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.

EisnerAmper

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.