax treatment of these "Section 1256 contracts," see the discussion later in this chapter.

TAX BASIS REPORTING REQUIREMENTS FOR INVESTORS

The Energy Improvement and Extension Act of 2008 provides that in the case of a covered security, every broker who is required to report the gross proceeds from the sale of the security must also report the adjusted basis in the security and whether any gain or loss with respect to the security is long-term or short-term. The reporting is generally done on Form 1099-B, "Proceeds from Broker and Barter Exchange Transactions." A covered security includes all stock acquired beginning in 2011 except stock in a regulated investment company for which the average basis method is available and stock acquired in connection with a dividend reinvestment plan, both of which are covered securities if acquired beginning in 2012. Options granted or acquired on or after January 1, 2014 are required to be reported.

The basis reported on Form 1099-B may not reflect application of the wash sale rules. Brokers are only required to report wash sales when the purchase and sale transactions occur in the same account. Therefore, you are required to adjust your basis for losses disallowed under those rules.

AVERAGE BASIS OF MUTUAL FUND SHARES

If you acquire shares in a mutual fund at various times and prices, you can calculate the gain or loss using an average cost basis. The shares need to be on deposit in an account handled by a custodian or agent who acquires or redeems those shares.

IDENTIFY LOTS TO REDUCE YOUR TAXES

If you only want to sell part of your holdings of a specific stock, you typically want to sell the lot with the highest cost first so that you can report the lowest gain. However, brokers frequently automatically sell the lots that you bought first, regardless of their relative cost. Avoid this mistake by instructing your broker in advance, in writing, that you want to sell the lots you have held long-term with the highest cost, assuming you are selling the position at a gain. If you are selling at a loss, generally sell the lowest cost lots first.

Note: *This assumes that the objective was to lower realized capital gains in the current year. It may have been more prudent to accelerate gains in the current year and postpone losses until the following year, if it is anticipated that your tax rate will increase in the subsequent year.*

WATCH OUT FOR THE AMT

Substantial net long-term capital gains will increase your deductible state and local income taxes, with the potential adverse effect of triggering the AMT either this year or next year. This will result in your losing the benefit of some or all of the deduction for the additional state income taxes. See Tax Tip 6 in the chapter on the AMT for an example of this. Also, substantial net long-term capital gains will increase your AGI, which will decrease applicable AMT exemptions and can result in triggering the AMT.

tax tip

8 MUTUAL FUND DISTRIBUTIONS ARE TAXABLE, EVEN IF THEY ARE AUTOMATICALLY REINVESTED

Typically, distributions from mutual funds are reinvested in the fund. The distribution itself does not change your aggregate value in the fund since it simply increases the number of shares you own at a lower per-share value.

However, a distribution is taxable in the year made, even if reinvested in the fund. For example, let's say you purchased 4,000 shares of an equity mutual fund on September 1, 2016 at $50 per share. Just before year-end, the fund makes a capital gain distribution of $5 per share when the fund is selling for $35 per share. You end up with capital gain income of $20,000 (4,000 shares at $5 per share), reportable on your 2016 return, even though the share value has decreased since your purchase. But your basis in the shares increases by the $20,000 that you reported as income.

Warning: *Exchanging mutual funds is generally considered a sale of the initial fund with potential capital gain or loss results, even if the new fund is in the same family of funds.*

AVOID CAPITAL GAINS TAX THROUGH CHARITABLE GIVING

You can avoid paying capital gains tax on appreciated securities that you have held for more than one year if you use them to make your charitable contributions. (For donations to private foundations, the stock must be publicly traded.) You receive a contribution deduction based on the fair market value of the security (subject to certain limitations based on your AGI), yet you never pay tax on the appreciation.

This can reap even greater rewards if you front load a private foundation or a donor-advised fund with appreciated long-term securities to fund future contributions. See the chapter on charitable contributions for a detailed discussion.

BEWARE OF THE MUTUAL FUND TRAP

A capital gain distribution from a mutual fund may include significant gains realized by the fund before you bought the shares.

As Tax Tip 8 shows, you end up paying tax on the gains, regardless of whether or not your position in the fund has appreciated. In effect, you have converted part of your initial investment into taxable income.

A benefit of owning stocks directly rather than through a mutual fund is that you can control when you realize gains and losses, giving you the advantage of deferring the tax on the gain, or taking losses to minimize your tax. However, by having direct ownership of stocks you may sacrifice some of the investment diversity that may be available in a mutual fund.

An alternative to an actively managed mutual fund would be a passively managed exchange traded fund or indexed fund.

TAKE LOSSES FROM WORTHLESS SECURITIES AND BAD DEBTS

When a security or non-business loan becomes completely worthless, you can at least recover some of your losses through tax savings. A worthless security is treated as a capital loss in the year it becomes totally worthless. For determining whether the loss is long-term or short-term, the security is deemed to be sold on December 31. To be considered worthless, a security must have absolutely no value. If it has even negligible value, you will usually be prevented from claiming it as a worthless security. You can avoid the absolute-no-value test by selling the security (in a bona fide sale) to an unrelated party for a nominal amount. If you complete the sale before the end of the year, you will be able to take the loss in the current year.

Note: *Do not confuse bankruptcy with worthlessness. Shares of stock of many companies in bankruptcy have some value.*

A non-business bad debt, typically an uncollectible loan, is similarly deductible as a capital loss at the end of the year in which it becomes entirely worthless. However, the loss is treated as a short-term loss regardless of how long the debt was outstanding. But make sure that it is not really a loan that you have simply forgiven. A forgiven loan will be treated as though you made a gift. If the total amount of gifts to any one person exceeds $14,000 for 2016, it will either reduce your lifetime gift tax exclusion or result in a gift tax if you have already exhausted the exclusion. See the chapter on gift and estate planning.

TREATMENT OF LOSSES FROM FRAUDULENT INVESTMENT ARRANGEMENTS

Unfortunately, taxpayers sometimes experience a loss from a fraudulent investment arrangement. For example, an investment advisor may have reported investment activities and resulting income amounts that were partially or wholly fictitious. In some cases, in response to requests for withdrawals, the investment advisor made payments of purported income or principal to the taxpayer, but these payments were made from amounts that other investors had invested in the fraudulent arrangement (e.g., a Ponzi scheme).

The Internal Revenue Code allows a deduction for losses sustained during the taxable year, not compensated by insurance or otherwise subject to various limitations. A loss from a fraudulent investment arrangement is deductible in the taxable year in which the taxpayer discovers the loss, provided that the loss is not covered by a claim for reimbursement or other recovery as to which the investor has a reasonable prospect of recovery. To the extent that the investor's deduction is reduced by such a claim, recoveries on the claim in a later taxable year are not includible in the investor's gross income.

The loss resulting from a fraudulent investment arrangement is generally the initial amount invested in the arrangement plus any additional investments, less amounts withdrawn, if any, reduced by reimbursements or other recoveries and reduced by claims as to which there is a reasonable prospect of recovery.

If an amount is reported to the investor as income in years prior to the year of discovery of the theft, and the investor included the amount in his or her gross income, and the investor does not subsequently withdraw the amount previously reported as income, the fictitious income may be included in the amount of the deductible theft loss.

A theft loss in these types of transactions entered into for profit may create or increase a net operating loss that can be carried back and/or forward under special rules.

WASH SALE CAN DISALLOW YOUR LOSS

The wash sale rule prohibits you from realizing a loss on a security if you buy the same or a substantially identical security (or option to buy such a security) within 30 days before or after you sell it. This requires you to be out of the position and/or at an investment risk for those 61 days if you want to realize a loss on the security yet buy it back for future growth. If you fail the wash sale "test," your loss will be realized only when the replacement security is sold.

If you don't want to risk being out of the position for more than 61 days, consider the following alternatives:

- Buy securities of another company in the same industry, or
- Buy shares in a mutual fund (or an exchange-traded fund) that specializes in the same industry, or
- Double up on the position 31 days before selling at a loss.

You can sell the alternative security or mutual fund after 30 days and use the proceeds to buy back securities in your original company, if you prefer.

One planning technique available is to sell appreciated securities in the current year in order to utilize capital losses and then buy back the stock immediately, thereby securing a step-up in basis. The wash sale rule does not apply to gains.

USE A BOND SWAP TO REALIZE LOSSES

You may be holding losses in your bond portfolio where you can realize a loss and immediately purchase somewhat similar bonds, yet avoid the wash sale rule. This strategy is referred to as a bond swap because your net position after the sale and subsequent purchase is similar to your position prior to the swap. For example, the replacement bond is not considered a substantially identical security (the wash sale test) if it has a different issuer or has a materially different stated interest rate or maturity.

SELLING SHORT AGAINST THE BOX

The reverse of the wash sale rule — the "constructive sale" rule — prevents you from locking in the appreciation on a security without recognizing any taxable gain by selling an identical security short. The 2 positions are deemed to be a constructive sale and you must realize gain as if the appreciated security was sold for its fair market value on the date of the short sale, thereby preventing you from deferring the gain to a future year.

An exception to this rule allows you to close the short sale within 30 days after the end of the tax year if you keep your appreciated position open and at risk for at least 60 days following the close of the short sale. Since closing the short sale is based on the delivery date, you actually need to close the short sale earlier so that you have enough time to have the shares delivered within the 30 days.

LONG-TERM CAPITAL GAINS AND DIVIDEND INCOME TAXED AT 0%

Net long-term capital gains and qualifying dividend income that would normally be taxed are not taxed at all for taxpayers whose taxable income is below certain thresholds. This rule applies to taxpayers with taxable income that would otherwise be taxed at either 10% or 15% before application of this rule.

TRANSFER APPRECIATED STOCK TO SAVE TAXES

You can transfer appreciated securities that you have held long-term to your child, or other beneficiary, who is subject to a low income tax rate and then have the child sell the securities and pay no federal tax. The child must be over age 19 (or if a full-time student, over age 24) to avoid the kiddie tax rule that assesses tax based on your tax rate, as discussed in the tax rate overview chapter. However, keep in mind that gift tax issues must be considered, as discussed in the chapter on gift and estate planning.

As an example, assume you transfer securities with unrealized gains of $30,000 to your single child over age 19 (who is not a full-time student), and the child only has wages from a summer job of $4,000. He or she would pay no tax on the $30,000 gain. This is because of a provision that treats capital gain income that would otherwise be taxed at either the 10% or 15% graduated tax rates as being taxed at a rate of zero. A single taxpayer can have taxable income of up to $37,650 in 2016 ($37,950 in 2017) and still be in the 15% tax bracket, thereby qualifying the taxpayer to a 0% tax rate on his or her capital gains.

DEFER CAPITAL GAINS TAX ON HIGHLY APPRECIATED SECURITIES

If you have appreciated securities that you are reluctant to sell because of the capital gains tax, consider creating a charitable remainder trust. By doing so, you will defer the tax and the trust will make annual payments to you. The remainder amount at the end of the trust's term will go to a charity you designate. See the chapter on charitable contributions for a more detailed discussion of the different types of charitable trusts.

SECTION 1256 CONTRACTS

Section 1256 contracts include regulated futures contracts, foreign currency contracts, non-equity options (including stock index options), dealer equity options and dealer securities futures contracts. The tax issues related to these contracts are different than typical capital gain assets. The gain or loss on these contracts is automatically treated as 60% long-term and 40% short-term, regardless of the holding period. Thus, the maximum effective federal tax rate on Section 1256 gains for 2016 and 2017 is 27.84% (31.64% when considering the additional 3.8% Medicare Contribution Tax) for certain taxpayers. Any unrealized gain or loss on the contracts at year-end is taxable in the current year as if sold, with an adjustment to your tax basis for the gain or loss already treated as realized at the end of the previous year.

INSTALLMENT SALE REPORTING BENEFITS

An installment sale can be a very tax-efficient method to realize a gain on the sale of an asset. While typically considered for real estate sales, it can also apply to sales of non-publicly traded property, such as stock in a privately held corporation or an interest in an LLC or partnership. If you are considering selling any of these assets, see the discussion in the chapter on passive and real estate activities.

SECTION 1031 LIKE-KIND EXCHANGES

The like-kind exchange rule allows you to defer taxes by exchanging property for other property that has the same nature or character. You don't pay taxes on any gain until you sell the property that you have received in the exchange, except to the extent of any cash or other boot ("unlike" property) received. Typically, this rule applies to the sale of rental real estate, although certain other types of property are also eligible. See the chapter on passive and real estate activities for a more detailed discussion of like-kind exchanges.

Note: *Like-kind exchange reporting is mandatory if the replacement property is the same as the surrendered property. Unlike installment sales, you cannot "opt out" of like-kind exchange reporting. While a like-kind exchange does not have to be a simultaneous swap of properties, you must meet 2 time limits or the entire gain will be taxable. The first limit is that you have 45 days from the date you sell the relinquished property to identify potential replacement property. The second limit is that the replacement property must be received and the exchange completed no later than 180 days after the sale of the exchanged property or the due date (with extensions) of the income tax return for the tax year in which the relinquished property was sold, whichever is earlier. The replacement property received must be substantially the same as the property identified within the 45-day limit described previously.*

QUALIFIED DIVIDEND INCOME

Qualified dividends received by an individual shareholder through December 31, 2016 and 2017 are taxed at 15% and 20% for taxpayers who fall into the 39.6% tax bracket. These rates are exclusive of the Medicare Contribution Tax of 3.8%. The following requirements and restrictions must be satisfied:

- The dividends must be paid by either a domestic corporation or a qualified foreign corporation (as defined below).

- You must hold the stock for more than 60 days during the 121 days beginning 60 days before the ex-dividend date. This increases to 90 days out of 181 days for certain preferred stock. The reduced rate is not available for dividends received if you are holding an equivalent offsetting short position in the same security.

Dividends taxed at 15% or 20% are not investment income for purposes of the investment interest expense limitation. However, just as is the case for net long-term capital gains, you can elect to tax the dividends at ordinary rates and eliminate some or all of this limitation on the deduction of investment interest. See the discussion in the chapter on interest expense.

Dividend income that is generally not eligible for the 15% or 20% rates, and therefore taxed at your ordinary income tax rate (as high as 39.6% or 43.4%, inclusive of the additional Medicare Contribution Tax), includes dividends received from:

- Money market mutual funds and bond funds.

- Real estate investment trusts ("REITs").

- Payments you received in lieu of dividends if your broker loans your shares to a customer (as part of a short sale) and dividends are paid to the short sale buyer before the short sale is closed.

A qualified foreign corporation is generally a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the U.S. that includes an exchange of information program. In addition, a foreign corporation is treated as a qualified foreign corporation if its stock is readily traded on an established securities market in the U.S. For this purpose, a share will be treated as so traded if an American Depository Receipt ("ADR") backed by the share is so traded. Dividends received from a foreign corporation that was either a foreign investment company or a passive foreign investment company ("PFIC") either for the year of distribution or the preceding year are not qualified dividends eligible for the 15% or 20% rates.

SECTION 1035 EXCHANGE

The law provides that no gain or loss shall be recognized on the exchange of an annuity contract for another annuity contract. The exchange treatment is for individuals who have merely exchanged one insurance policy for another which better suits their needs. The exchange without gain or loss recognition of an annuity contract for another annuity contract is limited to cases where the same person or persons are the obligee or obligees under both the original and exchanged contracts.

Under Revenue Procedure 2011-38, the direct transfer of a portion of the cash surrender value of an existing annuity in exchange for a second annuity contract will be treated as a tax-free exchange under Section 1035 if no amount (other than an amount received as an annuity for a period of 10 years or more or during one or more lives) is received during the 180 days beginning on the date of the transfer. A subsequent direct transfer of all or a portion of either contract involved in an exchange is not taken into account if the subsequent transfer qualifies (or is intended to qualify) as a tax-free exchange.

stock options, restricted stock and deferred compensation

Stock options, restricted stock, and other types of deferred compensation continue to be included by many employers as part of the overall benefits offered to executives of both private and public companies. The taxation of these components of compensation are quite complex and, if these benefits are mismanaged by an employee, the tax cost could be substantial.

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STOCK OPTION PLANS

In recent years, the number of companies offering stock options to their employees has decreased. However, given the recent stock market performance, there are many employees faced with important decisions of what to do with the stock options that they presently hold. These options may represent a significant portion of an employee's overall compensation. If you hold stock options, it is vital to understand the tax rules related to your options in order to maximize the after-tax cash flow related to these instruments. You need to frequently review your inventory of options which have been granted but not yet exercised, along with stock still held from previously exercised options, to develop a strategy for exercising your options and selling your stock while minimizing your tax exposure.

There are two kinds of employee stock options: incentive stock options ("ISOs") and nonqualified stock options ("NQSOs"). The tax rules governing the taxation of the exercise of options and the subsequent sale of shares differ substantially between ISOs and NQSOs. For all employee stock options there are 3 critical dates to remember for tax purposes: (1) the date the options are granted to you, (2) the date they are exercised, and (3) the date the stock acquired via the options is sold. You must carefully plan when to exercise stock options and how long to hold the shares (after they are exercised) before selling them.

INCENTIVE STOCK OPTIONS

ISOs give you the right to purchase company stock in the future at a fixed price that is determined at the time the options are granted. The options usually must be exercised within 10 years of receiving them. They cannot be transferred (except on death) and can be exercised only during employment or within 3 months of leaving the company. The exercise price cannot be less than the stock's fair market value at the time of the grant, and thus the stock must appreciate before the ISOs have any value. If they do — and once you've satisfied the applicable holding periods — you can buy shares at a price that is below their fair market value.

The key tax consequences related to the granting and exercising of ISOs include the following:

- There is no tax liability on the date the options are granted.
- There is no regular tax liability when you exercise a previously granted ISO. However, the spread between the exercise price (what is paid for the shares) and the fair market value of the shares at the time of exercise is treated as an addition when computing your AMTI.
- If the stock acquired by exercising the ISOs is owned at least 2 years from the time the options were granted or one year after they were exercised, whichever is later, a profitable sale of the stock will produce long-term capital gain income taxed at a maximum rate of 20%, plus a 3.8% Medicare Contribution Tax on net investment income for taxpayers above the threshold amounts. The gain will generally be the difference between the fair market value of the stock on the date of the sale and your exercise price. This is known as a qualifying disposition. For AMT purposes, the basis in the stock will be the fair market value on the date of exercise (to account for the adjustment mentioned above). Thus, the capital gain will be lower for AMT purposes than for regular tax purposes, although the maximum of a 20% federal tax rate applies to each.
- A disqualifying disposition occurs if you sell the stock within the later of one year after the option is exercised, or within 24 months of the grant date. The gain on this sale will be included as compensation and will be taxed at a federal rate as high as 39.6%. If the price of the stock sold changed from the date of exercise, you may also have a short-term gain component as well. However, there are no Social Security or Medicare taxes due on the compensation derived from disqualifying dispositions of ISOs.

In order to make the best decision of when to exercise your options and sell the underlying shares from both cash flow and tax perspectives, you need to:

- Project both your regular tax and AMT for the current year to determine the number of shares you can exercise without incurring a current-year AMT liability.
- Project multiple future tax scenarios based on different stock prices to assist you in deciding if you should exercise options now, even at the expense of incurring an AMT liability, to gain from potentially greater future tax savings. Also, you should consider the availability of the AMT credit discussed below.
- Determine how much cash you have available to exercise the options and, if necessary, consider a financing option for purchasing the stock. Among these alternatives are a cashless exercise and a stock swap. These techniques will be discussed later in this chapter.

AMT CREDIT

Even if the exercise of your ISOs results in an AMT liability, you will be eligible in future years to receive an AMT credit for AMT paid on these option exercises in future years. Generally, the credit you can use is limited to the annual amount that your regular tax exceeds your AMT without regard to the credit in each year. Any unused credit can be carried forward until the full amount is used. While it is usually recommended to avoid paying AMT on ISO exercises whenever possible, there may be situations when you may decide to go ahead with the exercise because of favorable market conditions.

Please see the chapter on tax credits for a detailed discussion of the AMT credit.

ISO SCENARIOS

The first decision to make is when to exercise your existing options, from now up to just before they are due to expire. Once you have exercised the options, you then must decide when to sell the shares. However, the tax consequence of selling the shares compared to continuing to hold the shares can be complicated since it depends on several factors. Some are clearly defined, such as the current trading price, the original exercise price, the trading price at the time of the exercise of the option, and the length of time you have held the shares since you exercised the option. But trying to plan for different scenarios when it is impossible to predict the future price of the stock makes it difficult to know the best choice. Here are some alternatives based on your current holdings combined with certain assumptions.

SHOULD YOU EXERCISE EARLY?

Exercising your options early rather than waiting until the expiration date can be advantageous, but you must consider cash flow and potential tax costs. On the plus side, exercising early:

- Starts your holding period so you can be eligible for the federal long-term capital gain rate sooner.
- Allows you to manage your AMT liability by giving you the ability to exercise just enough options to reach a break-even point between the AMT and regular tax (thereby avoiding the AMT). This can be done annually to allow you to exercise your options with minimal, or no, AMT cost.

tax tip

9 ISO TAX BENEFITS

Assume the following facts:

1. You are granted incentive stock options to buy 9,000 shares of your company stock for $20 per share on June 3, 2008.
2. On January 10, 2017, you exercise all 9,000 options when the fair market value is $30.
3. You hold the shares until January 12, 2018 and then sell them for $45 per share, and you were in the AMT in all years up to the year of the sale.

Your tax consequences without considering the Medicare Contribution Tax of 3.8% would be as follows:

- There is no tax due when the options are granted.
- There is no regular tax due when you exercise the grant and purchase the shares. However, you will have an AMT preference of $90,000 (9,000 shares at the excess of $30 over your cost of $20). Assuming you are already in the AMT, your additional AMT tax is $25,200 ($90,000 times the AMT rate of 28%).

When you sell the shares:

- You have a federal regular tax liability of $45,000 computed by applying the 20% long-term capital gain rate to the gain of $225,000, computed by subtracting the cost of $180,000 (9,000 shares at $20 per share) from your proceeds of $405,000 (9,000 shares at $45 per share).
- You will be eligible to offset your regular tax from the sale by $25,200 of AMT that you paid when you exercised the option. This is your AMT credit amount, but you can only utilize it to the extent your regular tax exceeds your AMT before the offsetting credit.
- Even if you cannot utilize the AMT credit because you are still in the AMT, your AMT tax on the gain is $27,000. This is 20% of the AMT gain of $135,000 based on proceeds of $405,000 less your AMT tax cost of $270,000 (9,000 shares at $30 per share when you exercised the options and reported a tax preference amount). You pay the lower AMT tax of $27,000 in the year of the sale rather than the regular tax of $45,000, thus saving $18,000 currently and possibly saving an additional $25,200 in the future.
- If you are not able to use all the AMT credit, you can continue to carry the unused credit forward to offset regular tax in a subsequent year.

- May reduce your overall AMT liability if you are able to exercise the ISOs at a time when you think the market price is close to bottoming out. Since the price is lower and the spread between the fair market value and your exercise price may be negligible, you can exercise more options without incurring an AMT liability, or just having to pay a small liability. Even if the exercise triggers the AMT you'll pay less than you would if you had exercised an equal number of options at a time when the stock price was higher.

Alternatively, on the negative side, exercising early:

- Accelerates the use of funds you need to purchase the shares,
- Can create an AMT liability before you have the proceeds from the sale of the stock to pay an AMT liability, and
- Exposes you to a loss if the value of the shares drops below your exercise cost.

ISO EXERCISED IN PRIOR YEARS

Assume the following: You have held 10,000 shares for more than 12 months from the exercise of an ISO grant in a prior year. Your exercise cost was $15 per share, and the stock was trading at $25 per share when you exercised the grant. You were subject to the AMT in the year of the exercise on the full amount of the spread between the fair market value of $25 and the exercise cost of $15.

If the current trading price is lower than your exercise price
If you have net capital gains for the year, you can sell the shares and realize a capital loss. As an example, assume the stock is currently trading at $12 per share. While you would only have a $3 per share regular tax loss ($12 less your exercise cost of $15), your AMT loss would be $13 per share ($12 less the $25 value when you exercised the options). If you are in the AMT this year, your AMT loss on the sale would be $130,000 ($13 per share times 10,000 shares), creating a potential tax savings of $27,140 in taxes ($130,000 times the 20% long-term capital gain rate plus $30,000 times 3.8% Medicare Contribution Tax on net investment income).

If the current trading price is higher than your exercise price but lower than the trading price at the time you exercised the grant
Assume the stock is currently trading at $19 per share. If you are not in the AMT for the year, you will realize a gain of $4 per share ($19 less exercise cost of $15), resulting in a tax of $9,520 (23.8% of 10,000 shares at $4 gain per share). But you may actually save taxes since you have an AMT credit available to offset your regular tax, if not already utilized. The AMT credit is $28,000 (28% of 10,000 shares at an AMT spread of $10 per share). Your tax savings will be $18,480 ($28,000 AMT credit less the $9,520 regular and Medicare Contribution tax on the sale, assuming you have sufficient regular tax liability).

The current trading price is higher than both your exercise price and the trading price at the time of the exercise
If you sell the shares, you will have a capital gain for both regular tax and AMT purposes. Assume the current stock price is $35. If you are not in the AMT, you would pay tax on the gain of $20 per share ($35 less your exercise cost of $15). As discussed above, you may have an AMT credit available to offset the tax on the gain. If you are subject to the AMT this year, your AMT gain would be $10 per share ($35 less the price at the time of exercise of $25). Your tax increase for federal tax purposes would be based on the AMT gain of $10 rather than the regular tax gain of $20. However, the additional 3.8% Medicare Contribution Tax on net investment income would be based on the $20 gain.

tax tip 10
ELIMINATE THE AMT IF THE STOCK PRICE DROPS AFTER AN EXERCISE

A falling stock price can result in costly tax consequences if the sale of stock purchased through exercising an incentive stock option is not planned for properly. Take the facts in Tax Tip 9 but assume your exercise of 9,000 shares was earlier this year and the price per share has fallen back to $20, your exercise price. As Tax Tip 9 demonstrates, your AMT tax on the exercise would be $25,200 ($90,000 preference at 28%) if the AMT applies. You will have to pay this tax even though the selling price of your shares is currently equal to the price you paid for them.

What can you do? Sell the shares before the end of the year so that you will have a disqualifying disposition. You would not have a regular tax liability since the selling price of $20 is now equal to your exercise price. But you will eliminate the $25,200 AMT that you would pay if you did nothing.

It may make sense to consider selling the shares even if the selling price is greater than your exercise price. Let's say the stock price has dropped to $23 per share after exercise and you will be in the AMT this year. If you sell the stock before the end of the year, you will realize ordinary income of $27,000 (9,000 shares at a gain of $3 per share based on the selling price of $23 and your cost of $20 per share). However, the AMT liability on the disqualifying disposition will be $7,560 ($27,000 x AMT rate of 28%), which is less than the $25,200 AMT that you would pay if you held the shares (as computed above). Because the wash sale rule (as discussed in the chapter on capital gains) does not apply to securities sold at a gain (regardless of any AMT benefit you receive), you can then repurchase the shares in the open market, even at a lower price, so that you would still own the same number of shares.

tax tip

11 USE THE AMT TO YOUR ADVANTAGE TO REDUCE TAXES ON THE SALE OF ISOs

Assume you exercised an ISO grant in 2007 and purchased 30,000 shares at the exercise price of $5 per share when the stock was selling for $15 per share. Despite the tax preference amount of $300,000 (30,000 shares times the $10 per share spread) you did not have an AMT liability that year because you had substantial ordinary income. You sell the shares in 2016 for $40 per share and you are in the AMT.

	Regular tax	AMT
Long-term capital gain	$ 1,050,000	$ 750,000
Tax at 20%	**210,000**	**150,000**
Effective tax rate on sale	**20%**	**14.29%**

Note: *This table does not include the impact of the Medicare Contribution Tax on net investment income.*

The long-term capital gain for regular tax purposes is $1,050,000 (proceeds of $1,200,000 less the $150,000 you paid to purchase the shares). For AMT purposes, the gain is only $750,000 since your basis is $15 per share (fair market value at the time of the exercise, even though you did not pay the AMT in that year). The result of the sale is that you only pay a current federal effective tax rate of 14.29% ($150,000 tax on the actual gain of $1,050,000).

ISOs EXERCISED EARLIER IN THE CURRENT YEAR

If you exercised ISOs earlier in the year, you may want to consider selling shares in a disqualifying disposition if certain conditions exist. Again, let's assume an original exercise price of $15 per share and a trading price of $25 per share at the time of exercise.

If the current trading price is less than the price you paid to exercise the option

First, determine if the AMT preference amount of $10 per share ($25 trading price at the time of exercise less your cost of $15 per share) will put you into the AMT or increase an already existing AMT liability. If so, consider selling the stock to eliminate the AMT that you will have to pay even though the stock price has dropped. As Tax Tip 10 illustrates, you could end up with a substantial tax without any funds to pay the tax. Also, you can always buy back the stock as long as you wait 30 days to avoid the wash sale rule discussed in the chapter on capital gains and dividends. If the AMT preference amount does not put you into the AMT, you can choose to continue holding the shares if you believe the stock will appreciate.

If the current trading price is higher than your exercise price but lower than the trading price when you exercised the option

If you sell the shares, you will have a disqualifying disposition and the excess of the current trading price over your exercise price will be taxable as compensation at ordinary income tax rates as high as 39.6%. But if you expect to be in the AMT this year, the sale of the shares will eliminate the AMT of $10 per share on phantom appreciation that no longer exists. As an example, let's assume the stock price has dropped to $18 per share. If you sell the shares, you will have ordinary income of $3 per share for both regular tax and AMT compared to $10 of income for AMT purposes had you taken no action.

If the current trading price is higher than both your exercise price and the trading price at the time of the exercise

Once again, if you sell the shares you will have a disqualifying disposition and the excess of the fair market value on the exercise date over your exercise price will be taxable as compensation at ordinary income tax rates. The additional increase on the sale at the date of exercise will be taxed as a short-term capital gain. So if the stock is selling for $30 per share, a sale of the shares would result in $15 of income per share sold taxed at potentially 39.6% for regular tax purposes. In addition $5 per share may be subject to the Medicare Contribution Tax of 3.8%. Thus, if you are not subject to the AMT during the year, it would not make sense to sell the stock during the year. If you would have been in the AMT with or without the ISO preference item it may make sense to sell the shares by year-end. This is because you may never get a benefit for the AMT paid.

NONQUALIFIED STOCK OPTIONS

Unlike ISOs, the exercise of NQSOs creates taxable ordinary income in the year of exercise for both regular tax and AMT purposes. The income is equal to the excess of the stock's fair market value on the date of exercise over the exercise price plus any amount that was paid for the option, where applicable. The granting of an NQSO does not result in taxable income unless the value of the option is readily ascertainable, which generally is not the case. The income recognized upon exercise will be taxed as compensation and will be subject to both Social Security and Medicare taxes.

When you sell the stock after exercising, any appreciation/depreciation in the stock's value will be taxed as capital gains/losses. The holding period for the underlying stock starts when you acquire the shares — it does not include the time you held the options. For long-term capital gain treatment, you must hold the shares for more than one year after the exercise date.

Unlike ISOs, NQSOs are sometimes transferable. However the employee (and not the transferee) will generally recognize income for tax purposes upon the exercise of the options.

You are not allowed to receive in-the-money options without triggering substantial penalties under provisions of the Internal Revenue Code restricting this type of deferred compensation (see below).

Tax Tip 12 illustrates the tax consequences of an exercise and sale of shares received from the exercise of an NQSO grant.

FINANCING TECHNIQUES

Unless you have sufficient available cash, it can be problematic to come up with the funds to exercise your stock options. You can borrow money — sometimes from the company itself — but there are other ways to finance your stock acquisition. Two such techniques are a cashless exercise and a stock swap.

A cashless exercise occurs when a broker lends you the cash needed to exercise the options and then, usually on the same day, helps you sell the stock. The broker recoups the funds you borrowed as well as a small amount of interest and you keep the excess funds. Your cost for the transaction is only the small interest charge.

A stock swap occurs when you use previously acquired company stock to pay for the options' exercise cost. Some companies will even grant you more options called "reloads" if you exercise an option with a stock swap. The number of additional options granted will be equal to the number of shares used to pay the exercise price.

RESTRICTED STOCK

The tax treatment of restricted stock differs considerably from stock options. If you receive compensation in the form of stock subject to a substantial risk of forfeiture, you can defer the recognition of income until the stock is no longer subject to that risk or you sell the stock. But you can elect, under Internal Revenue Code

tax tip

12 NQSO TAX CONSEQUENCES

If the 9,000 shares from exercise of the ISOs in Tax Tip 9 were from the exercise of NQSOs, you will recognize $90,000 of taxable compensation from the exercise (9,000 shares at $30 per share fair market value less the $20 exercise cost). When you sell the stock after holding it for more than one year, from the exercise of NQSOs, you will have a long-term capital gain of $135,000 (9,000 shares at $45 less your basis of $30 per share) at a maximum federal tax cost of $27,000 ($135,000 at 20%). Your net cash benefit from the exercise and sale will be:

Proceeds from the sale	$ 405,000
Cost to exercise the shares (9,000 shares at $20 per share)	(180,000)
Tax on exercise of options ($90,000 at 39.6%)	(35.640)
Tax when you sell the shares ($135,000 at 20%)	(27,000)
Net cash benefit	**$ 162,360**

Note: *This example does not take into consideration Social Security and Medicare taxes.*

Section 83(b), to recognize ordinary income when you receive the stock. You must make this election within 30 days after receiving the stock. However, before making the election, make sure your company's deferred compensation plan with respect to compensation received in the form of stock is in compliance with the requirements discussed in the next section.

A Section 83(b) election can be extremely important if the income taxable to you on the grant date is negligible. Why? Because the election allows you to convert future stock appreciation from ordinary income into long-term capital gain income, which is therefore eligible to be taxed at the much lower long-term capital gain tax rate. If you do not make the election, you will pay tax at ordinary income tax rates on the appreciation when the restrictions lift regardless of whether or not you sell the stock and realize any gain on the sale. See Tax Tip 13.

The disadvantage of making a Section 83(b) election is that you pay tax at ordinary income tax rates in the current year. Plus, taxes paid as a result of the election can't be refunded if you eventually forfeit the stock or the stock's value decreases. You will have a capital loss when you sell the stock, but not if you forfeit it.

DEFERRED COMPENSATION PLANS

The tax treatment of compensation received through a deferred compensation plan depends on rules governing the initial election to defer compensation and the ability to take distributions. The initial election to defer compensation must generally be made in the calendar year prior to the year the income is earned.

Distributions can only be made:

- At scheduled times selected at the time of the deferral, based on either specific dates or the age of the participant.
- At the termination of employment or service.
- On the disability or death of the participant.
- To alleviate an unforeseen emergency.
- Following a change in the ownership or effective control of the employer.

Failure to follow these rules will result in:

- Taxation of the compensation 'deferred' at the time it is deferred or credited to the participant, or at the time it vests, whichever is later.
- An additional tax of 20% on top of the ordinary income tax on the amount treated as compensation.
- An interest assessment based on the IRS underpayment rate plus 1% on the tax liability resulting from the recognition of the compensation.

Note: *ISOs are excluded from these provisions because their exercise price must be equal to their value at the time of the grant.*

ADDITIONAL REPORTING REQUIREMENTS

Every corporation that transferred to an employee a share of stock related to that person's exercise of an ISO during the current tax year is required to file Form 3921 with the IRS for each transfer made. Form 3921 includes the following information:

- The date the option was granted,
- The date the employee exercised the option,
- The number of shares of stock transferred to the employee,
- The fair-market value of the stock when the option was exercised, and
- The exercise price of the stock.

The forms are not required for an employee who is a nonresident alien. Employees must receive the Forms 3921 by January 31 following the end of the calendar year of reporting. The Form is also required to be filed with the IRS with the corresponding Form 1096 by February 28 following the calendar year reported (March 31 if filing electronically).

There are similar filing requirements for employee stock purchase plans.

tax tip

13 THE BENEFIT OF A SECTION 83(b) ELECTION FOR RESTRICTED STOCK

You receive 10,000 shares of restricted stock with a fair market value of $3 per share. In anticipation of an initial public offering ("IPO"), a 10 for 1 stock split gives you 100,000 shares. At the time of the IPO, the stock is offered at $6 per share and the risk of forfeiture is removed. You sell the shares 2 years later at $8 per share.

If you make an Internal Revenue Code Section 83(b) election within 30 days after receiving the stock

- You have $30,000 of compensation in the current year (10,000 shares at $3 per share) with a maximum federal tax cost of $11,880 ($30,000 at 39.6%).
- Your basis in the stock is $0.30 per share after the split ($30,000 of realized compensation divided by 100,000 shares).
- Your holding period begins on the day you receive the stock.
- You realize a long-term capital gain of $770,000 (100,000 shares at $8 per share less your basis of $0.30 per share) when you sell the stock, at a maximum federal tax cost of $154,000 ($770,000 at 20%).
- You incur a Medicare Contribution Tax on net investment income of $29,260 ($770,000 at 3.8%).
- You defer the tax you would have to pay when the company goes public to the time when the stock is sold.

If you don't make the election

- You don't have any compensation income this year.
- You have compensation of $600,000 (100,000 shares at the IPO price of $6 per share) when the company goes public (and the substantial risk of forfeiture no longer exists due to a change of control feature) at a maximum federal tax cost of $237,600 ($600,000 at 39.6%).
- You have a long-term capital gain of $200,000 when you sell the stock (100,000 shares at $8 per share less your basis of $6 per share) at a maximum federal tax cost of $47,600 ($200,000 at 23.8%).

Income Tax Comparison	
If you don't make the election	$ 285,200
If you make the election	195,140
Tax savings by making the election	**$ 90,060**

small business stock

Take advantage of preferential tax treatment available for certain small business stock.

SMALL BUSINESS STOCK TAX BENEFITS

Qualified small business ("QSB") stock can qualify for preferential federal tax treatment, including:

- Rollovers of gain if the proceeds are used to buy other qualified small business stock,
- Reduced tax rates, or
- Ordinary loss rather than capital loss treatment.

SALE OF QSB STOCK

The gain from the sale of QSB stock is eligible for a rollover which allows you to defer the tax on the gain. QSB stock is defined as stock:

- Issued by a domestic corporation
  - with less than $50 million of assets at the time of and immediately after issuance; and
  - which uses at least 80% of its assets in an active, qualified trade or business (see note below for restriction);
- Held by a non-corporate taxpayer (LLCs and S corporations qualify); and
- Acquired by the taxpayer at original issuance (after August 10, 1993).

Note: *Businesses in certain industries, such as hospitality, financing, professional services, and mining, do not qualify for this treatment.*

If a taxpayer holds the QSB stock for 5 years or more, the gain eligible for the exclusion is limited to the greater of $10 million or 10 times the taxpayers' basis in the QSB stock.

If an individual holds the QSB stock by a pass-through entity, he or she may still qualify for the exclusion if the individual taxpayer has held the stock consistently from the date of acquisition through the date of sale. Stock received by gift, death or distribution may also qualify as QSB stock. There are other rules for potentially broadening the holding period under Internal Revenue Code section 1202 where QSB or stock has been exchanged or converted.

Finally, taxpayers should also be aware that the state tax treatment may differ from the federal treatment of the gain.

REDUCED TAX RATES

Taxpayers who hold QSB stock for more than 5 years (based on the purchaser's first date of ownership as a C corporation) may exclude at least a portion of the gain on the sale of the QSB stock from gross income. The amount of exclusion is staggered based on tax holding dates:

- 100% of the gain if the stock has a tax holding date begins after September 27, 2010, resulting from the enactment of PATH. This provision has been made permanent.
- 75% of the gain if the tax holding date begins after February 17, 2009 and before September 28, 2010.
- 50% of the gain if the tax holding date begins before February 18, 2009.

The tax rate on the gain not subject to the exclusion, if any, is 28%, meaning that the 50% exclusion yields an effective rate of 14%, compared to the capital gains tax rate of 20% presently in effect.

Note: *Eligible gain from any one corporation is subject to a cumulative limit for a given year of the greater of (a) $10 million reduced by eligible gain taken in prior years or (b) 10 times the cost of all qualified stock of the issuer disposed of during the tax year. If the taxpayer is married filing separately, the gain eligible for exclusion is 50% of the $10 million limit or $5 million.*

AMT ADJUSTMENTS

Although excludable for regular tax purposes, a portion of the excluded gain on the sale of QSB stock may be an AMT preference item. The preference rates are also based on stock purchase dates:

- No preference adjustment for the sale of stocks with a tax holding date beginning after September 27, 2010, as a result of the enactment of PATH. This provision has been made permanent.
- 7% AMT preference adjustment of the amount excluded for all sales occurring prior to September 27, 2010.

Caution: *Taxpayers with net capital losses, who take advantage of the exclusion, should be aware that the AMT preference will trigger utilization of those AMT capital losses.*

chart 5

SECTION 1202 TAX RATE SCHEDULE SALES

Year of purchase	Regular net tax rate*	AMT effective rate	Capital gain rate	Benefit if in AMT
Pre 2001-02/17/2009	15.9%	16.88%	23.8%	6.92%
02/18/2009-09/27/2010	7.95%	9.42%	23.8%	14.38%
Post 09/28/2010	0%	0%	23.8%	23.8%

Planning Tip: *Qualified small business stock held for 5 years can result in additional savings.*
**As shown in the Tax Rate Schedule, the gain recognized from the sale of QSB stock is generally subject to the 3.8% net investment income tax which applies to capital gains. If all of the gain is excluded from gross income, it follows that the 3.8% net investment income tax would not apply. Further, this Schedule assumes that the taxpayer is in the highest applicable tax bracket.*

ROLLOVER OF QSB STOCK

The Section 1045 rollover rules permits non-corporate taxpayers to defer gain on a sale of QSB stock under certain circumstances.

To qualify for this rollover, a taxpayer must (a) own the stock for at least 6 months and (b) reinvest the proceeds within 60 days of sale in other QSB stock. The replacement stock purchased in the rollover may qualify for a future rollover under the same rules. The basis in the replacement stock is reduced by the deferred gain from the rollover and inherits the holding period of the stock sold for determining whether the capital gain treatment is short-term or long-term. If the reinvestment in the new QSB stock is less than the sale proceeds, the difference is taxable at regular tax rates.

The rollover provision does not apply to stock of an S corporation.

Note: *There is no carryover of holding period for purposes of determining the "more-than-6-months" requirement.*

If the stock is held by a pass-through entity of which you are a partner or shareholder, the entity can buy replacement stock and elect a tax-free rollover of the gain. Otherwise, the pass-through entity can notify you of the gain and you can defer tax by buying the replacement stock directly. The 60-day rule still applies, beginning on the day the entity sells the QSB stock — rather than the date you are notified of the sale. In addition, there may be other limitations on the amount of gain that a partner may defer in this context.

Note: *Rollovers into new QSB stock are still available as long as the replacement period is observed.*

CLAIM ORDINARY — NOT CAPITAL — LOSSES

If you sell small business stock at a loss, you can classify up to $100,000 ($50,000 if married filing separately) of the loss as an ordinary, rather than a capital, loss even if the holding period exceeds 12 months. This loss may be included in the computation of net operating losses.

To qualify for this treatment, you must have bought the stock at original issue and held it continuously until disposition. The issuing corporation must have had an initial capitalization of $1 million or less at the time the stock was issued and have derived not more than 50% of its income from investment activities (interest, dividends, royalties, rents, annuities, and sales or property exchanges) during the preceding 5 years.

passive and real estate activities

If you are an owner of a business in which you do not materially participate, the passive activity rules can limit your ability to deduct losses. And, if you hold rental real estate investments, the losses are passive even if you materially participate, unless you qualify as a real estate professional. Income from passive activities including rental real estate may also be subject to the 3.8% Medicare Contribution Tax on net investment income.

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WHAT ARE PASSIVE LOSSES?

A passive loss is a loss from a business activity in which you do not materially participate. The most common ways you are deemed to materially participate in a business activity, and thereby avoid the passive activity limitation rules, are if:

- You participate more than 500 hours in the activity during the year,
- Your participation constitutes substantially all of the participation in the activity,
- You work more than 100 hours per year in the activity and not less than any other person, including non-owners, or
- You work more than 100 hours per year in each of several activities, totaling more than 500 hours per year in all such activities.

Passive activity losses are deductible only to the extent that you have income from other passive activities to offset the losses, or when you completely dispose of the activity. If you have passive losses that you cannot deduct in the current year, you can carry these losses forward to the following year, subject to the same passive loss rules and limitations.

Taxpayers should keep detailed records as to the time they spend on a particular activity, especially when they participate in several activities. Moreover, there are specific rules as to what kind of work qualifies as participation.

CONVERT PASSIVE LOSSES

If you fail the material participation tests and you have passive losses that are subject to a disallowance, there are things that you can do to convert the disallowed losses into tax-saving deductible losses:

Dispose of the activity
Sell any passive activity with current or suspended passive losses through a bona fide sale to an unrelated party. The losses become fully deductible when the activity is sold — including any loss on the disposition (subject to capital loss limitations). Even if you realize a gain on the sale, you can still save taxes as Tax Tip 14 illustrates. But you must also be aware of the phantom income trap discussed in Tax Tip 15.

Increase your participation in loss activities
For an activity that is generating losses, consider increasing your participation to meet one of the tests listed above, if possible, so you will not be subject to a passive loss limitation for the activity in that year.

Increase the hours you participate in real property trades or businesses
If you are engaged in real estate activities, increase your hours to meet the real estate professional test (discussed below). If you are a real estate professional, your real estate losses are no longer treated as passive losses, allowing you to deduct them in full.

tax tip 14 USE PASSIVE ACTIVITY CAPITAL GAINS TO RELEASE SUSPENDED ORDINARY LOSSES

If you have suspended passive activity losses, you may be able to dispose of a passive activity at a gain and not have to pay any taxes. In fact, you may actually reduce your taxes despite the gain.

As an example, assume you have suspended passive losses of $300,000 from an activity that you have held for more than one year. You dispose of the activity in 2017 and realize a capital gain of $340,000. You would actually save federal taxes of $50,800 as well as receiving the proceeds from the sale.

This very favorable result is due to the fact that the suspended losses reduce your ordinary income at a 39.6% rate, whereas the long-term capital gain from the sale would be taxed at no more than 20%. The suspended loss would therefore reduce your tax by $118,800 (39.6% of $300,000) but the capital gain would only increase your tax by $68,000 (20% of $340,000). If you have a net capital loss carryover that you might not be able to utilize, your savings would even be greater since the gain could be offset by the carryover loss, giving you the full tax benefit of the loss (but a reduced carryover).

The tax savings would be reduced by the 3.8% Medicare Contribution Tax in the amount of $1,520 (3.8% of $40,000, which is the difference between the $340,000 capital gain and $300,000 ordinary loss)

UTILIZE YOUR PASSIVE LOSSES

If you have passive losses from activities that you cannot convert into "material participation" activities as discussed above, you should consider taking the following steps to utilize your passive losses:

Decrease your participation in income activities
For an activity in which you materially participate that is generating non-passive income, limit your participation to less than 500 hours, if feasible. Therefore, the activity may become passive and you can use the income to offset your passive losses. However, make sure that you are not still considered active under the other tests. This may result in the additional 3.8% Medicare Contribution Tax to the extent that the income is not fully offset by passive losses. If you or your spouse have been materially participating in the activity for 5 out of the last 10 years, you will be deemed to be materially participating in the current year, even if you do not participate at all in the current year.

Invest in income-producing passive activities
Consider investing in an income-producing trade or business that you will not materially participate in. This creates passive income to you which can be offset until you utilize all of your passive losses from other unrelated passive activities. This may result in the additional 3.8% Medicare Contribution Tax to the extent that the income is not fully offset by passive losses.

tax tip

15 THE PHANTOM INCOME TRAP

Income in excess of your net proceeds can be triggered upon the disposition of real estate. This results from prior deductions based on indebtedness. Therefore, you may have deducted losses and/or received cash distributions in prior years that were greater than your actual investment in the property. This is sometimes referred to as negative capital.

Phantom income to the extent of your negative capital can also occur if you dispose of your interest in the pass-through activity, even if the underlying property remains unsold. However, to the extent your prior year's passive losses were suspended, you would have an ordinary loss to offset this income. As Tax Tip 14 demonstrates, this can actually be a tax savings opportunity.

IDENTIFY YOUR ACTUAL PASSIVE LOSSES

When identifying your net passive losses, take into account the following:

- Investment and trading partnerships, S corporations and LLCs that only generate portfolio income, such as capital gains, interest and dividends, are not passive activities, even if you do not participate in the activity. Therefore, the investment income cannot offset your passive losses.
- Interest expense on money borrowed to fund your investment in a passive activity is treated as an additional passive activity deduction, subject to the same disallowance rules.
- Portfolio income, such as interest and dividends, from a passive activity cannot offset the passive losses from the activity.

LOSSES FROM LIMITED LIABILITY COMPANIES ("LLCS") AND LIMITED LIABILITY PARTNERSHIPS ("LLPS")

Generally, limited partners of an LLP are presumed to not be materially participating in the business, and thus these activities would be considered passive. There is an exception to the presumption of no material participation where an individual holds an interest in a limited partnership as both a limited partner and a general partner. In this case, such person can avoid the passive loss rules with respect to the limited partnership interest.

The courts have addressed whether the rules that apply to limited partnership interests also apply to members of an LLC. Although the IRS does not concur, recent cases have held that such members are not limited partners for purposes of determining their material participation in these activities. Rather, the facts and circumstances must be examined to ascertain the nature and extent of the participation of the member.

PASSIVE ACTIVITY CREDITS

Tax credits from passive activities, such as rehabilitation and low-income housing credits, can reduce your regular tax liability. However, for properties placed into service prior to 2008, these credits are limited to the amount of your regular tax attributable to your net passive income, and cannot be used to reduce your AMT. For post-2007 investments, both the qualified Rehabilitation Tax credit as well as the low-income housing credit can offset both regular tax and AMT to the extent of your tax attributable to passive activity income. If you have a net overall passive loss, the disallowed credits are carried forward and can be used to offset

tax tip

16 DEFER YOUR GAIN USING THE INSTALLMENT SALE METHOD

In 2017, you sell a nonresidential building for $2,000,000, net of closing costs, which you bought in 1998 for $600,000 (including subsequent improvements). At the time of the sale, you had accumulated depreciation of $400,000. Therefore your taxable capital gain is $1,800,000 ($2,000,000 less the cost of $600,000 plus the accumulated depreciation of $400,000). You will receive a 20% down payment of $400,000 before the end of the year and receive a mortgage from the buyer for the balance, with the first payment due in January of 2018. By using the installment sale method, you will defer $290,000 of federal tax to future years as the mortgage is paid down by the buyer.

	Full payment in current year	Installment sale method
Taxable gain in year of sale	**$ 1,800,000**	**$ 360,000**
Federal tax cost this year	**380,000**	**90,000**
Deferred tax		**290,000**

The taxable gain using the installment sale method is computed by multiplying the down payment of $400,000 by the gross profit ratio of 90%. The gross profit ratio is the taxable gain of $1,800,000 divided by the total proceeds of $2,000,000.

Caution: *You are subject to a tax rate of 25% on the portion of the gain that is attributable to previous non-accelerated depreciation deductions on real property on a "first in first out" (FIFO) method. Also, this method may not be advantageous when the tax rates of future years' installments are expected to increase.*

Note: *The 3.8% Medicare Contribution Tax on net investment income, which is not reflected in the above illustration, may apply to the gain and related interest net investment income.*

your taxes in future years. If you have net passive income but the credits are limited because of the AMT, you can carry the credits forward to offset your regular tax in future years when you are not in the AMT.

REAL ESTATE ACTIVITIES

Real estate activities are passive by definition, unless you qualify as a real estate professional. Regardless of whether you are a real estate professional or not, there are ways you can defer the tax from the gain on the sale of real estate properties, as discussed below. A separate rule allows you to deduct up to $25,000 of losses each year if you actively participate in a rental real estate activity. This special allowance is reduced, but not below zero, by 50% of the amount by which the taxpayer's AGI exceeds $100,000. It is completely phased out when AGI reaches $150,000.

REAL ESTATE PROFESSIONAL RULES

If you are a real estate professional, you can deduct rental real estate losses in full since you are not subject to the passive loss limitations. To qualify, you must annually:

- Perform more than 50% of your personal services in real property trades or businesses in which you materially participate, and
- Have more than 750 hours of service in these businesses.

In addition, you must materially participate in the rental real estate activity in order for that activity to be considered nonpassive. For example, a real estate broker who owns one or 2 apartments for rent might be a real estate professional but might not be considered to materially participate in the rental activity.

In the case of a joint return, the real estate professional requirements are satisfied if, and only if, at least one of the spouses separately satisfies both requirements. In regards to the material participation test though, work performed by a taxpayer's spouse in a trade or business is treated as work performed by the taxpayer.

Real estate professionals are not subject to the 3.8% Medicare Contribution Tax on net investment income, including capital gains, from rental real estate activities in which they materially participate.

Observation: *If you fail either test and you have real estate losses, try to increase your hours of service to meet the tests. For purposes of the real estate professional test, a taxpayer can elect to aggregate all of their real estate rental activities for purposes of determining material participation. Once the election is made, it continues unless the IRS consents to its revocation.*

INSTALLMENT SALE REPORTING BENEFITS

An installment sale can be a very tax-efficient method to defer a gain on the sale of real estate for future years. If you are contemplating a sale of real estate, consider agreeing to receive one or more payments after the year of the sale so that you are eligible to report the gain on the installment sale method. By doing so, you can defer much of the tax to future years.

The installment method allows you to report gain only as you receive principal payments. By simply deferring one payment until next year, you can defer the tax on that portion of the sales price by a full year (see Tax Tip 16). The gain you report in future years retains the same character as when it was sold. Therefore, if property that is sold had a long-term holding period, the gain reported in future years will also be long-term except for the interest element if interest is not stated on the deferred payments. You may also be entitled to interest payments on seller-financed mortgages or loans. The interest payments are taxable as ordinary income when received. You can use the installment sale method even if you owned the property through an entity in which you hold an interest if the entity does not elect out of the installment method. However, if the face amount of all installment receivables you own at December 31 exceeds $5 million, an interest charge on the deferred tax (assessed as an additional tax) will apply.

Caution: *Even if no payments are received in the year of sale, any recapture income under Internal Revenue Code ("IRC") sections 1245, 1250, or 751 is recognized immediately. Furthermore, when the deferred gain on the sale of real estate is attributable to both unrecaptured section 1250 gain (maximum tax rate of 25%) and regular capital gain (maximum tax rate of 20%), the unrecaptured section 1250 gain is reported first upon the receipt of principal payments.*

LIKE-KIND EXCHANGES

If you exchange investment or business property for property of a like-kind (same nature or character), you do not realize taxable gain at the time of the exchange, except up to the amount of any cash or other boot received (such as unlike property). The like-kind exchange rule gives you the opportunity to defer taxes until you sell the property that you receive in the exchange.

Like-kind exchanges typically are used when selling real estate and can yield substantial tax benefits. Even though the definition of like-kind property allows for a certain amount of flexibility, such as permitting an exchange of land for a building if both are held for investment purposes, specific and complex rules govern like-kind exchanges. These rules include a requirement that you cannot directly receive any cash or other consideration and must identify the replacement property with the qualified intermediary holding the funds within 45 days after the sale.

Caution: *Like-kind exchanges do not apply to the sale of stocks, bonds, other securities and other intangible assets such as a partnership interest. Also, the sale of your principal residence does not qualify for a like-kind exchange.*

Note: *Like-kind exchange reporting is not elective. Consider not engaging in a like-kind exchange if a taxable event is the better approach (e.g., when you have expiring losses, or state tax considerations).*

PATH

In December 2015, PATH made permanent several tax extensions and incentives. Some 15 provisions of PATH specifically address a variety of technical and policy considerations of REITs. One such noteworthy provision deals with tax-free spinoffs involving REITs. The provision provides that a spinoff involving a REIT will qualify as tax-free only if immediately after the distribution both the distributing and the controlled corporation are REITS. In addition, neither a distributing nor controlled corporation in a tax-free spinoff transaction that is not a REIT is permitted to elect to be treated as a REIT for 10 years following the tax-free spinoff. The provision applies to distributions made on or after December 7, 2015, but will not apply to any distribution pursuant to a transaction described in a ruling request initially submitted to the IRS on or before that date, which request has not been withdrawn and with respect to which a ruling has not been issued or decided in its entirety as of such date.

tax tip

17 LIKE-KIND EXCHANGES FOR VACATION HOMES

Like-kind exchanges for vacation homes that are converted to rental property are tricky, but can be worthwhile. It is possible for you to do a like-kind exchange if you turn a vacation home into a rental property. For example, if you stop using your vacation home, rent it out for a substantial period of time and then exchange it for other real estate and conduct the rental of that real estate as a business, then you have converted it to an investment property. This conversion could allow for a like-kind exchange. Of course, the timing and facts must support such a conversion. In addition, if the property swapped for is intended to be a new second or primary home, you are not allowed to move in immediately. In 2008 the IRS issued Rev. Proc. 2008-16, which includes a safe harbor rule under which it said it would not challenge whether a replacement dwelling qualified as investment property for purposes of a like-kind exchange. In order to meet this safe harbor, you must have held the relinquished property for at least 24 months and in each of the two 12-month periods immediately after the exchange: (1) you must rent the dwelling unit to another person for a fair rental for 14 days or more; and (2) your own personal use of the dwelling unit cannot exceed the greater of 14 days or 10% of the number of days during the 12-month period that the dwelling unit is rented at a fair rental. In addition, after successfully swapping one vacation/investment property for another, you cannot immediately convert it to your primary home and take advantage of the $500,000 primary residence exclusion. If you acquire property in the like-kind exchange and later attempt to sell that property as your principal residence, the exclusion will not apply during the 5-year period beginning with the date the property was acquired in the 1031 like-kind exchange.

Your specific fact pattern must support a position in which your vacation property or second home was in fact held for rental, investment, or business use and would therefore qualify for tax-deferred exchange treatment. The more rental, investment, or business use activity, the stronger the facts will be that the property was converted and held for rental or investment. The more you can substantiate that the property was held, treated and reported as rental or investment property, the better your position will be to support tax-deferred exchange treatment.

principal residence sale and rental

A principal residence may be one of the most tax-efficient investments you can own since you can exclude as much as $500,000 of the gain on its sale.

The sale of your principal residence is eligible for an exclusion of capital gain up to $500,000, if you file as a married filing jointly and meet the tests listed below (other taxpayers can exclude up to $250,000 of the gain). Any portion of the gain attributable to a home office or rental use is not eligible for the exclusion.

PASS THESE TESTS AND EXCLUDE UP TO $500,000 OF YOUR GAIN

To qualify for the full amount of the exclusion, you must meet all of the following conditions:

- Have owned your principal home for at least 2 years. Your principal residence can be a house, houseboat, mobile home, cooperative apartment or condominium. The 2-year rule may consist of 24 full months or 730 days. If you are filing a joint return, only one spouse need qualify in order to benefit from the exclusion of at least $250,000.

- Have used the home as your principal residence for at least 2 years, in the aggregate, during the 5-year period ending on the sale end date.

- Did not exclude the gain on a home sale within the last 2 years.

- Did not acquire your home through a like-kind exchange (also known as a 1031 exchange) during the past 5 years.

With regards to principal residence, occupancy of the residence is required. Short temporary absences, such as for vacation or other seasonal absences, even if the property is rented during such temporary absences, will be counted as periods of use.

A pro-rata exclusion is allowed if you fail the above tests as a result of a hardship, which includes a change in employment, health reasons, multiple births from the same pregnancy, divorce or legal separation, or other unforeseen circumstances and natural disasters. The pro-rata exclusion is generally equal to a fraction, the numerator of which is the number of months you used and owned the house as your principal residence within the past 2 years and the denominator is 24.

A reduction of the exclusion is required to the extent that any depreciation was taken after May 6, 1997 in connection with the rental or business use of the residence, unless there was a separate structure for the rental or business use. Regardless, there will be a taxable gain which equals to the amount of depreciation previously deducted and it will be taxed at a special 25% capital gain rate.

DO NOT ASSUME YOU CAN ALWAYS SELL YOUR HOUSE TAX-FREE

Many people mistakenly think that you can defer a gain from the sale of a principal residence if they buy a new home that costs more than the selling price of the old home. That law was repealed many years ago (in 1997, to be exact). Under current law, you will have to pay taxes to the extent that a net gain exceeds the maximum exclusion amount allowed. Here is an example for a married couple filing jointly and meeting all tests:

Net proceeds on sale	**$2,000,000**
Tax basis (including capital improvements)	**600,000**
Net gain on sale of home	**1,400,000**
Allowable exclusion	**(500,000)**
Taxable gain	**900,000**
2016 federal tax at maximum 20% capital gain rate and the 3.8% Medicare Contribution Tax on net investment income	**$ 214,200**

Notes: *This gain may be subject to state income taxes. See the chapter on state tax issues.*

The taxable gain will be subject to the 3.8% Medicare Contribution tax on net investment income. The excludable gain ($250,000/500,000) is not subject to this tax.

NO EXCLUSION ALLOWED FOR NONQUALIFIED USE OF PROPERTY

Beginning with sales or exchanges of your principal residence after December 31, 2008, you will no longer be able to exclude gain allocated to periods of nonqualified use of the property.

Generally, nonqualified use means any period after 2008 where neither you nor your spouse used the property as a principal residence. To figure the portion of the gain that is allocated to the period of nonqualified use, multiply the gain by the following fraction:

Total nonqualified use during period of ownership after 2008, divided by total period of ownership.

A period of nonqualified use does not include:

- Any portion of the 5-year period ending on the date of the sale that is after the last date you (or your spouse) use the property as a principal residence.
- Any period (not to exceed an aggregate period of 10 years) during which you or your spouse are serving on qualified official extended duty as a member of the uniformed services or foreign services of the United States, or as an employee of the intelligence community.
- Any other period of temporary absence (not to exceed an aggregate period of 2 years) due to change of employment, health conditions, or such other unforeseen circumstances as may be specified by the IRS.

SPECIAL CONSIDERATION FOR THOSE WHO FILE JOINT RETURNS

If you are married filing jointly, things can get a little more complicated if you want to be eligible for the maximum exclusion of $500,000. While either you or your spouse can meet the 2-year ownership test, the following rules apply to the use test and "no exclusion in prior 2 years" test:

- Both you and your spouse must meet the 2-year use test. If only one spouse meets the test, the exclusion is limited to $250,000.
- Both you and your spouse must meet the "no exclusion in prior 2 years" test. This can be an issue if you sell your home, claimed an exclusion of $250,000, marry a homeowner and then jointly sell that home within 2 years. If the spouse meeting the test is the homeowner, he or she will still be eligible for the $250,000 exclusion, and the spouse failing the test is not eligible for a pro-rated exclusion, unless the hardship rule applies, as discussed above.

SALE BY SURVIVING SPOUSE

A surviving spouse who has not remarried and sells a principal residence within 2 years from the date his or her spouse died can exclude $500,000 of gain rather than $250,000.

KNOW YOUR TAX BASIS

To minimize your taxable gain, you will want to have the highest tax basis possible, and have the documentation to substantiate the basis calculation. So be sure to maintain accurate records, including information on your original cost (including closing costs) and subsequent capital improvements.

Basis must be reduced by any pre-1988 deferrals of gain (i.e., when the law allowed taxpayers to defer tax by buying a new principal residence costing more than the net proceeds of their principal residence).

LOSS ON THE SALE OF YOUR HOME

Based on historical evidence, you would expect your home to appreciate after you purchase it. However, if you only hold it for a short time, or if unusual market conditions prevail, it is possible to lose money on the sale of your principal residence, especially after factoring in closing and improvement costs. Since a loss on the sale of a personal residence is not deductible, you do not gain a tax benefit from the loss. But if part of your home was rented or was used for your business, the loss attributable to that portion will be deductible, subject to various limitations, since it is a business loss rather than a personal loss.

RENTAL OF VACATION OR SECOND HOME

You should consider the tax consequences if you are planning to rent out your vacation or second home. Proper planning can help you maximize tax savings.

Tax-free rental income

If you rent your vacation home or principal residence for 14 days or less during the year, the rental income is tax-free, regardless of the amount of rent you receive. Even though you do not have to report this income, you can still deduct the full amount of qualifying mortgage interest and real estate taxes as itemized deductions on your tax return.

Rental expenses deductible in full

If you personally use your vacation home (including family members) for no more than the greater of 14 days a year or 10% of the total number of days it is actually rented out, the property is considered to be a rental property rather than a personal residence. As rental property, all ordinary and necessary expenses of maintaining the home are deductible against the rental income you receive. However, if your expenses exceed your income, your deductible loss may be limited since the rental activity is considered to be a passive activity. See the chapter on passive and real estate activities for a more detailed discussion.

Rental expenses limited by personal use

If you personally use your vacation home for more than the greater of 14 days or 10% of the total number of days it is rented (or available for rental, under a Tax Court case), it is considered a personal residence and your deductions may be limited, as follows:

- Qualifying mortgage interest and real estate taxes are deductible as rental expenses based on the number of days rented divided by the total number of days in the year.

- The balance of the real estate taxes and mortgage interest are deductible as itemized deductions.

- Other rental expenses, including depreciation, utilities and repairs, are deductible based on a ratio of the days the property was rented over the total number of days the property was used for rental and personal purposes.

- Expenses directly attributable to the rental activity itself (such as broker commissions on the rental income or advertising costs) are deductible in full.

- Net overall losses from the rental of a personal use residence are not currently allowable but are carried forward and available for use against income from the property in future years, including a gain on the sale.

To the extent that the property qualifies as rental real estate (personal use less than 10% or 14 days) losses may be subject to the passive loss rules. See the chapter on passive and real estate activities for more information.

LIKE-KIND EXCHANGES FOR VACATION HOMES

See Tax Tip 17 in the passive and real estate activities chapter for information on a planning opportunity using like-kind exchanges for vacation homes.

REPORTING REQUIREMENTS

You would typically report the sale of your principal residence on Schedule D of your personal income tax return. However, you do not have to report the sale of your principal residence on your income tax return unless:

- You have a gain on the sale. You would typically show the entire gain on the Schedule D of your tax return and then reduce your gains by the excludible portion.

- You have a loss and you received Form 1099-S. Since the IRS matches all Forms 1099 to the return, you would want to show the sale proceeds on the return and that there is no gain on the sale. Remember personal losses are not deductible.

charitable contributions

Your ability to control when and how you make charitable contributions can lower your income tax bill, effectively reducing the actual cost of any gift you make, while fulfilling your philanthropic objectives.

EisnerAmper

BASIC PLANNING IDEAS

You can save substantial taxes by simply:

- Using long-term appreciated property to fund your charitable contributions.
- Timing your contributions so that they are made in a year when your tax bracket will be higher.

More sophisticated planning techniques are discussed in this chapter, including using donor-advised funds, private foundations, and charitable trusts, to help you combine tax planning with your charitable goals.

For 2016, the benefit of the charitable contribution deduction may be reduced due to the itemized deduction limitation ("Pease" provision) that applies when AGI exceeds $259,400 ($311,300 for joint filers). For 2017, the thresholds increase to $261,500 ($313,800 for joint filers). Your itemized deduction limitation will be the lesser of (a) 3% of AGI above the applicable amount, or (b) 80% of the amount of the itemized deductions. Other limitations also apply (see Chart 6). Therefore, careful planning must be done to determine the true tax benefit of charitable contributions being considered. Multi-year income tax projections should be included as part of the charitable planning process.

USE LONG-TERM APPRECIATED PROPERTY

You should always use appreciated publicly traded securities that you have held for more than one year, rather than cash, to fund significant charitable contributions. You should also consider using other eligible appreciated property, such as artwork, that you can give to a museum. By doing so, you can get the double tax benefit of receiving a deduction equal to the full fair market value of the security or property (as if you contributed cash) and avoid paying capital gains tax on the appreciation (see Tax Tip 18).

There are limitations on the amount of contributions that you can deduct in a given year based on your AGI, as Chart 6 indicates. While a contribution of long-term appreciated property is generally limited to 30% of your AGI rather than the 50% limit that applies to cash, this is still usually a high ceiling and any disallowed contributions can be carried forward for the next 5 years.

TIME YOUR CONTRIBUTIONS

Always consider your tax rate for this year and future years before deciding when to make your contributions. Your tax rate may vary significantly in a year of unusual financial events, but more common is the impact that the AMT will have on your contributions. If possible, make your charitable contributions in a year that you are not likely to be in the AMT. In 2016, the difference between the maximum regular tax rate of 39.6% and the AMT rate of 28% is 11.6%.

If you expect your maximum tax rate to be the same next year, prepay your charitable contributions this year (if feasible and desired) to gain the advantage of accelerating the tax deduction.

tax tip

18 THE BENEFIT OF CONTRIBUTING LONG-TERM APPRECIATED SECURITIES RATHER THAN CASH

A stock that you have owned for many years has appreciated to $100,000 from its original purchase price of $60,000. You have decided that it may have very little future growth potential. Instead of selling the stock, you donate it to your favorite charity. Your tax savings by donating the stock rather than cash would be:

	Cash Donation from Proceeds	Stock Donation
Tax savings on contribution ($100,000 at 39.6% in 2016)	$ 39,600	$ 39,600
Capital gains tax if stock was sold ($40,000 at 23.8%*in 2016)	(9,520)	0
Net federal tax savings	**$ 30,080**	**$ 39,600**

Includes 3.8% Medicare Contribution Tax on net investment income.

The year that you can take the deduction is the year the charity actually receives the property. Therefore, make sure that you satisfy the legal transfer requirements for contributions of securities or other property that you make prior to year-end. One way to do this is by having the securities transferred directly from your brokerage account to the charity's brokerage account before year-end, thereby accelerating the process.

CONTRIBUTIONS DEDUCTIBLE ONLY AT COST RATHER THAN FAIR MARKET VALUE

Certain types of property will not avail you of a charitable deduction equal to the appreciated fair market value of the property. So, before contributing property, consider its eligibility and other options available to fund your charitable contributions. These types of property include:

Securities held for 12 months or less
If you contribute securities that you have held for 12 months or less, your charitable deduction is equal to the lesser of the fair market value or your basis in the stock. Therefore, you lose the deduction for any of the appreciation of the security.

Securities with a fair market value less than your cost
Never use these securities to fund your contributions since your deduction will be limited to the lower fair market value of the stock and you will permanently lose the benefit that you would have received had you sold these securities at a capital loss.

Other ordinary income property
The charitable deduction for ordinary income property is limited to the lesser of the fair market value or your basis in the property, even if you have held the property more than 12 months. Ordinary income property includes inventory items and property subject to depreciation recapture.

Tangible personal property
To get the property's full fair market value as a deduction, the appreciated property must qualify for long-term capital gain treatment had it been sold and the charitable organization must use this property in its exempt function (such as a painting given to a museum). Otherwise, your deduction will be limited to the lesser of your basis or the property's fair market value. Furthermore, if the charitable organization disposes of the property within 3 years, the donor will be required to include as ordinary income for the year of the disposition the difference between the charitable deduction and the donor's basis. However, if the organization certifies to the IRS, in writing, that the property's use was, or was intended to be, related to its exempt purpose or function, this rule would not apply.

Vehicles
If the charitable organization does not use the vehicle in its exempt function, but instead sells the vehicle (for over $500), your charitable deduction will be limited to the gross proceeds received from the sale by the charity, not the appraised value.

Fractional interest
A fractional interest contribution consists of a gift of an undivided portion of property to a charity that uses the property in connection with its exempt purposes (e.g., an interest in artwork that is contributed to a museum). In this situation, your initial charitable deduction will be the fair market value of the property multiplied by the fractional interest contributed.

As an example, let's say you donate the use of a painting valued at $400,000 to a museum for 3 months and you retain the painting for the remaining 9 months. Your charitable deduction would be $100,000 based on 25% of the value of the painting at the time of the contribution (3 months of the year). If you gift the use of the same painting next year for 6 months (additional 3 months or additional 25%) and the fair market value of the painting has increased to $440,000, your contribution would not be $110,000 based on 25% of additional contribution multiplied by the value of the painting when contributed. Instead, it would be $100,000 since a subsequent fractional interest donation of the same property is limited to the lesser of the value at the time of the initial fractional contribution or the value on the additional contribution date.

Beware that "recapture" will occur if you make an initial fractional contribution of artwork, then fail to contribute all of your remaining interest in the artwork to the same donee on or before the earlier of the date that's 10 years from the initial fractional contribution or the date of your demise ("specified period"). Recapture consists of an income inclusion in the year in which the specified period falls and is in the amount that was previously deducted plus interest running from the due date of the return for the year of the deduction until paid and a penalty of 10% of the amount of the income inclusion.

Remainder Interest in Real Property
The owner of real estate, such as a vacation home, can have full use of the property throughout his or her life and leave a remainder interest to a charitable organization. You will receive a charitable deduction based on the present value of the remainder interest in the property in the year that the remainder interest is contractually conveyed, not when the charity actually takes title to the property. Therefore, you receive a current deduction even though the charity does not receive the property until the condition of the conveyance occurs (death of the donor).

Conservation Easement
A conservation easement is a contribution of a real property interest to a charitable organization that uses the easement exclusively for conservation purposes. A real property interest for this purpose includes a perpetual restriction on the use of the real property. The donor does not give up ownership, control, or enjoyment of the land. The easement only restricts what can be done on or to the land. In the typical case, a perpetual conservation easement is given to a qualified conservation organization. The charitable deduction is equal to the difference in the fair market value of the property with and without the easement and requires a qualified appraisal. This type of charitable contribution often gives the IRS cause to scrutinize the valuation on which the deduction is based.

Under a temporary provision that had terminated for contributions made in taxable years beginning after December 31, 2014, the 30% contribution base limitation on deductions or capital gain property by individuals did not apply to 'qualified conservation contributions.' Rather, the 50% contribution base limitation and 5-year carryover applies. PATH reinstated and made permanent these provisions.

Unreimbursed expenses
Although you cannot get a charitable deduction for services performed on behalf of a charitable organization, you may deduct incidental unreimbursed expenses incurred while performing these services. Travel expenses to and from the place where the services are performed are deductible. You can deduct expenses of operating your car including tolls and parking fees but not expenses connected with maintenance of the car such as depreciation, repairs or car insurance. Alternatively, you can deduct 14¢ per mile. Reasonable expenses for meals and lodging while "away from home" in performing charitable services are deductible as well. Expenses that are considered personal and not specifically incurred in the performance of services on behalf of a charitable organization are not deductible.

IRA DISTRIBUTIONS AS CHARITABLE CONTRIBUTIONS

The provision for qualified charitable distributions, which allows IRA and inherited IRA owners age 70½ or older to transfer portions of their accounts to qualifying charities tax-free while satisfying all or a portion of their required minimum distributions, has been made permanent as a result of PATH.

According to the provision, if you are age 70½ or older, you can make tax-free distributions to charity from an IRA of up to $100,000 per year. These distributions must be made directly to the charity and are neither includible as income nor deductible as an itemized deduction on your tax returns.

In order to qualify, the charitable distribution must be made to a public charity. Payments to a donor-advised fund, supporting organization or private foundation do not qualify.

This technique has additional benefits since, unlike a taxable distribution, the distribution is not included in AGI. This may therefore impact the Medicare Contribution Tax on net investment income, the 3% reduction of itemized deductions, and the limitation of personal exemptions.

HOW TO ACCELERATE THE TAX BENEFIT OF FUTURE CONTRIBUTIONS AND MEET PHILANTHROPIC GOALS

Certain charitable vehicles allow you to accelerate the tax benefit of future contributions into the current year while retaining practical control over when such contributions are actually made to your intended charity. The most common charitable planning vehicles include:

- Donor-Advised Funds
- Private Foundations
- Charitable Trusts

DONOR-ADVISED FUNDS VS. PRIVATE FOUNDATIONS

Contributing to either a donor-advised fund or a private foundation offers a tax deduction (subject to different limitations), but they have their differences. The donor-advised fund is the simpler and less costly alternative. Using a private foundation requires you to create a legal entity with annual tax filings, subject to an excise tax on net investment income and other potential excise taxes (see the discussion below). Yet, despite these disadvantages, the private foundation can still be a preferable alternative if substantial amounts are involved, so consider the following similarities and differences when evaluating either of these options:

Obtain a large charitable deduction in the current year
Both a donor-advised fund and a private foundation allow you the ability to avoid paying capital gains tax on appreciated marketable securities held more than one year when such property is donated. However, a private foundation is subject to an excise tax of 2% on its net investment income, including capital gains on the appreciated property you contributed. The excise tax can be reduced to 1% depending on the foundation's level of granting in a given year. An income tax will be assessed on a foundation's unrelated business

income as well as an onerous excise tax if the foundation is involved in various acts of self-dealing or other prohibited transactions.

Retain control of the timing, amount and payment of future charitable contributions
The donor-advised fund permits you to make your contributions to a public charity that will retain them in an account (which can bear your name) for future charitable distributions. Typically, the fund will follow your charitable preferences, though it is not legally obligated to do so. The private foundation generally gives you more direct control, which can sometimes make it easier to achieve your investment goals and ensure that your charitable objectives are accomplished.

Maintain management control of the private foundation's investments
This can be one of the major advantages of the private foundation. You retain full control over all investment decisions, allowing you to use your investment expertise and resources to maximize the assets in the foundation.

Involve family members
A private foundation can provide intangible benefits by involving family members in a collaborative philanthropic effort. Your family can benefit from having the responsibility of making management decisions and formulating a mission statement to satisfy the family's overall charitable desires. The management responsibilities of the foundation can be passed down from one generation to another, perpetually keeping it in your family's name. It is also possible to give your children the ability to recommend charitable distributions for your donor-advised fund.

Make minimum distributions
A private foundation is subject to a rule which requires an annual distribution to charities equal to at least 5% of the average value of its assets. Excise taxes will be assessed on foundations that fail to distribute the required minimum distribution. Typically, although not always, the actual earnings and appreciation of the assets in the foundation are greater than the 5% minimum distribution. Donor-advised funds do not have a minimum grant distributions rule.

CHARITABLE TRUSTS

A charitable trust can provide the following benefits:

- Convert appreciated property into an annuity.
- Diversify your portfolio and defer capital gains tax.
- Obtain a current-year charitable deduction for the present value of a remainder interest left to charities by using a charitable remainder trust. However, with the present low interest rate environment, this deduction is lower than in the past.
- Pass appreciation on to your beneficiaries by using a charitable lead trust.

There are two types of charitable trusts — charitable remainder trusts ("CRTs") and charitable lead trusts ("CLTs"). You can set up either as an annuity trust or a unitrust. The annuity trust pays a fixed dollar annuity that is based on a fixed percentage of the initial trust value. The unitrust pays an annuity that will vary since it is based

tax tip

19 USE A CRAT TO DIVERSIFY YOUR PORTFOLIO AND PROVIDE YOU WITH AN ANNUITY

As an original shareholder in a company that went public, you now own stock that is worth $1,000,000 with a tax basis of only $400,000. You would like to diversify your portfolio but you have been reluctant to do so because of the capital gains tax.

One option you might want to consider is establishing a charitable remainder annuity trust ("CRAT"). By doing so, you can combine your desire to diversify your portfolio with your charitable giving intentions. The trust can sell the stock and pay no tax on the $600,000 gain at the time of the sale since the trust is a nontaxable entity. The trust can then use the proceeds from the sale to purchase other investments which, in turn, diversifies your overall portfolio allocation since you retain an annuity interest in the trust.

Assuming you choose a 10% payout rate, you will receive an annuity of $100,000 for the term of the trust, much of which will be eligible for the net long-term capital gains tax rate of 23.8% (inclusive of the Medicare Contribution Tax on net investment income) based on the undistributed gain of $600,000. You will also receive a current-year charitable contribution for the present value of the remainder interest going to charities. Remember, though, that the family loses the remainder value since it will pass to charities at the end of the trust's term.

on a fixed percentage of the trust's annual fair market value, which necessitates annual valuations.

CHARITABLE REMAINDER TRUSTS

A CRT can help you diversify your portfolio and increase your annual income stream while satisfying charitable desires (see Tax Tip 19). If you contribute highly appreciated securities to a CRT, such as a concentrated position in low basis stock, the CRT can sell them without incurring a current capital gains tax. You will not only diversify your portfolio and reduce market risk, but you will also receive an annuity based on the securities' fair market value. You will be taxed as you receive annuity payments, as discussed below. The annuity you receive will probably exceed the income you are currently receiving from the contributed securities (but you will be foregoing future appreciation in excess of the annuity).

The CRT's assets grow tax-deferred because it is not subject to tax and you only pay tax on the annuity payouts as you receive them. Therefore, the CRT can immediately sell the appreciated stock that you contributed and spread out the tax on the gain over the life of the annuity (you may never actually pay the full tax). The taxable nature of the annuity is based on the trust's undistributed accumulated income at year-end, subject to the ordering rules. The assets remaining at the end of the trust's term go to your designated charities.

You can choose to have the annuity paid to your beneficiaries instead of yourself, but you must consider gift tax consequences since you will have made a gift to your beneficiaries equal to the annuity's present value. The gift amount is set at the date of the transfer to the CRT. Typically, this may result in lower overall gift and estate taxes if the IRS tables used for determining the present value of the annuity payouts are at a rate that is lower than the actual growth rate experienced by the CRT. You can also reduce overall family income taxes if the beneficiary's tax rates are lower than your tax rates.

chart 6

CHARITABLE CONTRIBUTION LIMITATIONS BASED ON ADJUSTED GROSS INCOME

The maximum deduction you are allowed for your charitable contributions is subject to a limitation based on your AGI, as noted below. However, see the discussion above and notes below for ways to increase some of the limitation amounts. To the extent that your deduction is limited, you can carry the disallowed contributions forward for 5 years, subject to the same annual percentage limitations.

Contributions Made To	**AGI Limitation**	
	Cash and Ordinary Property Income	**Appreciated Capital Gain Property**
Public Charities*	50%	30%
Nonoperating Private Foundations	30%	20%
Private Operating Foundations**	50%	30%

These ceiling amounts can be increased in the following ways:

- If a nonoperating private foundation makes qualifying distributions out of its corpus within 2½ months after the end of its taxable year equal to 100% of the contributions it received during that year, the 30% limitation for cash and ordinary income property increases to 50% and the 20% limitation for appreciated capital gain property increases to 30%.
- The 30% limitation for appreciated capital gain property donated to public charities and private operating foundations can be increased to 50% by electing to reduce your contribution to the property's cost. This is only advisable if your contributions would otherwise be limited and it is unlikely that you will benefit from the carryover in the future.

**Donor-advised funds are treated as public charities.*

***Private operating foundations are nonpublicly supported organizations that devote most of their earnings and assets to the conduct of their own tax-exempt purposes.*

To qualify as a CRT, the trust must satisfy the following rules:

- The term of the trust cannot exceed 20 years and the trust must be irrevocable.
- The annual annuity income payout to the beneficiary must be at least 5%, but not greater than 50% of either the initial amount transferred to an annuity trust or the annual year-end fair market value of the assets for a unitrust.
- The value of the remainder interest to the charity must be at least 10% of the trust's initial fair market value.

CHARITABLE LEAD TRUSTS

The CLT is basically the reverse of the CRT. The annuity is paid to the charity and you or your beneficiaries receive the remainder interest at the end of the trust's term. But the income tax implications are complex because you are only allowed a charitable deduction if the CLT is structured as a grantor trust (with you reporting the annual income and charitable deduction). If the trust is set up as a non-grantor trust, you don't receive a charitable deduction but you are also not taxed on the income the trust earns.

Despite these complexities, a CLT can be an effective gift and estate tax planning tool because you are subject to gift tax only on the present value of the remainder interest you are giving away. This allows you to gift a much greater interest in assets, such as stock in an early stage company, and pay little or no gift taxes. If the stock value grows significantly, your beneficiaries will enjoy the excess appreciation since the growth will be greater than the earnings rate in the IRS tables for valuing the present value of the remainder interest, which has recently been very low. However, they will have to wait until the trust term ends in order to receive the remaining assets.

SUBSTANTIATE YOUR CASH CHARITABLE CONTRIBUTIONS

Regardless of the amount of the contribution, cash donations to charitable organizations must be substantiated with a bank record or written communication from the donee organization showing the name of the donee organization, the date the contribution was made, the amount of the contribution and the value of any benefit to you. Therefore, you must make sure to obtain the necessary documentation to support your cash charitable donations. A cancelled check is no longer sufficient substantiation if the contribution is $250 or more. The written acknowledgement must explicitly state whether any goods or services were received in connection with the donation. This rule eliminates your ability to deduct weekly cash contributions made at religious gatherings unless you can meet the substantiation rules.

NONCASH CONTRIBUTION APPRAISAL REQUIREMENTS AND LIMITATIONS

If you contribute property worth more than $5,000, you are required to obtain a qualified appraisal. Also, you must complete and attach Form 8283, Noncash Charitable Contributions Appraisal Summary, to your tax return. This form must include the qualified appraiser's signature, and an authorized person from the charitable organization must complete, sign and date the appropriate section of the form, indicating the date of the contribution and whether the property is being used for the charity's exempt purpose.

A complete copy of the signed appraisal must be attached to your tax return if you contribute any of the following:

- Artwork appraised at $20,000 or more.
- Any item, or group of similar items, for which you are claiming a charitable deduction greater than $500,000.
- Easements on buildings in historic districts.

Caution: *A qualified appraisal must meet certain criteria to be acceptable:*

- *The appraisal must be made not earlier than 60 days before the date you contribute the property and before the due date (including extensions) of your tax return on which the deduction is claimed.*
- *The appraiser must be an individual who has either earned an appraisal designation from a recognized professional appraisal organization, has met certain minimum education and experience requirements, regularly prepares appraisals for which he or she is paid, or demonstrates verifiable education and experience in valuing the type of property being appraised.*

Contributions of similar items of property with an aggregate value exceeding $5,000 are subject to the same requirements. For example, if you contribute clothing valued at $3,000 to one charity and your spouse contributes clothing valued at $2,500 to another charity, you would need to obtain qualified appraisals for both contributions. The appraisal requirements do not apply to contributions of cash, publicly traded securities or non-publicly traded stock worth less than $10,000.

If these requirements are not satisfied, no charitable deduction is allowed, even if the charity received the property and the value is not in dispute.

Medicare Contribution Tax on net investment income

Charitable gifts are not deductible for purpose of calculating 3.8% Medicare Contribution Tax on net investment income of high income taxpayers.

interest expense

Interest expense may reduce your tax liability, but deductibility depends on how the proceeds from the debt are used.

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INTEREST DEDUCTIBILITY

Your ability to deduct interest payments is subject to many rules and limitations. Deductibility of interest expense depends on how you used the debt proceeds. Before incurring any new debt, you should consider the options available to you to get the best tax result from the interest you will pay on the debt. Also, periodically review your debt to determine whether you can replace debt generating nondeductible interest with other debt so that you can lower your taxes.

Once deductible, there are also rules that categorize whether the interest is deductible against your AGI (also known as "above-the-line" deductions) or as an itemized deduction. Generally, above-the-line interest deductions will yield a better tax result. This difference can especially be significant in reducing your state and local income tax bill, since many states do not allow itemized deductions (or severely limit them). Chart 7 summarizes the nature of the different types of interest deductions.

QUALIFIED RESIDENCE

Interest paid on mortgage debt used to acquire or improve your home is deductible as qualified residence interest, subject to limitations. The 2 types of qualified mortgage debt are:

Acquisition debt
This is debt incurred on the acquisition, construction or substantial improvement of your principal residence and your second home (a so-called vacation home if used for personal purposes). The debt must be secured by the residence and is limited in total to $1 million ($500,000 if married filing separately). Acquisition debt also includes debt from a refinancing of an existing acquisition debt, but only up to the principal of that debt at the time of the refinancing plus any proceeds used to substantially improve your residence. A home equity loan that is used to substantially improve your residence qualifies as acquisition debt. Qualified residence interest does not include interest paid on loans from individuals, such as your parents, if your home is not security for the debt and the debt is not recorded at the appropriate government agency (for example, the county clerk's office).

chart 7

INTEREST EXPENSE DEDUCTION

Nature Of Debt	Nature of Deduction		
	Not Deductible	**Itemized Deduction**	**Above-the-Line Deduction**
Qualified residence (including a second home)		▪	
Personal or consumer	▪		
Taxable investments		▪	
Tax-exempt investments	▪		
Trading activities			▪
Business activities			▪
Passive activities			▪
Education loans			▪

Note: *Other rules may limit your ability to deduct the interest expense in full.*

Mortgage insurance premiums
PATH extends through 2016 the treatment of qualified mortgage insurance premiums as interest for purposes of the mortgage interest deduction. This deduction phases out ratably for a taxpayer with AGI of $100,000 to $110,000.

Home equity debt
In addition to acquisition debt, you can deduct mortgage interest on a home equity debt up to $100,000 ($50,000 if married filing separately) as long as the debt is secured by a qualified principal residence and does not exceed the equity in your house. Combined with acquisition debt, it allows you to deduct interest on qualifying debt up to $1,100,000. Interest on home equity debt up to $100,000 is deductible as qualified mortgage interest regardless of how you use the proceeds (except if used to purchase tax-exempt bonds). However, interest on home equity debt not used to substantially improve your residence is not allowable as a deduction against the AMT thereby effectively increasing your interest rate if you are in the AMT.

Points
Points may be fully deductible in the year paid, or they may be deducted over the life of the loan. In order to be deductible in the year paid, the following are some criteria that must be met:

- Your loan is secured by your principal residence.
- You use the loan to buy or build your principal residence.
- The points were stated as a percentage of the indebtedness.
- The amount is clearly shown in closing statement as points.

If the loan is to refinance your principal residence or a second home, points must be deducted over the life of the loan. If the loan is paid off early, you may deduct any points not already deducted in the year in which the loan is paid off.

For 2016, the benefit of the mortgage interest deduction may be reduced due to the itemized deduction limitation that applies when AGI for single filers exceeds $259,400 ($311,300 for joint filers). Your itemized deduction limitation will be the lesser of (a) 3% of the AGI above the applicable amount, or (b) 80% of the amount of the itemized deductions. The 2017 threshold amounts are $261,500 for single filers, $313,800 for married filing jointly, $287,650 for head of household, and $156,900 for married individuals filing a separate return.

tax tip

20 CONVERT NONDEDUCTIBLE DEBT INTO DEDUCTIBLE MARGIN DEBT

You can reduce or eliminate your personal debt by converting it into deductible margin debt. Rather than using the proceeds from the sale of securities to buy other securities, use the proceeds to pay off your personal debt. You can then use margin debt, to the extent available, to buy new securities. Your total debt and your total stock portfolio remain the same, but you will have converted nondeductible interest into deductible investment interest (assuming no other limitations apply). And the interest rate on margin debt is typically lower than the rate on consumer debt.

Caution: *Keep loan proceeds totally separate from other funds whenever possible. This can avoid reallocation by the IRS, and may save important tax deductions.*

PERSONAL OR CONSUMER DEBT

Interest expense from personal (or consumer) interest expense is nondeductible. This type of debt includes interest paid on debt used to pay personal expenses, buy consumer goods (including cars), or satisfy tax liabilities. The simplest way to convert this nondeductible interest into deductible interest is to take out a home equity loan to pay off your personal debt. Remember, you can use up to $100,000 of home equity debt for any purpose, including paying off personal and credit card debt. In addition to making the interest deductible, you'll benefit from the generally lower interest rate on this type of debt. If you have already utilized your home equity line, see Tax Tip 20 for a method to convert personal debt into investment debt.

If you have interest expense arising from a passive activity that is being limited because you have excess passive losses, consider replacing this debt with home equity debt or investment debt in the same manner as discussed in Tax Tip 20.

INVESTMENT INTEREST

Investment interest is interest on debt used to buy assets that are held for investment. Margin debt used to buy securities is the most common example of investment debt. Another typical source of investment debt is the pro rata share of investment debt incurred by a pass-through entity (partnership, LLC, or S corporation). The investment interest expense on this debt is treated in the same manner as if you personally paid the interest.

Interest on debt used to buy securities which generate tax-exempt income, such as municipal bonds, is not tax-deductible. But be careful, since this rule can reach further than you would expect. As Tax Tip 21 illustrates, you are required to allocate interest expense to the tax-exempt income, rendering a portion of the interest expense as nondeductible.

Investment interest expense is only deductible up to the amount of your net investment income. Generally, this includes taxable interest, nonqualifying dividends (as discussed below) and net short-term capital gains (but not net long-term capital gains). Your investment income is reduced by deductible investment expenses (other than interest) directly connected with the production of investment income (e.g., investment advisory fees) but only to the extent they exceed 2% of your AGI. If you are in the AMT, your net investment income will generally be higher because it does not get reduced by investment expenses since you did not receive a tax benefit for these deductions. As a result, your deductible investment interest can be greater for AMT purposes. Any disallowed interest for the regular tax or AMT is carried forward and can be deducted in a later year, to the extent that there is adequate net investment income.

For 2016, qualified dividend income that is eligible for the 15% (20% if AGI exceeds $415,050 for single filers ($418,400 in 2017), $233,475 for married filed separately ($235,350 in 2017), and $466,950 for married filed jointly ($470,700 in 2017)) preferential tax rate is not treated as investment income for purposes of the investment interest expense limitation. However, dividends not qualifying for this rate, including dividends received from money market mutual funds and bond funds, are subject to ordinary income tax rates and therefore qualify as investment income.

If you have an investment interest expense limitation, an election is available to allow you to treat any portion of your net long-term capital gains and qualifying dividend income as investment income. Generally, this election should only be used if you do not expect to be able to utilize any of the investment interest carryover in the near future. This election can increase the amount of investment interest expense that you can deduct in the current year. By making this election, you lose the favorable lower capital gains and qualified dividend tax rate of 15% or 20%, but you get to reduce your taxable income by the increased investment interest expense you deduct at the higher ordinary income tax rates.

As an example, assume in 2017 you are subject to the maximum tax rate of 39.6% and you have $100,000 of investment interest expense in excess of your net investment income. You also have net long-term capital gains of $500,000. By electing to treat $100,000 of the $500,000 long-term capital gains as ordinary income, you pay an extra $19,600 of tax on the capital gains ($100,000 of elected gains taxed at 39.6% rather than 20%). However, you save $39,600 of tax since your taxable income is lower by the additional investment interest expense ($100,000 at 39.6%). Therefore, your net tax drops by $20,000. Plus, you will save state taxes if your state of residency allows you to reduce your income by all, or some, of your itemized deductions.

Additionally, the investment interest expense deduction can help reduce the 3.8% Medicare Contribution Tax on net investment income.

ABOVE-THE-LINE DEDUCTIONS

Interest expense deductible "above-the-line" against your AGI gives you a greater tax benefit than interest treated as an itemized deduction. This is because the interest expense reduces your AGI, which in turn reduces the 2% phase-out of your miscellaneous itemized deductions, and, if applicable, the limitation on deductible medical expenses, charitable deductions and other items affected by AGI. For 2016 and beyond, it will also impact the overall limitation on your itemized deductions and personal exemptions. But even more beneficial for most taxpayers is that the interest will be deductible against your state income, rather than nondeductible if you live in a state that does not allow itemized deductions (such as Connecticut, Pennsylvania and New Jersey), or limited in a state that disallows a portion of your itemized deductions (such as New York and California).

tax tip

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INDIRECT TAX-EXEMPT DEBT CAN LIMIT YOUR DEDUCTIBLE INTEREST

It is common to have one investment account that holds mostly tax-exempt municipal bonds and a separate account that holds mostly taxable investments (such as stock in publicly traded companies). Assume that you want to use your available margin in the account holding taxable investments to purchase additional stock. Even though you are not using margin in your tax-exempt account, your interest deduction will be limited because of an IRS ruling that requires you to allocate a portion of the debt to your tax-exempt holdings based on the ratio of your tax-exempt investments to your total investments. This ruling was designed to prevent a taxpayer from reaping a double tax benefit, and thus treats your accounts as one account and deems you to have indirectly borrowed some of the debt to maintain your tax-exempt account. Therefore, before you borrow against your securities, consider the real after-tax cost of the interest you will be paying.

Interest expense eligible for this favorable treatment includes:

Trading interest

This is interest incurred on borrowings against taxable securities if you are actively engaged in the business of trading personal property (securities), rather than simply as an investor. This interest commonly passes through a trading partnership or LLC. The interest will be classified as trading interest to you even if you have no involvement in the management of the entity, so long as the entity meets the tests for actively engaging in the business of trading personal property. However, in such a case, the trading interest is still subject to the investment interest expense limitation discussed above.

Business interest

This is interest on debt traced to your business expenditures, including debt used to finance the capital requirements of a partnership, S corporation, or LLC involved in a trade or business in which you materially participate. This also includes items that you purchase for your business (as an owner) using your credit card. These purchases are treated as additional loans to the business, subject to tracing rules that allow you to deduct the portion of the finance charges that relate to the business items purchased.

Interest on education loans

A qualified education loan is any debt incurred solely to pay the qualified higher education expenses of the taxpayer, the taxpayer's spouse, or an individual who was the taxpayer's dependent at the time the debt was incurred.

For 2016 and 2017, the maximum deductible amount for educational loan interest is $2,500. The student loan interest begins to phase-out for taxpayers whose MAGI exceeds $65,000 in 2016 and 2017 ($130,000 for 2016 and $135,000 for 2017 for joint returns) and is completely eliminated when MAGI is $80,000 in 2016 and 2017 ($160,000 in 2016 and $165,000 in 2017 for joint returns).

Passive activity interest expense

Passive interest expense is interest on debt incurred to fund passive activity expenditures, whether paid by you directly or indirectly through the capital requirements of a pass-through business entity. The interest is an additional deduction against the income or loss of the activity, thereby deductible against AGI. However, since the interest expense becomes part of your overall passive activity income or loss, it is subject to the passive activity loss limitations. See the chapter on passive and real estate activities.

retirement plans

Contributing to retirement plans can provide you with financial security as well as reducing and/or deferring your taxes. However, there are complex rules that govern the type of plans available to you, the amount you can contribute, whether contributions need to benefit your employees, and the requirements for taking funds out of the plan. Failure to adhere to these rules can have severe adverse tax consequences.

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RETIREMENT PLAN BENEFITS

Retirement plans (other than Roth IRAs and plans offering Roth 401(k) plans) offer these tax saving advantages:

- Your contributions grow tax-deferred until withdrawn.
- Your contributions are tax deductible, thereby reducing your current year's taxes.

Roth IRAs and Roth 401(k) plans offer different tax savings opportunities by providing for tax-free growth and withdrawals in the future, but there is no current-year tax deduction for your contributions.

chart

8

RETIREMENT PLANS

Retirement plans available to self-employed individuals include:

- Simplified Employee Pension (SEP) Plans
- SIMPLE IRA or SIMPLE 401(k) Plans
- Defined Contribution Plans including 401(k) Plans
- Defined Benefit Plans

Employer-sponsored salary deferral plans available to employees include:

- 401(k) Plans
- 403(b) Plans for Employees of Public Schools or Tax-Exempt Educational, Charitable and Religious Organizations
- 457(b) Plans for Employees of Government Organizations
- SIMPLE Plans for Companies with 100 or Fewer Employees

Individual Retirement Accounts (IRAs) available to all individuals, subject to income limitations:

- Roth
- Traditional
- Education

AVAILABLE RETIREMENT PLANS

There are many different types of retirement plans available with different contribution and distribution rules. The specific plan(s) you can contribute to depends on a variety of factors, including your income, whether you are an employee or self-employed, and whether or not you contribute to or participate in other retirement plans.

Self-employed individuals have more flexibility to choose plans to maximize contributions. Employees are more limited since they will have to make contributions based on the type of plan their employer offers, but may gain the advantage of having their employer match some or all of their contributions. Employees may also be eligible to make contributions to other plans in addition to the ones offered by their employer, if they have earned income from a self-employment activity (such as consulting or directors' fees). Employees or self-employed individuals and their spouses may also be eligible to contribute to a traditional or Roth IRA.

Chart 8 shows the different types of retirement plans that you may be eligible to participate in. Chart 9 shows the maximum annual contributions that you can make for 2016 and 2017.

SIMPLIFIED EMPLOYEE PENSION PLAN

A SEP plan allows you, in your capacity as employer, to make contributions to your own IRA and to eligible employees' IRAs. If you do not have employees, the plan is a single participant plan for your benefit. If you have eligible employees, you must also make contributions on their behalf. The maximum allowable annual contribution to a SEP is $53,000 for 2016 and $54,000 for 2017. However, the contribution on behalf of a self-employed individual cannot exceed 25% of his or her eligible compensation (net of the deduction for the contribution). The contribution limit for common law employees covered by a SEP is the lesser of 100% of their eligible compensation or $53,000 for 2016 and $54,000 for 2017.

There are several advantages of a SEP compared to a qualified defined contribution plan (e.g., a profit-sharing plan). Unlike a defined contribution plan, which must be established by December 31, a SEP plan can be set up any time prior to the due date of the tax return for the current year of the sponsoring entity (including extensions as late as October 15) and you can still deduct contributions on your prior year's tax return, even though made in the next year. Another advantage is that SEPs do not require the same documentation as defined contribution plans, nor is Form 5500 required to be filed annually.

QUALIFIED DEFINED CONTRIBUTION AND BENEFIT PLANS

A qualified defined contribution plan can be a profit-sharing plan, a money purchase pension plan, or a target benefit pension plan.

The maximum contribution to a defined contribution plan for each employee is the lesser of $53,000 in 2016 and $54,000 for 2017 or 100% of his or her compensation. For self-employed individuals, the maximum contribution will generally be limited in the same manner as for SEPs unless 401(k) provisions are included in the plan.

A qualified defined benefit plan sets a future annual pension benefit and then actuarially calculates the contributions needed to attain that benefit. Because the plan is actuarially driven, the annual contribution may exceed those allowable for other types of plans, and is based on the employee's age, average annual income and annual desired benefit (limited to the maximum allowable annual benefit). The maximum allowable annual benefit is the lesser of $210,000 in 2016 and $215,000 for 2017 or 100% of earned income.

Whether you choose a defined contribution or a defined benefit plan, your plan must be in place by December 31 of the year for which you want to make tax deductible contributions to the plan. As long as the plan is in existence on that date, you can make tax deductible plan contributions to a defined contribution plan as late as the due date of that year's income tax return, including extensions (as late as October 15, or September 15 for sole proprietors, partnerships, LLCs or corporations). For calendar year-defined benefit plans, contributions must be made by September 15, regardless of an extension to file until October 15.

In-Plan Roth conversions

Employees can elect under certain conditions to convert some or all of certain amounts that were contributed to a plan on a pre-tax basis into a Roth after-tax account inside of the plan. This is known as an "in-plan" Roth conversion. Both 401(k) plans and 403(b) plans may permit such a conversion, but the plan documents must provide for the in-plan conversion.

There is no recharacterization option for an in-plan Roth conversion, so once a conversion is made it is irrevocable.

chart 9

RETIREMENT PLAN MAXIMUM ANNUAL CONTRIBUTION LIMITS

	Maximum Annual Contribution	
Type of Plan	**2016**	**2017**
401(k), 403(b), salary deferrals	**$ 18,000**	**$ 18,000**
Defined-contribution plan including salary deferral amounts above	**53,000**	**54,000**
Defined-benefit plan*	**210,000**	**215,000**
Traditional and Roth IRAs	**5,500**	**5,500**
SEP Plans	**53,000**	**54,000**
457(b) salary deferrals to state and local government and tax-exempt organization plans	**18,000**	**18,000**
SIMPLE plans (Savings incentive match plan for employees)	**12,500**	**12,500**
Catch-up contributions for individuals age 50 or older		
• 401(k), 403(b) and 457(b) plans	**6,000**	**6,000**
• Traditional and Roth IRAs	**1,000**	**1,000**
• SIMPLEs	**3,000**	**3,000**

** This is the maximum annual benefit that can be provided for by the plan, based on actuarial computations.*

Application to plans and participants

Any current or former plan participant who has an account balance in the plan and who is eligible to receive an eligible rollover distribution ("ERD") can make the Roth conversion election. The election is available to surviving spouses, but not non-spouse beneficiaries. There is no income limit or filing status restriction for this election. The conversion may be applied to any type of vested contributions (and earnings thereon) that are currently distributable and would be treated as an ERD. Contribution types that would be eligible for conversion are: pre-tax 401(k), 403(b), and 457(b) deferrals; matching contributions; and profit sharing contributions. In addition, certain after-tax contributions may be rolled over to an in-plan Roth account.

SALARY DEFERRAL PLANS (401(k), 403(b) AND 457(b) PLANS)

A 401(k) plan is a profit sharing plan that allows participants to elect to have a portion of their compensation contributed to the plan. The maximum employee elective contribution that can be made for 2016 and 2017 is $18,000 ($24,000 for taxpayers age 50 and over). This annual limit applies to your total contributions even if you have more than one employer or salary deferral plan.

Similar provisions apply for 403(b) and 457(b) plans.

SIMPLE PLANS

An employer that had no more than 100 employees who earned $5,000 or more of compensation in the preceding year can establish a SIMPLE plan as long as the employer doesn't maintain any other employer-sponsored retirement plan. A SIMPLE plan can take the form of an IRA or a 401(k) plan. Both plans allow employees to contribute up to $12,500 for 2016 and 2017 ($15,500 for taxpayers age 50 and over) with the employer generally required to match employee contributions at a maximum of 3% of the employee's compensation. For a SIMPLE IRA, the employer may choose to reduce the matching contribution to less than 3% but no less than 1% in 2 out of every 5 years.

Caveat: *The benefit of a SIMPLE plan is that it is not subject to non-discrimination and other qualification rules, including the top-heavy rules, which are generally applicable to qualified plans. The downside is that you cannot contribute to any other employer-sponsored retirement plan and the elective contribution limit is lower than for other types of plans. For the employee, the mandatory employer matching requirement can be attractive, though limited. For the employer, the contributions are not discretionary.*

chart 10

UNIFORM LIFE TABLE

If you are either unmarried, or married but your spouse is either not the sole beneficiary or is not more than 10 years younger than yourself, you can compute your required minimum distribution by using this table. Assuming you are 73 years old and your qualified retirement plans, in the aggregate, were valued at $2,000,000 at the end of 2016, you would be required to take a minimum distribution of $80,972 in 2017 ($2,000,000 divided by a distribution period of 24.7).

Age	Distribution Period	Age	Distribution Period
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

PATH allows a taxpayer to roll over amounts from an employer-sponsored retirement plan (e.g., a 401(k) plan) to a SIMPLE plan, provided that the plan has existed for at least 2 years.

INDIVIDUAL RETIREMENT ACCOUNTS (IRAs)

Reminder: *You can make only one rollover from an IRA to another (or the same) IRA in any 12-month period, regardless of the number of IRAs you own. The one-rollover-per-year limitation is applied by aggregating all of an individual's IRAs, including SEP and SIMPLE IRAs, as well as traditional and Roth IRAs, effectively treating them as one IRA for purposes of the limit. Please note that the following rollovers are exempted from this rule:*

- Trustee-to-trustee transfers between IRAs are not limited because you do not receive a physical check from the originating IRA to deposit to the new IRA. Therefore, the transfer is not considered a rollover by the IRS. The assets and/or cash are electronically transferred from the old IRA trustee to the new IRA trustee.
- Rollovers from traditional to Roth IRAs ("conversions") are not limited (because they generate tax revenue).

Example: *If you have 3 traditional IRAs, (IRA-1, IRA-2 and IRA-3), and you took a distribution from IRA-1 on January 1, 2017 (received a check) and rolled it over into IRA-2 the same day (must be within 60 days), you could not roll over any other 2017 IRA distribution unless the rollover meets one of the above exceptions or the transition rule discussed below.*

The 2 most common types of IRAs are Roth IRAs and traditional IRAs. While there are significant differences between these IRAs, there are also common rules that apply to both of them. You can contribute up to $5,500 for 2016 and 2017 ($6,500 if at least age 50) to either IRA account, or both combined. To be deductible as a contribution for a traditional IRA (Roth contributions are not tax deductible) in the current year, you must make the contribution on or before April 15 of the following year. An extension to file your tax return does not extend this date. To be eligible to contribute to either IRA, you must have earned income equal to or greater than the IRA contribution amount. Taxable alimony is considered earned income for IRA purposes.

TRADITIONAL IRA: CURRENT TAX DEDUCTION

A traditional IRA allows a current tax deduction for your contributions and the earnings grow tax-deferred. The contributions lower your current year's taxes, but future distributions will be fully taxable as ordinary income, subject to ordinary income tax rates at the time of distribution. Also, once you reach age 70½, you can no longer make contributions in that year or future years. You can only make tax deductible contributions to a traditional IRA if you (or your spouse, if married) do not actively participate in an employer-sponsored retirement plan for any part of the year. However, you can still make contributions to an employer-sponsored plan and deduct your own IRA contributions if you meet one of these exceptions:

- You are single and your MAGI does not exceed $61,000 in 2016 and $62,000 for 2017. A partially deductible IRA contribution is allowed until your MAGI reaches $71,000 in 2016 and $72,000 for 2017.
- You are married, but only one of you actively participates in an employer-sponsored plan and your combined MAGI doesn't exceed $184,000 in 2016 ($186,000 in 2017). Only the non-active participant can make a deductible IRA contribution. A partially deductible contribution can be made until the combined MAGI reaches $194,000 in 2016 ($196,000 in 2017).
- Both you and your spouse (if filing jointly) participate in employer-sponsored plans, but your combined MAGI does not exceed $98,000 in 2016 and $99,000 in 2017. You can make a partially deductible IRA contribution until your MAGI reaches $118,000 in 2016 and $119,000 in 2017.
- You can always make a nondeductible contribution irrespective of the income limitations or participation in an employer-sponsored plan up until the year you attain age 70½.

ROTH IRA: NO TAXES ON DISTRIBUTIONS

A Roth IRA differs from a traditional IRA primarily because your contributions are made on an after-tax basis, but your withdrawals are generally tax-free. A Roth IRA offers these advantages over a traditional IRA:

- You never pay any income tax on the earnings if you take only qualified distributions. To qualify as a tax-free distribution, the Roth IRA must have been opened more than 5 years ago and the distribution must be made after age 59½ (with a few exceptions).

- Distributions before reaching age 59½ (and other nonqualified distributions) are first treated as a nontaxable return of your contributions. To the extent these distributions do not exceed your contributions, they are not taxed. This gives you more flexibility to withdraw funds to cover financial emergencies. However, amounts that exceed your accumulated contributions are subject to regular income tax, plus an additional 10% penalty as nonqualified distributions.

- Original account owners and their spouses who are designated beneficiaries are not required to take distributions beginning at age70½ — or ever.

- Your contributions can continue to be made to the plan after you reach age 70½, as long as you have sufficient earned income and/or alimony.

- Contributions to a Roth IRA can be made even if your MAGI is too high for a traditional IRA or you are covered by an employer-sponsored plan. The AGI limits for making Roth IRA contributions are $184,000 in 2016 ($186,000 in 2017) if you are married filing jointly, or $117,000 in 2016 ($118,000 in 2017) if you are single or head of household (with partial contributions permitted until your AGI reaches $194,000 in 2016 ($196,000 in 2017), if married filing jointly and $132,000 in 2016 ($133,000 in 2017) if single or head of household).

If you already have a traditional IRA in place, you may want to consider rolling part or all of the balance into a Roth IRA. The advantage of this rollover is that you convert tax-deferred future growth into tax-free growth. The disadvantage is that the amount of the rollover from the traditional IRA is taxable, as if you received the distribution. Before you roll over anything, evaluate the potential benefit of the tax-free growth compared to the lost earnings on the tax you pay because of the rollover.

- **Who should make a conversion to a Roth IRA?** Those individuals who have many years to go before retirement and who should be able to recover the tax dollars lost on the conversion may benefit from a conversion. Others who may benefit are those who anticipate being in a higher tax bracket in the future and those able to pay the tax on the conversion from non-retirement account assets.

- **What are some planning ideas for high-income taxpayers?** High-income individuals can make nondeductible contributions to a traditional IRA this year and in future years so that the amounts can be converted to Roth IRAs. However, to the extent an individual also has a traditional IRA funded with pre-tax contributions, the conversion is deemed to be made pro rata from each IRA. High income individuals whose spouses are much younger and who do not anticipate the need to take distributions should consider a conversion to a Roth since the spouse may take the Roth IRA as her own and distributions will not be required until the second spouse passes.

REQUIRED MINIMUM DISTRIBUTION ("RMD") RULES

You must generally start taking RMDs from your qualified retirement plan or traditional IRA by April 1 of the year following the year in which you reach age 70½. For each year thereafter, the RMD amount must be taken by December 31 of that year. If you are a participant in a qualified retirement plan of your current employer, you should refer to the plan document or consult with your employer regarding when you must begin receiving RMDs from the plan as some plans do not require you to take RMDs until you terminate your employment even if you have already reached age 70½ before leaving your employer. For example, if you own 5% or less of the employer and are still employed by the employer at 70½, the plan document may allow you to defer taking distributions from the plan until you actually retire. This exception does not apply to SEPs or SIMPLE IRAs.

Note: *If you turned or will turn 70½ during the year, you can either take a distribution in that year or defer the distribution until the following year. If you elect to defer, you must take 2 distributions the following year (the first by April 1 and the second by December 31).*

Generally, if you fail to take an RMD from your qualified retirement plan or traditional IRA after you reach 70½, you are subject to a 50% penalty on the shortfall. If you are subject to the penalty, you do not have to take a catch-up distribution since the penalty effectively covers the income tax that you would have had to pay on the distribution, as well as a penalty. The RMD is computed by taking the aggregate value of all your qualified retirement plans at December 31 of the prior year and dividing that sum by a distribution period determined by the IRS. There are 2 tables for determining the distribution period. One is called the Uniform Lifetime Table and is used by unmarried individuals, or a married individual if the individual's spouse is either not the sole beneficiary or is not more than 10 years younger than the individual. The other table is the Joint Life and Last Survivor Expectancy Table and is used when the spouse is the sole beneficiary and is more than 10 years younger than the individual. The Uniform Lifetime Table, the more commonly used table, is reproduced in Chart 10 with an example of how to compute your RMD.

AVOID EARLY WITHDRAWAL PENALTIES

Generally, withdrawals from employer-sponsored qualified plans and IRA accounts are taxed at your ordinary income tax rate. If taken before reaching age 59½ you are also subject to a 10% early withdrawal penalty unless you meet one of the following exceptions:

- You take distributions because of job separation (such as early retirement) and you are at least 55 years old at the time you terminate your employment with the employer. These distributions must be made as part of a series of substantially equal periodic payments (made at least annually) for the individual's life (or life expectancy) or the joint lives (or joint life expectancies) of the individual and the designated beneficiary(ies). If early distributions are from an employee plan, payments must begin after separation of service.

Note: *This exception does not apply to IRA accounts.*

- You receive distributions under a qualified domestic relations order (pertaining to a court-ordered separation or divorce).
- You have a qualifying disability.
- You are the beneficiary on the account of a deceased participant.
- You use distributions for medical expenses, limited to the amount not otherwise deductible.
- You take distributions in the form of substantially equal periodic or annuity payments for a period of at least 5 years and the last payment is received in a year after you reach age 59½.
- You use the distribution to make a first-time home purchase (limited to $10,000).
- You use the distribution to pay for qualified higher education expenses for you, your spouse, your children or your grandchildren.

DISTRIBUTIONS BETWEEN AGE 59½ AND 70½

Even though you are not required to take distributions between the ages of 59½ and 70½, you may need to take them to meet expenses or you may want to take them if your tax bracket is low. Though you are not subject to the early withdrawal penalties, the distributions are taxable in the year withdrawn. If you take distributions to take advantage of a low tax bracket, make sure you compare the benefit of the reduced rate against the loss of the tax-deferred growth had the funds been left in the retirement account.

LUMP-SUM (OR OTHER ELIGIBLE) DISTRIBUTIONS

Amounts distributed from a qualified retirement plan can be rolled over tax-free into an IRA or another qualified plan as long as the transfer is done directly from trustee to trustee. If you personally receive the funds, 20% of the distribution is required to be withheld for federal income taxes (some states also require state income tax withholding). If you fail to roll over the full amount of the distribution (before any withholding tax) within 60 days to another IRA or qualified retirement plan, you will also be subject to income tax and possibly early withdrawal penalties on the distribution if you are under age 59½.

Special Planning Note: *Distributions from qualified plans that are not made from a designated Roth account may be rolled over directly to a Roth IRA. Under these rules, you will be required to pay income taxes in the year of the distribution, but will not be subject to the mandatory 20% tax withholding or the 10% early distribution penalty if you are younger than age 59½. Previously, only distributions from designated Roth accounts of qualified plans could be directly rolled over to a Roth IRA without being subject to the income limitation.*

SURVIVING SPOUSE DISTRIBUTION RULES

Upon the death of a participant/owner of a qualified retirement plan or IRA, a surviving spouse can make an eligible rollover distribution into his or her own plan or IRA. Distributions from the surviving spouse's plan or IRA would not be required until he or she reached age 70½. At that time, the RMD rules discussed above would apply.

NONSPOUSE BENEFICIARIES

If allowed under the terms of the plan document, distributions from a deceased participant's qualified retirement plan are permitted to be rolled over into an IRA for a beneficiary who is not the decedent's spouse, such as a child of the deceased. The rollover must be in the form of a direct trustee-to-trustee transfer to an IRA for the benefit of the beneficiary. The IRA is treated as an inherited IRA so the beneficiary will not have the ability to roll over the IRA to another IRA in the future. However, the beneficiary will now be allowed to take funds out of the inherited IRA over his or her life expectancy, beginning in the year after the decedent's death, rather than fully within 5 years (as noted below).

If the plan document governing your plan does not provide for non-spouse rollovers to an inherited IRA, then non-spouse beneficiaries such as children of the deceased are not eligible to roll over a decedent's qualified plan balance into their own plan or IRA. They must take distributions based on the minimum distribution method used by the decedent if he or she had already reached 70½, or within 5 years after the decedent's death if the decedent had not yet begun taking required minimum distributions.

A non-spouse beneficiary of a decedent's IRA will have to commence taking RMDs beginning in the year following the year of the IRA account holder's death based on the life expectancy of the oldest beneficiary (if more than one primary beneficiary is named). This is true whether the IRA account holder was already taking RMDs or died before his or her required beginning date. Alternatively, if the IRA account holder died before his or her required beginning date, the beneficiary(ies) have the option of still using the 5-year rule, which does not require any distributions from the account until the year containing the fifth anniversary of the IRA account holder's death. However, in that year, the entire account must be distributed.

estate and gift tax planning

On January 1, 2013, Congress enacted ATRA. This law created certainty and provides for planning opportunities to reduce tax cost of transferring your assets to your beneficiaries.

EisnerAmper

ESTATE, GIFT AND GENERATION-SKIPPING TAXES

Background

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") provided, among other provisions, a phased reduction in the maximum rate of estate and generation-skipping taxes during the years 2002 through 2009, elimination of these taxes for 2010, and a reinstatement of these taxes after 2010 at the tax rates (and with the exclusions) in effect in 2001. Almost everybody believed that Congress would act to either permanently repeal the estate and generation-skipping taxes or, more likely, enact a modified regime for these taxes to begin in 2010 (or earlier).

In December 2010, Congress enacted the 2010 Tax Relief Act— a temporary, 2-year reprieve from the sunset provisions of EGTRRA. This Act extended and modified the federal estate, gift, and generation-skipping tax provisions through December 31, 2012. These provisions allowed estates of married couples whose assets were $10 million or less to avoid federal transfer taxes in 2011. For 2012, an inflation adjustment made this $5.12 million per person ($10.24 million for a married couple).

On January 1, 2013, the final compromise was reached and ATRA permanently extended and modified federal estate, gift, and generation-skipping tax provisions. For 2015 and 2016, due to inflation adjustment, the exclusion amount increased to $5.43 million (or $10.86 million per couple) and $5.45 million per person (or $10.9 million per couple), respectively. For 2017, the exclusion has been increased to $5.49 million per person or $10.98 million per couple.

As a result of ATRA, the $5 million exclusion, adjusted for inflation, has been made permanent with a maximum tax rate of 40%. This rate was a compromise between 35% and 55% marginal tax rates of previously enacted estate and gift tax provisions.

chart 11 MAXIMUM GIFT, ESTATE, AND GST TAX RATES AND EXEMPTIONS

The following chart shows the rates and exemptions for the tax years 2010 through 2016 and thereafter:

	Maximum Rates	Exemptions (Cumulative Tax-Free Transfers)			State Tax Credit
Year	Gift, Estate and GST Tax	Gift	Estate	GST	
2010*	35%	$1,000,000	$5,000,000	$5,000,000	NO
2011	35%	$5,000,000	$5,000,000	$5,000,000	NO
2012	35%	$5,120,000	$5,120,000	$5,120,000	NO
2013	40%	$5,250,000	$5,250,000	$5,250,000	NO
2014	40%	$5,340,000	$5,340,000	$5,340,000	NO
2015	40%	$5,430,000	$5,430,000	$5,430,000	NO
2016	40%	$5,450,000	$5,450,000	$5,450,000	NO
2017 and thereafter**	40%	$5,490,000	$5,490,000	$5,490,000	NO

**Unless carryover basis and no estate tax is chosen.*
***Adjusted for inflation for later years.*

For estates in excess of exclusion amounts, there are still opportunities to decrease tax cost of transferring assets to beneficiaries.

Where do you begin?
Estate planning will help you to maximize the wealth that can be transferred to your beneficiaries.

Here are some effective strategies that you should consider to reduce the eventual estate tax on your assets:

Make annual gifts
For 2016, the annual gift exclusion allows you to make tax-free gifts up to $14,000 per individual (or $28,000 if you are married). The annual gift exclusion remains at $14,000 for 2017. By making gifts annually to any number of your relatives or friends, you could end up transferring substantial amounts out of your estate without using any of your lifetime gift tax exclusion.

Use your lifetime exclusion
Also consider utilizing your 2016 lifetime gift tax exclusion of $5.45 million (adjusted each year for inflation and for any exclusion previously utilized). If married, this gives you and your spouse the ability to transfer up to $10.9 million (adjusted annually for inflation) tax-free during your lifetimes. This is in addition to your annual gift exclusions mentioned previously. See Chart 11 for the rates and exemptions for 2010 through 2017. Also, see Tax Tip 22.

Consider portability of the lifetime exclusion
Prior to the 2010 Tax Relief Act, married couples had to do careful planning and maintain separately owned assets in order to exclude $7 million (each had a $3.5 million estate tax exclusion) of their assets from federal transfer taxes imposed on their estates after both died. Commencing in 2011, married couples could exclude $10 million ($10.9 million for 2016 and 10.98 million for 2017) of their assets from federal transfer taxes. This is accomplished by a concept known as "portability."

The executors of estates of decedents dying on or after January 1, 2011 may elect to transfer any unused exclusion to the surviving spouse. The amount received by the surviving spouse is called the Deceased Spousal Unused Exclusion ("DSUE") amount. If the executor of the decedent's estate elects transfer, or portability, of the DSUE amount, the surviving spouse can apply the DSUE amount received from the estate of his or her last-deceased spouse against any tax liability arising from subsequent lifetime gifts and transfers at death.

As an example, assume that one spouse dies in calendar year 2017 with a taxable estate of $8 million and leaves it all outright to the surviving spouse (who has $4 million of his or her own assets). No federal estate tax would be due from the estate of the first to die because the surviving spouse receives all of the assets and there is an unlimited marital deduction, and none of the deceased spouse's $5.49 million exclusion would be used. If the deceased spouse's executor elects to transfer the unused $5.49 million, the surviving spouse will have a $10.98 million exclusion (disregarding the inflation indexing) from federal transfer taxes. If the surviving spouse has $12 million of assets on his or her death, only $1.02 million will be subject to the federal estate tax (assuming the surviving spouse dies prior to January 1, 2018). As a result of ATRA, portability has been made permanent.

Although portability of the exclusion simplifies estate tax planning for many couples, there are still significant advantages to using the exclusion in the estate of the first spouse to die, which often necessitates the creation of a "bypass trust." These include:

- Removal of future income and appreciation from transfer taxes.
- Protection of the assets from potential creditors.

tax tip

22 USE YOUR LIFETIME GIFT TAX EXCLUSION NOW

You should consider using your lifetime gift tax exclusion immediately if you haven't already done so. Otherwise, the transferred assets may remain in your estate with all future income and appreciation thereon subject to estate tax, either at your death, or, if married, typically at your surviving spouse's death. As a result of ATRA, if you and your spouse have not yet used your exclusions, you can make gifts of $10.9 million in 2016 or $10.98 million in 2017 (in addition to the annual exclusion gifts of $14,000 to each donee from each of you).

The benefit of utilizing your lifetime gift tax exclusion is as follows (assuming a 5% compounded annually after-tax growth rate):

If you transfer $10.98 million in 2017, the $10.98 million will grow to $29,133,209 in 20 years, which will be available to your beneficiaries free of gift and estate taxes. If the appreciated assets pass to your beneficiaries through your estates, assuming you and your spouse will have a combined estate in excess of the estate tax exclusion at the time of your surviving spouse's death, the estate tax on the assets that you did not transfer during your lifetime may be as high as $7,261,284 ($29,133,209 less the $10.98 million exclusion still available at an assumed tax rate of 40%). Your beneficiaries will receive the net balance of $21,871,925, rather than the $29,133,209 had you transferred the assets now.

- Preservation of the assets for children and grandchildren (e.g., in a situation where the surviving spouse remarries).

Make taxable gifts

Although there is a reluctance to pay gift taxes, for those people who have used up their available exclusion and can afford to transfer additional assets, paying gift taxes will often increase the amount available for your beneficiaries. For example, assume that you have previously used your available exclusion amount and you have another $5 million that you wish to gift. If you have a large estate, assuming the 40% estate tax rate effective for 2017, your beneficiaries will only receive $3,000,000. However, if you make a net gift of $3,571,429, which is the $5 million amount less gift taxes of $1,428,571 ($3,571,429 at the 40% rate) and survive for 3 years, your beneficiaries will receive an extra $571,429 ($3,571,429 less $3,000,000). (This example ignores the time value of money.) This difference arises because the estate tax is "tax inclusive," which means that the tax is on the amount of total assets and not the amount actually going to the heirs. Furthermore, if the grantor survives 3 years, the taxes are removed from his or her estate.

Gifts to minors

One of the common methods of making gifts to children and grandchildren under the age of 21 is to arrange for ownership of the assets to be held by an individual as custodian for the minor under a state's Uniform Transfers to Minors Act ("UTMA"). This type of ownership was previously under the Uniform Gifts to Minors Act ("UGMA"). Under the UTMA, the custodian is required to transfer the property to the minor upon the minor attaining age 21, or to the minor's estate upon the minor's death before age 21. However, it is possible for the custodianship to terminate at age 18 if the designation of ownership contains, in substance, the phrase "until age 18."

It is important to make sure that the person who gifts the property does not serve as a custodian under the UTMA for the minor with respect to that property. If the donor is serving as a custodian and dies before the UTMA status terminates (e.g., before the minor reaches the age of 21), the property held under the UTMA will be included in the donor's taxable estate for estate tax purposes. Fortunately, this result can be avoided with proper advance planning. For example, if a spouse transfers his or her property for the benefit of his or her child and his or her spouse serves as custodian under the UTMA, the property would not be included in the deceased spouse's taxable estate should he or she die before the UTMA status terminates.

tax tip 23

TRANSFER APPRECIATION WITH A GRAT FREE OF GIFT TAXES

You transfer securities in a company that has great potential to a 3-year grantor retained annuity trust ("GRAT"). The securities are currently valued at $1,000,000 (200,000 shares at $5 per share). As an example, based on a 1.6% IRS rate (for November 2016) you could set the annuity at 34.40564% to zero out the remainder interest and pay no gift tax on the transfer. You would receive an annuity payment of $344,056 per year ($1,000,000 times .3440564% totaling $1,032,168). Assume the stock appreciates to $8 per share at the end of the first year, $9 at the end of the second year, and $10 at the end of the third year. Since the GRAT does not hold any liquid assets, you will need to use the stock to pay your annuity, as follows:

Shares transferred to GRAT	**200,000**
Shares used to pay annuities:	
Year 1 ($344,056 divided by $8 per share)	(43,007)
Year 2 ($344,056 divided by $9 per share)	(38,228)
Year 3 ($344,056 divided by $10 per share)	(34,406)
Shares remaining at the end of the GRAT's term	84,359
Value of shares transferred to beneficiaries ($10 per share)	**$ 843,590**

Other methods for transferring assets to minors (or for their benefit of) include:

- Section 529 college savings accounts,
- Section 2503(c) trusts for the benefit of persons under 21 years of age,
- Life insurance trusts,
- Discretionary trusts,
- Direct payment of educational and medical expenses to the qualified educational institution or the medical provider, and
- Totten trust (pay-on-death) bank/securities accounts.

Pay medical and education costs
You can directly pay unlimited tuition and medical expenses for any person free of gift taxes. This exclusion is in addition to the annual gift exclusion. Payments can include health insurance premiums and tuition for elementary school through graduate school. You must make these payments directly to the qualifying educational organization or medical provider.

Use loans rather than gifts
Lending money to your beneficiaries is a viable option to avoid current gift taxes or the use of your lifetime gift exclusion. You can then use your annual gift tax exclusion to enable your beneficiary to pay the interest due and/or part of the debt principal each year.

For the month of November 2016, the minimum interest rates required by the Internal Revenue Service to be charged on loans with interest to be compounded annually, referred to as applicable federal rates ("AFR"), are:

- 0.68% if the term of the loan is 3 years or less (short-term).
- 1.33% if the term is more than 3 years and less than 9 years (mid-term).
- 2.07% if the term is 9 years or longer (long-term).

These rates are low by historical standards and provide an excellent opportunity to use loans to your beneficiaries as a technique for transferring wealth free of gift and estate taxes. However, you need to make sure that the loan is bona fide (i.e., you intend for it to be repaid) and properly documented.

Note: *Connecticut is the only state which imposes gift taxes.*

Use trusts and other family entities
Entities and trusts that should be considered for transferring future appreciation out of your estate at minimal or no gift tax include:

- **GRAT:** A GRAT pays you an annuity at a fixed rate in exchange for the assets transferred to the GRAT. If the transferred assets appreciate in excess of the interest rate used by the IRS (1.6% in November 2016), the excess appreciation will pass tax-free to your beneficiaries. With the IRS rates relatively low, the GRAT is an attractive option (see Tax Tip 23).
- **Family limited partnerships and LLCs:** Family limited partnerships ("FLPs") and family limited liability companies ("FLLCs") can be very effective gift and estate tax planning vehicles (though not without some complications and risks). These entities allow you to transfer assets to your beneficiaries, typically at a discounted value, while you retain control of investment decisions and the timing and amount of distributions to the partners (typically family members) (see Tax Tip 24).
- **Personal residence trust:** This is a form of a GRIT (which is a grantor retained interest trust) that uses your principal residence as the asset contributed to the trust with your right to live in the house for a period of time as the annuity payment.

tax tip

24 THE ADVANTAGES OF AN FLP OR FLLC

Let's assume in 2017 you and your spouse have not yet used any of your lifetime gift exclusions of $10.98 million ($5.49 million each). You can transfer assets valued at $15,685,714 to an FLP or FLLC, in addition to your annual exclusion gifts, free of gift taxes (based on the assumption that you can sustain a 30% minority and marketability discount on the value of the limited interests).

How much will your beneficiaries receive? The value of their limited partnership interests could grow, free of gift or estate taxes, to $41,618,869 in 20 years from the initial amount of $15,685,714 using a 5% after-tax growth rate. By comparison, if the assets were left to accumulate in your estate, the estate tax could be as high as $12,255,548 (net of the $10.98 million exclusion assuming a maximum rate of 40%), leaving $29,363,321 to your beneficiaries. Thus, there is a potential savings of $12,255,548.

- **Irrevocable life insurance trust ("ILIT"):** An ILIT can remove life insurance proceeds from your estate, thereby transferring substantial wealth to your beneficiaries. However, payment of premiums and gift taxes on the premiums may reduce the tax benefits.

- **Charitable trust:** A charitable trust can help you diversify your portfolio and combine estate planning with your charitable desires. See the chapter on charitable contributions for a more detailed discussion.

- **Bypass trust:** This trust can help you divide your assets properly, so that the future income and appreciation on the assets in the bypass trust escape estate tax when the second spouse dies. However, in states that only allow an exclusion that is less than the federal exclusion, it may be appropriate to limit the amount going into a bypass trust.

Utilize your generation-skipping transfer tax exemption
If you transfer assets directly to your children and they eventually pass the assets down to their children, 2 levels of estate tax will be paid (assuming both estates are in excess of the exemption amounts). If you make transfers directly to your grandchildren, or for their eventual benefit, through a trust or other entity, or to other "skip persons" (individuals 2 or more generations lower than you), you will be subject to the GST tax (at a 40% estate tax rate under current law) in addition to gift or estate taxes.

The GST exemption allows you to transfer up to $5.45 million free of the GST tax in 2016 (increasing to $5.49 million in 2017). If you have not yet used the full amount of your gift tax exemption, consider making gifts to your grandchildren (or to a trust for their benefit) up to the amount of your remaining GST tax exemptions, if you can afford to do so. There is no portability between spouses for the GST exemption.

GRANTOR RETAINED ANNUITY TRUST

When you create a GRAT, you (as a grantor) have made a gift equal to the fair market value of the assets transferred to the GRAT less the present value of the annuity payments you will receive from the trust during the trust's term. The annuity payments are calculated at the IRS prescribed rate so there is no gift tax on transfer to the GRAT ("zero-out" GRAT) and theoretically no assets should be left at the end of the trust term.

The success of the GRAT depends on the amount of income earned and appreciation on the assets during the GRAT term. Income and asset appreciation in excess of the IRS rate (for example 1.6% used for November 2016 transfers) will cover annuity payments during the term of the trust and remaining assets will pass to your beneficiaries gift tax-free (see Tax Tip 23).

All income earned by the GRAT is taxable to you, so the trust's assets are not depleted by income taxes.

Note: *If you should die before the expiration of the GRAT's term, the assets would be brought back into your taxable estate, subject to certain limitations.*

FAMILY LIMITED PARTNERSHIPS AND LIMITED LIABILITY COMPANIES

As Tax Tip 24 illustrates, FLPs or FLLCs can be very beneficial estate planning tools. You can contribute assets to such an entity in exchange for general partnership and limited partnership interests (or member interest if an FLLC). You and/or your spouse typically keep the general partner interest (or remain the managing member of a limited liability company). This interest allows you to retain management control of the investment and distribution decisions (though this control must be set up carefully). You would typically gift only the limited partnership interests, but not in excess of your available annual and lifetime exclusions, thereby avoiding gift tax. Because the limited interests are minority interests subject to lack of marketability and lack of control, the value of the gift can be discounted and the corresponding tax-free amount of the gift can be increased. You should obtain an appraisal to substantiate the discounted value. Care must be exercised to be sure that the control does not result in the FLP's entire assets being included in the grantor's estate.

An even more effective way to use an FLP or FLLC is to create trusts to hold the limited partnership interests for your beneficiaries. These trusts can be grantor trusts for tax purposes, requiring you, as grantor, to include all of the income of the trust on your tax return. You pay all the taxes on the income earned by the FLP or FLLC, allowing the trust to grow tax-free. In effect, you are making an additional tax-free gift. Before doing this, you should make sure your financial position will allow you to continue paying all the income taxes even though you cannot take any cash distributions from the FLP or FLLC.

Rather than gifting the limited partnership interests, another way to transfer the interests to your beneficiaries is to sell the interests to a grantor trust for their benefit. Since such a trust usually has limited funds to purchase the interests, the sale would be done on an installment basis (subject to a rule requiring the trust to be adequately capitalized). The installment payments that you are required to receive would come from distributions to the trust from the partnership, typically from the annual income. By using this grantor trust method, the trust can receive the income free of taxes, thereby increasing the annual cash to fund payment of the installment note.

While FLPs and FLLCs can be effective estate planning vehicles, they must be carefully structured, fully implemented substantially before death occurs, and have a bona fide, nontax purpose. In addition, the proper tax and accounting records should be maintained, income and gift tax returns should be carefully prepared and all transactions should conform to the legal documents. Unless these precautions are taken, the arrangement may not be upheld in the event of a challenge by the Internal Revenue Service.

In August 2016, the IRS issued proposed regulations under Section 2704 that impose limitations on valuation discounts for transfers of interests in family-controlled entities. These regulations may limit or eliminate lack of control discounts and may impact marketability discounts. The proposed regulations are not finalized and are met with a lot of comments and opposition. If you are considering transferring an interest in a family controlled entity, you will want to consider the proposed regulations.

QUALIFIED PERSONAL RESIDENCE TRUST

A qualified personal residence trust ("QPRT") is a form of a GRIT that allows you to transfer your personal residence to a trust (typically for your children's benefit) even though you continue to live in the home during the trust's term (e.g., 10 years). You hold an income interest in the home based on the present value of your right to live there during the term of the trust. Gift tax applies to the fair market value of the house reduced by the retained income interest (as actuarially computed using IRS interest rates).

The value of the house at the end of the QPRT's term will go to your beneficiaries free of additional gift or estate taxes. When the QPRT term expires, your children (or a trust for their benefit) will own the residence. They must charge you a fair market value rent to allow you to continue using the residence, and the rent you pay will decrease your taxable estate. If you do not intend to live in the home and your beneficiaries do not want to live there, the trust can sell the house and reinvest the funds in other investments. In either case, there is no additional gift tax when the QPRT terminates. However, the benefits are lost if you die before the QPRT term ends.

LIFE INSURANCE

Life insurance can serve an important function in your estate plan because it can provide your beneficiaries liquidity to pay estate taxes, especially if the value of your business (or other non-liquid assets) represents a significant portion of your estate. Life insurance can also provide immediate funds to help your family maintain their standard of living and for other purposes. But if the proceeds are left in your taxable estate, the federal estate tax could reduce the proceeds by as much as 40% for 2016 and beyond. To avoid this tax, you must ensure that the proceeds of your life insurance policies are

chart 12

2016 STATE ESTATE TAX RATES AND EXEMPTIONS

State	Maximum Estate Tax Rate	Maximum Gift Tax Rate	Exemption
New York	16%	None	$4,187,500/5,250,000*
New Jersey	16%	None	$675,000**
Connecticut	12%	12%	$2,000,000
Pennsylvania	(a)	None	None

(a) An inheritance tax of 4.5% is imposed on transfers to direct descendants and lineal heirs, 12% on transfers to siblings and 15% on other taxable transfers.

**The exemption amount changes on April 1, 2017. The amount applicable through March 31, 2017 is $4,187,500. The amount from April 1, 2017 through December 31, 2018 will be $5,250,000.*

***In 2017, the New Jersey Estate Tax Exclusion increases to $2,000,000. Effective January 1, 2018, the New Jersey Estate Tax will be repealed. However, the New Jersey Inheritance tax will not be repealed.*

Note: *California and Florida have no estate tax. In Florida, there may be a need to file other forms to remove the automatic Florida estate tax lien.*

not payable to either you or your spouse's estate, and that neither of you possess any incidence of ownership in the policy at death.

A properly structured irrevocable life insurance trust ("ILIT") can remove life insurance proceeds from your estate, if the trust is both the policy's owner and beneficiary. The trust can also provide income to your surviving spouse and principal to your children (or other beneficiaries) upon your spouse's death. In addition, the trustee can properly manage and invest the insurance proceeds for future growth.

If you use any of the following funding methods, you can make the trust the owner of the insurance policy without being deemed to have any incidence of ownership:

- Gift sufficient funds to the trust so it can buy the insurance policy and pay all current and future premiums.
- Assign a current policy to the trust and gift future premiums. However, the transfer must be completed at least 3 years before your death to avoid inclusion in your taxable estate.
- Gift to the trust the annual premiums on a policy owned by the trust either by paying them directly or first depositing them in a trust account.
- Sale of the policy to the trust.

Be careful of gift tax issues to the extent you gift funds to purchase the policy, pay premiums or transfer an existing policy that has value. You will only incur a gift tax if the amount exceeds the available annual exclusion and any remaining lifetime gift tax exemption. The government's position is that the annual exclusion is only available if the trust document includes a withdrawal (Crummey) power and the beneficiaries are notified in writing of their right of withdrawal. It is important to properly comply with this administrative requirement.

There are some disadvantages to life insurance trusts, but they can be minimized with proper planning. There will be some additional costs: You will incur legal fees since a carefully drafted trust instrument is needed to satisfy specific rules, and there may be trustee commissions. Also, income tax returns may be required if the trust has assets generating taxable income. These are almost always grantor trusts. However, if the trust only holds the life insurance policy and you pay the annual premiums through gifts, income tax returns will generally not be required.

If you have a life insurance policy that has been in force for at least 3 years, it may prove beneficial to review the policy to see if premiums can be lowered and/or the death benefit can be increased. It is sometimes possible to find a more favorable policy and obtain it in exchange for your old policy on a tax-free basis.

STATE ESTATE TAX CONSIDERATIONS

You should keep in mind that many states also impose an estate or inheritance tax on persons who are domiciled in the state or have property located in the state. Some of these states continue to impose their estate or inheritance tax even if there is no federal estate tax. Others (e.g., Florida) impose no such tax when there is no federal estate tax credit for taxes paid to a state.

Changes to estate taxes in New York

On April 1, 2014, New York State passed legislation known as the Budget Legislation with the new estate tax rates and estate exclusion amounts. The new estate tax provisions are in effect for decedents dying on or after April 1, 2014.

Prior to this legislation, New York estates above $1 million in assets were subject to New York estate taxes. Under the Budget Legislation, the estate exclusion amount will be gradually increased and by April 1, 2017 it will reach the 2013 federal estate tax exclusion of $5.25 million. After January 1, 2019 the basic exclusion amount will equal the federal exclusion amount and will be indexed for inflation in the same manner as the federal exclusion. Below are the basic exclusion amounts ("BEAs") for decedents dying on or after the following dates:

- April 1, 2014 and before April 1, 2015: $2,062,500
- April 1, 2015 and before April 1, 2016: $3,125,000
- April 1, 2016 and before April 1, 2017: $4,187,500
- April 1, 2017 and before Jan. 1, 2019: $5,250,000
- January 1, 2019 and beyond: federal exclusion amount indexed for inflation

Unfortunately, the above basic exclusion amounts start to phase out once the estate's taxable value exceeds the BEA in effect at that time. Furthermore, the estate's exclusion amount is fully phased out once the estate's taxable amount is over 105% of the current BEA.

The legislation also provides for inclusion of taxable gifts "not otherwise included" in the federal gross estate if the gift was made after March 31, 2014 and before January 1, 2019 and the gift was made within 3 years of the donor's death. Annual exclusion gifts do not get pulled back into the New York taxable estate.

IMPACT ON CERTAIN EXEMPT ORGANIZATIONS

As a result of PATH, the gift tax will not apply to the transfer of money or other property to a tax-exempt organization described in IRC section 501(c)(4) (generally, social welfare organizations) or IRC section 501(c)(6) (generally, trade associations and business leagues).

CONSISTENT BASIS REPORTING FOR ESTATES

Under the Surface Transportation and Veterans Health Care Choice Act of 2015, IRC section 6035 introduced reporting requirements to assure that a beneficiary's basis in certain property acquired from a decedent be consistent with the value of the property for estate tax purposes. Because many executors were not prepared to comply with the new reporting requirements, the IRS extended the due date for filing Form 8971, Information Regarding Beneficiaries Acquiring Property From a Decedent and distributing Schedules A to beneficiaries. Final regulations issued in December 2016 confirmed that no further extensions beyond June 30, 2016 would apply to initial reporting and that the rule going forward is to file the form within 30 days of filing Form 706.

NON-TAX CONSIDERATIONS

There are many non-tax reasons to review your estate plan and the related documents.

It is advisable to periodically review your estate plan to make sure it is in conformity with your current wishes and the current state of the law. This review should include nontax considerations, such as:

- Who are your executors and trustees?
- Do you have a power-of-attorney and is it current?
- Is your health care proxy and/or living will current?
- Have you provided for long-term care for your spouse and yourself?
- Are the beneficiaries on your qualified plans and life insurance policies in accordance with your present desires?
- Does your estate plan include new children, grandchildren, etc.?
- Have you named appropriate guardians for your minor children should both parents be deceased while the children remain minors?
- Has anyone mentioned in your will died?
- Will your assets be preserved for your family in the case of a divorce?
- Do you have adequate creditor protections included in your planning?
- At what age do you want your children, grandchildren or other beneficiaries to have full access to inherited assets?
- Do you have a beneficiary with special needs that you want to provide for?
- Do you wish to leave a legacy to a charitable or educational organization?
- If there is a family business, are you satisfied with the beneficiaries who will receive that interest? Has a succession plan for the business been put into place? Do you need to equalize amongst your children where only children working in the business are receiving interests in the business?

tax credits

There are many credits available to reduce your federal tax liability, but all are subject to complex limitations based on income and whether or not you are subject to the alternative minimum tax.

TAX CREDIT OVERVIEW

The following is a discussion of the credits that impact most taxpayers:

Foreign Tax Credit
The U.S. taxes its residents on their worldwide income including foreign-sourced income which may be also subject to tax in foreign jurisdictions. To avoid double taxation, subject to certain limitations, the U.S. allows its residents either a credit or deduction for taxes imposed by foreign countries and possessions of the U.S. In general, a credit is more advantageous as it is a dollar-for-dollar offset to the taxpayer's U.S. income tax liability, whereas a deduction is a reduction to income subject to tax. There are limits on the amount of foreign tax credits an individual may be able to take in a particular year. There is a separate calculation of foreign tax credits allowed each year which could result in a difference between your regular and AMT foreign tax credit allowed. Any foreign tax credits not fully utilized in the current year due to limitations may be carried back one year and forward 10 years. The most common forms of income that result in the payment of foreign taxes include dividends paid by foreign corporations and business income earned by foreign pass-through entities. It is very common to incur foreign taxes through securities that are held in your investment accounts or from an underlying ownership interest in a partnership or other pass-through entity that has an investment in a foreign entity.

Child Tax Credit
A nonrefundable child tax credit of $1,000 per qualifying child is available to offset your tax liability.

Qualifying children are defined as:

- A son, daughter, stepson, stepdaughter, or a descendant of such child; a brother, sister, stepbrother, stepsister, or a descendant of such relative.
- A child who has not attained the age of 17 by the end of the tax year and who is either a U.S. citizen or national, or a resident of the U.S.

However, the child tax credit is not available to many taxpayers since it begins to phase out when MAGI reaches $110,000 for joint filers, $55,000 for married filing separately and $75,000 for unmarried individuals, head of household and qualifying widowers. The credit is reduced by $50 for every $1,000, or fraction thereof, of MAGI above the threshold amount.

Should the credit be disallowed, an additional child tax credit may be allowed. Individuals are eligible for a refundable child tax credit equal to the lesser of the unclaimed portion of the nonrefundable credit amount or 15% of their earned income in excess of $3,000. The earned income limitation is set at $3,000. For taxpayers with 3 or more qualifying children, the refundable credit will be equal to the lesser of the credit that would have been allowed without the tax limit and the excess of the taxpayer's social security taxes for the year over the taxpayer's earned income credit for the year. The credit is allowed up to the $1,000 per child credit amount, if the allowable child tax credit exceeds the total tax liability, taking into account the AMT.

The earned income threshold of $3,000 is made permanent by PATH.

Child and Dependent Care Credit
If you pay someone to take care of your children or other qualifying persons so that you and your spouse can work or go to school, then you qualify to take the credit for child and dependent care expenses. Qualifying expenses include expenses paid for household services and for the care of a qualifying individual. A qualifying individual can include a dependent who was under age 13 at the close of the tax year or a dependent who was physically or mentally incapable of self-care and who had lived with you for more than half of the year.

The maximum amount of dependent care expense on which you can calculate the credit is $3,000 for one qualifying individual or $6,000 for 2 or more qualifying individuals. The amount of the dependent care expenses eligible for a credit must be reduced by any payments received through an employer-provided dependent care assistance program. The amount of the allowable credit is based on your AGI, with the applicable credit percentage ranging from 20% to 35%. The 35% credit is for lower income taxpayers. Once your AGI exceeds $43,000, the maximum rate allowed is 20%. These percentages entitle you to a credit of $600/$1,200 and $1,050/$2,100, respectively, based on the number of qualifying individuals.

American Opportunity and Lifetime Learning Credits
There are 2 education-related credits: the American Opportunity Credit ("AOC"), which is a modified Hope Credit, and the Lifetime Learning Credit. These credits are available to individuals who incurred tuition expenses pursuing college or graduate degrees or vocational training. The AOC allows taxpayers a maximum credit per eligible student of $2,500. The Lifetime Learning Credit allows a taxpayer to take a maximum credit of $2,000 per taxpayer. A more detailed discussion of these credits can be found in the chapter on education incentives.

PATH has made the American Opportunity tax credit permanent.

Adoption Credit
For 2016, a nonrefundable credit of up to $13,460 may be claimed for qualified adoption expenses. The credit is phased out ratably for taxpayers with MAGI over $201,920 and no credit is allowed for taxpayers with MAGI over $241,920 or higher. Qualified adoption expenses include reasonable and necessary adoption fees, court costs, attorney fees and other expenses which are directly related to the legal adoption of an eligible child. An eligible child is an individual who has not attained the age of 18 at the time of the adoption or who is physically or mentally incapable of caring for himself or herself. A credit for the adoption of a special needs child is allowed regardless of the actual qualified expenses.

For U.S. adoptions, you may be able to claim the credit before the adoption is finalized and if you adopt a special needs child you may qualify for the full amount of the credit.

For 2017, the credit allowed is $13,570 and phased out ratably for taxpayers with MAGI over $203,540 and completely phased out at $243,540.

Residential Energy Property Credit
The tax credit allowed for the cost of qualifying improvements that meet certain energy efficient standards expired on December 31, 2016 as a result of PATH.

A tax credit was allowed for the cost of qualifying improvements that met certain energy efficient standards. The credit was equal to the sum of:

- 10% of amounts paid or incurred for energy efficient building envelope components plus
- Specified dollar amounts for the purchase of residential energy property.

The credit was limited to $500 ($200 for windows) minus the credits claimed in previous years.

Residential Energy Efficient Property Credit
A tax credit is allowed up to 30% of the cost of qualified energy property and the credit for each half kilowatt of capacity of fuel cell property is limited to $500. This credit applied to expenditures for the following qualified energy equipment installed before 2017:

- Small wind energy property,
- Geothermal heat pump property, and
- Fuel cell property.

The credit for solar electric property and solar water heating property, however, is available for property placed in service through December 31, 2021, based on an applicable percentage. The applicable percentages are:

- In the case of property placed in service after December 31, 2016, and before January 1. 2020, 30%.
- In the case of property placed in service after December 31, 2019, and before January 1, 2021, 26%.
- In the case of property placed in service after December 31, 2020, and before January 1, 2022, 22%.

Qualified Plug-In Electric Drive Motor Vehicle Credit
The maximum tax credit allowed for individuals who purchase plug-in electric vehicles is $7,500, and if the vehicle did not have battery capacity of at least 5 kilowatt hours, the minimum credit of $2,500 applied.

To qualify as a plug-in electric drive vehicle, the vehicle must:

- be made by a manufacturer,
- be acquired for use or lease but not resale,
- have its original use commencing with the taxpayer,
- be treated as a motor vehicle for purposes of Title II of the Clean Air Act,
- have a gross vehicle weight rating of not more than 14,000 pounds,
- be propelled to a significant degree by an electric motor that draws electricity from a battery with a capacity of not less than 4 kilowatt hours and that is capable of being recharged from an external source of electricity.

Qualified Research Credit
This is a credit for expenditures paid or incurred for research that was technological in nature and whose application was for use in developing a new or improved business component. This credit is made permanent as a result of PATH. In general, the credit was equal to 14% of the qualified research expenditures incurred that exceeds 50% of the average qualified research expenses for the 3 prior years. In addition, for taxable years beginning after December 31, 2015, eligible small businesses ($50 million or less in gross receipts) may claim the credit against AMT liability.

Further, the credit against the employers' payroll tax liabilities is available for certain businesses (gross receipts of $5 million or less and no gross receipts for any taxable year before the 5 years ending with the tax year). So, for a 2016 return, a business is not eligible if it generated gross receipts prior to 2012.

AMT Credit

If you pay the AMT in one year, you may be entitled to a tax credit against your regular tax in a subsequent year. You qualify for an AMT credit if any of your AMT liability is derived from "deferral items" such as depreciation adjustments and the tax preference on the exercise of ISOs. See the chapter on the AMT for a more detailed discussion.

Work Opportunity Credit

The work opportunity tax credit is a federal tax credit available to employers for hiring individuals from certain target groups who have consistently faced significant barriers to employment through taxable years beginning on or before January 1, 2020. The credit is based on qualified wages paid to the employee for the first year of employment. In general, qualified wages are capped at $6,000. The credit is 25% of the qualified first-year wages for those employed at least 120 hours but fewer than 400 hours and 40% for those employed 400 hours or more.

PATH also extends the credit beginning in 2016 to apply to employers who hire qualified long-term unemployed individuals (those unemployed for 27 weeks or more).

Due Diligence Checklist

Paid preparers will be required to complete and attach Form 8867 to the return in those cases where the Earned Income Credit, the Child Tax Credit and additional Child Tax Credit, and the American Opportunity Credit are utilized. Preparers will be required to maintain copies of the documents that were relied upon to determine eligibility of the qualifying taxpayer.

education incentives

Tuition funding programs, tax credits and education expense deductions are available to help many families fund the cost of college and certain other educational expenses.

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EDUCATION INCENTIVES AVAILABLE

There are education incentives that provide tax benefits to assist you in funding the cost of a college education for your family members, but some of them are subject to phase outs based on AGI, thereby limiting the incentives that may be available to you. See the state tax issues chapter for additional incentives.

The tax incentives available to help pay college costs include:

- Section 529 plans.
- American Opportunity credit and Lifetime Learning credit.
- Education deductions, including student loan interest.

529 PLANS

Probably the most popular tax incentive college funding method is a Section 529 plan (qualified tuition program) since it is available to all taxpayers, regardless of their income. These plans offer the following benefits:

- Although the contributions to the 529 plans are not currently tax deductible on the federal level, the earnings from the plan are tax deferred for federal and state taxes.
- Distributions are tax-free if used to pay qualified education expenses at any accredited college, university, or graduate school and most community colleges and certified technical training schools in the United States as well as many schools abroad.
- Distributions can be used to pay for tuition, certain room and board expenses, books, supplies, a computer, computer software and even internet expenses, so long as the computer is used for college work. Allowable computer software must be predominantly educational in nature, so software designed for games, sports or hobbies is excluded.
- Control of the funds remains in the hands of the account owner (not the beneficiary), even after the beneficiary reaches legal age, permitting the account owner to change beneficiaries at any time and for any reason. You may change the beneficiary to another child if the original beneficiary does not go to college, or excess funds remain in one child's account after college. You can also change the beneficiary to yourself if a financial emergency requires you to have access to the funds. However, any distributions representing income earned within the plan will be taxable if not used for qualified education purposes.
- Age and income restrictions do not apply to the account owner or beneficiary, unlike other tax incentive education plans.
- You are not limited to just the plans offered by the state you live in. In addition, you can change your choice of plan every 12 months and roll over plan funds to a new plan. This gives you more investment options and possibly higher contribution ceilings.

Funds deposited into a Section 529 plan for the benefit of another person are considered a gift for gift tax purposes. Although the plan's assets are excluded from your estate, there are gift tax considerations. However, to the extent you used your annual gift exclusion to fund a 529 plan, you will have to limit other tax-free gifts to stay within the annual exclusion amount of $14,000 per donee. For 2016 and 2017, you may elect to treat up to $70,000 ($140,000 if married) of the contribution for an individual as if you had made it ratably over a 5-year period. The election allows you to apply the annual exclusion to a portion of the contribution in each of the 5 years, beginning with the year of contribution. Also, if your state of residence allows a deduction for the contributions to the plan, you will generally only be allowed to take the deduction for one year's amount in the initial year that you fund the plan.

Private institutions can offer a prepaid tuition program if they satisfy Section 529 requirements. Distributions from these private plans used for qualified education expenses will also be tax-free.

Section 529 plans also have their disadvantages. Investment options are limited to the plan's choices of investment vehicles. Also, even though you can withdraw funds for uses other than qualified higher education expenses, you'll have to pay income tax and an additional 10% penalty on the earnings, similar to a premature distribution from a retirement account.

PATH modified section 529 rules to treat any distribution from a section 529 account as coming from that account, rather than aggregating all of the accounts. This is so even if the individual making the distribution is operating more than one account. Additionally, a refund of tuition paid with amounts distributed from a section 529 account is treated as a qualified expense if those amounts are re-contributed to a section 529 account within 60 days.

Observation: *The Tax Increase Prevention Act of 2014 ("TIPA") included the Achieving a Better Life Experience ("ABLE") Act, which allows states to establish and operate an ABLE program. Severely disabled individuals (under age 26) would be able to open a section 529 savings account and make annual contributions up to the gift tax exclusion limit of $14,000 for 2016 (also $14,000 for 2017), adjusted annually for inflation. The account may be used to meet qualifying* *disability expenses of a designated beneficiary. Any distribution that exceeds qualified disability expenses is included in gross income and subject to an additional tax of 10%.*

AMERICAN OPPORTUNITY AND LIFETIME LEARNING CREDITS

The American Opportunity/Hope Scholarship Tax credit ("AOTC") and Lifetime Learning credit are available if you pay qualified tuition and related education expenses, which includes course materials such as books, supplies and equipment. Room and board expenses do not qualify for either credit.

However, these credits have income limitations which phase out the available credits. The AOTC is phased out ratably with MAGI between $80,000 and $90,000 if single or head of household and $160,000 and $180,000 if married filing jointly for the years 2016 and 2017. The Lifetime Learning credit is phased out ratably with MAGI between $55,000 and $65,000 for 2016 ($56,000 and $66,000 for 2017) if single or head of household and $111,000 and $131,000 for 2016 ($112,000 and $132,000 for 2017) if married filing jointly.

- American Opportunity tax credit. A $2,500 annual credit per student is available for the first 4 years of post-secondary education with enrollment on at least a half-time basis in a program leading to a degree. Generally, you can receive up to $1,000 as a refundable credit even if you owe no taxes. However, the refundable credit will not be allowed to an individual if he or she is subject to the kiddie tax and other limitations.

- Lifetime Learning credit. A $2,000 annual credit per taxpayer is available for an unlimited number of years of post-secondary, graduate, or certain other courses to acquire or improve your job skills. The credit is equal to 20% of the first $10,000 of qualified expenses, up to the maximum amount of $2,000.

EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

Under a qualified educational assistance plan, up to $5,250 of the benefits will not be included in the gross income of the employee. There is no requirement that educational assistance be job-related. Educational expenses include tuition, fees and similar payments, books, supplies, and equipment. However, employer-provided tools or supplies that the employee may retain after completing a course of instruction are includible in gross income. Further, you cannot use any of the tax-free education expenses paid for by your employer under this plan as the basis for any other deduction or credit, including the American Opportunity tax credit and Lifetime Learning credit.

25 AGI TOO HIGH TO CLAIM A CREDIT? HAVE YOUR CHILD TAKE IT

If you pay qualified expenses for your children but income limitations prevent you from taking the American Opportunity tax credit or Lifetime Learning credit, you may have your children claim the credit on their tax returns instead. However, you must forego claiming the dependency exemption that you are otherwise entitled to. The maximum federal tax benefit you will lose in 2016 is $1,418 ($4,050 exemption times the maximum rate of 35%*). If your child can claim the full amount of the lifetime learning credit to reduce his or her own tax liability, you will save a maximum of $582. This savings could increase up to $2,000 if you are in the AMT as no personal exemptions are allowed in computing your income subject to AMT. If you are not in AMT and your AGI is above certain threshold amounts, your personal exemption deduction may also be disallowed. This benefit may be reduced when considering the state income tax impact.

**Although the maximum federal income tax rate is at 39.6%, the maximum rate that can be applied for education credit is at 35%, because that is the rate where the personal exemptions are fully phased out.*

Please note that a child under age 24 cannot claim the refundable portion of American Opportunity tax credit as long as one of the parents is alive.

INTEREST ON EDUCATION LOAN

Certain education expenses are deductible in computing against your federal AGI, subject to income limitations, including interest on education loans. You can take the above-the-line deduction of up to $2,500 of interest paid on qualified education loans annually, subject to a phase out that eliminates the deduction. For tax year 2016, the maximum deduction is reduced when your MAGI reaches $130,000 if married filing jointly and $65,000 for other taxpayers. The deduction is completely phased out when MAGI is $160,000 if married filing jointly and $80,000 for other taxpayers. For tax years beginning in 2017, the maximum deduction is reduced when your MAGI reaches $135,000 if married filing jointly and $65,000 for other taxpayers. The deduction is completely phased out when MAGI is $165,000 if married filing jointly and $80,000 for other taxpayers. For more on this topic please see the chapter on interest expense.

international tax planning and reporting requirements

Foreign earned income exclusions and foreign tax credits can significantly reduce the U.S. tax liability incurred on foreign-sourced income and help to avoid double taxation. Complex reporting is required for U.S. persons owning foreign assets including bank accounts and other financial investments.

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FOREIGN TAX ISSUES

Multinational clients with cross-border income from employment and investments are in today's mainstream. Many taxpayers are discovering that they are subject to taxation and/or reporting in both U.S. and foreign jurisdictions. Not all U.S. citizens and resident aliens are aware of their obligation to report their worldwide income to the IRS. As a result, the U.S. continues to pursue U.S. persons who fail to report income and file certain tax forms. These complex issues not only impact you if you are on an overseas assignment or retired abroad, but have broad-reaching implications even if you have never left the U.S. For instance, these issues arise if you invest in hedge funds, private equity funds, and other entities that own interests in foreign operating businesses or invest in foreign securities or have foreign retirement plans. Even holding cash in a foreign bank can trigger a reporting requirement.

This chapter is intended to provide an overview of the income exclusions, foreign tax credits, reporting requirements, and elections involving foreign employment and investments.

Significant legislation enacted in 2010 (the "HIRE Act") imposed a new U.S. withholding regime for U.S. income earned by non-U.S. persons and tightened the reporting requirements for offshore accounts and entities set up in foreign jurisdictions. This provision of the HIRE act is the Foreign Account Tax Compliance Act, also known as FATCA. FATCA requires that certain foreign financial institutions play a key role in providing U.S. tax authorities greater access into U.S. taxpayers' foreign financial account information. See FATCA section below.

Through the creation of the FATCA regime, the U.S. has inspired a movement towards greater global tax transparency; similar to the FATCA compliance regime, banks and other investment institutions of foreign nations will have significant additional reporting responsibilities.

FOREIGN EARNED INCOME EXCLUSION AND FOREIGN HOUSING EXCLUSION/DEDUCTION

In general, the worldwide income of a U.S. citizen or resident who is working abroad is subject to the same income tax and return filing requirements that apply to U.S. citizens or residents living in the U.S. However, if you are working abroad, you may qualify for one or more special tax benefits:

- Exclude up to $101,300 of foreign earned income in 2016 and $102,100 in 2017.
- Either (a) exclude part, or all, of any housing income

tax tip

26 TAX BENEFITS OF THE FOREIGN EARNED INCOME AND HOUSING EXCLUSIONS

Your company sent you to work in Dubai in 2016 for several years, so you qualify as a bona fide resident of the UAE in 2016. Assume you earn $500,000 per year and your company reimburses you for $125,000 of housing costs which are taxable to you. You would be able to exclude the following income from your U.S. income tax return:

- $101,300 of your salary.
- $40,966 of the housing expense reimbursements.

The maximum 2016 foreign earned income exclusion is $101,300, regardless of which foreign country you are working in. The housing exclusion is based on which country and city you are living in (see Chart 13 for some of the more common foreign cities).

Dubai is considered to be an expensive city to live in, so the annual housing exclusion amount is $57,174. Of this amount, you are not eligible to exclude $44.28 per day, or $16,208 for a full year. Therefore, your 2016 housing exclusion will be $40,966 ($57,174 - $16,208). When added to your foreign earned income exclusion of $101,300, you can exclude a total of $142,266.

Therefore, you will be taxed in the U.S. on $482,734 related to your employment in Dubai ($500,000 compensation plus $125,000 housing cost reimbursements less the exclusions of $142,266).

Note: *Although the UAE does not impose an income tax, in this example, if you paid income tax to a country that imposes a tax, you may also be eligible to receive a foreign tax credit against the U.S. tax imposed on the remaining income. However, only 77.24% of these taxes will be allowable as a foreign tax credit that can offset your U.S. income tax (i.e., only $482,734 of the total $625,000 of income will be subject to tax: $482,734 divided by $625,000 is 77.24%).*

As you can see in Tax Tip 26, your foreign housing exclusion might be limited depending on where you live. In order to see the differences in limits for housing deductions in 2016, see Chart 13 on the next page.

chart 13

FOREIGN HOUSING EXCLUSIONS

The amount of foreign housing exclusions costs that you can exclude from your 2016 U.S. income tax return depends on both the country and city you are living in. Below are listed the maximum amounts you can exclude for some common foreign cities, before the adjustment for the daily living cost of $44.28 per day, or $16,208 for a full year.

Country	City	Maximum Annual Housing Exclusion
Canada	Toronto	$ 41,400
China	Hong Kong Beijing	114,300 71,200
France	Paris	68,600
Germany	Berlin	41,100
India	New Delhi	56,124
Italy	Rome	52,100
Japan	Tokyo	81,300
Russia	Moscow	108,000
Switzerland	Zurich	39,219
United Arab Emirates	Dubai	57,174
United Kingdom	London	82,000

reimbursements you receive or (b) deduct part, or all, of any housing costs paid (i.e., for taxpayers having salary or self-employment earnings).

- Claim a foreign tax credit against your U.S. tax liability for income taxes you pay or accrue to a foreign country, or if more beneficial, take an itemized deduction for the taxes paid.
- Reduce your overall tax liability under tax treaties that the U.S. has with foreign countries.
- If eligible, claim exemption from paying social security tax in the foreign country, based on a Totalization Agreement the U.S. has with the foreign country. Totalization Agreements are essentially "treaties that cover social security taxes" designed to eliminate dual coverage for the same work. You will be required to pay U.S. Social Security and Medicare tax on such income.

To qualify for the foreign earned income and the foreign housing exclusions, you must establish a tax home in a foreign country and meet either the bona fide residence or physical presence test, defined below:

Bona fide residence test
To qualify under this test, you must establish residency in a foreign country for an uninterrupted period that includes an entire calendar year. Brief trips outside the foreign country will not risk your status as a bona fide resident, as long as the trips are brief, and there is intent to return to the foreign country.

Physical presence test
This test requires you to be physically present in a foreign country for at least 330 full days in a consecutive 12-month period, but not necessarily a calendar-year period.

Planning Tip: *If you pay no foreign tax or the effective tax rate in the foreign jurisdiction is lower than the U.S. effective tax rate, claiming the exclusion will generally be more beneficial.*

On the other hand, if the foreign jurisdiction imposes tax at a higher effective rate than the U.S., it is likely that the U.S. tax on the foreign earned income will be completely offset by the foreign tax credit regardless of whether the exclusion is claimed.

You should consider whether foregoing the exclusion may result in a lower utilization of foreign tax credits in the current year so that a larger amount of foreign tax credits can be carried back or forward for utilization in other years. You should also consider whether the foreign earned income exclusion and housing exclusion election will mitigate your state tax burden to the extent that you remain taxable on worldwide income in the state of residency.

Otherwise, in certain circumstances, it may be more beneficial to forego the exclusion in favor of claiming only a greater foreign tax credit.

Claiming the exclusion is a binding election. Once you have claimed the exclusion, you will be required to continue to claim it in all future years. If you revoke the election, you will not be allowed to claim the exclusion again until the sixth tax year after the year of revocation unless you receive permission from the IRS. If you have claimed the exclusion in the past, the benefit of revoking the exclusion must be weighed against the possible ramifications of being unable to re-elect the exclusion for 5 years. There is no downside of forgoing the exclusion if you have never claimed it in the past.

Note: *For Americans residing overseas, the foreign earned income exclusion is not considered when calculating the applicable thresholds for either the 3.8% Medicare Contribution Tax on net investment income or the .9% Additional Medicare Tax on earned income.*

FOREIGN TAX CREDIT

A foreign tax credit may be claimed by U.S. citizens, resident aliens, and in certain cases by nonresident aliens. Typically states do not allow foreign taxes to offset state income tax liabilities. An exception to this includes New York State, which allows a credit for certain Canadian provincial income taxes. Unlike the exclusions discussed above, you do not need to live or work in a foreign country in order to claim the foreign tax credit. You may be eligible for the credit if you paid or accrued foreign taxes in the tax year. Common examples of foreign-sourced income that may generate foreign tax credits include dividends paid by foreign corporations, including those paid on your behalf through a mutual fund, and foreign business income earned by a flow-through entity.

You are entitled to claim either a tax credit or an itemized deduction for taxes paid to foreign countries. Though not always the case, the tax credit is typically more beneficial since it can reduce your U.S. federal tax liability on a dollar-for-dollar basis.

Generally, only foreign income taxes qualify for the foreign tax credit. Other taxes, such as foreign real and personal property taxes, do not qualify. However, these other taxes may still be deductible as itemized deductions on your U.S. income tax return.

- Taxes paid on income excluded from U.S. gross income (e.g., foreign earned income exclusion or a treaty-based return position taken).
- Taxes paid to the countries that participate in certain international boycotts.
- Taxes of U.S. persons controlling foreign corporations and partnerships if certain annual international returns are not filed.
- Certain taxes paid on foreign oil-related, mineral, and oil and gas extraction income.

Your ability to claim a credit for the full amount of foreign taxes paid or accrued is limited based on a ratio of your foreign-sourced taxable income to your total taxable income. This ratio is applied to your actual tax (excluding the 3.8% Medicare Contribution Tax on net investment income) before the credit to determine the maximum amount of the credit that you can claim. If you are not able to claim the full amount of the credit in the current year, you must carry the excess back to the immediately preceding tax year and if not utilized in the prior year, the remaining credit is carried forward for the next 10 tax years, subject to a similar limitation in those years.

The credit is calculated for each separate type of foreign-sourced income. In other words, foreign taxes paid on dividends are subject to a separate limitation than foreign taxes paid on income from salary or an active trade or business. Foreign-sourced income is generally classified into 2 different baskets for determining the allowable credit:

- **Passive income:** This category includes dividends, interest, rents, royalties, and annuities.
- **General limitation income:** This category includes income from foreign sources which does not fall into the passive separate limitation category and generally is income earned from salary, pensions or an active trade or business.

In addition you are required to maintain a separate foreign tax credit limitation basket for each country in which income is resourced under an income tax treaty. This provision applies to income classified as U.S.-sourced income under U.S. tax law, but treated as foreign-sourced under an income tax treaty.

EXPATRIATION EXIT TAX

If you plan on giving up your U.S. citizenship or relinquishing your U.S. legal permanent residency status ("green card") and are considered a "covered expatriate," you will pay an income tax at the capital gains rate as though you had sold all of your assets at their fair market value on the day before the expatriation date. The 3.8% additional Medicare Contribution Tax on net investment income may apply in the case of a "covered expatriate" who is subject to the exit tax. Any gain on the deemed sale in excess of a floor of $693,000 for 2016 ($699,000 for 2017), is immediately taxed ("mark-to-market tax"). Losses are taken into account and the wash sale rules do not apply. An election can be made to defer the tax on the deemed sale until the asset is actually sold (or the taxpayer's death, if sooner) provided a bond or other security is given to the IRS. Deferred compensation items and interests in non-grantor trusts are not subject to the tax but are generally subject to a 30% withholding tax on distributions to the expatriate. IRAs and certain other tax-deferred accounts are treated as if they were completely distributed on the day before the expatriation date (early distribution penalties do not apply).

Former long-term residents who held a U.S. green card for anytime during 8 out of the last 15 years and all U.S. citizens are subject to the expatriation regime if they:

- Had average annual net income tax liability for the 5 years ending before the date of expatriation or termination of residency in excess of an annual ceiling, which is $161,000 for 2016 and $162,000 for 2017;
- Had a net worth of $2 million or more when citizenship or residency ended; or
- Failed to certify compliance under penalties of perjury on Form 8854, Initial and Annual Expatriation Statement, with all U.S. federal tax obligations for the 5 tax years preceding the date of expatriation.

A U.S. citizen or resident will have to pay tax on a gift or bequest received from an individual who had expatriated after June 17, 2008. The tax does not apply to the extent that the gift or bequest during the year is within the annual gift tax exclusion ($14,000 for both 2016 and 2017). The tax does not apply if the transfer is reported on a timely filed gift tax return or estate tax return or to transfers that qualify for the marital or charitable deductions. The value of a transfer not covered by an exception is taxable to the recipient at the highest rate on taxable gifts, which is currently 45%.

U.S. INCOME TAXATION OF NONRESIDENT INDIVIDUALS

Residents are taxed differently than nonresidents. Resident aliens are taxed on worldwide income at graduated tax rates much the same as a U.S. citizen. A nonresident alien, however, is taxed at graduated rates only on income that is effectively connected with a U.S. trade or business or at a flat 30% rate on U.S.-sourced income that is not effectively connected with a U.S. trade or business (unless a lower income tax treaty rate applies). Nonresident taxpayers are specifically exempt from the 3.8% Medicare Contribution Tax on net investment income.

A foreign national is generally deemed a resident alien of the U.S. if one of the 2 following tests is met:

- Lawful permanent residence (green card test); or
- Substantial presence test.

If an individual is physically present in the U.S. for at least 31 days during 2017 and has spent at least 183 days during the period of 2017, 2016, and 2015 counting all of the days of physical presence in 2017, but only ⅓ of the days of presence in 2016, and only ⅙ of the number of days in 2015, the individual will be deemed a resident for U.S. tax purposes.

Except as noted below, you are treated as being present in the U.S. on any day that you are physically present in the country at any time during the day. Exceptions include days spent in the U.S. for the following circumstances:

1. Days you regularly commute to work in the U.S. from a residence in Canada or Mexico.
2. Days you were in the U.S. for less than 24 hours when you were traveling between 2 places outside the U.S.
3. Days you were temporarily in the U.S. as a regular crew member of a foreign vessel engaged in transportation between the U.S. and a foreign country or a possession of the U.S. unless you otherwise engaged in trade or business on such a day.
4. Days you were unable to leave the U.S. because of a medical condition or medical problem that arose while you were in the U.S.

5. Days you were an exempt individual (e.g., foreign government-related individual, teacher or trainee, student or a professional athlete competing in a charitable sporting event).

Note: *If you qualify to exclude days of presence in the U.S. because you were an exempt individual (other than a foreign government-related individual) or because of a medical condition or medical problem, you must file Form 8843, Statement for Exempt Individuals and Individuals with a Medical Condition. In addition, there are certain elections available to nonresidents who move to the U.S. that could minimize global taxation.*

Even though you may otherwise meet the substantial presence test, you will not be treated as a U.S. resident for 2017 if you do not have a green card and:

- You were present in the U.S. for fewer than 183 days during the calendar year in question,
- You establish that during the calendar year, you had a tax home in a foreign country, and
- You establish that during the calendar year, you had a closer connection to one foreign country in which you had a tax home than to the U.S., unless you had a closer connection to 2 foreign countries.

You will be considered to have a closer connection to a foreign country other than to the U.S. if you or the IRS establishes that you have maintained more significant contacts with the foreign country than with the U.S.

IRS Form 8840, Closer Connection Exception Statement for Aliens, will need to be submitted with your U.S. nonresident income tax return for the year in which you meet the substantial presence test and you are exempt from it because you also meet the closer connection test.

Alternatively, you may be considered a nonresident if you also would qualify as a resident of your home jurisdiction under the tie breaker clause of an income tax treaty with the U.S.

U.S. REPORTING REQUIREMENTS FOR NONRESIDENT ALIENS

Form 1040NR/1040NR-EZ

This form is used by nonresident aliens of the U.S. to annually report U.S.-sourced income and the payments of U.S. tax, made either through withholding by the payor or through estimated tax payments. The U.S. tax liability for the year is computed and any tax due in excess of payments made during the year is remitted to the U.S. Treasury. A U.S. nonresident may also be subject to state income tax on the income earned in one or more states.

Foreign nationals, nonresident aliens and other taxpayers who have filing or payment obligations under U.S. law and are not eligible for a social security number are required to obtain an Individual Taxpayer Identification Number ("ITIN"). The IRS will only issue ITINs when applications include original documentation (e.g., passports and birth certificates) or copies of these documents that have been certified by the issuing agency. There are certain exceptions for families of military personnel and for persons who have certain types of income subject to withholding (e.g., pensions). ITINs issued after 2012 may have a 5-year expiration period.

Note: *When reporting as a U.S. nonresident, residents of another country under the provision of a treaty will be required to file Form 1040NR/1040NR-EZ and include applicable forms to report interests in foreign entities, (e.g., Forms 8621, 5471, and 8865) and financial accounts (see below).*

Form 1042-S

If you are a nonresident of the U.S. and receive income from U.S. sources, you will receive Form 1042-S. This is the annual information return prepared by the payor to report your name, address, amount and type of income paid and any taxes withheld.

This form is normally distributed no later than March 15 of the following year. If the recipient of the income is a U.S. person, a Form 1099 would be issued instead; Forms 1099 are generally due to be received by U.S. persons no later than January 31 of the following year. Information on Form 1042-S may also be reported to the tax authorities in the recipients' country of residence.

Form W-8 BEN

This form is provided by a nonresident alien to a payor to certify the recipient's residency status as beneficial owner of the income. If applicable, this form should also be completed to claim the benefits of an income tax treaty.

Form W-8 BEN-E

This form is provided by a foreign entity to document its foreign status to a payor to certify the recipient's status as beneficial owner of the income. If applicable, this form should also be completed to claim the benefits of an income tax treaty.

Caution: *If you give the payor the wrong form you will likely receive unnecessary (and avoidable) correspondence from the IRS.*

FOREIGN REPORTING REQUIREMENTS FOR U.S. CITIZENS AND RESIDENTS

There are many IRS tax forms that must be completed and attached to your tax return to disclose foreign holdings and to make elections that could prove valuable to you. As more and more individuals invest in foreign companies, whether held directly by you or through a pass-through entity such as an investment partnership or hedge fund, your reporting requirements increase. These requirements place an additional burden on the amount of information you must include with your U.S. income tax return. Failure to do so could result in substantial penalties and the loss of beneficial tax elections. Some of the most common of these forms are:

- Form 114 (formerly TDF 90-22.1), Report of Foreign Bank and Financial Accounts.
- Form 8621, Return by a Shareholder of a Passive Foreign Investment Company (PFIC) or Qualified Electing Fund (QEF).
- Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation.
- Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships.
- Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations.
- Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts.
- Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner.
- Form 8938, Statement of Foreign Financial Assets.

FORM 114 (FORMERLY TDF 90-22.1) — REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS ("FBAR")

If you are a U.S. person (including a corporation, partnership, exempt organization, trust or estate) and have a financial interest in or signature authority over a foreign financial account, you may be subject to FBAR reporting.

The FBAR must be filed on an annual basis if you have a financial interest in or signature authority over one or more financial accounts in a foreign country with an aggregate value exceeding $10,000 at any time during the year. Beginning with the 2016 FBAR and forward, the due date for this form will be April 15 of the following year instead of June 30 and filers will be able to seek a 6-month extension of this deadline.

Note: *U.S. citizens residing abroad will receive an automatic extension of time to file the FBAR until June 15 of the following year and an additional 4-month extension will be granted upon request. The requirement for submission of both new and amended filings for all years must be done online and CPAs can file FBAR forms on behalf of their clients as long as they have a document granting them that authority.*

Financial accounts include bank, securities, derivatives, foreign mutual funds or other financial accounts (including any savings, demand, checking, deposit, annuity, or life insurance contract other than term insurance or other account maintained with a financial institution). The IRS continues to suspend the reporting of offshore commingled funds, such as hedge funds and private equity funds.

A financial interest in an account includes being the owner of record or having legal title, even if acting as an agent, nominee, or in some other capacity on behalf of a U.S. person. Taxpayers who have signatory authority over accounts owned by others (e.g., minor children, parents, etc.) are also reportable. A financial interest also includes an account held by a corporation in which you own, directly or indirectly, more than 50% of the total voting power or value of shares; a partnership in which you own an interest of more than 50% in the capital or profits; or a trust as to which you or any other U.S. person has a present beneficial interest in more than 50% of the assets or receives more than 50% of the current income.

In the case of a non-willful failure to file the FBAR, the IRS may impose a maximum penalty of $10,000 per account. New procedures issued by the IRS in 2015 limit the maximum penalty imposed where there is willfulness. The memo specifically instructs examiners to calculate a single penalty for all years combined and then allocate it to each year. The single penalty is 50% of the highest aggregate balance in any of the years under examination. Criminal penalties could also be assessed for willful violations.

Note: *In previous years the maximum penalty was the greater of $100,000 or 50% of the highest balance in the account during the year.*

OFFSHORE VOLUNTARY DISCLOSURE PROGRAMS

Since 2009 the IRS has offered various programs designed for taxpayers to voluntary disclose previously unreported foreign income or assets. Two of the programs which focus on disclosure of foreign assets are the Offshore Voluntary Disclosure Program ("OVDP") and the Streamlined Filing Compliance Procedure ("SFCP"). Both programs provide an opportunity for taxpayers to come forward and disclose unreported foreign income and file information returns while paying a reduced penalty or, in some cases, no penalty at all. In the case of the OVDP, the individual may also avoid criminal prosecution. In 2014 the IRS announced important changes to both programs. Specifically, the IRS imposed stricter requirements and potentially higher penalties for taxpayers participating in the OVDP, and expanded the original SFCP program in taxpayer friendly ways to include taxpayers residing both in the U.S. and abroad.

Note: *There is no set application deadline for these programs and the IRS can change the terms, increase penalties or decide to end them altogether at any time. Thus, taxpayers who can benefit from participating in these programs should act promptly.*

FORM 8621, RETURN BY A SHAREHOLDER OF A PASSIVE FOREIGN INVESTMENT COMPANY OR QUALIFIED ELECTING FUND

U.S. persons who invest in a foreign corporation which is a PFIC are subject to the harsh PFIC regime. Unless a qualified electing fund ("QEF") election or mark-to-market ("MTM") election is made they will pay tax on gains from the sale of the investment or on certain distributions from the PFIC ("excess distribution"). Also if neither of these 2 elections is made, upon disposition of all or some of the PFIC stock or certain distributions ("excess distributions") the harsh PFIC rules will also apply. These rules require a ratable allocation of any gain over the years during which the shares were held and that gain is taxed at the highest rate on ordinary income in effect for each of the years involved, rather than the beneficial long-term capital gains rate in the year of disposition. An interest charge is also imposed on the tax, and begins running from the period to which such gain is allocated. In certain situations, this tax can exceed 100% of the gain (ergo, "harsh").

Classification as a PFIC occurs when 75% or more of the corporation's income is passive or when more than 50% of the corporation's assets generate passive income. Passive income includes, but is not limited to, interest, dividends, and capital gains.

U.S. shareholders who make the QEF election on Form 8621 are required to annually include in income the pro rata share of the ordinary earnings and net capital gains of the corporation, whether or not distributed, thus avoiding the onerous PFIC tax.

Alternatively, a shareholder of a PFIC may make a mark-to-market election on Form 8621 for marketable PFIC stock. If the election is made, the shareholder includes in income each year an amount equal to the excess, if any, of the fair market value of the PFIC stock as of the close of the tax year over the shareholder's adjusted basis in the stock; or deducts the excess of the PFIC's adjusted basis over its fair market value at the close of the tax year (the deduction is limited to cumulative income that was included in previous years). If the election is made, the PFIC rules do not apply. Amounts included in income or deducted under the MTM election, as well as gain or loss on the actual sale or other disposition of the PFIC stock, are treated as ordinary income or loss.

U.S. persons (i.e., individuals, corporations, partnerships, trusts, and estates) owning PFICs are required to file Form 8621 regardless of whether an excess distribution has occurred or an election has been made. This applies to U.S. shareholders who own shares directly and indirectly who are at the lowest tier of a chain of companies.

Ownership of PFIC stock through another U.S. taxpayer may also trigger reporting in certain instances. U.S. persons who are required to include an amount in income under the QEF or MTM regimes for PFIC stock held through another U.S. taxpayer are not required to file if another shareholder through which the U.S. person holds the PFIC stock timely files. The filing applies to domestic estates, non-grantor trusts and U.S. owners of domestic or foreign grantor trusts that own PFIC stock.

U.S. persons who are beneficiaries of foreign estates and foreign non-grantor trusts that have made QEF or MTM elections are required to file, while those beneficiaries of domestic estates or trusts are only required to file if the estate or trust fails to file the form. U.S. beneficiaries are required to report in any case in which the beneficiary receives an excess distribution or recognizes gains treated as excess distributions.

A limited filing exception applies for certain shareholders with respect to an interest owned in a PFIC for which the shareholder is subject to PFIC tax where no QEF or MTM election is in effect. The exception applies only if the shareholder is not subject to PFIC tax with respect to any excess distributions or gains treated as excess distributions and either (a) the aggregate value of all PFIC stock owned by the shareholder at the end of the tax year of the shareholder does not exceed $25,000 ($50,000 for joint filers), or (b) the PFIC stock is owned by the shareholder through another PFIC, and the value of the shareholder's proportionate share of the upper-tier PFIC interest in the lower-tier PFIC does not exceed $5,000.

FORM 926, RETURN BY A U.S. TRANSFEROR OF PROPERTY TO A FOREIGN CORPORATION

Form 926 is used to report certain transfers of tangible or intangible property to a foreign corporation. While there are certain exceptions to the filing, generally the following special rules apply to reportable transfers:

- If the transferor is a partnership, the U.S. partners of the partnership, not the partnership itself, are required to report the transfer on Form 926 based on the partner's proportionate share of the transferred property.

- If the transfer includes cash, the transfer is reportable on Form 926 if immediately after the transfer the person holds, directly or indirectly, at least 10% of the total voting power or the total value of the foreign corporation, or the amount of cash transferred by the person to the foreign corporation during the 12-month period ending on the date the transfer exceeds $100,000.

The penalty for failure to comply with the reporting requirements is 10% of the fair market value of the property at the time of the transfer, limited to $100,000 if the failure to comply was not due to intentional disregard.

FORM 8865, RETURN OF U.S. PERSONS WITH RESPECT TO CERTAIN FOREIGN PARTNERSHIPS

Form 8865 is required to report information with respect to controlled foreign partnerships, transfers to foreign partnerships, or acquisitions, dispositions, and changes in foreign partnership ownership. A separate Form 8865, along with the applicable schedules, is required for each foreign partnership.

There are 4 categories which define who is required to file the form and how much information must be provided. The categories are:

- **Category 1:** A U.S. person who owned more than a 50% interest in a foreign partnership at any time during the partnership's tax year.

- **Category 2:** A U.S. person who at any time during the tax year of the foreign partnership owned a 10% or greater interest in the partnership while the partnership was controlled by U.S. persons each owing at least 10% interest. However, if there was a Category 1 filer at any time during that tax year, no person will be considered a Category 2 filer.

- **Category 3:** A U.S. person, including a related person, who contributed property during that person's tax year to a foreign partnership in exchange for an interest in the partnership, if that person either owned directly or indirectly at least a 10% interest in the foreign partnership immediately after the contribution, or the value of the property contributed by such person or related person exceeds $100,000. If a domestic partnership contributes property to a foreign partnership, the partners are considered to have transferred a proportionate share of the contributed property to the foreign partnership. However, if the domestic partnership files Form 8865 and properly reports all the required information with respect to the contribution, its partners will generally not be required to report the transfer. Category 3 also includes a U.S. person that previously transferred appreciated property to the partnership and was required to report that transfer under IRC section 6038B, if the foreign partnership disposed of such property while the U.S. person remained a partner in the partnership.

- **Category 4:** A U.S. person who had acquired or disposed of or had a change in proportional interest may be required to report under this category if certain requirements are met.

A penalty of $10,000 can be assessed for failure to furnish the required information within the time prescribed. This penalty is applied for each tax year of each foreign partnership. Furthermore, once the IRS has sent out a notification of the failure to report the information, an additional $10,000 penalty can be assessed for each 30-day period that the failure continues, up to a maximum of $50,000 for each failure.

FORM 5471, INFORMATION RETURN OF U.S. PERSONS WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS

Form 5471 is used to satisfy the reporting requirement for U.S. persons who are officers, directors, or shareholders in certain foreign corporations. You will be required to file this form if you meet one of the following tests (Category 1 has been repealed):

- **Category 2:** You are a U.S. person who is an officer or director of a foreign corporation in which a U.S. person has acquired stock that makes him/her a 10% owner with respect to the foreign corporation, or acquired an additional 10% or more of the outstanding stock of the foreign corporation..

- **Category 3:** You are a U.S. person who acquires stock in a foreign corporation which, when added to any stock owned on the date of acquisition or without regard to stock already owned, meets the 10% stock ownership requirement with respect to the foreign corporation, or

  - You are a person who becomes a U.S. person while meeting the 10% stock ownership requirement with respect to the foreign corporation, or

  - You are a U.S. person who disposes of sufficient stock in the foreign corporation to reduce your interest to less than the 10% stock ownership requirement.

- **Category 4:** You are a U.S. shareholder who owns more than 50% of the total combined voting power of all classes of stock entitled to vote or more than 50% of the total value of the stock in a foreign corporation for an uninterrupted period of 30 days or more during any tax year of the foreign corporation.

- **Category 5:** You are a U.S. shareholder who owns stock in a controlled foreign corporation ("CFC") for an uninterrupted period of 30 days or more and who owns the stock on the last day of that year. A CFC is defined as a foreign corporation that has U.S. shareholders (counting only those with at least a 10% interest) that own on any day of the tax year of the foreign corporation more than 50% of the total combined voting power of all classes of its voting stock, or the total value of the stock of the corporation.

Note: *Certain constructive ownership rules apply in determining stock ownership for these purposes.*

The same penalties that apply for failure to file Form 8865 also apply to Form 5471 (see the discussion in the previous section). The information required to properly complete the Form 5471 can be extensive and at times difficult to obtain.

One of the issues faced by U.S. multinationals is that profits earned by foreign subsidiaries can often be subjected to U.S. federal income tax, even if the cash that represents those earnings is not repatriated. This is the result of the wide variety of anti-deferral rules introduced by Congress over the years.

Most notably, Subpart F was designed to currently tax the types of income that could be easily moved into low tax jurisdictions, such as dividends, interest, rents and royalties. The anti-deferral rules aim to subject such income to federal tax in the year in which the subsidiary earns it. The CFC look-through rule provides that certain dividends, interest, rents and royalties paid between related parties are excluded from the calculation of Subpart F. Accordingly the look-through rule operates to reduce the global effective tax rate for many multinational companies.

Observation: *The look-through rule for related parties has been permanently extended as a result of PATH.*

Another oft-encountered rule under the Subpart F regime is the rule which limits the CFC's investment in U.S. Under this provision if a CFC extends a loan to its U.S. shareholder or a party related to its U.S. shareholder, the loan is deemed a dividend for U.S. taxpayers. Included in the definition of a loan are certain trade receivables as well as using the CFC as collateral or as a guarantor to obtain a bank loan in the U.S.

FORM 3520, ANNUAL RETURN TO REPORT TRANSACTIONS WITH FOREIGN TRUSTS AND RECEIPT OF CERTAIN FOREIGN GIFTS AND FORM 3520-A, ANNUAL INFORMATION RETURN OF FOREIGN TRUST WITH A U.S. OWNER

U.S. persons who either create a foreign trust, receive distributions from a foreign trust, or receive gifts or bequests from foreign persons are required to file Form 3520.

A foreign trust is defined as a trust in which either a court outside of the U.S. is able to exercise primary supervision over the administration of the trust or one or more non-U.S. persons have the authority to control all substantial decisions of the trust.

The information return must be filed in connection with the formation of a foreign trust, the transfer of cash or other assets by the settlor or grantor to a foreign trust, and the receipt of any distributions by a U.S. beneficiary from a foreign trust. Any uncompensated use of foreign trust property (e.g., real estate or personal property) by a U.S. grantor, U.S. beneficiary, or any related person is treated as a distribution to the grantor or beneficiary equal to the fair market value of the use of the property and must be reported. The use or loan of trust property will not be considered a distribution to the extent the loan is repaid with a market rate interest or the user makes a payment equal to the fair market value of such use within a reasonable time frame.

Gifts or bequests that you receive in the form of money or property from a non-resident alien (including a foreign estate) that is valued in the aggregate at more than $100,000 annually and gifts in excess of $15,671 in 2016 ($15,797 for 2017) from a foreign corporation or foreign partnership are also reported on Form 3520.

Form 3520 must be filed by the due date of your individual income tax return, including extensions. The failure to do so may subject you to a penalty of 35% of the gross value of any property transferred to the trust, 35% of the gross value of the distributions received from the trust, or 5% of the amount of certain foreign gifts for each month for which the gift goes unreported (not to exceed 25% of the gift).

In addition to the filing requirements of Form 3520, there is also a requirement to file Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner, which is an annual information return of a foreign trust with at least one U.S. owner and which is considered a grantor trust. If you are a U.S. person who directly or indirectly transfers property to a foreign trust, the trust is presumed to have a U.S. beneficiary and is considered a grantor trust unless you can demonstrate that under the terms of the agreement, no income or corpus of the trust can be paid or accumulated for the benefit of a U.S. person. As the U.S. owner, you are responsible for ensuring that the foreign trust annually furnishes certain information to the IRS and the other owners and beneficiaries of the trust.

Form 3520-A must be filed by March 15 after the foreign trust's tax year, in the case of a calendar-year trust. A 6-month extension can be requested on IRS Form 7004.

FORM 8938, STATEMENT OF FOREIGN FINANCIAL ASSETS

U.S. citizens or resident aliens filing joint returns who hold, at the end of the year, an aggregate of more than $100,000 (or $50,000 for single taxpayers) in certain foreign assets (e.g., a foreign financial account, an interest in a foreign entity, or any financial instrument or contract held for investment that is held and issued by a foreigner) will be required to report information about those assets on Form 8938. Those taxpayers filing jointly who hold $150,000 (or $75,000 for single) in foreign assets at any time during the year also have a filing obligation regardless of whether the end-of-year threshold is met. This requirement is in addition to the FBAR reporting. Form 8938 is part of the annual income tax return, whereas the FBAR is filed separately.

Beginning after December 31, 2015, certain domestic corporations, partnerships, and trusts that are considered formed or availed of for the purpose of holding, directly or indirectly, specified foreign financial assets (special domestic entities) must file Form 8938 if the total value of those assets exceeds $50,000 on the last day of the tax year or $75,000 at any time during the tax year.

For U.S. citizens or resident aliens living outside of the U.S. the filing thresholds are increased to $400,000 (or $200,000 for single taxpayers). Also, individuals not required to file a U.S. income tax return for the tax year are not required to file Form 8938 even if the aggregate value of the specified foreign financial assets is more than the appropriate reporting threshold and there is a reporting exception for foreign financial assets reported on certain information returns.

Noncompliance with these rules for any tax year could result in a failure-to-file penalty of $10,000 and continuing failure to file penalties up to $50,000. In addition, a 40% understatement penalty for underpayment of tax as a result of a transaction involving an undisclosed specified foreign financial asset can be assessed; Criminal penalties may also apply.

For tax returns filed after March 18, 2010, the statute of limitations for assessing tax with regard to cross-border transactions or for certain foreign assets will be extended for 3 years from the date certain informational reporting is submitted related to the transaction or the asset if the failure to report was due to reasonable cause and not willful omission. If an omission is in excess of $5,000 related to a foreign financial asset, the statute of limitations will be extended from 3 years to 6 years and would not begin to run until the taxpayer files the return disclosing the reportable foreign asset.

Observation: *The definition of a reportable foreign asset is much broader than under the FBAR rules and includes interests in offshore hedge funds, private equity funds, and real estate holding companies.*

FOREIGN ACCOUNT TAX COMPLIANCE ACT—FATCA

Beginning July 1, 2014, foreign financial institutions are required to report directly to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. To properly comply, a foreign financial institution was required to enter into a special agreement with the IRS by June 30, 2014. A participating institution will be required to implement certain due diligence procedures prior to opening an account, identify U.S. account holders who have opened accounts or after the effective date of the agreement, and have certain procedures for pre-existing accounts. The U.S. account holder will need to provide the institution with a Form W-9 to identify the status as a U.S. person and the institution will report the information to the IRS. Those institutions that do not participate and account owners unwilling to provide information will be subject to a 30% withholding tax on certain U.S.-sourced payments including interest, dividends and proceeds from the sale of securities.

state tax issues

New York, New Jersey, Connecticut, Pennsylvania, and California tax most of the income subject to federal income tax, but all 5 states either limit or exclude the itemized deductions you claimed on your federal return. Florida does not impose income taxes on individuals.

EisnerAmper

INTRODUCTION

You do not get a complete picture of your personal tax situation until you consider the impact of income taxes in the state or states where you work or live, or from which you derive certain types of income. Each state has specific tax laws so the impact can be very different depending on the state jurisdictions in which you are subject to tax. This chapter is devoted to providing a summary of the state income taxes that may impact you if you work or live in the states of New York, New Jersey, Connecticut, Pennsylvania and California. Florida does not impose a personal income tax.

But before we discuss the factors that distinguish these states from each other, we should point out the rules relating to income exclusions, which are quite similar:

chart 14

2016-2017 MAXIMUM NEW YORK TAX RATES

State or City	Maximum Tax Rates
New York State	**8.82%**
New York City	**3.876%**

For 2012-2017, the maximum NYS tax rate is applicable for married filing joint taxpayers with income over $2 million. For income under $2 million, the top rate is 6.85%.

INCOME EXCLUSIONS

New York, New Jersey, Connecticut, Pennsylvania and California do not tax the following items of income:

- Interest on obligations of:
  1. The U.S. and its possessions, such as Puerto Rico (e.g., U.S. Treasury bills and bonds),
  2. Governmental agencies and municipalities within your state of residence, and
  3. Port Authority of New York and New Jersey for residents of New York and New Jersey, including such interest earned through bond funds.

Caution: *New York, New Jersey, Connecticut, Pennsylvania and California tax the interest income from municipal bonds issued by any state other than their own. A mutual fund needs to have at least 50% of its assets invested in tax-exempt U.S. obligations and/or in California or its municipal obligations in order for any "exempt-interest dividends" to be exempt from California tax. The amount of income that can be excluded from California is based on the percentage of assets so invested.*

A mutual fund needs to have at least 80% of its assets in tax-exempt U.S. obligations and/or in New Jersey or its municipal obligations in order for "exempt-interest dividends" to be exempt from New Jersey tax. The amount of income that can be excluded from New Jersey is based upon the percentage of assets so invested. However, distributions from mutual funds attributable to interest from federal obligations are exempt from New Jersey tax irrespective of whether the 80% test is met.

- State and local income tax refunds (since they do not allow a deduction for payments of state and local income taxes).
- Social Security benefits.
- Certain pension and retirement benefits, subject to various limitations, including the payor of the pension, the age of the recipient, and which state is being considered.

NEW YORK

TAX RATES

Chart 14 shows the maximum tax rates imposed by New York State and New York City. These rates apply to all types of income since New York does not have lower tax rates for net long-term capital gains or qualifying dividend income.

DEDUCTION ADJUSTMENTS

Your allowable federal itemized deductions are reduced if your New York adjusted gross income ("NYAGI") exceeds $200,000 ($100,000 for single or married filing separately filers). The reduction starts at 25% and increases to 50% if your NYAGI exceeds $525,000 and is below $1 million. For tax years through 2017, for individuals with NYAGI of more than $1 million and less than $10 million, total itemized deductions are limited to 50% of the federal deduction for charitable contributions. The 50% is reduced to 25% for individuals with NYAGI over $10 million through tax year 2017.

New York State allows a deduction of $1,000 for each dependent. In addition, New York State allows a deduction for some qualified education expenses, subject to certain limitations.

BONUS DEPRECIATION

New York State does not conform to federal rules regarding bonus depreciation, as discussed in the business owner issues and depreciation deductions chapter.

The exception to this rule is that federal bonus depreciation is allowed in limited areas of Lower Manhattan — the "Liberty Zone," south of Canal Street to the East River; and the "Resurgence Zone," south of Houston Street and north of Canal Street.

To the extent you take advantage of bonus depreciation on your federal return, either directly or from a pass-through entity, you will need to recompute your New York depreciation without applying the bonus depreciation rules. New York State does conform to the federal rules regarding IRC Section 179 depreciation expense, as discussed in the business owner issues and depreciation deductions chapter.

NEW YORK LONG-TERM CARE INSURANCE CREDIT

New York State allows a credit equal to 20% of the premiums paid during the tax year for the purchase or continuing coverage under a qualifying long-term care insurance policy.

FAMILY TAX RELIEF AND "CIRCUIT BREAKER" TAX CREDITS

For tax years 2014 through 2016, there is a refundable credit of $350 available for New York residents with NYAGI of at least $40,000 but not more than $300,000 who claimed one or more dependent children under the age of 17 on the last day of the tax year and had a tax liability that was equal to or greater than zero.

Qualifying New York City residents can claim a credit against property taxes paid when property tax exceeds a percentage, varying from 4 to 6%, of their income. Both homeowners and renters are eligible, and the amount of property tax deemed paid by renters is set at 15.75% of adjusted rent paid in the taxable year.

NEW YORK CITY UBT

Self-employed persons working in New York City are subject to a 4% Unincorporated Business Tax ("UBT") if their total unincorporated business gross income exceeds $85,000 (after the maximum allowance for taxpayer's services of $10,000 (limited to 20% of UBT income) and a $5,000 exemption).

New York City residents can claim a credit against their NYC personal income tax for a portion of the UBT paid by them, including their share of the UBT tax paid by a partnership. The credit is 100% of the UBT paid if your taxable income is $42,000 or less, gradually declining as your income reaches $142,000, at which point the credit is limited to 23% of the UBT paid.

Beginning in 2009, single sales factor is being phased in over 10 years. For 2016, the allocation formula was 87% receipts, 6.5% property, 6.5% payroll. For 2017, the allocation formula is 93% receipts, 3.5% property, 3.5% payroll.

METROPOLITAN COMMUTER TRANSPORTATION MOBILITY TAX ("MCTMT")

Beginning in 2009, a tax was imposed on employers and self-employed individuals engaged in business within the 5 boroughs of New York City and the counties of Nassau, Rockland, Orange, Putnam, Suffolk, Dutchess and Westchester. A graduated tax rate between 0.11% and 0.34% applies to employers based upon the amount of quarterly payroll. For quarters beginning on or after April 1, 2012, payroll must be greater than $312,500 in a calendar quarter before the employer tax applies. The tax also applies to self-employed individuals, including partners in partnerships and members of LLCs that are treated as partnerships based on their net earnings from self-employment allocated to the MCTD. The tax does not apply if the allocated net earnings from self-employment are $50,000 or less for the year.

COLLEGE SAVINGS PROGRAM, CREDITS AND EXPENSES

New York State has a program that allows you to make contributions to Section 529 plans as discussed in detail in the chapter on education incentives. New York State allows a deduction up to $5,000 ($10,000 if married filing jointly) if paid to a New York Section 529 plan.

In addition, a tuition credit or itemized deduction is available if you were a full-year New York State resident and your spouse or dependent (for whom you taken an exemption) was an undergraduate student enrolled at or who attended an institution of higher education and paid qualified tuition expenses, and are not claimed on another person's return. The credit may be as much as $400 per student; 4% of qualified expenses up to $10,000. Alternatively, the maximum tuition deduction is $10,000 per student. You may claim the credit or the deduction, but not both.

NEW JERSEY

TAX RATES

The maximum tax rate imposed by New Jersey is 8.97%. This rate applies to all types of income since New Jersey does not have lower tax rates for net long-term capital gains or qualifying dividend income.

Note: *For New Jersey, the marginal tax rate for single taxpayers with taxable income in excess of $75,000 but less than $500,000 is 6.37%. Married/civil union partner taxpayers filing jointly are subject to the 6.37% rate on income in excess of $150,000 but less than $500,000. Single and married/civil union partner taxpayers filing jointly with incomes over $500,000 are subject to a top marginal rate of 8.97%.*

DEDUCTION ADJUSTMENTS

Except as noted below, no deduction is allowed for itemized deductions since New Jersey is a "gross income" state. In addition to the income exclusions noted above, New Jersey allows the following deductions to reduce your taxable income:

- Personal exemptions of $1,000 each for you and your spouse (or domestic partner). New Jersey allows a $1,500 personal exemption for each dependent child or other dependent (who qualifies as your dependent for federal income tax purposes). Taxpayers 65 years of age or over at the close of the taxable year, blind, or disabled, and certain dependents attending college are allowed an additional $1,000 exemption.

- Alimony, separate maintenance, or spousal support payments to the extent they are includible in the gross income of the recipient (regardless of where the recipient lives).

- Medical expenses in excess of 2% of New Jersey gross income.

- The 50% portion of business travel and entertainment expenses that is disallowed on your federal return for self-employed individuals, business owners, and partners in a partnership.

- Property taxes up to a maximum of $10,000 paid on a personal residence.

- Tenants are allowed a property tax deduction based on 18% of the rent paid during the year.

If you are considered a self-employed individual for federal income tax purposes or you received wages from an S corporation in which you were a more than 2% shareholder, you may deduct the amount you paid during the year for health insurance for yourself, your spouse/civil-union partner/domestic partner, and your dependents. The amount of the deduction may not exceed the amount of your earned income, as defined for federal income tax purposes, derived from the business under which the insurance plan was established. You may not deduct any amounts paid for health insurance coverage for any month during the year in which you were eligible to participate in any subsidized plan maintained by your (or your spouse's/civil-union partner's/domestic partner's) employer. Note that for federal tax purposes, you may be able to deduct amounts paid for health insurance for any child of yours who is under the age of 27 at the end of 2016. However, for New Jersey purposes, you may deduct such amounts only if the child was your dependent.

BONUS DEPRECIATION

New Jersey has not conformed to federal rules regarding bonus depreciation. See the chapter on business owner issues and depreciation deductions.

IRC SECTION 179 EXPENSE

New Jersey permits a limited IRC Section 179 deduction of up to a maximum of $25,000. If you have more than one business, farm or profession, you may not deduct more than a total of $25,000 of IRC Section 179 costs for all activities. To the extent higher IRC Section 179 deductions were taken for federal purposes, you will need to recompute your New Jersey deduction.

COLLEGE SAVINGS PROGRAM

New Jersey does not provide for a college savings credit or deduction.

NEW JERSEY HOMESTEAD BENEFIT AND SENIOR FREEZE (PROPERTY TAX REIMBURSEMENT) PROGRAMS

These programs provide property tax relief for amounts paid on a principal residence.

Senior Freeze Program
The Senior Freeze Program provides for a reimbursement of the difference between the amount of property taxes paid for the base year and the amount for which you are applying for a reimbursement. Applicants must meet the following conditions to be eligible for a Senior Freeze property tax reimbursement:

- Have been age 65 or older OR receiving federal Social Security disability benefits;
- Have lived in New Jersey for at least 10 years as either a home-owner or renter;
- Have owned and lived in your home for at least 3 years;
- Have paid the full amount of the property taxes due on the home for the base year and each succeeding year up to and including the year in which you are claiming the reimbursement; and
- Have met the income limits for the base year and for each succeeding year up to and including the year for which you are claiming the reimbursement. These limits apply regardless of marital/civil-union status. However, applicants who are married or in a civil union must report combined income of both spouses/civil-union partners.

Note: *Under the terms of the State Budget for FY 2017, only those applicants whose income for 2014 did not exceed $85,553 and whose income for 2015 did not exceed $70,000 (the original limit was $87,007) will be eligible to receive reimbursements for 2015 provided they met all the other program requirements. Residents whose 2015 income was over $70,000 but not over $87,007 will not receive reimbursements for 2015, even if they met all the other program requirements. The Division of Taxation will send notices to these applicants advising them that they are not eligible to receive reimbursement payments for 2015. However, by having filed an application by the October 17, 2016 extended due date, these residents established their eligibility for benefits in future years and ensure that they will be mailed an application for 2016.*

The Senior Freeze Program is expected to continue in 2017 for property taxes paid in 2016.

Homestead Benefit Program
The requirements for the Homestead Benefit are slightly different, have different filings deadlines and are not age-based. It is possible to be eligible for both the Homestead Benefit Program and the Senior Freeze (Property Tax Reimbursement) program, but the amount of benefits received cannot exceed the amount of property taxes paid on their principal residence.

ESTATE TAX

Starting in 2017, the New Jersey estate tax income exclusion will increase from $675,000 to $2 million. The estate tax will be eliminated altogether after January 1, 2018.

EARNED INCOME TAX CREDIT

Applicable for tax years starting on or after January 1, 2016, the credit will increase from 30% of the federal level to 35%.

RETIREMENT INCOME TAX

Effective starting with tax year 2017, the retirement income tax exclusion for joint filers will increase from $20,000 to $40,000, and will continue to increase each year until it caps out at $100,000 in 2020. For a married person filing separately, the exclusion will gradually increase from $10,000 to $50,000, and for a single taxpayer, it will gradually increase from $15,000 in 2017 to $75,000 in 2020.

VETERANS' EXEMPTION

Beginning in 2017, veterans who are honorably discharged from active service in the military or the National Guard are eligible for an additional $3,000 exemption.

CONNECTICUT

TAX RATES

The maximum tax rate imposed by Connecticut is 6.99%. This rate applies to all types of income since Connecticut does not have lower tax rates for net long-term capital gains or qualifying dividend income.

Note: *The maximum tax rate for Connecticut is 6.9% for the following individuals:*

- Filing status is Single or Married filing separately with Connecticut taxable income of over $250,000 but not over $500,000.
- Filing status is Head of Household with Connecticut taxable income of over $400,000 but not over $800,000.
- Filing status is Joint or Qualifying Widow(er) with Connecticut taxable income of over $500,000 but not over $1,000,000.

If your taxable income is more than these thresholds, the maximum tax rate is 6.99%.

RECAPTURE TAX AMOUNT FOR TAXPAYERS IN HIGHER INCOME BRACKETS

A taxpayer whose Connecticut AGI exceeds the income thresholds specified below, after computing his or her Connecticut income tax liability using the applicable tax rates, and after applying the 3% phase-out provision, is required to add the recapture amount of tax as indicated below. The result of the recapture tax is essentially that the entire AGI is taxed at the highest income tax rate, without the benefit of graduated rates.

- Filing status is Single or Married filing separately: If Connecticut AGI is more than $200,000.
- Filing status is Head of household: If Connecticut AGI is more than $320,000.
- Filing status is Joint or Qualifying widow(er): If Connecticut AGI is more than $400,000.

DEDUCTION ADJUSTMENTS

No deductions are allowed for itemized deductions, as Connecticut is a "gross income" state, as modified by the income exclusions noted above.

Connecticut allows resident individual taxpayers' income tax credits for real estate and personal property taxes paid to Connecticut political subdivisions on their primary residences or privately owned or leased motor vehicles. The maximum credit amount cannot exceed your personal tax liability. These credits are phased out for higher income persons.

BONUS DEPRECIATION

Connecticut has conformed to federal rules regarding bonus depreciation. Connecticut does not allow bonus depreciation for C corporations. See the chapter on business owner issues and depreciation deductions.

IRS SECTION 179 EXPENSE

Connecticut does conform to the federal rules regarding IRC Section 179 depreciation expense as discussed in the business owner's issues and depreciation deductions chapter.

COLLEGE SAVINGS PROGRAM

Connecticut taxpayers may deduct contributions to the Connecticut Higher Education Trust from federal AGI, up to $5,000 for individual filers and $10,000 for joint filers. Amounts in excess of the maximum allowable contributions may be carried forward for 5 years after the initial contribution was made.

The "CHET Baby Scholars" program provides up to $250 toward a newborn's future college costs. For children born or adopted on or after January 1, 2015, CHET Baby Scholars will deposit $100 into a CHET account. A second deposit of $150 will be made if family and friends add at least $150 to the child's enrolled CHET account within 4 years. The deadline to participate is 12 months after the child's birth or adoption and there are no income limitations.

tax tip

27 RESIDENCY CAUTION

Your principal residence is in Connecticut but you work in New York City and maintain an apartment there. During the year you were present in New York for more than 183 days. You are a statutory resident of both New York State and New York City for tax purposes. As a result, Connecticut, New York State, and New York City would tax all of your income. A partial credit is available to offset some of this additional tax.

You can eliminate this tax by being present in New York State for 183 days or less or by eliminating the New York City apartment. By statute, a partial day in New York is considered a full day spent in New York with minor exceptions. Also, a day working at your home in Connecticut will be considered by New York to be a day working in New York, while Connecticut will consider it a day working in Connecticut. Therefore, income allocated to these days will be taxed by both New York State and Connecticut with no offsetting credit. Be sure to maintain substantiation to support the days in and out of New York.

PENNSYLVANIA

TAX RATES

Pennsylvania imposes a flat tax on all income at a rate of 3.07% (see Chart 15). Pennsylvania has 8 categories (buckets) of income, and income/loss from one bucket may not be used to offset income/loss from another. The single flat tax rate of 3.07% applies to all types of income since Pennsylvania does not have lower tax rates for net long-term capital gains or qualifying dividend income.

Income from a business is subject to allocation and apportionment to the extent the business is "doing business" both within and outside of Pennsylvania. The default method is specific allocation if the taxpayer has books and records to substantiate the allocation. However, most taxpayers apportion their business income. The apportionment formula for Pennsylvania Personal Income Tax purposes is an equal-weighted 3-factor method, and the sales factor utilizes a cost of performance method.

Note: *The 3-factor apportionment method, based upon cost of performance, differs from the corporate tax apportionment method of a single sales factor based upon market sourcing.*

Philadelphia imposes a Wage Tax on compensation earned by residents of the City and on nonresidents who work within the City. The tax rate for compensation paid after July 1, 2016 is 3.9004% for residents and 3.94741% for nonresidents. However, nonresidents may apportion their income based upon duty days spent working within the City of Philadelphia.

chart 15

2016-2017 MAXIMUM PENNSYLVANIA TAX RATES

State or City	Maximum Tax Rates
Pennsylvania	**3.07%**
Philadelphia	**3.9102%**

See chart 16 for Philadelphia rate of tax withheld on Form W-2.

Philadelphia imposes an unearned income tax, known as the "School Income Tax," upon all residents of the City. The tax rate for 2016 is 3.9004%, and typically matches the Wage Tax rate. Some examples of taxable unearned income are dividends, certain rents and royalties, S corporation distributed income, and short-term (held for 6 months or less) capital gains. Earned income that is other-wise subject to the Philadelphia Business Income and Receipt Tax ("BIRT"), the Net Profits Tax ("NPT") or Wage Tax is not subject to the School Income Tax.

Philadelphia imposes a BIRT (f/k/a the Business Privilege Tax ("BPT")) upon all persons engaged in business within the City. "Persons" includes individuals, partnerships, associations and corporations. Rental activities are usually considered to be business activities. The BIRT is the sum of 2 taxes; one on income and one

chart 16

PHILADELPHIA RATE OF TAX WITHHELD ON FORM W-2 FOR WAGES

Period	Resident	Nonresident
July 1, 2014 - June 30, 2015	**3.924%**	**3.4915%**
July 1, 2015 - June 30, 2016	**3.9102%**	**3.4928%**
July 1, 2016 and subsequent years	**3.9004%**	**3.4741%**

on gross receipts. For 2016, the gross receipts tax rate is 0.1415%, and the income tax rate is 6.39% on net taxable income. For the 2016 tax year, the income tax apportionment methodology is a single sales factor. The sales factor and taxable receipts for the gross receipts tax are determined on a cost of performance method for most businesses, notably software companies use market-based sourcing of receipts.

Philadelphia imposes a NPT on the net profits from the operation of a trade, business, profession, enterprise or other activity conducted by individuals, LLCs, partnerships, associations or estates and trusts. The tax is imposed on the entire net profit of any self-employed person who is a resident of Philadelphia regardless of the location of the business. It is also imposed on businesses conducted in Philadelphia by nonresidents. Corporations are not subject to this tax. Also, the proportionate amount of partnership, LLC, and other association income attributable to corporate partners or members is exempt from the NPT. For residents, the NPT rate is 3.9004% for 2016 and 3.9102% for 2015 and for non-residents the NPT rate is 3.4741% for 2016.

DEDUCTION ADJUSTMENTS

No deductions are allowed for itemized deductions, as Pennsylvania is a "gross income" state, as modified by the income exclusions noted above.

BONUS DEPRECIATION

Pennsylvania requires that taxpayers add back the federal bonus depreciation. The taxpayer may then subtract an amount equal to 3/7 of the taxpayer's ordinary depreciation deduction under IRC Sec. 167. The deduction may be claimed in succeeding taxable years until the entire amount of the addback has been claimed. Any disallowed depreciation not claimed as a result of the subtraction may be claimed in the last year that the property is depreciated for federal tax purposes.

IRC SECTION 179

Pennsylvania permits a limited deduction of up to a maximum of $25,000 using IRC section 179. If you have more than one business, farm or profession, you may not deduct more than a total of $25,000 of IRC section 179 costs for all activities. To the extent higher Section 179 deductions were taken for federal purposes, you will need to recompute your Pennsylvania depreciation deductions.

COLLEGE SAVINGS PROGRAM

Pennsylvania allows a deduction of up to the maximum federal annual exclusion amount of $14,000 ($28,000 if married filing jointly) for 2016 to any Pennsylvania or non-Pennsylvania 529 plan in computing Pennsylvania taxable income.

CALIFORNIA

TAX RATES

California's top marginal income tax rate is 12.3% for the 2016 tax year. This rate applies to all types of income since California does not have lower tax rates for net long-term capital gains or qualifying dividend income.

The following table shows the 2016 marginal tax rates in effect for married filing joint taxpayers:

Taxable Income:

$526,444 or less	9.3%
$526,445 to $631,732	10.3%
$631,733 to $1,052,886	11.3%
Over $1,052,886	12.3%

There is an additional Mental Health Services Tax of 1% for taxable income in excess of $1,000,000.

BONUS DEPRECIATION

California did not conform to the federal bonus depreciation provisions.

IRC SECTION 179 EXPENSE

California law only allows a maximum deduction of $25,000. The California maximum expensing amount is reduced dollar-for-dollar by the amount of qualified expensing-eligible property placed in service during the year in excess of $200,000. California's $200,000 phase-out threshold is not adjusted for inflation.

ESTIMATED TAX PAYMENTS

Installments due shall be 30% of the required annual payment for the first required installment, 40% of the required annual payment for the second required installment, and 30% of the required annual payment for the fourth required installment. No payment is required for the third installment.

You are to remit all payments electronically once you make an estimate or extension payment exceeding $20,000 or you file an original return with a total liability over $80,000 for any taxable year that begins on or after January 1, 2009. Once you meet the threshold, all subsequent payments regardless of amount, tax type, or taxable year must be remitted electronically. Individuals who do not pay electronically will be subject to a 1% noncompliance penalty.

There are limits on the use of the prior year's tax safe harbor. Individuals who are required to make estimated tax payments, and whose California AGI is more than $150,000 (or $75,000 for married filing separately), must figure estimated tax based on the lesser of 90% of their current year's tax or 110% of their prior year's tax including AMT. Taxpayers with current year California AGI equal or greater than $1,000,000 (or $500,000 for married filing separately), must figure estimated tax based on 90% of their tax for the current year.

SUSPENDED NET OPERATING LOSS CARRYOVERS

For taxable years beginning 2008 through 2011, California suspended the net operating loss deduction. However, taxpayers with MAGI of less than $500,000 for 2008/2009 and $300,000 for 2010/2011 were not affected by the net operating loss suspension rules.

Taxpayers may continue to compute and carry over net operating losses during the suspension period. The carryover period for suspended 2008–2011 losses is extended by one year for losses incurred in 2010; 2 years for losses incurred in 2009; 3 years for losses incurred in 2008; and 4 years for losses incurred in taxable years beginning before 2008.

California allows net operating losses incurred in taxable years beginning on or after January 1, 2013, to be carried back to each of the preceding 2 taxable years. A net operating loss cannot be carried back to any taxable year before January 1, 2011. For net operating losses attributable to 2013, the carryback amount to any taxable year cannot exceed 50% of the net operating loss. For 2014 net operating losses, the carryback cannot exceed 75% of the net operating loss. Net operating losses attributable to taxable years beginning on or after January 1, 2015 can be carried back in full. A taxpayer may elect to relinquish the entire carryback period with respect to a net operating loss for any taxable year. If the taxpayer elects to relinquish the carryback period, the net operating loss is carried forward only to the years eligible under the applicable carryover period.

FLORIDA

TAX RATES

Florida does not impose a personal income tax.

PROPERTY TAX EXEMPTIONS

Florida resident property owners may receive an exemption from a portion of Florida property taxes. The homestead exemption provides that the first $25,000 of the value of a taxpayer's primary, permanent Florida residence is exempt from all property taxes, including school district taxes. The second $25,000 of value is fully taxable, and the third $25,000 of value is exempt from all non-school taxes.

In addition to the homestead exemption, there are $500 exemptions from property tax available to widows and widowers who have not remarried and to legally blind individuals. Florida also provides property tax exemptions for military veterans and military members deployed during the previous calendar year.

S CORPORATIONS

Florida recognizes the federal S corporation election and does not impose tax on S corporations except for years when they are liable for federal tax. Tax on taxable S corporations is imposed only on built-in gains and passive investment income. Because Florida does not have a personal income tax, other S corporation income is not taxed.

Qualified subchapter S subsidiaries are not treated as separate corporations or entities from the S corporation parent.

BONUS DEPRECIATION AND SECTION 179 EXPENSING

C corporations are taxed in Florida.

Florida conforms to federal rules regarding bonus depreciation for property placed in service after December 31, 2014.

For tax years beginning before January 1, 2015, Florida required that taxpayers add back to taxable income 100% of Federal Section 179 deductions in excess of $128,000 and deduct $^{1}/_{7}$ of the addback each year for 7 years. For assets placed in service after 2014, no addbacks are required for section 179 deductions.

OTHER CONSIDERATIONS

BUILD AMERICA BONDS

Build America Bonds (tax credit type) provide the bondholder a non-refundable tax credit of 35% of the interest paid on the bond each year. If the bondholder lacks sufficient tax liability in any year to fully utilize that year's credit, the excess credit can be carried forward for use in future years.

NONRESIDENT TAXATION

Residents of New York, New Jersey, Connecticut, Pennsylvania or California working in other states as nonresidents are taxed by that other state. The income subject to tax is generally based on an allocation of salary and other earned income, using a formula comparing days worked within and outside the state. Also, the sale of real property located in a nonresident state by a nonresident is typically subject to tax by the nonresident state. This includes the gain on the sale of a cooperative apartment by a nonresident of New York State. However, you are allowed to reduce your resident state tax by a credit amount based on the tax paid to the nonresident state, subject to limitations.

Note: *New York State treats days worked at home for the convenience of the employee as days worked in New York. To qualify as a day worked outside New York, you must prove that there was a legitimate business reason that required you to be out of state, such as meeting with a client or customer. You should keep a diary or calendar of your activities and with supporting documents proving your whereabouts (e.g., airplane tickets, credit card statements, bank statements and your passport).*

New York taxes certain income received by a nonresident related to a business, trade, profession or occupation previously carried on within New York, whether or not as an employee. This income includes, but is not limited to, income related to covenants not to compete and income related to termination agreements.

Note: *Pennsylvania has signed reciprocal agreements with Indiana, Maryland, New Jersey, Ohio, Virginia, and West Virginia under which one state will not tax employee compensation subject to employer withholding by the other states. These agreements apply to employee compensation only and not to income from sole proprietorships, partnerships and other entities.*

Note: *Other state tax credits are allowed California residents for net income taxes paid to another state (not including any tax comparable to California's alternative minimum tax) on income also subject to the California income tax. No credit is allowed if the other state allows California residents a credit for net income taxes paid to California. These reverse credit states include Arizona, Indiana, Oregon and Virginia.*

RESIDENCY CAUTION

Individuals who maintain a residence in one jurisdiction, such as New York City, but also have a residence in another jurisdiction must be very careful to avoid the strict rules that could make them a resident of both jurisdictions for tax purposes (see Tax Tip 27). Generally, if you maintain a permanent place of abode in New York, New Jersey, Connecticut or Pennsylvania and spend more than 183 days in that state, you will be taxed as a resident of that state even if your primary residence is in another state. California applies a similar test using 9 months as the threshold, unless you can prove that the time spent in the state was due to a temporary or transitory purpose. In addition, the domicile test treats you as a resident of New York or New Jersey even if you only spend as little as 30 days in the state if you continue to be domiciled there. "Domicile" is generally defined as the place which is most central to your life and is determined using a facts and circumstances test.

STATE ESTATE OR INHERITANCE TAXES

New York, New Jersey, Connecticut and Pennsylvania impose an estate or inheritance tax on persons who are domiciled in the state or have property located in the state. California and Florida do not have an estate or inheritance tax. See the chapter on estate and gift tax planning for a further discussion.

Connecticut is the only state in the country that imposes a state gift tax. The gift tax is imposed if the aggregate amount of Connecticut taxable gifts made on or after January 1, 2005 is $2,000,000. The maximum amount of gift or estate tax that a donor or decedent will be required to pay is $20 million. This cap is in effect for gifts made on or after January 1, 2016 and for estates of decedents dying on or after January 1, 2016.

appendicies

appendix

A 2017 FEDERAL TAX CALENDAR FOR INDIVIDUAL TAXPAYERS

Date	Deadline To
January 17, 2017	• Pay final installment of 2016 estimated taxes.
April 1, 2017	• Take first IRA required minimum distribution if you reached age 70½ in 2016.
April 12, 2017	• File electronically 2016 Report of Foreign Bank and Financial Accounts (FinCEN114) in time to be received by the Treasury by April 15, 2017
April 18, 2017	• File individual income tax and gift tax returns (or extension request) and pay balance of 2016 taxes due. • Make 2016 IRA contributions. • Make first quarter estimated tax payment for 2017 (for individuals and trusts). • File income tax return for trust (or extension request) and pay balance of 2016 taxes due.
June 15, 2017	• Make second quarter estimated tax payment for 2017.
July 31, 2017	• File Keogh plan report (Form 5500) or extension request.
September 15, 2017	• Make third quarter estimated tax payment for 2017. • Make 2016 money-purchase and defined benefit plan contributions.
October 2, 2017	• File 2016 income tax return for trusts, if on extension.
October 12, 2017	• File electronically 2016 Foreign Bank and Financial Accounts (FBAR) in time to be received by the Treasury by October 15, 2017 if on extension
October 16, 2017	• File 2016 individual income tax and gift tax returns, if on extension. • Make 2016 profit-sharing Keogh plan contributions and SEP contributions, if your tax return is on extension.
December 31, 2017	• Prepay expenses deductible on your 2017 return, including state and local taxes not due until January 15, 2018 (or even April 17, 2018), if you will not be in the AMT in 2017 or you will be in a lower tax bracket in 2018, and take capital losses to offset capital gains. • Accelerate income if you are in a lower tax bracket in 2017 than you expect to be in 2018. • Establish a Keogh or defined benefit plan for 2017. • Convert a traditional IRA to a Roth IRA. • Take required IRA minimum distribution for 2017.
January 16, 2018	• Pay final installment of 2017 estimated taxes.

Note: *There are additional filing requirements if you have household employees or if you are a business owner and you pay employees and/or independent contractors.*

appendix

B 2016 FEDERAL TAX RATE SCHEDULE

If Taxable Income Is:

Over	But Not Over	The Tax Is		+	Of The Amount Over
		Married Filing Jointly or Qualifying Widow(er)			
$ 0	$ 18,550.00	$ 0.00	+	10%	$ 0.00
18,550.00	75,300.00	1,855.00	+	15%	18,550.00
75,300.00	151,900.00	10,367.50	+	25%	75,300.00
151,900.00	231,450.00	29,517.50	+	28%	151,900.00
231,450.00	413,350.00	51,791.50	+	33%	231,450.00
413,350.00	466,950.00	111,818.50	+	35%	413,350.00
466,950.00		129,996.50	+	39.6%	466,950.00
		Single			
$ 0.00	$ 9,275.00	$ 0.00	+	10%	$ 0.00
9,275.00	37,650.00	927.50	+	15%	9,275.00
37,650.00	91,150.00	5,183.75	+	25%	37,650.00
91,150.00	190,150.00	18,558.75	+	28%	91,150.00
190,150.00	413,350.00	46,278.75	+	33%	190,150.00
413,350.00	415,050.00	119,934.75	+	35%	413,350.00
415,050.00		120,529.75	+	39.6%	415,050.00
		Married Filing Separately			
$ 0	$ 9,275.00	$ 0.00	+	10%	$ 0.00
9,275.00	37,650.00	927.50	+	15%	9,275.00
37,650.00	75,950.00	5,183.75	+	25%	37,650.00
75,950.00	115,725.00	14,758.75	+	28%	75,950.00
115,725.00	206,675.00	25,895.75	+	33%	115,725.00
206,675.00	233,475.00	55,909.25	+	35%	206,675.00
233,475.00		65,289.25	+	39.6%	233,475.00
		Head of Household			
$ 0	$ 13,250.00	$ 0.00	+	10%	$ 0.00
13,250.00	50,400.00	1,325.00	+	15%	13,250.00
50,400.00	130,150.00	6,897.50	+	25%	50,400.00
130,150.00	210,800.00	26,835.00	+	28%	130,150.00
210,800.00	413,350.00	49,417.00	+	33%	210,800.00
413,350.00	441,000.00	116,258.50	+	35%	413,350.00
441,000.00		125,936.00	+	39.6%	441,000.00

appendix

C 2017 FEDERAL TAX RATE SCHEDULE

If Taxable Income Is:

Over	But Not Over	The Tax Is	+		Of The Amount Over
		Married Filing Jointly or Qualifying Widow(er)			
$ 0	$ 18,650.00	$ 0.00	+	10%	$ 0.00
18,650.00	75,900.00	1,865.00	+	15%	18,650.00
75,900.00	153,100.00	10,452.50	+	25%	75,900.00
153,100.00	233,350.00	29,752.50	+	28%	153,100.00
233,350.00	416,700.00	52,222.50	+	33%	233,350.00
416,700.00	470,700.00	112,728.00	+	35%	416,700.00
470,700.00		131,628.00	+	39.6%	470,700.00
		Single			
$ 0.00	$ 9,325.00	$ 0.00	+	10%	$ 0.00
9,325.00	37,950.00	932.50	+	15%	9,325.000
37,950.00	91,900.00	5,226.25	+	25%	37,950.00
91,900.00	191,650.00	18,713.75	+	28%	91,900.00
191,650.00	416,700.00	46,643.75	+	33%	191,650.00
416,700.00	418,400.00	120,910.25	+	35%	416,700.00
418,400.00		121,505.25	+	39.6%	418,400.00
		Married Filing Separately			
$ 0	$ 9,325.00	$ 0.00	+	10%	$ 0.00
9,325.00	37,950.00	932.50	+	15%	9,325.00
37,950.00	76,550.00	5,226.25	+	25%	37,950.00
76,550.00	116,675.00	14,876.25	+	28%	76,550.00
116,675.00	208,350.00	26,111.25	+	33%	116,675.00
208,350.00	235,350.00	56,364.00	+	35%	208,350.00
235,350.00		65,814.00	+	39.6%	235,350.00
		Head of Household			
$ 0	$ 13,350.00	$ 0.00	+	10%	$ 0.00
13,350.00	50,800.00	1,335.00	+	15%	13,350.00
50,800.00	131,200.00	6,952.50	+	25%	50,800.00
131,200.00	212,500.00	27,052.50	+	28%	131,200.00
212,500.00	416,700.00	49,816.50	+	33%	212,500.00
416,700.00	444,550.00	117,202.50	+	35%	416,700.00
444,550.00		126,950.00	+	39.6%	444,550.00

appendix

D 2016 AND 2017 MAXIMUM EFFECTIVE RATES

	Federal	NYS Resident	NYC Resident	CA Resident	CT Resident	NJ Resident	PA Resident
Maximum Tax Rates	VAR%	8.82%(a)	12.696%	13.3%(b)	6.99%(c)	8.97%(d)	3.07%(e)
Effective Tax Rates If Not In The AMT Ordinary Income							
39.6% Bracket*	39.6%	45%	47%	48%	44%	45%	41%
35% Bracket*	35%	41%	43%	44%	40%	41%	37%
33% Bracket*	33%	39%	42%	42%	38%	39%	35%
28% Bracket	28%	34%	37%	38%	33%	34%	30%
25% Bracket	25%	32%	35%	35%	30%	32%	27%
Long-Term Capital Gains And Qualifying Dividends If Not In The AMT							
20% Bracket*	20%	27%	30%	31%	26%	27%	22%
Effective Tax Rates If In The AMT Ordinary Income							
28% Bracket	28%	37%	41%	41%	35%	37%	31%
26% Bracket	26%	35%	39%	39%	33%	35%	29%
Long-Term Capital Gains And Qualifying Dividends If In The AMT							
20% Bracket	20%	29%	33%	33%	27%	29%	23%

* If the maximum ordinary income tax rate for federal is 39.6%, 35%, or 33% and modified adjusted gross income ("MAGI") exceeds $250,000 for married filing joint, $200,000 for single and $125,000 for married filing separate taxpayers, you may be subject to an additional 3.8% Medicare Contribution Tax on net investment income. Similarly, if you meet these MAGI thresholds, long term capital gains may be taxed at 23.8%.

(a) For NYS, the maximum tax rate is applicable for taxable income over $2,140,900 for married filing jointly. If taxable income is under $2,140,900, the rate is 6.85%.

(b) The maximum California rate includes the 1% Mental Health Service Tax. The top rate for married filing jointly taxpayers with $1,052,886 or less of taxable income is 12.3%.

(c) For Connecticut married filing jointly taxpayers with taxable income below $500,000, the maximum tax rate is 6.9%.

(d) The maximum tax rate for New Jersey applies to taxable income in excess of $500,000. If your taxable income is less than $500,000, your maximum tax rate is 6.37%.

(e) The Pennsylvania maximum rate does not include the City of Philadelphia tax on wages and self-employment income of 3.9102% for Philadelphia residents and 3.4828% for nonresidents.

Note: *These effective tax rates do not include payroll and self-employment taxes or the 4% New York City Unincorporated Business Tax.*

appendix

E 2017 FEDERAL AND STATE TAX RETURNS DUE DATES*

Not on Extension (Assuming calendar year end for all entities)

Return Type	Federal	NY	CA	CT	FL	NJ	PA
Individual	April 18	SAF**	SAF	SAF	N/A	SAF	SAF
Trust & Estate (c)	April 18	SAF	SAF	SAF	N/A	Apr 15	SAF
FBAR (a)	April 15	N/A	N/A	N/A	N/A	N/A	N/A
3520	April 15	N/A	N/A	N/A	N/A	N/A	N/A
3520-A	March 15	N/A	N/A	N/A	N/A	N/A	N/A
Partnership(e)	March 15	SAF	SAF	April 18	April 1	April 15	April 18
C-Corporation(d)	April 18	SAF	SAF	May 1	May 1	SAF	May 15
S-Corporation	March 15	SAF	SAF	April 15	May 1	April 18	April 18
Tax-Exempt (b)	May 15	SAF	SAF	SAF	June 1	N/A	N/A
Form 5500	July 31	N/A	N/A	N/A	N/A	N/A	N/A
Information Returns (i.e., W-2 and 1099s)	Forms W-2 and certain 1099-MISC due to IRS/SSA January 31 (same date they are due to the taxpayer). All other Forms 1099 due February 28; March 31 if filed electronically.						

Extension Requested (Assuming calendar year end for all entities)

Return Type	Federal	NY	CA	CT	FL	NJ	PA
Individual	October 16	SAF**	SAF	SAF	N/A	SAF	SAF
Trust & Estate (c)	October 2	SAF	Oct. 15	Sept. 15	N/A	Sept. 15	Sept. 15
FBAR (a)	October 15	N/A	N/A	N/A	N/A	N/A	N/A
3520	October 15	N/A	N/A	N/A	N/A	N/A	N/A
3520-A	September 15	N/A	N/A	N/A	N/A	N/A	N/A
Partnership(e)	September 15	SAF	SAF	SAF	SAF	SAF	SAF
C-Corporation(d)	September 15	Oct. 15	Oct. 15	Nov. 1	Nov. 1	Oct. 15	July 14
S-Corporation	September 15	Oct. 15	SAF	SAF	Nov. 1	Oct. 15	Oct. 15
Tax-Exempt (b)	November 15	SAF	SAF	SAF	Dec. 1	N/A	N/A
Form 5500	October 15	N/A	N/A	N/A	N/A	N/A	N/A
Information Returns (i.e., W-2 and 1099s)	No extensions available						

* *Revised due dates resulting from the Surface Transportation & Veterans Health Care Choice Improvement Act of 2015*

** *""SAF" means the state return due date is the same as the federal return due date.*

(a) *Note that unlike tax returns, FBARs do not have a next-business-day rule if the deadline falls on a Saturday, Sunday, or legal holiday*

(b) *New extension will be a single, automatic 6-month extension, easing the administrative burden on exempt organizations by simplifying the process of extending the Form 990 returns, and eliminating the need to request a second extension after 3 months.*

(c) *For fiscal year estates, the original due date is the 15th date of the fourth month after the year-end. The extended due date is 5½ months after the original due date. Trusts are always on a calendar year basis.*

(d) *For C corporations the new due date is the 15th day of the fourth month following the close of the tax year. For C corporations with fiscal years ending on June 30, this change is deferred until 2026. Corporations will be allowed an automatic 6-month extension, except the 5-month extension until September 15 will remain for calendar year corporations until 2026, and corporations with a June 30 year-end will get a 7-month extension until 2026.*

(e) *Partnerships will be required to file their returns by the 15th day of the third month after the close of their tax year, and will have a maximum 6-month extension.*

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