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Dear Clients and Friends,

We thank both our new and returning clients for continuing to use us for their tax, consulting, and accounting needs. We value working with each of you. We strive to provide the best professional services to you in a timely manner. We want to let you know how much we appreciate your confidence in us. Thank you so much!

Every one of us can develop a year-end tax planning strategy that reflects his or her situation. We would like to help you attain your minimum legal tax liability. Our office can help you prepare such a strategy.

New Administration

Wow! Many of us didn't see that coming. A Trump administration with a Republican Congress is anticipated by many to implement provisions that will change the tax landscape. First of all, note that there will not likely be any changes retroactive to 2016. Most analysts believe the changes will only apply to 2017 and future years. However, there is still a lame-duck session and Congress is notorious for passing tax legislation in the last few days of December. What those could be is anyone's guess.

We do admit that our crystal ball is quite foggy right now. As a result, we will not make any predictions regarding new tax laws. However, we can summarize some of the recently stated intentions. There is a strong desire for lower tax rates overall. There are also proposals for increasing the standard deduction, eliminating personal exemptions, and limiting itemized deductions for higher income taxpayers. Reasons that significant tax reform may not happen include cost constraints and the increasing budget deficit. Someone has to pay for lower taxes. There is also the hurdle of needing 60 Senate votes to avoid filibusters. So, there is likely to be some compromise to have any movement in the area of tax reform. Later in this letter, we will discuss traditional year-end tax planning. If you believe that tax rates will be lower going forward, these traditional planning strategies will serve you well.

Identity Theft and IRS Issues

One of the most troubling issues regarding tax returns is the pervasive fraud that is happening with the filing of false tax returns and refunds issued. This is mostly done via identity theft and the thieves are becoming more sophisticated by the month. The IRS, state taxing authorities, and software providers have joined to implement security procedures to make it more difficult to file fraudulent returns. You must protect your identity in all aspects of your life. Use of public Wi-Fi can significantly increase your risk. If you believe there is an issue with your returns or you believe you are a victim of identity theft, contact us or the IRS immediately. The IRS has implemented procedures to deal with this identity theft. However, it does take time for them to sort it out. **Remember, the IRS does not contact taxpayers by email or telephone. Emails and phone calls purportedly from the IRS are scams. If in doubt, contact us.** That being said, Congress has authorized collection agencies to contact taxpayers, which most of the time will be by phone. You are not required to provide them with any information.

The IRS has shortened the time given to taxpayers to respond to some of its notices. Historically, the IRS has given the taxpayers 30 days to respond. Some notices now are requiring a taxpayer response within 10 or 15 days. If you receive correspondence from the IRS, please open it immediately and contact us. Don't put it aside. Our experience is that many times the information that the IRS has obtained independently is incorrect. We can generally respond on your behalf with no additional tax due.

Affordable Care Act (ACA)

Taxpayers must report if they had minimum essential health coverage on their tax returns. For those that do not have this coverage, they may be liable for a shared responsibility payment and should carefully review the significant number of exemptions available, which cover many different circumstances. Penalty amounts are fully phased-in for 2016 to the greater of \$695 per adult and \$347.50

per child or 2.5% of income above the filing threshold. It is possible to project the amount of any payment. Our office can assist you in both understanding these complex ACA provisions and planning for their impact.

Tax Legislation

In late 2015, Congress made the following tax provisions permanent for individuals:

- Educator Expense Deduction. Grades K-12 teachers, instructors, principals, counselors, and aids (those working at least 900 hours during the school year) may take an above-the-line deduction for qualified unreimbursed expenses up to \$250 paid during the year. This deduction was expanded to include professional development expenses. Also note that expenses beyond \$250 qualify as itemized miscellaneous deductions (so provide us with all of these types of expenses).
- The American Opportunity Tax Credit for college education costs providing a credit for up to \$2,500 annually per student.
- State and Local Sales Tax Deduction. Taxpayers may elect to deduct state and local sales taxes in lieu of state and local income taxes.
- IRA Distributions to Charity. Tax-free distributions, up to a maximum of \$100,000 per taxpayer each year, from individual retirement accounts to public charities by individuals age 70½ or older, have been allowed as an alternative to reporting the income and taking an itemized deduction. There can be a significant tax benefit here. If this interests you, please contact us.

The following items were extended until December 31, 2016 and have not been extended beyond. If any of these items affect you, you should consider making sure they occur in 2016:

- Mortgage Insurance Premium Deduction. Mortgage insurance premiums can be deducted as qualified residence interest.
- Exclusion of Cancellation of Indebtedness on Principal Residence. This provision allows taxpayers to exclude from income the cancellation of mortgage debt of up to \$2 million on a qualified principal residence.
- Higher Education Tuition and Fees Deduction. The above-the-line higher education tuition deduction provides a maximum \$4,000 deduction for qualified tuition and fees at post-secondary institutions of learning, including colleges, universities, and vocational schools, subject to income phaseouts. This item is not expected to be renewed due to making the American Opportunity Credit permanent.
- Residential energy property expenditures (such as energy efficient heat pumps, furnaces, central air conditioning systems and water heaters). There are strict guidelines on what qualifies for this credit. Note that solar energy systems continue to qualify for the credit until the end of 2022.

Traditional Year-End Considerations

A number of traditional year-end tax planning strategies may be helpful in maximizing tax savings, depending upon your overall tax situation anticipated for the rest of 2016 and estimated for 2017. Basic tax planning is to defer income and accelerate deductions. These include:

1. Take full advantage of retirement plan deductions including 401(k) plan, IRA, and SEP contributions.
2. Donate to charity before the year end if you will itemize deductions. Contributions paid by credit card before year end are deductible even before you have paid the credit card bill.
3. Donate non cash goods before year end. If the total is over \$500 special reporting requirements are required (see our website for assistance with valuation of these items).
4. Accelerate payment of other itemized deductions.
 - a. If a property tax payment is not due until early next year consider paying before year end (most escrow accounts do this for you).
 - b. Make January state estimated tax payments in December.
 - c. If you have high medical and dental expenses, pay any bills before the end of the year. This only applies if your total medical expenses will be more than 10% (7.5% for a return where the taxpayer or spouse was born before 1/2/1952) of your adjusted gross income.
5. For those that are close to the standard deduction amount (\$12,600 for those married filing jointly, \$6,300 for those single or married filing separately, or \$9,300 for those head of household; also those over age 65 can add \$1,250 (\$1,550 if single) each to the amounts listed), consider bunching itemized deductions into 2016 (see items 2-4 above) and taking the standard deduction in 2017 or vice versa.
6. If you have capital gains, consider selling stocks that have lost money to offset capital gains if it is economically beneficial to do so.
7. Defer income into the next year if possible.
8. Accelerate business deductions if you have net income.

9. Pay college tuition before year end if you have not reached the maximum allowed for deductions and credits.
10. Make sure you have taken any required minimum distributions (RMDs) from retirement plans if you are over 70½. The penalty is onerous.
11. If you believe a Roth IRA is better than a traditional IRA, consider Roth conversions in 2016 or delay them until 2017.
12. Consider additional contributions to your Health Savings Account if you have a high deductible health plan.
13. If you are subject to the Alternative Minimum Tax, accelerating certain deductions (for example property taxes and miscellaneous itemized deductions) will not reduce your overall tax liability; so there is no benefit in doing so.
14. If you have a gifting strategy, make sure all gifts are made before the year end. An individual can gift \$14,000 tax free to each recipient annually.
15. **Consult us.** Many of these strategies can be complicated.
 - a. Selling losing stocks may not be a good strategy depending upon numerous other factors. Some of these factors are your capital gains tax rate, expectations for the stock in the future, etc.
 - b. If you expect to earn less next year, accelerating deductions and postponing income may not save you money depending upon your tax bracket and more.
 - c. See number 9. Depending upon your income you may not qualify for education credits or deductions.
 - d. See number 13. The Alternative Minimum Tax is a very tricky subject to say the least.

Capital Gains/Dividends, AMT, and More

The tax rate on net capital gain is no higher than 15% for most taxpayers. Net capital gain may be taxed at 0% for taxpayers in the 10% or 15% ordinary income tax brackets (taxable income less than \$37,650 for single and married filing separately; \$75,300 for married filing jointly or qualifying widow(er); and \$50,400 for head of household). Consequently, taxpayers in this situation can sell stock at a gain and buy the same stock back immediately with no tax due as long as the gain does not push them into the higher tax bracket. However, a 20% rate on net capital gain applies to the extent that a taxpayer's taxable income exceeds the thresholds set for the 39.6% ordinary tax rate (\$415,050 for single; \$466,950 for married filing jointly or qualifying widow(er); \$441,000 for head of household, and \$233,475 for married filing separately). The 3.8% net investment income tax may also apply for some taxpayers.

Keep in mind the "wash sale rules" when reviewing year-end capital gains and dividends. Wash sales are sales of stock or securities in which losses are realized, but not recognized for tax purposes, because the seller acquires substantially identical stock or securities within 30 days before or after the sale. Nonrecognition, however, applies only to losses; gains are recognized in full.

The alternative minimum tax (AMT) requires personalized attention. If you have been previously subject to AMT, you may be in future years as well or if you have a change in circumstances. No single factor automatically triggers AMT liability, but some common factors are itemized deductions for taxes (including state and local income taxes, real estate taxes, and personal property taxes) and miscellaneous expenses. These are not deductible for AMT purposes.

Also for higher-income taxpayers, there is a phase-out of itemized deductions and personal exemptions. Taxpayers in this situation (\$259,400 for singles, \$311,300 for married couples, \$285,350 for head of household, and \$155,650 for married filing separately) may want to explore the value of deferring itemized deductions or reducing adjusted gross income.

Other

Life Events: Marriage, death of a spouse, the birth or adoption of a child, retirement, a new job, loss of a job, the purchase of a new residence, a change in filing status, and other life events impact year-end tax planning. Sometimes timing matters.

We urge everyone to review their IRA beneficiary forms to make sure that they are up-to-date. Please be aware that upon your death the IRA beneficiary form controls where the IRA goes, not your will or trust, so making sure these forms are accurate is essential. We have seen instances of death after divorce where the IRA funds went to the divorced spouse because these forms were not changed. The result was not the one intended by the deceased. In order to "stretch" your IRA payouts, your IRA needs to have a designated beneficiary. Beneficiary forms for other retirement plans and insurance policies should also be reviewed.

IRAs: Beginning in 2015, the IRS instituted tougher restrictions on moving money between IRA accounts. Account-to-account transfers are unlimited. Taking distributions yourself and redepositing the funds (known as rollovers) can only be done once in a 12-month period no matter how many IRAs that you have.

Michigan: There are no major changes in Michigan income tax this year.

Charitable deductions: As we head into the holiday giving season, please know that all cash donations to charity must be documented – no exceptions. You do not necessarily have to provide all supporting documents to us, but you must have them in your files. You are no longer allowed any write-offs for contributions of cash or other monetary gifts unless you retain either a bank record such as a canceled check, or a written statement from the charity. For donations of over \$250, the canceled check is not enough – you must have the statement from the charity prior to the filing of your tax return.

Also, for clothing and household item donations to Goodwill and other charities, we need you to create an itemized list and value each item. This is the documentation the IRS requires. We can provide guidance on values (visit our website for assistance with these values). Items donated to charity must be in “good or better” condition.

Mileage Rates: The 2016 standard mileage rate for business miles is \$.54 per mile. The medical and moving mileage rate for 2016 is \$.19; for charitable miles it is \$.14. The IRS requires good records to substantiate your mileage deductions. There is no substitute for a mileage log to prove business miles driven. The simplest log is to record your miles on your calendar.

Don't forget to include your charitable mileage in your tax information – including those trips to drop items at Goodwill. Do you volunteer at church or school? Those miles are deductible as well. Medical miles to the doctor or pharmacy are also deductible, if you qualify for a medical deduction.

Office in home deduction: The IRS issued a safe harbor option simplified method for this deduction. The taxpayer can deduct \$5 per square foot annually for no more than 300 square feet for a maximum deduction of \$1,500 under this method. You can still use the deduction under prior rules if that method is more advantageous for you.

Businesses: *Travel and entertainment* – make sure to document time, place, amount, business purpose, and who you met with for each expense. The IRS always reviews these expenses in an audit. *Inventory* – You must count the inventory once a year – as of December 31 if that is your year-end. It is an IRS requirement. *Assets* – Immediate write-off of assets less than \$2,500 each. *Vehicles* – If you deduct actual vehicle expenses rather than the cents-per-mile method and you are contemplating the purchase of a vehicle before year-end, depending on the size of the vehicle, you may be able to deduct \$25,000 in 2016.

Foreign Bank and Brokerage Accounts: This does not apply to foreign investments held in US brokerage accounts. If you have any foreign trust, bank and/or brokerage accounts with a combined value greater than \$10,000 on **any day of the year**, or you hold specific foreign financial assets (excluding land) greater than \$50,000 at the end of the tax year, you are required to report them. The IRS is hitting this hard, and the penalty for failure to file the form is up to \$500,000. Also, be sure to tell us about any income generated by these accounts, even if you did not receive a 1099.

Social Security Earnings Statements: We recommend that every year or two you review the earnings that Social Security has on file for you. It is much easier to correct any errors now rather than many years later at retirement. Go to www.ssa.gov and set up an account. It will allow you to verify your earnings and get an estimate of your future benefits (and much more).

Conclusion

This letter is meant to summarize the most common tax law changes and planning items, but it cannot cover everything. If you are aware of a provision that affects you, please contact our office to discuss the effects on your personal tax and financial situation.

Sometimes tax planning involves avoiding surprises when taxes are due in April. If you have unusual transactions to report for 2016, give us a call soon so that we can make sure you are prepared and have done all you can in 2016 to help your tax situation.

Our 2016 tax organizer will arrive in January. Returning clients will receive a personalized organizer which will contain information from last year's return. We hope the organizer will make it easier to collect this year's information. New clients will receive a generic organizer for their use.

For more details about the year-end planning ideas we have discussed, and to review other strategies, please contact our office. Together, we can create a customized 2016 year-end tax strategy tailored to you.

In the meantime, have a wonderful Holiday Season! We look forward to hearing from you soon.

Very truly yours,

Doug and associates