How to play – and win – the tax waiting game in 2016

Presented by:

Safe Harbor LLP
CPAs and Tax Consultants

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The agenda

- Tax planning basics
- Executive compensation
- Investing
- Real estate
- Business
- Charitable giving
- Family & education
- Retirement
- Estate planning

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Timing income and deductions to your tax advantage

AMT rates and exemptions

- **Separate tax system that limits or disallows certain deductions and treats certain income items differently**
- **Top AMT rate of 28% vs. top regular rate of 39.6%**

Tax rate	AMT brackets			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
26%	$ 0 – $ 185,400	$ 0 – $ 185,400	$ 0 – $ 185,400	$ 0 – $ 92,700
28%	Over $ 185,400	Over $ 185,400	Over $ 185,400	Over $ 92,700
AMT exemptions				
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
Amount	$ 53,600	$ 53,600	$ 83,400	$ 41,700
Phaseout[1]	$ 119,200 – $ 333,600	$ 119,200 – $ 333,600	$ 158,900 – $ 492,500	$ 79,450 – $ 246,250

[1] *The AMT income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.*

Note: *Consult your tax advisor for AMT rates and exemptions for children subject to the "kiddie tax."*

Avoiding or reducing AMT

- **Triggers**
  - State and local income tax deductions and property tax deductions
  - Deductions for interest on home equity debt not used to improve your principal residence
  - Miscellaneous itemized deductions subject to 2% of adjusted gross income floor
  - Long-term capital gains and dividend income
  - Accelerated depreciation adjustments and related gain or loss differences when assets are sold
  - Tax-exempt interest on certain private-activity municipal bonds
  - Incentive stock option (ISO) exercises
- **Timing income and deductions can allow you to:**
  - Avoid the AMT
  - Reduce its impact
  - Take advantage of its lower maximum rate

If you could be subject to the AMT *this* year:

- **Accelerate income into 2017**
  - May allow you to benefit from the lower maximum AMT rate
- **Defer expenses you *can't* deduct for AMT purposes**
  - May allow you to preserve those deductions
- **Defer expenses you *can* deduct for AMT purposes**
  - Deductions may become more valuable because of the higher maximum regular tax rate
- **Carefully consider the tax consequences of exercising ISOs**

If you could be subject to the AMT *next* year:

- **Defer income into 2017**
  - May allow you to pay a relatively lower AMT rate
- **Prepay expenses that will be deductible in 2017, but that won't help you in 2017 because they're not deductible for AMT purposes**
- **Sell private-activity municipal bonds whose interest could be subject to the AMT**

The AMT credit

If you pay AMT in one year on deferral items,
you may be entitled to a credit in a subsequent year.

In effect, this takes into account timing
differences that reverse in later years.

Timing income and expenses

- **If you don't expect to be subject to the AMT in 2016:**
  - Don't defer income to 2016
  - Don't accelerate deductible expenses into 2016
- **If you expect to be in a higher tax bracket in 2016 — or if you expect tax rates to go up:**
  - The opposite approach may be beneficial
- **Individual situations vary – please consult with a tax professional!**

2015 individual income tax rates

Tax rate	Regular tax brackets			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
10%	$ 0 – $ 9,225	$ 0 – $ 13,150	$ 0 – $ 18,450	$ 0 – $ 9,225
15%	$ 9,226 – $ 37,450	$ 13,151 – $ 50,200	$ 18,451 – $ 74,900	$ 9,226 – $ 37,450
25%	$ 37,451 – $ 90,750	$ 50,201 – $ 129,600	$ 74,901 – $ 151,200	$ 37,451 – $ 75,600
28%	$ 90,751 – $ 189,300	$ 129,601 – $ 209,850	$ 151,201 – $ 230,450	$ 75,601 – $ 115,225
33%	$ 189,301 – $ 411,500	$ 209,851 – $ 411,500	$ 230,451 – $ 411,500	$ 115,226 – $ 205,750
35%	$ 411,501 – $ 413,200	$ 411,501 – $ 439,000	$ 411,501 – $ 464,850	$ 205,751 – $ 232,425
39.6%	Over $ 413,200	Over $ 439,000	Over $ 464,850	Over $ 232,425

What you may be able to time

- **Income items**
  - Bonuses
  - Consulting or other self-employment income
  - U.S. Treasury bill income
  - Retirement plan distributions, to the extent they:
    - Won't be subject to early withdrawal penalties
    - Aren't required
- **Deductible expenses**
  - State and local income taxes and property taxes
  - Mortgage interest and margin interest
  - Charitable contributions

WARNING: Prepaid expenses can generally be deducted only in the year to which they apply.

Limit on itemized deductions

- **Reduces certain deductions by 3% of adjusted gross income (AGI) amount that exceeds applicable threshold**
  - Doesn't apply to deductions for medical expenses, investment interest, or casualty, theft or wagering losses
- **2016 AGI thresholds for triggering the reduction**
  - $258,250 for singles
  - $284,050 for heads of households
  - $309,900 for married filing jointly
  - $154,950 for married filing separately
- **See if you can reduce AGI to stay under the threshold**
- **If not, consider the reduction's impact before timing expenses**

Miscellaneous itemized deductions

- **Many expenses are deductible only to the extent they exceed 2% of AGI**
  - Deductible investment expenses, including advisory fees, custodial fees and publications
  - Professional fees, such as tax planning and preparation, accounting, and certain legal fees
  - Unreimbursed employee business expenses, including travel, meals, entertainment and vehicle costs
- **"Bunching" expenses may allow you to exceed the 2% floor**

WARNING: Don't bunch miscellaneous itemized deductions subject to the 2% floor into a year when you may be subject to the AMT.

Health-care-related breaks

- **If medical expenses exceed 10% of AGI, you can deduct the excess amount**
  - 7.5% floor for taxpayers age 65 and older
- **Eligible expenses may include:**
  - Health insurance premiums
  - Long-term care insurance premiums (limits apply)
  - Medical and dental services
  - Prescription drugs
  - Mileage (23 cents per mile driven for health care purposes in 2016)
- **Consider bunching nonurgent medical procedures into one year to exceed the floor**
- **Expenses that are reimbursable by insurance or paid through a tax-advantaged account aren't deductible**

Health Savings Accounts (HSAs)

- **HSAs allow pretax or deductible contributions**
  - $3,350 for self-only coverage in 2016
  - $6,650 for family coverage in 2016
  - Additional $1,000 for those age 55 or older
- **To be eligible, you must be covered by qualified high-deductible health insurance**
- **Can bear interest or be invested**
- **Can grow tax-deferred similar to an IRA**
- **Withdrawals for qualified medical expenses are tax-free**
- **Carry over balances from year to year**

Flexible Spending Accounts (FSAs)

- **Redirect pretax income to employer-sponsored account**
  - Employer determines limit
  - Limit cannot exceed $2,550 in 2016
- **Plan reimburses employee for qualified medical expenses**
- **What you don't use by the end of the plan year, you generally lose, but your plan might:**
  - Allow you to roll over up to $500 to the next year, or
  - Give you a 2½-month grace period to incur expenses to use up the previous year's contribution
- **If you have an HSA, the FSA is limited to funding certain "permitted" expenses**

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Sales tax deduction

- **Expired Dec. 31, 2014, but Congress might revive it**
- **Allowed you to take an itemized deduction for state and local *sales* taxes in lieu of state and local *income* taxes**
- **No need to keep receipts and track all sales tax you pay**
  - Exception for major purchases

Employment taxes

- **You must pay Social Security and Medicare taxes on earned income**
- **12.4% Social Security tax applies only up to the Social Security wage base**
  - $118,500 for 2016 (up from $117,000 for 2014)
- ***All* earned income is subject to the 2.9% Medicare tax**
- **Both taxes are split equally between the employee and the employer**

Self-employment taxes

- **You pay both the employee and employer portions of employment taxes**
  - Employer portion (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible above the line
- **Other above-the-line deductions**
  - 100% of health insurance costs up to net self-employment income
  - Contributions to a retirement plan
  - Contributions to an HSA (if eligible)
- **Above-the-line deductions are particularly valuable because they reduce AGI and modified AGI (MAGI)**

Additional 0.9% Medicare tax

- **Taxpayers must pay this tax on FICA wages and self-employment income exceeding $200,000**
  - $250,000 for joint filers
  - $125,000 for separate filers
- **Income timing strategies may allow you to avoid or minimize the tax**
  - Employees: Bonuses or stock option exercises
  - Self-employed: Purchasing equipment or invoicing customers
  - S corp shareholder-employees: Salary vs. distributions

The 0.9% tax and withholding

- **Employers are obligated to withhold the tax beginning in the pay period when wages exceed $200,000 for the calendar year**
  - Without regard to an employee's filing status or income from other sources
- **If you *don't* owe the tax but your employer *is* withholding it:**
  - You can claim a credit on your 2016 income tax return
- **If you *do* owe the tax but your employer *isn't* withholding it:**
  - You can file a Form W-4 to request additional *income* tax withholding
  - You can make estimated tax payments

Owner-employees: Partnerships and LLCs

- **Generally all trade or business income that flows through to you will also be subject to self-employment taxes**
  - Even if the income isn't actually distributed to you
- **Such income generally isn't subject to employment taxes if you're:**
  - A limited partner or
  - An LLC member whose ownership interest is the equivalent of a limited partnership interest
- **The extent to which the additional 0.9% Medicare tax or 3.8% net investment income tax (NIIT) will apply depends on the situation**

Owner-employees: Corporations

- **Only income received as salary is subject to employment taxes and, if applicable, the 0.9% Medicare tax**
- **S corporations**
  - Reduce employment tax by keeping salary relatively, but not unreasonably, low and increasing distributions of company income
- **C corporations**
  - You may prefer to take more income as salary as opposed to dividends if the overall tax paid by both the corporation and you would be less

WARNING: To avoid back taxes and penalties, salary must be "reasonable."

Smart tax planning for your exec comp package is critical

Restricted stock

- **Income recognition normally deferred until stock is no longer subject to risk of forfeiture or you sell it**
  - You then pay tax on stock's FMV at your ordinary-income rate
- **Make Sec. 83(b) election to recognize ordinary income when you *receive* stock, which may be beneficial if:**
  - The income would be negligible or
  - The stock is likely to appreciate significantly before income would otherwise be recognized
- **Election allows you to:**
  - Convert future appreciation from ordinary income to long-term capital gains income
  - Defer it until stock is sold

More restricted stock considerations

- **Disadvantages of Sec. 83(b) election**
  1. You must prepay tax in the current year, which could also trigger or increase exposure to:
     - The 39.6% ordinary-income tax rate
     - The additional 0.9% Medicare tax
  2. Prepaid taxes can't be refunded if you eventually forfeit the stock or sell it at a decreased value
  3. When you sell the shares, any gain will be included in net investment income and could trigger or increase your liability for the 3.8% net investment income tax (NIIT)

Restricted stock units (RSUs)

- **Tax treatment differs from restricted stock**
  - RSUs aren't eligible for the Sec. 83(b) election
  - No opportunity to convert ordinary income into long-term gains
- **Offer a limited ability to defer taxes**
  - RSUs aren't taxable until the employee actually receives the stock
  - Rather than having the stock delivered immediately upon vesting, you may be able to arrange with your employer to delay delivery
  - This will defer income tax — and may allow you to reduce or avoid exposure to the additional 0.9% Medicare tax

WARNING: Any income deferral must satisfy the strict requirements of Internal Revenue Code Section 409A.

Incentive stock options (ISOs)

- **Owe no tax when ISOs are granted**
- **Owe no *regular* income tax when you exercise ISOs**
- **If you sell stock purchased through ISOs:**
  - *After* holding the shares one year from exercise and two years from grant:
    - You pay tax at long-term capital gains rate
  - *Before* long-term capital gains treatment applies:
    - A "disqualifying disposition" occurs and gain is taxed at ordinary-income rates

WARNING: In the year of exercise, a tax "preference" item is created for the difference between the stock's FMV and the exercise price; this can trigger the alternative minimum tax (AMT).

ISO strategies

- **Waiting to exercise and sell is often beneficial**
  - Stock value may be highest, assuming it's appreciating
  - Garner long-term capital gains treatment
- **Sometimes acting earlier can be advantageous**
  - Exercise early to start holding period so you can sell and receive long-term capital gains treatment sooner
  - Exercise when the bargain element is small or the market price close to bottoming out to reduce or eliminate AMT liability
  - Exercise annually so you can buy only the number of shares that will achieve a breakeven point between the AMT and regular tax
  - Sell in a disqualifying disposition and pay the higher ordinary-income rate to avoid AMT on potentially disappearing appreciation

More ISO considerations

- **Exercising early also has disadvantages**
  - Accelerates the need for funds to buy the stock
  - Exposes you to a loss if the shares' value drops below your exercise cost
  - May create a tax cost if the preference item from the exercise generates AMT liability
- **Timing of exercises could positively or negatively affect your exposure to additional taxes**
  - 39.6% ordinary-income tax rate
  - 20% long-term capital gains rate
  - 3.8% NIIT

Nonqualified stock options (NQSOs)

- **Tax treatment differs from ISOs**
  - NQSOs create compensation income on bargain element when exercised
    - Regardless of whether the stock is held or sold immediately
    - Taxed at ordinary-income rates
  - Don't create an AMT preference item
- **May need to make estimated tax payments or increase withholding to cover tax on exercise**

WARNING: An exercise could trigger or increase exposure to top tax rates, the additional 0.9% Medicare tax and the NIIT.

Nonqualified deferred compensation (NQDC)

- **NQDC plans differ from qualified plans, such as 401(k)s**
  - Favor highly compensated employees
  - Plan funding is not protected from employer's creditors
- **Employment taxes are generally due once services have been performed and there's no longer a substantial risk of forfeiture**
  - Even though compensation may not be paid or recognized for income tax purposes until much later
  - Employer may withhold your portion of employment taxes from your salary or ask you to write a check for the liability
  - If your employer pays your portion of employment tax, you'll have additional taxable income
  - The additional 0.9% Medicare tax could apply

Keep taxes from chipping away at investment returns

The net investment income tax (NIIT)

- **Applies to the lesser of net investment income or the amount by which modified adjusted gross income (MAGI) exceeds these thresholds:**
  - $200,000 for singles and heads of households
  - $250,000 for married filing jointly
  - $125,000 for married filing separately
- **Strategies that can help save or defer income tax on investments can also help avoid or defer NIIT liability**
- **Strategies that reduce MAGI may allow you to avoid or reduce the tax**

Capital gains tax and timing

Assets held	2015[1]
12 months or less (*short term*)	Taxpayer's ordinary-income tax rate
More than 12 months (*long term*)	
■ 39.6% ordinary-income tax bracket	20%
■ 25%, 28%, 33% or 35% ordinary-income tax bracket	15%
■ 10% or 15% ordinary-income tax bracket	0%
Some key exceptions	
Long-term gain on collectibles, such as artwork and antiques	28%
Long-term gain attributable to certain recapture of prior depreciation on real property	25%
Gain on qualified small business (QSB) stock held more than 5 years	
■ Acquired on or before Feb. 17, 2009	14%[2]
■ Acquired after Feb. 17, 2009, and before Sept. 28, 2010	7%[3]
■ Acquired on or after Sept. 28, 2010	0%

[1] *In addition, the 3.8% NIIT applies to net investment income to the extent that modified adjusted gross income (MAGI) exceeds $200,000 (singles and heads of households), $250,000 (married filing jointly) or $125,000 (married filing separately).*

[2] *Effective rate based on 50% exclusion from a 28% rate.*

[3] *Effective rate based on 75% exclusion from a 28% rate.*

Timing strategies

- **Appreciating investments that don't generate current income aren't taxed until sold, so holding on to them:**
  - Defers tax
  - Possibly allows you to time sale to your advantage
- **If you've cashed in big gains:**
  - Look for unrealized losses in your portfolio
  - Sell them to offset gains

WARNING: Substantial net long-term capital gains can trigger the alternative minimum tax (AMT).

Wash sale rule

- **Prevents you from taking a loss on a security if you buy a substantially identical security within 30 days before/after selling the security that created the loss**
- **Loss recognized only when replacement security is sold**
- **Getting around the rule:**
  - Immediately buy securities of different company in same industry or shares of mutual fund holding similar securities
  - Wait 31 days to repurchase same security
  - Before selling, purchase additional shares equal to number of shares you want to sell at a loss; wait 31 days to sell the original portion
  - Do a bond swap

Loss carryovers

- **Deduct up to $3,000 of losses against ordinary income**
  - $1,500 for married taxpayers filing separately
- **Carry forward excess losses indefinitely**
- **Loss carryovers can be a tax-saving tool in future years**
- **Remember that capital gains distributions from mutual funds also can absorb losses**

The 0% rate

- **Applies to long-term gain that would be taxed at 10% or 15% based on the taxpayer's ordinary-income rate**
- **If you have adult children in these tax brackets, consider transferring appreciated assets to them**
  - They can enjoy the 0% rate
  - Even more powerful strategy if you'd be subject to the 3.8% NIIT or the 20% long-term capital gains rate
- **Consider any gift tax consequences**

WARNING: If the child will be under age 24 on Dec. 31, make sure he or she won't be subject to the "kiddie tax."

Paying attention to details

- **Trade date, not the settlement date, of publicly traded securities determines the year in which you recognize the gain or loss**
- **Be sure to specifically identify which block of shares is being sold if you:**
  - Bought the same security at different times and prices and
  - Want to sell high-tax-basis shares to reduce gain or increase a loss and offset other gains

3 mutual fund tax pitfalls

1. **High turnover rates**
   - Choose funds with low turnover rates that provide long-term gains
2. **Reinvestments of earnings**
   - Keep track of additions, and increase basis accordingly
3. **Buying shares late in the year**
   - Funds often declare a large capital gains distribution at year end
   - You can be taxed on the full distribution amount in the current year

Sec. 1244 small business stock

- **If you sell qualifying Sec. 1244 stock at a loss:**
  - You can treat up to $50,000 ($100,000 for joint filers) as an ordinary, rather than a capital, loss
  - This is regardless of the holding period
- **This means you can use it to offset ordinary income, reducing your tax by as much as 39.6% of this portion of the loss**

WARNING: Sec. 1244 applies only if total capital invested isn't more than $1 million.

QSB stock: Tax-free gain rollovers

- **If you reinvest QSB stock sale proceeds in other QSB stock, you can defer tax on your gain until you dispose of the new stock**
  - Reinvestment must occur within 60 days
  - Rolled-over gain reduces your basis in the new stock
  - New stock's holding period for tax purposes includes the holding period of the stock you sold
- **To be a QSB, a business must be engaged in an active trade or business and not have assets that exceed $50 million**

QSB stock: Exclusion of gain

- **Stock must have been held for more than five years**
- **Amount of exclusion depends on acquisition date**
  - 75% for stock acquired after Feb. 17, 2009, and before Sept. 28, 2010
  - 100% for stock acquired on or after Sept. 28, 2010, and before Jan. 1, 2016
  - 50% if stock wasn't acquired during one of these two periods
- **Taxable portion of QSB gain is subject to lesser of your ordinary-income rate or 28%**

Passive activities

- **Passive activity income may be subject to the 3.8% NIIT**
- **Passive activity losses generally are deductible only against income from other passive activities**
  - Carry forward disallowed losses to the following year, subject to the same limits
- **To avoid passive activity treatment:**
  - Participate in a trade or business more than 500 hours/year *or*
  - Demonstrate that your involvement constitutes substantially all of the participation in the activity

If you don’t pass the 500-hour test

- **Increase your involvement to exceed 500 hours**
  - The activity will no longer be passive
- **Group activities together**
  - Can allow you to exceed the 500-hour limit
- **Look at other activities to increase passive income**
  - Limit participation in another activity that’s generating income so that you don’t meet the 500-hour test
  - Invest in another income-producing trade or business that will be passive to you
- **Dispose of the activity**
  - Generally allows you to deduct all passive losses — including any loss on disposition (subject to basis and capital loss limitations)

Income investments

- **Qualified dividends are taxed at the favorable long-term capital gains rate**
- **Interest income taxed at ordinary-income rates of up to 39.6%**
- **Some dividends subject to ordinary-income rates**
  - Real estate investment trusts (REITs)
  - Regulated investment companies (RICs)
  - Money market mutual funds
  - Certain foreign investments

Tax treatment of bond income

- **Interest on U.S. government bonds is taxable on federal returns but generally exempt on state and local returns**
- **Interest on state and local government bonds is excludable on federal returns**
  - Tax-equivalent yield = actual yield / (1 – your marginal tax rate)
- **Interest on corporate bonds is fully taxable for both state and federal purposes**
- **Bonds with original issue discount (OID) can create unexpected tax consequences**

WARNING: Tax-exempt interest from private-activity municipal bonds can trigger or increase AMT liability.

Investment interest expense

- **Interest on debt used to buy assets held for investment is deductible**
- **Deduction can't exceed net investment income reduced by other investment expenses**
  - Net investment income, for this deduction, doesn't include long-term capital gains or qualified dividend income
  - Disallowed interest is carried forward
- **Payments a short seller makes to the stock lender in lieu of dividends may be deductible**
- **Interest on debt used to buy securities that pay tax-exempt income isn't deductible**
- **Passive interest expense becomes part of your overall passive activity income or loss, subject to limitations**

An uneven real estate recovery calls for planning and foresight

Home-related deductions

- **Property tax deduction**
  - Pay tax when it's most beneficial
  - Isn't deductible for alternative minimum tax (AMT) purposes
- **Mortgage interest deduction**
  - Up to combined total of $1 million of mortgage debt
  - Deduct points paid related to principal residence
- **Home equity debt interest deduction**
  - Debt limit of $100,000 on debt used for any purpose
  - Consider using home equity debt to pay off credit cards or auto loans

WARNING: Interest on home equity debt not used for home improvements could trigger or increase AMT liability.

Home office deduction

- **Deduct portion of expenses allocable to the portion of home used for the office**
  - Mortgage interest and property taxes
  - Insurance and utilities
  - Depreciation
- **Alternatively, use the simplified option to claim the deduction**
- **Employee: miscellaneous itemized deduction subject to 2% floor**
- **Self-employed: deduct from self-employment income; no floor**

WARNING: Your home office must be used for your employer's benefit or, if you're self-employed, used as your principal place of business (or used substantially and regularly to conduct business) and that must be the *only* use of the space.

Home rental rules

- **If you rent out principal residence or second home for less than 15 days:**
  - Don't need to report the income
  - Can't deduct expenses directly associated with the rental
- **If you rent out principal residence or second home for 15 days or more:**
  - Must report the income
  - May be able to deduct rental expenses
  - Whether home is classified as rental property for tax purposes affects deduction

Rental property vs. nonrental property

- **Rental property**
  - Deduct rental expenses, including losses, subject to real estate activity rules
  - *Can't* deduct *interest* attributable to personal use of the home
  - *Can* take personal portion of *property tax* as an itemized deduction
- **Nonrental property**
  - Deduct rental expenses only to the extent of rental income
    - Excess can be carried forward to offset rental income in the future
  - Take itemized deduction for personal portion of both mortgage interest and property taxes
  - It may be beneficial to reduce personal use of a residence so it will be classified as a rental property

Home sales

- **When selling principal residence, you can exclude up to $250,000 ($500,000 for joint filers) of gain**
  - To support tax basis, keep thorough records
  - You must meet certain tests, and gain that's allocable to a period of "nonqualified" use generally isn't excludable
- **Gain qualifying for exclusion will also be excluded from the 3.8% net investment income tax (NIIT)**
- **Losses on principal residence generally aren't deductible**
- **Second homes are ineligible for gain exclusion**
  - Consider converting to rental use before selling
  - It can then be considered a business asset

Real estate activity rules

- **Income and losses are typically passive**
  - Passive income may be subject to 3.8% NIIT
  - Passive losses are deductible only against passive income; excess is carried forward
- **Only real estate professionals qualify for "active" tax treatment**
  - Perform more than 50% of personal services in real property trades or businesses in which they materially participate
  - Spend more than 750 hours of service in such businesses
- **Increase hours to meet the test**

WARNING: The IRS has successfully challenged claims of real estate professional status in instances where the taxpayer didn't keep adequate records of time spent.

3 expired depreciation-related tax breaks

1. **50% bonus depreciation**
   - This additional first-year depreciation allowance was for qualifying leasehold improvements
2. **Section 179 expensing**
   - This was an election to deduct under Sec. 179 up to $250,000 of qualified leasehold-improvement, restaurant and retail-improvement property
3. **Accelerated depreciation**
   - This break allowed a shortened recovery period of 15 years for qualified leasehold-improvement, restaurant and retail-improvement property

Tax-deferral strategies for investment property

- **May also enable you to keep income low enough to avoid:**
  - 3.8% NIIT
  - 20% long-term capital gains rate
- **Installment sale**
  - Defer gains by spreading over several years as you receive the proceeds
  - Ordinary gain is recognized in year of sale, even if no cash is received
- **Section 1031 exchange**
  - Exchange one real estate investment for another
  - Defer paying tax on gain until you sell replacement property

For an enviable financial statement, implement a robust tax plan

Projecting income

- **Defer income to next year**
  - If using cash method of accounting, defer billing for products or services
  - If using accrual method, delay shipping products or delivering services
- **Accelerate deductible expenses into current year**
  - If cash-basis taxpayer, make estimated state tax payment before Dec. 31, but beware of the alternative minimum tax (AMT)
  - Charge expenses on a credit card and deduct them in the year charged
- **Take the opposite approach**
  - May save you more tax if it's likely you'll be in a higher bracket next year

WARNING: Don't let tax considerations get in the way of sound business decisions.

Depreciation

- **Assets with a useful life of more than one year generally must be depreciated over a period of years**
- **Modified Accelerated Cost Recovery System (MACRS)**
  - Generally more advantageous than straight-line method
  - Larger deductions in early years of asset's life
- **Midquarter convention**
  - If more than 40% of the year's asset purchases are in the last quarter
  - Less favorable than MACRS
- **50% bonus depreciation**
  - Expired Dec. 31, 2014, with a few exceptions
  - Congress may revive it

Sec. 179 expensing election

- **Allows you to deduct rather than depreciate asset purchases**
- ***New or used* assets qualify, such as:**
  - Equipment
  - Furniture
  - Off-the-shelf computer software
- **The 2016 expensing limit is $25,000**
  - Break begins to phase out dollar-for-dollar when total asset acquisitions for the tax year exceed $200,000
  - Can't reduce net income below zero to create a net operating loss

WARNING: The expensing limit and phaseout threshold have dropped significantly from their 2014 levels.

IRS final regs for tangible property repairs vs. improvements

- Costs incurred on incidental repairs and maintenance can be expensed and immediately deducted
- Costs incurred to acquire, produce or *improve* tangible property must be depreciated
- Make sure you're taking all of the repair and maintenance deductions you're entitled to

Cost segregation study

- **Identifies property components and related costs that can be depreciated faster**
- **Increases current deductions**
- **Examples of assets that typically qualify:**
  - Decorative fixtures
  - Security equipment
  - Parking lots
  - Landscaping

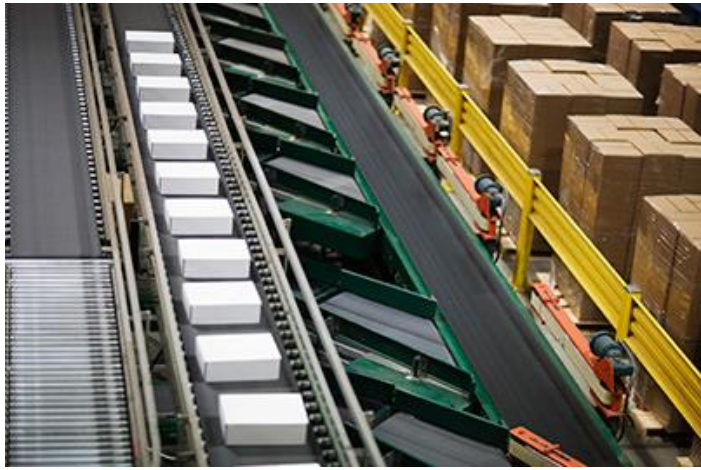
Vehicle-related deductions

- **Deduct actual out-of-pocket expenses (fuel, insurance, depreciation, etc.) or mileage**
  - 57.5 cents per business mile driven in 2016
- **Purchases of *new or used* vehicles may be eligible for Sec. 179 expensing**
- **Passenger automobiles are subject to lower limits**
- **If a vehicle is used for both business and personal purposes, the associated expenses must be allocated between deductible and nondeductible use**

WARNING: The depreciation limit is reduced if the business use is less than 100%. If business use is 50% or less, you can't use Sec. 179 expensing or the accelerated regular MACRS; you must use the straight-line method.

Manufacturers' deduction

- **Deductible amount is 9% of the lesser of qualified production activities income or taxable income, limited by W-2 wages paid**
- **Available also to businesses engaged in certain *nonmanufacturing* activities, such as:**
  - Construction
  - Engineering
  - Architecture
  - Computer software production
  - Agricultural processing



- **Can't be used in determining self-employment income**
- **Generally can't reduce net income below zero**
- **Can be used against the AMT**

Employee benefits

- **Qualified deferred compensation plans**
  - Pension, profit-sharing, SEP and 401(k) plans, SIMPLEs
  - Employer contributions are deductible; employee contributions can be pretax
- **Fringe benefits**
  - Aren't included in employee income, yet the employer can deduct any portion of the benefit it pays and typically also avoid payroll tax
  - Examples include employee discounts, group term-life insurance, parking and mass transit / van pooling, and health insurance
- **HSAs, FSAs and HRAs**
  - Employer contributions are deductible by the employer and not included in employee income
  - Employee contributions (if allowed) are pretax
  - Employee withdrawals for qualified expenses are tax-free

HSAs vs. FSAs vs. HRAs

- **HSAs — HDHP required**
  - Employee must be covered by a high-deductible health plan (HDHP)
  - 2016 contribution limits: $3,350 for self-only coverage and $6,650 for family coverage; additional $1,000 for those age 55 or older
- **FSAs — use it or lose it**
  - What isn't used by the end of the plan year generally is lost, but plan can:
    - Allow employees to roll over up to $500 to the next year, or
    - Give a 2½-month grace period to incur expenses to use up the contribution
  - Employer determines contribution limit; limit cannot exceed $2,550 in 2016
  - If employee has an HSA, FSA is limited to funding certain "permitted" expenses
  - Child and dependent care FSA: 2016 contribution limit is $5,000
- **HRAs — no annual limit on contributions**
  - Only the employer can contribute

Health benefits: Play-or-pay provision

- **Takes effect in 2016**
- **Imposes a penalty on "large" employers if just one full-time employee receives a premium tax credit**
  - "Large" employers generally include those with at least 50 full-time employees or the equivalent
  - Premium tax credits are available to employees only if:
    - They don't have access to "minimum essential coverage" from their employer, or
    - Coverage employer offers is "unaffordable" or doesn't provide "minimum value"
- **Employers with 50 to 99 full-time employees or the equivalent might qualify for an exemption for 2016**

WARNING: Even if employers qualify for the exemption, they will still be subject to the information reporting requirements in 2016.

Net operating losses (NOLs)

- Occur when operating expenses and other deductions exceed revenues
- Can be carried back two years to generate current tax refund
- Any loss not absorbed is carried forward up to 20 years
- Carrying back an NOL may provide a needed influx of cash
- You can elect to forgo the carryback if carrying the entire loss forward is more beneficial

Tax credits

- **Two valuable credits expired Dec. 31, 2014**
  1. The research credit generally is equal to a portion of qualified research expenses
  2. Work Opportunity credit benefited businesses hiring employees from certain disadvantaged groups
- **Congress may revive one or both credits**
- **One credit that didn't expire: Retirement plan credit**
  - Small employers (generally those with 100 or fewer employees) may be eligible for a $500 credit per year for three years
  - Credit is limited to 50% of qualified startup costs

Health care credit

- **Maximum credit is 50% of premiums paid**
  - Employer must contribute at least 50% of total premium or a benchmark premium
  - Full credit available for employers with 10 or fewer full-time equivalent employees (FTEs), who on average earn less than $25,800 per year
  - Partial credit available to employers with fewer than 25 FTEs, who on average earn less than $51,600

WARNING: To qualify for the credit, online enrollment in the Small Business Health Options Program (SHOP) generally is required beginning in 2016. The credit can be taken for only two years, and they must be consecutive.

Business structure

Flow-through entity or sole proprietorship	C corporation
One level of taxation: The business's income flows through to the owner(s).	Two levels of taxation: The business is taxed on income, and then shareholders are taxed on any dividends they receive.
Losses flow through to the owner(s).	Losses remain at the corporate level.
The top individual tax rate is 39.6%.	The top corporate tax rate is generally 35%, and the top rate on qualified dividends is 20%.

Exit planning

Strategy for passing on responsibility for running the company, transferring ownership and extracting money from the business.

WARNING: Requires planning well in advance of the transition.

Buy-sell agreements

- **Control what happens to the business when a specified event occurs**
  - Retirement
  - Disability
  - Death
- **Among other benefits, a well-drafted agreement:**
  - Provides a ready market for the departing owner's shares
  - Prescribes a method for setting a price for the shares
  - Allows business continuity by preventing disagreements caused by new, unwanted owners
- **Life or disability insurance can be used for funding**
  - Proceeds are generally excluded from the beneficiary's taxable income

Other exit options

- **Succession within the family**
  - Sell and/or give interests
  - Now may be a particularly good time to do so
- **Management buyout**
  - Can provide smooth transition
  - Avoids expense of finding an outside buyer
- **Employee stock ownership plan (ESOP)**
  - Qualified retirement plan allows employees to be owners
  - Can provide liquidity and even a tax-favored loan
- **Selling to an outsider**
  - If you find the right buyer, you may be able to sell at a premium
  - First put your business in a sell-ready state

Sale or acquisition

- **Tax consequences can have a major impact on the transaction's success — or failure**
- **Asset vs. stock sale**
  - Sellers typically prefer a stock sale
  - Buyers typically prefer an asset sale
- **Tax-deferred transfer vs. taxable sale**
  - Generally better to postpone tax, but
  - Some advantages to a taxable sale

Installment sales

- **Often used when buyer:**
  - Lacks sufficient cash
  - Pays a contingent amount based on the business's performance
- **Also used when seller wants to spread gain over a number of years**
  - Could help avoid triggering the 3.8% net investment income tax
  - Could also help avoid 20% long-term capital gains rate
- **Can backfire on the seller**
  - Must report depreciation recapture in year of sale
  - If tax rates increase, overall tax could be more

CHARITABLE GIVING

Putting your donations to work in 2016

Cash donations

- **Easy to make; the key is to substantiate them**
  - Under $250: Gift supported by canceled check, credit card receipt or written communication from charity
  - $250 or over: Gift must be substantiated by the charity
- **Deduction limits**
  - Can't exceed 50% of adjusted gross income (AGI)
    - 30% for gifts to nonoperating private foundations
  - Excess can be carried forward up to five years

WARNING: Charitable deductions are allowed for alternative minimum tax (AMT) purposes, but your tax savings may be less.

Stock donations

- **Appreciated publicly traded stock held more than one year can be one of the best charitable gifts**
  - Can deduct current fair market value
  - Avoid tax on gain from selling the property
  - Especially beneficial if you face the 3.8% net investment income tax (NIIT) or the top 20% long-term capital gains rate
- **Deduction limits**
  - Can't exceed 30% of AGI
    - 20% for nonoperating private foundations
  - Excess can be carried forward up to five years

WARNING: Don't donate stock worth less than your basis. Instead, sell it so you can deduct the loss. Then donate the proceeds.

Other types of donations

Type of donation	Ordinary-income property	Tangible personal property used for tax-exempt function	Tangible personal property *not* used for tax-exempt function	Use of property	Vehicle *sold* by the charity	Vehicle *used* by the charity
Examples	Stocks or bonds held one year or less, inventory	Artwork donated to museums	Artwork donated to charity auction	Use of vacation home; loan of artwork	Charity sells vehicle within specified period	Vehicle used to deliver meals to elderly
Deduction	Lesser of fair market value (FMV) or tax basis	FMV	Your basis	Generally no deduction	Amount charity receives from sale	FMV

Note: Additional limits apply.

Making gifts over time

- **Private foundation gives you significant control over how your donations will be used**
  - Complex rules can make foundations expensive to run
- **Donor-advised fund (DAF) enables you to influence how your donations are spent**
  - Avoids a foundation's tight rules and high expenses

WARNING: To deduct a DAF contribution, you must obtain written acknowledgment from the sponsoring organization that it has exclusive legal control over the assets contributed.

Charitable remainder trust (CRT)

- **Benefits a charity while ensuring your financial future**
  - For a given term, it pays an amount to you (some of which generally is taxable)
  - At term's end, remaining assets pass to one or more charities
  - You receive a deduction for the present value of amount going to charity
  - Property is removed from your estate
- **Can help diversify your portfolio if you own non-income-producing assets that would generate a large capital gain if sold**

CRT: Gain deferral

- **Because a CRT is tax-exempt, it can sell the property without paying tax on the gain**
  - The trust can then invest the proceeds in a variety of stocks and bonds
- **You'll owe capital gains tax only as you receive CRT payments**
  - Because payments are spread over time, much of the liability will be deferred
  - A portion of each payment might be considered tax-free return of principal
  - Can help reduce or avoid exposure to the 3.8% NIIT and the 20% top long-term capital gains rate

Charitable lead trust (CLT)

- **Benefits charity while transferring assets to loved ones at reduced tax cost**
  - For a given term, it pays an amount to one or more charities
  - At term's end, remaining assets pass to "remainder" beneficiaries
  - You make a taxable gift equal to the present value of the amount going to remainder beneficiaries
  - Property is removed from your estate
- **If the CLT's earnings outperform the Sec. 7520 rate, the excess earnings transfer to the remainder beneficiaries tax-free**
- **In the current environment, CLTs may be especially advantageous**
  - Low interest rates and high gift tax exemption
  - May allow you to transfer more gift- and estate-tax-free

Tax breaks can make raising kids less costly

Child and adoption credits

- **Tax credits reduce your tax bill dollar-for-dollar**
- **For each child under age 17 at the end of the year, you may be able to claim a $1,000 child credit**
- **If you adopt in 2016, you may qualify for:**
  - Adoption credit
  - Employer adoption assistance program income exclusion
  - Both are $13,400 per eligible child
- **Credits phase out for higher-income taxpayers**
  - Child credit: $110,000–$130,000 modified adjusted gross income (MAGI) for joint filers
  - Adoption credit: $201,010–$241,010 MAGI for joint filers

Child care expenses

- **Child and dependent care credit**
  - Can apply to a portion of dependent care expenses for children under age 13 or other qualifying dependents
  - Eligible expenses are limited to $3,000 for one dependent, $6,000 for two or more
  - Income-based limits reduce the credit but don't phase it out altogether

- **Flexible Spending Account (FSA)**
  - Contribute up to $5,000 to employer-sponsored child and dependent care FSA
  - Plan pays or reimburses you for expenses
  - You can't use those same expenses to claim a tax credit

IRAs for teens

- **2016 contribution limit is lesser of $5,500 or 100% of earned income**
- **Traditional IRA contributions generally are deductible**
  - Distributions will be taxed
- **Roth IRA contributions are not deductible**
  - Qualified distributions will be tax-free
- **Consider giving teens the amount they're eligible to contribute**
  - Keep the gift tax in mind
- **If teens don't have earned income and you own a business, consider hiring them**
  - Must be paid in line with what you'd pay nonfamily employees for the same work

529 plans

- Although contributions aren't deductible for federal purposes, some states offer tax incentives for contributing
- Plan assets grow tax-deferred
- Contribution limits are high, with no income restrictions
- No beneficiary age limit for contributions or distributions
- You control account — even after child is of legal age
- You can make rollovers to another qualifying family member

529 prepaid tuition vs. savings plan

- **Prepaid tuition plans allow you to secure current tuition rates**
  - Pluses
    - Tuition guaranteed regardless of cost at the time the beneficiary attends school
  - Minuses
    - Uncertainty in how benefits will apply to a different school
    - Doesn't cover costs other than tuition
- **College savings plans can be used for qualified expenses**
  - Pluses
    - Tax-free distributions can be used to pay not just tuition but also mandatory fees, books, equipment, supplies, and room and board (generally)
  - Minuses
    - Limited to investment options offered by the plan
    - For funds already in the plan, you can make changes to investment options only twice a year or when you change beneficiaries

Jumpstarting a 529 plan

- **To avoid gift taxes on contributions, you must apply your gift tax annual exclusion or lifetime exemption**
- **A special break for 529 plans allows you to front-load five years' worth of annual exclusion gifts in one year**
  - This adds up to $70,000 — or $140,000 if you and your spouse split the gift
  - This is *per beneficiary*
- **For grandparents, this can be a powerful estate planning strategy**

Coverdell Education Savings Accounts (ESAs)

- **Similar to 529 college savings plans in some ways**
  - Contributions aren't deductible for federal purposes
  - Plan assets grow tax-deferred
  - Distributions used to pay qualified expenses are income-tax-free
- **Advantages over 529 plans**
  - Tax-free distributions aren't limited to college expenses — can also fund elementary and secondary school costs
  - More investment options
- **Disadvantages**
  - Annual ESA contribution limit per beneficiary is only $2,000
  - Income-based phaseout may reduce or eliminate your ability to contribute
    - Joint filers: $190,000–$220,000 MAGI
  - Any remaining ESA assets generally must be distributed when beneficiary reaches age 30, and any earnings may be subject to tax and a 10% penalty

Uniform Gifts to Minors Act (UGMA) / Uniform Transfers to Minors Act (UTMA)

- UGMA/UTMA accounts can be used to fund college expenses without the limitations of 529 plans or ESAs
- Transfer is irrevocable
- You maintain control over the assets, but only until the age at which the account terminates (age 18 or 21 in most states)
- Transfer qualifies for the annual gift tax exclusion
- Less attractive from an income tax perspective than they used to be

The “kiddie tax”

- **Applies to children under age 19 and full-time students under age 24**
  - Unless the student provides more than half of his or her support from earned income
- **Any unearned income beyond $2,100 (for 2016) is taxed at the parents’ marginal rate**
  - Keep this in mind before transferring income-generating assets to children

Education credits

- **American Opportunity credit**
  - For first four years of postsecondary education
  - Up to $2,500 *per student* per year
  - Income-based phaseout may reduce or eliminate your credit
    - Joint filers: $160,000–$180,000 MAGI
- **Lifetime Learning credit**
  - For postsecondary education expenses, even beyond the first four years
  - Up to $2,000 *per tax return* per year
  - Income-based phaseout may reduce or eliminate your credit
    - Joint filers: $110,000–$130,000 MAGI

Should your child claim an education credit?

- **If your dependent child claims one of the credits, you must forgo your dependency exemption for him or her**
- **Because of the exemption phaseout, you might lose your exemption anyway**
  - If your exemption *is* fully phased out, there likely is no downside to your child taking the credit
  - If your exemption *isn't* fully phased out, compare the tax savings your child would receive from the credit with the savings you'd receive from the exemption

WARNING: Expenses paid with tax-free distributions from 529 plans or ESAs can't be used to claim these credits.

Education deductions

- **Tuition and fees deduction**
  - Deduct above-the-line up to $4,000 of qualified higher education tuition and fees — but only if this break is extended for 2016 and your income isn't too high
  - Expenses paid with tax-free distributions from 529 plans or ESAs can't be used to claim the deduction.
- **Student loan interest deduction**
  - Deduct up to $2,500 of interest *per tax return*
  - Income-based phaseout may reduce or eliminate your deduction
    - Joint filers: $130,000–$160,000 MAGI

Build tax savings into your retirement planning

Tax-deferred plans

- **Employer-sponsored plans, such as 401(k)s, 403(b)s, 457s, SARSEPs and SIMPLEs**
  - Pretax contributions reduce modified adjusted gross income (MAGI)
  - Plan assets grow tax-deferred
  - Possible pretax employer matching
- **Traditional IRAs**
  - Contributions may be deductible
  - Assets grow tax-deferred
  - 2016 contributions can be made as late as April 18, 2016

How much can you contribute in 2016?

	Regular contribution	Catch-up contribution[1]
Traditional and Roth IRAs	$ 5,500	$ 1,000
401(k)s, 403(b)s, 457s and SARSEPs[2]	$ 18,000	$ 6,000
SIMPLEs	$ 12,500	$ 3,000

[1] *For taxpayers age 50 or older by the end of the tax year.*

[2] *Includes Roth versions where applicable.*

Note: *Other factors may further limit your maximum contribution.*

Options for business owners and the self-employed

- **Set up a plan that may allow much larger contributions**
  - Especially beneficial if you might be subject to the NIIT
  - If you have employees, they generally must be allowed to participate
- **Profit-sharing plan**
  - Defined contribution plan that allows discretionary employer contributions and flexibility in plan design
  - You can make deductible 2016 contributions as late as the due date of your 2016 return, including extensions
- **Simplified Employee Pension (SEP)**
  - Provides benefits similar to profit-sharing plan but easier to administer
  - You can establish a SEP in *2016* and still make deductible 2016 contributions as late as the due date of your 2016 return, including extensions

Profit-sharing plan vs. SEP

Profit-sharing plan	SEP
2015 maximum contribution: $53,000 or $59,000.	**2015 maximum contribution:** $53,000.
Eligibility: You can't contribute more than 25% of your compensation generally, but you can contribute 100% up to the 401(k) limits if the plan includes a 401(k) arrangement. To qualify for the $59,000 limit, your plan must include a 401(k) arrangement and you must be eligible to make catch-up contributions (that is, be age 50 or older).	**Eligibility:** You can't contribute more than 25% of your eligible compensation (net of the deduction for the contribution if you're self-employed). So, to make the maximum contribution, your eligible compensation must be at least $212,000 ($265,000 if you're self-employed).

Note: *Other factors may further limit your maximum contribution.*

Owners/self-employed: Another option

- **Defined benefit plan**
  - Sets future pension benefit and actuarially calculates contributions needed to attain the benefit
  - Maximum annual benefit for 2016: $210,000
    - If less, 100% of average earned income for highest three consecutive years
    - 2016 contribution needed to attain projected future benefit may exceed maximum contributions allowed by other plans
    - Good option for owners age 50 or older with a younger staff
  - You can make deductible 2016 contributions as late as the due date of your 2016 return, including extensions

WARNING: Employer contributions generally are required and must be paid quarterly if there was a shortfall in funding for the prior year.

Roth options

- **Tax-free distributions, but contributions don't reduce current-year taxable income**
- **Roth IRAs**
  - Income-based phaseout may reduce or eliminate ability to contribute
  - Estate planning advantages are an added benefit
- **Roth conversions**
  - Turn tax-*deferred* future growth into tax-*free* growth
  - No income-based limit applies
  - Converted amount is taxable in the year of conversion
  - Whether a conversion makes sense depends on many factors

WARNING: A Roth IRA conversion could push you into a higher income tax bracket or trigger the 3.8% NIIT.

More Roth options

- **"Back door" Roth IRA**
  - Consider this option if you don't have a traditional IRA
    - Set up traditional account
    - Make a nondeductible contribution
    - Convert the traditional account to a Roth account
  - Only tax due will be on any growth in the account between the time you made the contribution and the date of conversion
- **Roth 401(k), 403(b) or 457**
  - If plan allows, you can designate some or all of your contributions as Roth
    - Any employer match will be made to a traditional plan
  - No income limits on designating Roth contributions
    - High-income taxpayers can contribute
  - Plans can now more broadly permit employees to convert some or all of existing plan to a Roth plan

Early withdrawals

- **A penalty generally applies to "early" withdrawals**
  - With a few exceptions, this means before age 59½
  - Penalty is 10%, in addition to any income tax otherwise due
- **Early withdrawal reduces potential tax-deferred future growth**
- **Roth IRA withdrawal a slightly better option**
- **Alternatives:**
  - Borrow from your 401(k)
  - Tap taxable investment accounts

Leaving a job

- **Don't take a lump-sum distribution**
- **Consider these options to avoid current income tax and penalties**
  - Stay put
    - You may be able to leave your money in your old plan
  - Roll over to new employer's plan
    - Only one plan to keep track of
    - Compare new plan's investment options to the old plan
  - Roll over to an IRA
    - Possibly the best option: IRAs offer many investment choices

WARNING: To avoid potentially negative tax consequences, request a direct rollover from your old plan to your new plan or IRA.

Required minimum distributions (RMDs)

- **RMDs must generally be taken after age 70½**
  - Penalty equal to 50% of amount you should have withdrawn
  - Avoid RMD rule for Roth 401(k), Roth 403(b) or Roth 457 by rolling funds into Roth IRA
- **Distributions between ages 59½ and 70½ or beyond your RMD after age 70½ could save taxes in low-tax-bracket years, but consider whether they could:**
  - Cause Social Security payments to become taxable
  - Increase income-based Medicare premiums and prescription drug charges
  - Affect other deductions or credits with income-based limits

WARNING: Retirement plan distributions could trigger or increase the 3.8% NIIT.

Estate planning can secure your legacy

Estate tax

- **Rate is 40%**
  - Scheduled to remain at that level
- **Exemption increased to $5.43 million for 2016**
  - Will continue to be adjusted for inflation annually
- **Review your estate plan in light of the changing exemption**
  - Avoid unintended tax consequences
  - Make the most of available exemptions
  - Ensure assets will be distributed according to your wishes

Gift tax

- **Gift tax follows estate tax exemption and rate**
- **Any gift tax exemption used during life reduces estate tax exemption available at death**
- **Exclude certain gifts of up to $14,000 per recipient each year**
  - $28,000 per recipient if your spouse splits gift with you or you're giving community property

WARNING: You need to use your 2016 exclusion by Dec. 31. The exclusion doesn't carry over from year to year.

Generation-skipping transfer (GST) tax

- **Generally applies to transfers made to people two generations or more below you**
- **Is in addition to any gift or estate tax due**
- **Follows the estate tax exemption and rate**
- **GST tax exemption can be a valuable tax-saving tool**
  - Grandparents can use it to make transfers to grandchildren and avoid any tax at their children's generation

State taxes

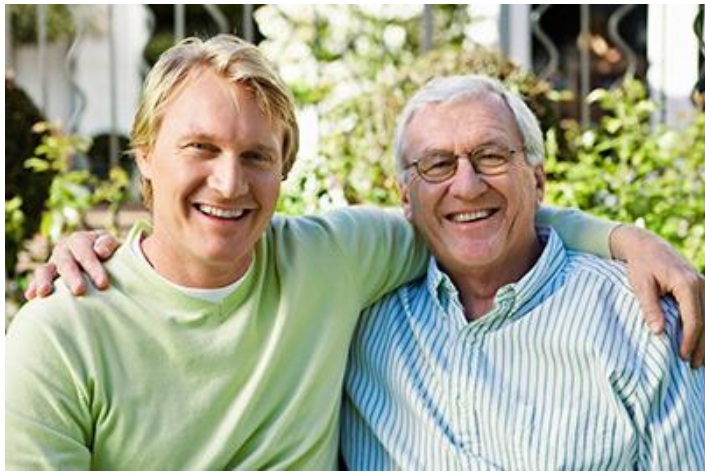
- A federal estate tax deduction is available for state estate taxes paid
- Many states impose estate tax at a lower threshold than the federal government does
- To avoid unexpected tax liability or other unintended consequences, it's critical to consider state law

Exemption portability

- **If spouse dies and leaves unused exemption, estate can permit surviving spouse to use that exemption**
  - Available only for the most recently deceased spouse, doesn't apply to the GST tax exemption, isn't recognized by some states and must be elected on an estate tax return — even if no tax is due
- **Provides flexibility if proper planning hasn't been done**
- **Doesn't protect future growth on assets from estate tax like applying the exemption to a credit shelter trust does**
  - Consider setting up marital trusts and making asset transfers to the extent necessary to fully fund them
  - Transfers to a spouse are tax-free under the marital deduction, assuming he or she is a U.S. citizen

Tax-smart giving: Choose gifts wisely

- **To minimize *estate tax*, gift property with the greatest future appreciation potential**
- **To minimize *your beneficiary's income tax*, gift property that hasn't already appreciated significantly since you've owned it**
- **To minimize *your own income tax*, don't gift property that's declined in value**
  - Sell the property so you can take the tax loss
  - Gift the sale proceeds



More tax-smart giving ideas

- **Plan gifts to grandchildren carefully**
  - Annual exclusion gifts are generally exempt from GST tax
  - For gifts that don't qualify for the exclusion to be entirely tax-free, you must apply both your GST tax exemption and gift tax exemption
- **Pay tuition and medical expenses**
  - Payments won't be treated as a taxable gift if you make them directly to the provider
- **Make gifts to charity**
  - Donations to qualified charities aren't subject to gift taxes and may provide an income tax deduction

Gift business or FLP interests

- **Leverage your annual exclusions and lifetime exemption, because interests may be eligible for valuation discounts**
  - For example: If discounts total 30%, you can gift an ownership interest equal to as much as $20,000 tax-free because the discounted value doesn't exceed the $14,000 annual exclusion
  - The IRS may challenge the value, so a professional, independent valuation is strongly recommended
- **With a family limited partnership (FLP), you fund the FLP and then gift limited partnership interests, which may be eligible for a discount**

WARNING: The IRS scrutinizes FLPs, so be sure to set up and operate yours properly.

Trusts provide many benefits

- **Potentially significant tax savings**
- **Some control over what happens to the assets**
- **Credit shelter trust**
  - Helps married couples minimize estate tax and provides additional benefits
- **Qualified terminable interest property (QTIP) trust**
  - Is good for benefiting first a surviving spouse and then children from a prior marriage

More trusts to consider

- **Qualified personal residence trust (QPRT)**
  - Allows you to give your home to your children today
  - Removes the home from your taxable estate at a reduced tax cost (provided you survive the trust's term)
  - You retain the right to live in the home for a certain period
- **Grantor-retained annuity trust (GRAT)**
  - Works like a QPRT, but allows you to transfer other assets
  - Receive payments from the trust for a certain period
- **GST trust**
  - Also known as a "dynasty" trust
  - Can help you leverage both your gift and GST tax exemptions
  - Great way to lock in currently high exemptions while removing future appreciation from your estate

Life insurance

- **Life insurance can be used to:**
  - Replace income
  - Pay estate taxes
  - Equalize assets passing to children who aren't involved in a family business
  - Pass leveraged funds to heirs free of estate tax

- **Proceeds generally are income-tax-free to beneficiaries**
- **With proper planning, proceeds aren't included in taxable estate**

Thank you for attending

Please contact us for assistance:

http://www.safeharborcpa.com/

Safe Harbor LLP