

# 2016 TAX PLANNING GUIDE



**Ameritrade**

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Planning for taxes makes good financial sense. When you take the time to plan, you know you are doing what you can to minimize your tax burden.

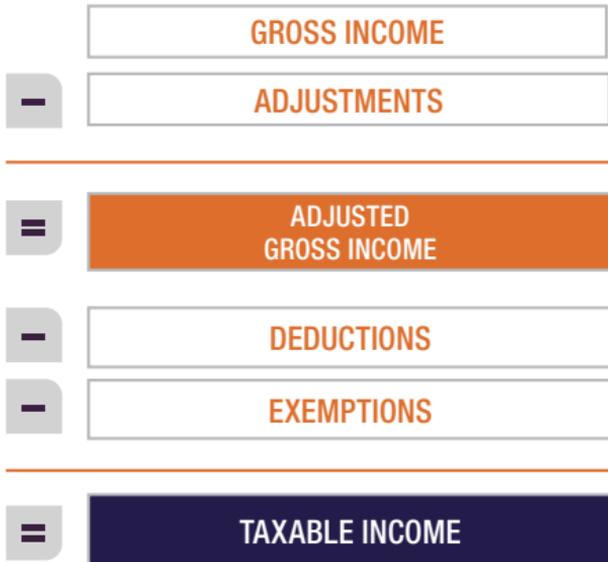
Everyday financial decisions and transactions can affect your taxes more than you may realize. This *2016 Tax Planning Guide* explains how taxes fit into your financial picture and suggests strategies that can help lower your federal income-tax liability. The *Guide* includes helpful explanations of important individual and business tax provisions along with examples of how the rules work.

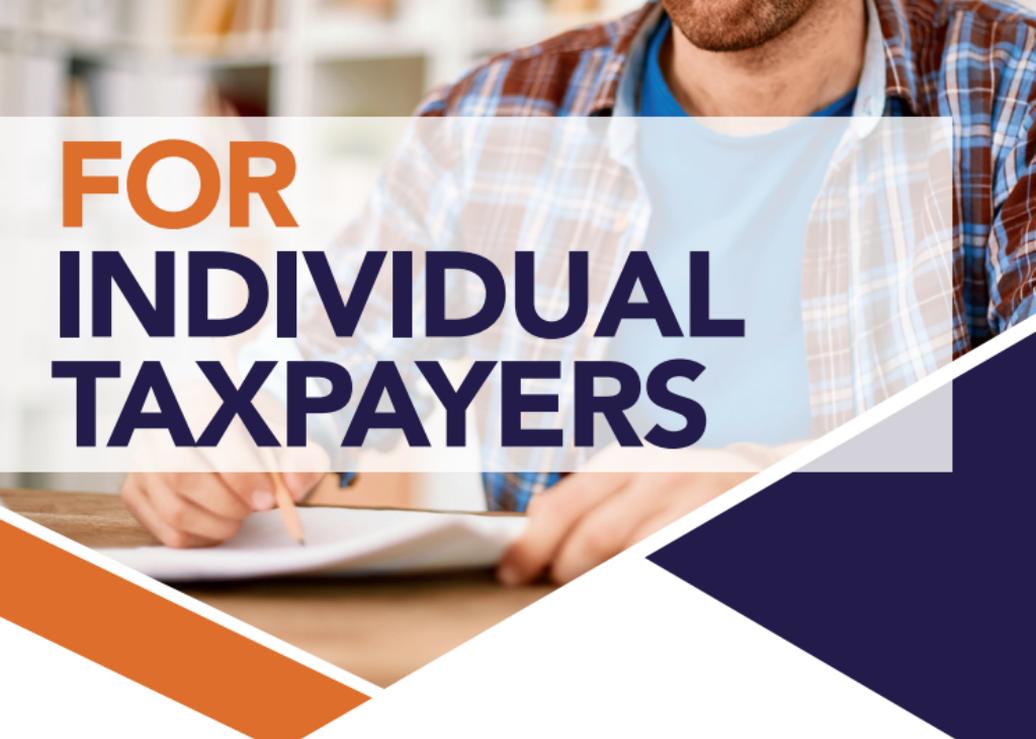
As you read the *Guide*, please keep in mind that everyone's tax situation is different. Before implementing any of the strategies discussed here, you will want to secure professional advice.

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# FOR INDIVIDUAL TAXPAYERS

## GETTING STARTED

When you are planning for taxes, both the income and expense sides of the equation deserve your attention. On the income side, you'll want to look for opportunities to generate tax-deferred, tax-free, or lower taxed income. On the expense side, be alert to potentially deductible expenses, as well as any expenses that may qualify for a tax credit.

Every year, you have a choice of claiming the standard deduction or deducting specific actual expenses called itemized deductions. You'll want to choose the option that results in the largest overall deduction.

Additionally, the tax code lists several expenses that may be deducted from your gross income in arriving at your adjusted gross income (AGI). These are called adjustments or above-the-line deductions. They are especially valuable deductions because several tax breaks depend on having AGI below specified amounts.

Unlike a tax deduction, which reduces the amount of your income that will be subject to tax, a tax credit directly reduces your tax liability.

The tax rate schedules for individuals are shown on page 4. For planning purposes, focus on your marginal tax rate — the rate that applies to your last dollar of taxable income. You can use your marginal rate to estimate the tax effect of various planning strategies. If, for example, your marginal tax rate is 35%, a \$1,000 deduction would save you \$350 of tax.

[%]

## INDIVIDUAL TAX RATE SCHEDULES

FILING STATUS	RATE (%)	TAXABLE INCOME (\$) BRACKETS*
 <b>SINGLE</b>	10	0 – 9,275
	15	9,276 – 37,650
	25	37,651 – 91,150
	28	91,151 – 190,150
	33	190,151 – 413,350
	35	413,351 – 415,050
	39.6	Over 415,050
 <b>HEAD OF HOUSEHOLD</b>	10	0 – 13,250
	15	13,251 – 50,400
	25	50,401 – 130,150
	28	130,151 – 210,800
	33	210,801 – 413,350
	35	413,351 – 441,000
	39.6	Over 441,000
 <b>MARRIED FILING JOINTLY (AND SURVIVING SPOUSES)</b>	10	0 – 18,550
	15	18,551 – 75,300
	25	75,301 – 151,900
	28	151,901 – 231,450
	33	231,451 – 413,350
	35	413,351 – 466,950
	39.6	Over 466,950
 <b>MARRIED FILING SEPARATELY</b>	10	0 – 9,275
	15	9,276 – 37,650
	25	37,651 – 75,950
	28	75,951 – 115,725
	33	115,726 – 206,675
	35	206,676 – 233,475
	39.6	Over 233,475

\* These taxable income brackets are the estimated brackets for 2016. The IRS had not announced the official 2016 inflation adjustments at the time of publication.

## FAMILY MATTERS

As the years pass, family situations tend to change — and those changes can have an impact on tax planning.

**Dependent care credit.** If you pay child care expenses so that you (and your spouse) can work, look into claiming this credit. Your child must be under age 13. The credit is also available for the expenses of caring for a disabled spouse or other adult dependent while you work. The minimum credit rate is 20%, and up to \$3,000 of expenses (\$6,000 for the care of two or more individuals) can qualify for the credit.

The expenses of sending a child to summer day camp can qualify as child care expenses for credit purposes. However, no credit is allowed for the cost of an overnight camp.

**Divorced parents.** A child may be treated as the dependent of both divorced parents for certain medical-related tax deductions and exclusions. For example, the parent who pays a child's medical expenses is entitled to deduct them, even if the other parent claims the dependency exemption for the child.

**Helping a parent.** You may be able to claim a parent you are helping to support as your dependent. You are entitled to the dependency exemption if your parent's gross income, not counting nontaxable Social Security benefits, is less than the exemption amount (estimated to be \$4,050 for 2016) *and* you provide more than half of your parent's total support. For purposes of this test, support includes both taxable and nontaxable Social Security benefits.

### Does your child have to file?

Children who have job earnings or “unearned” income from savings and investments may have to file income-tax returns, even if they are dependents. In some situations, parents may be able to include a child's investment income on their



own return. Your tax advisor can help you determine if a separate return is required for your child.

**Hiring your child.** Do you own a business? Giving your child a job could be a family tax saver. You'll be able to deduct your child's wages from your business income, reducing both your income taxes and your self-employment taxes. A dependent child may earn up to \$6,300 in 2016 (estimated amount) income-tax free because of the standard deduction. Any wages your child earns over that amount probably would be taxed at the lowest 10% marginal tax rate. The 10% bracket for single filers is projected to extend to the first \$9,275 of taxable income in 2016.

## WILL YOU OWE THE AMT?

The alternative minimum tax (AMT) system adds another layer of complexity to your tax planning. Even if you've escaped it in the past, don't overlook the possibility that you'll have to pay additional taxes because of the AMT.

Figuring the AMT is complicated because taxable income must be recomputed under special rules. Many deductions are not allowed, and certain income that is otherwise nontaxable must be included in AMT income. You will have to pay the AMT — in addition to your regular taxes — if your AMT income is more than the exemption amount for your filing status. The AMT rates are 26% and 28%, and the AMT exemptions phase out at higher levels of income.

If you are expecting a potential AMT problem, consider these planning points.



- The interest on “private activity” municipal bonds generally is not tax exempt for AMT purposes. But the tax law makes an exception for private activity bonds issued in 2009 and 2010. Before investing in private activity bonds, check their tax status.
- If your marginal tax rate is higher than the 28% maximum AMT rate, you may benefit from accelerating income into a tax year when you will pay AMT anyway. But consider the time value of money before doing so, since you will be paying taxes earlier.
- Also consider deferring late-year expenses that you can’t deduct for AMT purposes to next year if you expect that you won’t be subject to the AMT next year. Examples include investment fees and taxes.

## MINIMIZING TAXES ON YOUR INVESTMENTS

As an investor, you’re focused on the returns your investments earn. When all is said and done, though, the amount you have left after taxes matters most.

**Capital gains rates.** Net long-term capital gains and qualified dividends are taxed at favorable rates. The maximum rate is 20% for taxpayers in the top 39.6% regular tax bracket and 15% for most other taxpayers. For net gains that would otherwise be taxed in the two lowest regular brackets, the rate is 0% — in other words, the gains are not taxable.

When you are projecting taxes on the sale of rental or other depreciable real property, keep in mind that the maximum rate on long-term capital gains is 25% to the extent of prior depreciation. Similarly, the maximum rate on collectibles gain is 28%.

**3.8% net investment income tax.** If your modified AGI will exceed \$200,000 (\$250,000 on a joint return; \$125,000 if married filing separately), you’ll want to be sure to consider the 3.8% net investment income tax in your planning. This tax applies to the *lesser of* (1) your net investment income or (2) the amount by which your modified AGI exceeds the applicable threshold for your filing status.

For purposes of the 3.8% tax, net investment income includes taxable interest, dividends, annuities, royalties, rents, net capital gain, and income earned from passive trade or business activities. It does not include municipal bond interest or distributions from tax-deferred retirement plans.

- If you are planning to sell an appreciated real estate investment in 2016, consider structuring the transaction as an installment sale (i.e., the buyer would pay you part of the purchase price in 2016 and the remainder in one or more subsequent tax years) if it would lessen your exposure to the 3.8% net investment income tax.
- If you have passive income from a trade or business activity, consider increasing your participation in the activity to avoid having the activity classified as passive.

**Capital losses.** Nobody likes investment losses, but they can help you at tax time. You can use capital losses to offset capital gains on other transactions plus an additional \$3,000 of ordinary income (\$1,500 if married filing separately) annually. You may carry forward capital losses that you are unable to deduct because of these limitations to future tax years, subject to the same restrictions.

However, losses from a “wash sale” are not deductible. A wash sale is a loss-generating sale of securities that occurs within 30 days before or after the purchase of substantially identical securities.

Be cautious about the wash-sale rule if you participate in a mutual fund or stock dividend reinvestment program. A sale of shares at a loss within 30 days of a purchase of shares through the dividend reinvestment program would be considered a wash sale.

*You should consider a mutual fund’s investment objectives, charges, expenses, and risks carefully before you invest. The fund’s prospectus, which can be obtained from your financial representative, contains this and other information about the fund. Read the prospectus*

carefully before you invest or send money. Shares, when redeemed, may be worth more or less than their original cost.

**Tax-exempt bonds.** Unlike interest on corporate or U.S. government bonds, municipal bond interest is generally exempt from federal income taxes. (As mentioned earlier, certain private activity bond interest is includable in AMT income.) You can use the table below to compare tax-exempt and taxable yields in your tax bracket.



## COMPARING YIELDS

TO MATCH THE TAX-EXEMPT YIELD BELOW	IN THIS TAX BRACKET				
	25%	28%	33%	35%	39.6%
	YOU NEED TO EARN A TAXABLE YIELD OF:				
3.0%	4.0%	4.2%	4.5%	4.6%	5.0%
3.5%	4.7%	4.9%	5.2%	5.4%	5.8%
4.0%	5.3%	5.6%	6.0%	6.2%	6.6%
4.5%	6.0%	6.3%	6.7%	6.9%	7.5%
5.0%	6.7%	6.9%	7.5%	7.7%	8.3%
5.5%	7.3%	7.6%	8.2%	8.5%	9.1%
6.0%	8.0%	8.3%	9.0%	9.2%	9.9%

*The table does not consider the effect of state income taxes. Some states exempt interest received by state residents on in-state municipal bonds.*



## RETIREMENT PLANNING

The tax benefits associated with employer-sponsored retirement plans and individual retirement accounts (IRAs) can help you build your retirement savings.

**Workplace plans.** 401(k) plans, 403(b) plans, and SIMPLE plans all offer the opportunity for you to invest by contributing a portion of your pay to the plan. The tax benefits of plan participation include:

- Pretax contributions — the salary you contribute is not subject to income taxes until you receive distributions from the plan.
- Tax-deferred earnings — contributions are invested on a tax-deferred basis. Because the IRS does not share in your account earnings until you receive distributions, your investment can grow faster than it would if taxes were paid each year.

A 401(k) or 403(b) plan also may offer an after-tax Roth contribution option. With this option, you lose the benefit of pretax contributions, but you can receive qualified distributions from your Roth account income-tax free.

**IRAs.** Your annual IRA contributions — Roth and traditional — are limited to \$5,500 (\$6,500 if you are over age 50). The annual limit is subject to inflation adjustment.

Contributions to a traditional IRA are tax deductible if you (and your spouse, if you are married) are not eligible to participate in an employer's retirement plan. With plan participation, certain income limits apply to deductions for IRA contributions. Ask your advisor about limits that might apply to you.

A Roth IRA offers nondeductible contributions and potentially tax-free withdrawals after five years (1) once you are at least age 59½, (2) to pay up to \$10,000 of first-time homebuying expenses, or (3) on account of disability. Distributions to account beneficiaries after death are also tax free as long as the five-year requirement has been met.



To contribute to a Roth IRA for 2016, your modified AGI can't be more than \$132,000 if you are single, \$194,000 if you are married and file a joint return, and \$10,000 if you are married and file a separate return. The allowable contribution is reduced with AGI over \$117,000 (single), \$184,000 (joint), and \$0 (separate). These AGI limits are the estimated inflation-adjusted amounts for 2016.

- Another way to fund a Roth IRA is by converting a traditional IRA. You are not limited in the amount you can convert, and there are no income or filing status restrictions.
- While a Roth conversion provides an opportunity for future tax-free earnings, it also triggers income taxes on previously tax-deferred amounts in your traditional IRA. Your current tax rate, as well as your expectations regarding future tax rates and the possibility of tax law changes, will be issues to consider as you weigh a possible conversion.
- The IRS allows a limited period in which taxpayers can “recharacterize” a traditional-IRA-to-Roth-IRA conversion, essentially treating the conversion as though it hadn't been made. Having this flexibility can save unnecessary taxes.

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**Example.** A couple of months after Sara converts her \$100,000 traditional IRA to a Roth IRA, the market value of her IRA investments declines significantly. Within the IRS's required period, Sara notifies the IRA trustees that she wishes to recharacterize her Roth IRA contribution as a traditional IRA contribution. The recharacterization avoids tax on the IRA's \$100,000 conversion value. After a waiting period, Sara will have the option of reconverting her account to a Roth IRA — potentially at a lower tax cost if the IRA hasn't recovered its value.

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**Premature distributions.** Withdrawing money from a tax-deferred plan or an IRA before age 59½ can result in a 10% tax penalty *in addition to* income taxes. However, the tax law provides a number of penalty exceptions.

- For example, you can take amounts from an IRA early without penalty to pay qualified higher education expenses or first-time homebuying expenses of up to \$10,000. (These penalty exceptions do not apply to qualified plan distributions.)
- A little-known way to avoid the penalty is by taking a series of substantially equal periodic payments. The IRS has rules for calculating the payment amounts. At a minimum, you must take the payments at least annually for five years or until you reach age 59½, whichever comes *later*.
- If you terminate employment during or after the calendar year in which you attain age 55, you can receive a distribution from a 401(k) or other qualified plan without penalty after you've separated from service. But the penalty could apply if you roll your 401(k) savings into an IRA and then make an early withdrawal from the IRA, since this particular penalty exception does not apply to IRA withdrawals.

**Required distributions.** The tax law does not allow you to leave money in tax-deferred plans indefinitely. After you reach age 70½, you generally must begin taking annual “required minimum distributions” (RMDs) from your traditional IRAs and any employer-sponsored plans in which you participate. Your employer’s plan may permit you to delay the start of RMDs past age 70½ if you haven’t retired and are not a 5% owner of the company. And what about your Roth IRA? Minimum distributions are not required from Roth IRAs until after the account owner’s death.



- If you are a beneficiary of an IRA or plan account, consider your withdrawal options carefully. You may have an opportunity to delay income taxes by stretching out withdrawals over your life expectancy. Plan assets also may be transferred into an IRA. (Requirements apply.)
- As the sole beneficiary of your spouse's IRA, you would have the opportunity to retitle the account in your own name after your spouse's death and be treated as the owner for tax purposes. This treatment may be advantageous if you want to delay RMDs until after you reach age 70½. However, if you expect to take money from the IRA before age 59½, you may prefer to be treated as the IRA beneficiary so that the 10% penalty on early withdrawals will not apply.

**Social Security.** A portion of your Social Security retirement benefits will be subject to tax if your “provisional income” for the year is more than \$25,000 (\$32,000 on a joint return). You will be taxed on up to 85% of your benefits if your provisional income is more than \$34,000 (\$44,000 if married filing jointly). Provisional income is defined as your AGI with certain modifications, plus one half of your Social Security benefits for the year. You also have to include otherwise tax-exempt municipal bond interest in your provisional income.

## CHARITABLE CONTRIBUTIONS

Your contributions to qualified organizations are generally tax deductible as an itemized deduction. If you plan to make a large donation, be mindful that the amount you may deduct each year is limited by a percentage-of-income ceiling. The applicable percentage depends on the type of property you contribute and the type of charity that receives your contribution. Discuss your options with your tax advisor.

**Records.** You must have records to support your deduction. For cash contributions *of any amount*, you must have a written receipt from the charity or a bank record showing the name of the charity, the date of the contribution, and the amount. You will also need a record of your noncash contributions, and, if they

exceed \$500, you'll have to file a special form with your tax return. You may need an appraisal for larger gifts.

**Stock contributions.** Contributing publicly traded stock you've held longer than one year avoids capital gains tax on any price appreciation, while allowing you to deduct the stock's full market value on the date of your gift. You don't get the same tax break for contributions of appreciated stock you've held one year or less — your deduction for the contribution will be limited to your basis in the stock (generally, your cost).

For stock that has declined in value, you'll obtain a better tax result by selling the shares and contributing the proceeds than you will by donating the shares outright. The reason: You'll be able to deduct a capital loss as well as your contribution.

Please be aware that the timing and value of stock contributions will be determined by the date on which the charity receives the donated securities. If you are contemplating a gift near the close of the taxable year, be sure to check with your broker for any cut-off dates they may impose in order to have the transaction processed by year end.

**Volunteers.** If you do volunteer work, you may be entitled to deduct various unreimbursed expenses as charitable contributions. Potentially deductible expenses include the cost of gas and oil used in driving your car while performing services for the organization (or you may use a standard mileage rate of 14¢ per mile to figure the cost), supplies, and uniforms. If you travel overnight on behalf of an organization, you generally may deduct your unreimbursed travel, transportation, lodging, and meal expenses.



**When you receive a benefit.** Figuring the amount of your tax deduction can be tricky when you contribute to a qualified organization and receive a benefit in return. In this situation, your deduction is limited to the amount over and above the value of the benefit you receive.

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**Example.** Dan pays \$150 for a ticket to a dinner held for the benefit of a charity, and the dinner's fair market value is \$50. Dan's deduction is limited to \$100 — the difference between the amount he paid for the ticket and the value of the dinner.

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Under a special rule, you may deduct as a charitable contribution 80% of payments made to a college or university in exchange for the right to buy tickets to an athletic event at the school. If you receive tickets in return, you can't deduct the price of the tickets, but 80% of the remaining amount you pay is deductible.

## ON THE HOME FRONT

Maintaining your household probably takes a large share of your income every year. You'll want to be sure you capitalize on any tax benefits available to you.

**Mortgage interest and taxes.** You may deduct interest paid on up to \$1 million of debt incurred to acquire your principal and/or a second residence, as well as interest paid on up to \$100,000 of home equity debt, as an itemized deduction. The deduction for home equity interest is available even if you don't spend the money on your home. You also may include the real estate taxes you pay on your property in your itemized deductions.

**Refinancing your home mortgage.** Your lender may charge you points (prepaid interest) in connection with a mortgage refinancing. Generally, you may deduct the points over the new loan's term as an itemized deduction. But you may deduct points currently to the extent you spend the refinancing proceeds on improvements to your principal residence. If you refinance a second time, you may deduct the balance of the points on your first refinancing, assuming you are switching lenders. If you refinance again with the same lender, any points remaining from the first refinancing are deductible over the new loan's term.

**REEP credit.** There is a 30% residential energy-efficient property (REEP) tax credit for installing solar electric and hot water systems, geothermal heat pumps, small wind turbines, and fuel cell systems. Various requirements apply.

**Home rentals.** Renting your personal residence for fewer than 15 days during the year can provide a source of tax-free income. However, this tax break extends only so far — expenses associated with the rental of your residence, such as advertising and utilities, are not deductible. When you rent your home for 15 days or more during the year, your rental income is taxable, but, in this situation, rental expenses are tax deductible (within certain tax law limitations).

**Office in the home.** If you own a home-based business or professional practice, you may be able to deduct various expenses related to using your home for business purposes, such as electricity, heating/cooling, homeowners or renters insurance, and trash removal. Instead of deducting actual expenses allocated to your home office, you have the option of deducting \$5 for each square foot of office space (maximum of 300 square feet).

Deductions for an office in the home generally are available only if you use the space regularly and exclusively for business. The IRS won't allow a deduction if the office occasionally doubles as a den or guest room — even if you use the space strictly for business during the workday.

Homeowners who claim home office deductions using the actual-expense method (instead of the \$5-per-square-foot method) face a potential tax downside when they sell their homes. The tax law's capital gain exclusion for home sales (discussed next) will not be available for gain due to depreciation allowable for the home office after May 6, 1997.

**Selling your home.** Up to \$250,000 of gain (\$500,000 for joint filers) on the sale of a principal residence is not subject to tax if you meet tax law requirements. Generally, you may claim this exclusion only once every two years, and you must have owned the home and used it as your principal residence for at least two of the five years immediately before the sale.

The maximum \$250,000/\$500,000 gain exclusion is prorated if you sell your home before meeting these requirements because of a change in employment, for health reasons, or because of certain other unforeseen circumstances.

## EDUCATION TAX INCENTIVES

Given the high cost of higher education, tax incentives are an important piece of the planning puzzle for anyone who is setting aside money for future costs or currently paying for education.

**529 plans.** Many states sponsor qualified tuition programs — prepaid tuition plans and college savings plans — that provide tax benefits under Section 529 of the federal tax code. You can't deduct contributions to a 529 plan on your federal tax return. However, you are not taxed on investment earnings while your money remains in the plan, and plan distributions to pay the account beneficiary's qualified higher education expenses are tax free.

The definition of qualified higher education expenses includes tuition, fees, books, supplies, equipment required for the beneficiary's enrollment or attendance, and expenses for special needs services. Room and board costs for a student who is at least half-time also qualify (subject to a limit).

You are not limited to investing in your state's plan. However, certain plan benefits may not be available unless you meet specific requirements, such as state residency. Before you invest, find out whether a particular plan has restrictions on the timing and use of plan distributions.

*Before investing in a 529 plan, consider the investment objectives, risks, and charges and expenses associated with municipal fund securities. The issuer's official statement contains more information about municipal fund securities, and you should read it carefully before investing.*



**Coverdell ESA.** An education savings account (ESA) offers federal tax benefits similar to a 529 plan. However, ESA contributions for a beneficiary are limited to \$2,000 annually. ESA contributions are phased out for taxpayers with modified AGI between \$95,000 and \$110,000 (between \$190,000 and \$220,000 for joint filers).

Unlike funds in a 529 plan, ESA money may be used tax free for a child's elementary or secondary school tuition and related costs (in addition to higher education expenses).

**Student loan interest.** Interest paid on personal loans is usually not tax deductible. However, the tax law makes an exception for up to \$2,500 per year of interest paid on qualified higher education loans. This above-the-line deduction is available not only for interest paid on your (and your spouse's) qualified education loans but also for interest on any loans you take to finance your dependent child's higher education. If you are married, you must file jointly to claim the deduction. It phases out with joint AGI between \$130,000 and \$160,000 (\$65,000 and \$80,000 for single filers). These AGI figures are estimated for 2016.

**Education tax credits.** An American Opportunity credit of up to \$2,500 (per student) or a Lifetime Learning credit of up to \$2,000 (per tax return) may be available for the payment of qualified tuition and related expenses for yourself, your spouse, or your dependents. The American Opportunity credit is for any of a student's first four years of college. It phases out with modified AGI between \$80,000 and \$90,000, or between \$160,000 and \$180,000 on a joint return. The Lifetime Learning credit is available for each year of post-secondary education, including graduate school and eligible job training. The credit phases out with modified AGI between \$55,000 and \$65,000, or between \$111,000 and \$131,000 on a joint return. (Phaseout ranges are the estimated inflation-adjusted ranges for 2016.) You may not claim both education credits for the same student's expenses, and neither credit is available to a married taxpayer filing separately.



# FOR BUSINESS TAXPAYERS

## START-UP STRATEGIES

In the midst of all the activity that accompanies starting a business, tax matters can be easily overlooked. Here are some pointers that will be of interest to you if you are planning to start a business.

**Start-up expenses.** You'll want to keep track of the expenses you incur in launching the business, such as pre-opening advertising, travel and survey fees, consulting fees, and wages. Up to \$5,000 of start-up expenses may be deducted in the year your business begins, with any additional expenses deductible over a period of 180 months. Absent the election, start-up expenses must be capitalized. Note that the \$5,000 limit is reduced dollar for dollar once total start-up costs exceed \$50,000.

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**Example.** Before they opened their new restaurant in March 2016, the Garcias spent \$8,000 on start-up costs. The Garcias elected to write off \$5,000 of those expenses on their 2016 return. They may deduct the remaining \$3,000 of expenses over a period of 180 months, at a rate of \$16.67 per month ( $\$3,000 \div 180$ ), starting in March. Their total 2016 deduction for the expenses is \$5,166.67 ( $\$16.67 \times 10 \text{ months} = \$166.67$ ;  $\$5,000 + \$166.67 = \$5,166.67$ ).

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**Organizational expenses.** A new corporation also may deduct up to \$5,000 of costs incurred in setting up the company in the tax year in which it begins business. Examples include legal and accounting fees for establishing the corporation, state incorporation fees, the cost of drafting the corporation's bylaws, and director and shareholder meeting expenses. Any remaining organizational costs are deducted ratably over 180 months. As with start-up expenses, the \$5,000 limit is reduced as expenses exceed \$50,000. A corporation may opt out of this treatment and capitalize its organizational costs.

**Section 1244 stock.** You are going into business to make money, not to lose it. Still, if you are incorporating a new business, you should consider taking the precautionary measure of qualifying the stock your corporation issues as "Section 1244" stock.

This will require meeting certain tax law requirements. In addition, you should maintain certain records concerning the stock.

What's the benefit? Section 1244 treatment will enable you to deduct any future losses on your stock as ordinary losses, up to an annual maximum of \$50,000 (\$100,000 on a joint return). Ordinary loss treatment is generally preferable to

capital loss treatment, since your annual deduction for capital losses is limited to the amount of your capital gains plus an additional \$3,000 (\$1,500 for married-separate filers).

## REVIEWING BUSINESS ENTITY CHOICES

Even if you have been in business for some time, you may benefit from reviewing the various forms of business to make sure that your current structure continues to meet your needs from both a non-tax and a tax point of view. Some key tax considerations follow.

**Corporation.** Unless a "Subchapter S" election is made, a corporation uses the accompanying corporate tax



rate schedule to figure the federal income taxes due on its taxable income. When corporate income is distributed to shareholders as dividends, the corporation receives no deduction for the payments, and the income is taxed again to the shareholders.

- Individual shareholders enjoy a relatively low tax rate on qualified dividends (see page 7).
- A corporation may deduct reasonable amounts of compensation paid to shareholders employed by the company. By paying out corporate earnings in the form of tax-deductible compensation, double taxation of the earnings is avoided.
- Leasing business property or equipment to your corporation is another way to draw out corporate earnings on a tax-deductible basis. Your corporation deducts the rent expense (the amount must be reasonable), and you declare the rent as income.

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## CORPORATE TAX RATES

TAXABLE INCOME	RATE
Up to \$50,000	15%
\$50,001 - \$75,000	25%
\$75,001 - \$100,000	34%
\$100,001 - \$335,000	39%
\$335,001 - \$10 million	34%
Over \$10 million - \$15 million	35%
Over \$15 million - \$18,333,333	38%
Over \$18,333,333	35%

The IRS may assess an “accumulated earnings penalty” on a regular corporation that retains more earnings and profits than are necessary to meet reasonable business requirements. The penalty, equal to 20%

of “accumulated taxable income,” is designed to encourage corporations to pay taxable dividends to shareholders.

A corporation may accumulate up to \$250,000 (\$150,000 for certain service corporations) without penalty because of an accumulated earnings credit. Corporations should document the reasons for additional accumulations — the anticipated purchase of a new facility or equipment, for example — in the corporate minutes.

Like individual taxpayers, regular corporations may be subject to the alternative minimum tax (AMT). The corporate AMT rate is 20%, and an exemption of up to \$40,000 is available. However, the \$40,000 exemption is phased out for corporations with AMT income between \$150,000 and \$310,000.

A corporation is exempt from the AMT if it qualifies as a “small” corporation. A small corporation is one that has average annual gross receipts for all three-year periods beginning after 1993 and ending before the current year of no more than \$7.5 million. For a corporation’s first three-year period (or portion of a period), a \$5 million average gross receipts threshold applies.

**S corporation.** Making an S election for a corporation can avoid the problem of double taxation. Subject to certain exceptions, an S corporation does not pay corporate income taxes at the federal level. Instead, the corporation’s income, losses, deductions, and credits are allocated, or “passed through,” to its shareholders for inclusion on their tax returns. As a result, the corporate income is taxed only once, to the shareholders.

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**Example.** Roy owns 60% of the stock in an S corporation, and Michelle owns the other 40%. For its 2016 tax year, the S corporation has taxable income of \$200,000. The corporation pays no federal income tax on the \$200,000 of income. Instead, Roy includes \$120,000 of the income on his personal return, and Michelle includes \$80,000 on hers.

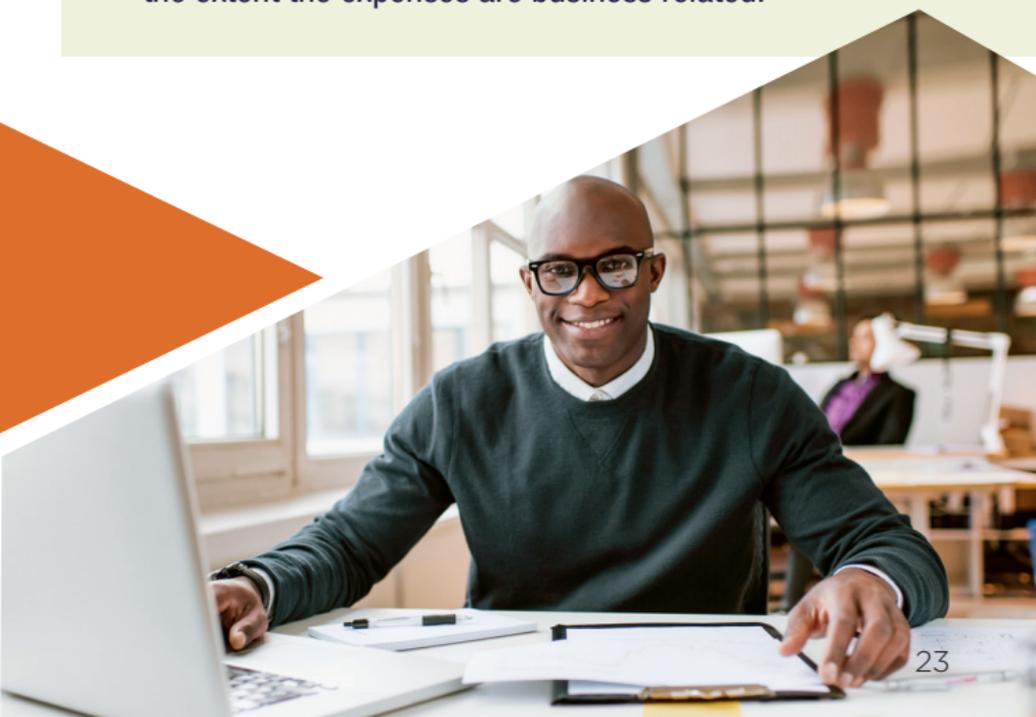
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**Limited liability company (LLC).** An LLC can have one owner, or the company can have co-owners, called “members.” An LLC’s income generally is taxed to the owners individually. An LLC has more freedom in allocating income and deductions among the owners than an S corporation, which must make such allocations according to ownership percentages.

**Partnership.** A partnership, by definition, has more than one owner. Partnerships do not pay federal income taxes at the entity level but must file an annual informational return with the IRS. Among other matters, the partnership agreement addresses how business profits and losses will be divided among the partners.

**Sole proprietorship.** The business income and expenses of a sole proprietor are reported on Schedule C, an attachment to the individual income-tax return. Net earnings from the business are taxed directly to the owner.

- A married couple who jointly own and operate an unincorporated business and file a joint income-tax return may elect “qualified joint venture” treatment. Making this election eliminates the requirement to file annual partnership returns for the business. Instead, the couple divides the income and expenses of the business, and each reports these amounts on the appropriate form, such as Schedule C.
- To minimize self-employment taxes, plan to take as many deductions as possible on Schedule C. For example, professional fees should be claimed on Schedule C to the extent the expenses are business related.



## DEDUCTION PLANNING

Much of your business tax planning effort may center on ensuring that potential deductions are not overlooked. Timing issues also may be important in ensuring that you gain the maximum benefit from your deductions.

**Bad debts.** Monitor your company's accounts receivable and determine if any amounts are uncollectible and can be written off as bad debts. But note: Businesses that use the cash method of accounting may not deduct bad debts because they do not report sales revenue for tax purposes until they receive payment.

**Depreciation.** The ability to recover a portion of amounts spent on machinery, equipment, buildings, and other assets through depreciation deductions is a significant tax benefit, especially for capital-intensive businesses. Properly segregating fixed asset costs is essential, since the period over which an asset can be depreciated and the amount deductible in each year vary with the category to which the asset is assigned under the Modified Accelerated Cost Recovery System (MACRS).



### MACRS ASSET CLASSES

PROPERTY CLASS	ASSETS INCLUDED*
3-year	Tractor units for over-the-road use
5-year	Automobiles, trucks, computers, copiers and other office machinery
7-year	Office furniture and fixtures, agricultural machinery and equipment
10-year	Vessels, barges, and tugs
15-year	Certain land improvements
20-year	Farm buildings (other than certain single-purpose structures)
25-year	Water utility property
Residential rental property (27.5-year)	Apartment buildings, single-family rental properties
Nonresidential real property (39-year)	Office buildings, stores, warehouses

\* The lists of property included in each class are not all-inclusive.

- The depreciation period for commercial buildings and their structural components is 39 years. However, it may be possible to segregate certain building-related costs and depreciate them more quickly than the building itself.
- With non-real-estate assets, a business generally may deduct a full half-year's worth of depreciation in the first year, regardless of the date the asset is placed in service. However, when more than 40% of such assets are placed in service during the last quarter of the tax year, depreciation is figured using a "mid-quarter convention." In many cases, use of the mid-quarter convention will result in a lower overall depreciation deduction that year. So try to time your purchases to your best advantage.

**Section 179 deduction.** Don't overlook the possibility of deducting up to \$25,000 of your 2016 business asset purchases instead of depreciating them. You can make this election for most non-real-estate assets. Note that the Section 179 expensing limit is reduced dollar for dollar as asset purchases rise from \$200,000 to \$225,000, and the deduction can't exceed taxable income from active trades or businesses.\*

**Lower cost assets.** Like many businesses, you may have accounting procedures in place calling for lower cost assets to be expensed rather than capitalized. The IRS allows companies to elect the same treatment for "de minimis" asset purchases that cost up to \$5,000 per item (\$500 if a company does not have an "applicable financial statement"). Asset purchases that are expensed in accordance with the de minimis election do not count against the annual Section 179 expensing limit. (Certain requirements apply.)



\* Legislation that would increase the Section 179 expensing limit was under consideration at the time of publication.

**NOL deductions.** Your business may carry back a net operating loss (NOL) to offset taxable income for the two preceding tax years. Carrying back an NOL allows a business to secure a refund of taxes paid for those years.

If not completely absorbed, the balance of the NOL may be carried forward for up to 20 years. Instead of carrying an NOL back to previous tax years, a business may elect to carry its NOL forward. This election is worth considering if a company expects to generate a large profit — and a high tax bill — the next year.

- As an S corporation shareholder, you may deduct your allocable share of the corporation's net operating loss — provided you have sufficient “basis” in your S corporation stock and any loans you have made to the corporation. If you need to increase your basis to gain a tax deduction for an NOL, consider loaning the company money before year-end.
- Personally guaranteeing a bank or other third-party loan to your S corporation will not increase your basis because you do not make an actual economic outlay. However, if you make payments on the guarantee, those will increase your basis.

**Domestic production activities.** Manufacturers, construction contractors, software companies, engineering and architectural firms, and other businesses involved in U.S. production activities may be eligible to deduct 9% of their qualified production activities income or, if less, 9% of their taxable income (determined without regard to the deduction). The deduction is limited to 50% of W-2 wages allocable to domestic production gross receipts.

**Timing.** From a cash flow standpoint, deducting an expense in the current year and actually paying it in the next tax year can be advantageous.

- Bonuses, vacation pay, and charitable contributions may be deductible in the current year if paid within the first 2½ months of the following tax year. These strategies are not available to cash-method businesses, and various restrictions and requirements apply.
- Companies that sponsor profit sharing plans have until the extended due date of their tax return to make a deductible contribution for the previous tax year.

## TAX CREDITS

Several tax credits are available to business taxpayers.

**Energy credits.** Installing solar energy property, small wind turbines, geothermal heat pumps, and other types of energy-efficient property for business use can result in a tax credit. The property must meet official quality and performance standards, and other requirements apply.

**Small employer health insurance credit.** Eligible small employers may be entitled to a tax credit of up to 50% of their contribution toward employee health coverage. The credit is available for two consecutive tax years. Very generally, an eligible small employer has:

- No more than 25 full-time equivalent employees (FTEs) during its tax year
- Employees who have average annual wages of no more than \$51,800 (projected inflation-adjusted amount for 2016)
- A qualifying arrangement in effect that requires the employer to contribute at least 50% of the premiums

Various other detailed requirements apply.



**Tip credit.** A food and beverage establishment can get credit for its share of Social Security taxes paid on cash tips in excess of the amount treated as wages for purposes of satisfying minimum wage requirements.

**Retirement plan startup.** The credit is 50% of administrative and retirement-related education expenses for the first three plan years (maximum annual credit of \$500).



**Other credits.** Several other credits are available to businesses, including the low-income housing credit, the disabled access credit, and the credit for employer-provided child care. Be sure to investigate all of the credits that may be available to your business as you plan your 2016 taxes.

## HEALTH CARE REFORM

The employer shared responsibility provisions and the related information reporting requirements of the Affordable Care Act (ACA) became effective in 2015. If your business is large enough to be affected, you must offer “minimum essential” health coverage that is “affordable” and provides “minimum value” to your full-time employees and their dependents or potentially be required to make a shared responsibility payment to the IRS.

For 2016, these rules apply only to “applicable large employers” (ALEs) that had an average of at least 50 full-time employees (including FTEs) in the previous year.

“Dependent” is defined differently for this purpose. A dependent is an employee’s child (including a child who has been legally adopted or placed for adoption) who has not reached the age of 26. Spouses, stepchildren, and foster children are *not* considered dependents.

There are two types of employer shared responsibility payments. The table provides some details.



## EMPLOYER SHARED RESPONSIBILITY PAYMENTS



APPLIES WHEN

AMOUNT

### 1. FOR FAILURE TO OFFER MINIMUM ESSENTIAL HEALTH COVERAGE

Minimum essential coverage is NOT OFFERED to at least 95% of full-time employees and their dependents *and* a premium tax credit is

allowed or paid to one or more full-time employees for purchasing coverage through an ACA exchange.

**\$2,160**

per full-time employee (includes *all* full-time employees except the first 30).

### 2. FOR FAILURE TO OFFER HEALTH COVERAGE THAT IS AFFORDABLE AND OF MINIMUM VALUE

Minimum essential coverage is OFFERED to at least 95% of full-time employees and their dependents but a premium tax credit is

allowed or paid to one or more full-time employees for purchasing coverage through an ACA exchange.

**\$3,240**

for each full-time employee who receives the premium tax credit. Capped at the amount described in (1).

*Note: Amounts shown are for the full year and are projected inflation-adjusted amounts for 2016. The payment is calculated on a monthly basis.*

## Sponsoring a Retirement Plan

Retirement plans are not only a sought-after employee benefit, they also offer business owners a valuable opportunity to reduce their tax burden. Subject to tax law limits, contributions to a qualified retirement plan for you and any eligible employees are tax deductible. Plan investment earnings are tax deferred, and benefits are not taxed until distributed.

**401(k) plans.** Participants defer a portion of their pay to individual plan accounts on a pretax basis. The sponsoring employer may make matching contributions but isn't required to do so. In addition to pretax contributions, a 401(k) plan may offer a Roth contribution option. If you are self-employed and do not have employees, you might consider establishing a "solo" 401(k) plan.

**Profit sharing plans.** Flexibility is one of the key advantages of a profit sharing plan. Whether your company will contribute for a given year — and how much — can be left to its discretion. (Annual contribution limits apply.) If desired, a profit sharing plan may incorporate a 401(k) salary deferral feature, which would give participating employees the ability to save money in the plan through payroll deduction.

**Simplified Employee Pension (SEP) plans.** As the name implies, a SEP plan is relatively easy to establish and administer. The business funds the plan with tax-deductible contributions to SEP-IRAs set up for the plan participants. The annual employer contribution is discretionary.



**SIMPLE plans.** Like SEP plans, SIMPLE plans are relatively easy to set up and maintain. Eligible employees have the opportunity to make payroll contributions to the plan on a pretax basis, and the employer is required to make matching or nonelective contributions for employees annually based on a matching formula or percentage that meets minimum tax law requirements.

**Defined benefit plans.** Benefits are provided in the form of a traditional pension, typically based on average pay and length of service. Although defined contribution plans, such as those described above, are more commonly used today, a defined benefit plan can be ideal for older owners who desire faster accumulation of benefits. Another avenue you might explore is a hybrid plan (e.g., a cash balance plan) that has features of both a defined contribution and a defined benefit plan.



## HOW RETIREMENT PLANS COMPARE

	WHICH EMPLOYERS SHOULD CONSIDER THIS PLAN?	MAY EMPLOYEES CONTRIBUTE?	MUST EMPLOYERS CONTRIBUTE?
<b>401(k)</b>	All employers	Yes	No — however, employer contributions are allowed
<b>PROFIT SHARING</b>	All employers	No	Yes — contributions can be discretionary
<b>SEP</b>	All, but typically appeals to small employers	No*	Yes — discretionary contributions
<b>SIMPLE</b>	Limited to employers with 100 or fewer eligible employees and no other retirement plan	Yes	Yes — must match employee contributions up to 3% of pay or contribute 2% of pay for all eligible employees

\* Elective deferrals are allowed if the plan is a salary reduction SEP (SAR-SEP) established before 1997.



We hope the strategies presented in this *Tax Planning Guide* will be helpful to you in your 2016 tax planning.

*The general information provided in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your situation.*

