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Dear Clients and Friends,

With a new administration taking shape in our nation's capital after the elections, you can expect that significant tax reforms will be debated, and perhaps enacted, in the near future. But the greatest impact on year-end tax planning in 2016 will likely derive from what happened late last year, not what will happen next year.

In the waning days of 2015, Congress passed the Protecting Americans from Tax Hikes (PATH) Act, which was promptly signed into law. This new federal legislation reinstated dozens of favorable tax provisions that had expired, many of them retroactive to the beginning of 2015. In some cases, the new law made often-extended tax breaks permanent, with certain modifications. The changes included in the PATH Act provide both individual and business taxpayers with a clearer picture about the optimal tax moves to make before the end of this year.

Furthermore, other developments occurring the last few years—such as a series of new cases, rulings and IRS regulations—could affect your year-end tax decisions. Finally, you might be able to benefit from various other tax-saving opportunities previously written into the Internal Revenue Code.

Keeping all that in mind, we have prepared the following **2016 Year-End Tax-Planning Letter**. For your convenience, the letter has been divided into three sections:

- Individual Tax Planning
- Business Tax Planning
- Financial Tax Planning

Be aware that the concepts discussed in this letter are intended to provide only a general overview of year-end tax planning. It is recommended that you review your personal situation with a tax professional.

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Alternative Minimum Tax

Despite some recent favorable changes, the alternative minimum tax (AMT) continues to impact millions of unsuspecting taxpayers each year. The calculation for determining AMT liability involves inclusion of technical adjustments and tax preference items, such as add-backs for certain deductions, and subtraction of an exemption amount. After comparing the AMT result to your regular tax, you effectively pay the higher of the two.

The exemption amount for 2016 is $53,900 for single filers and $83,800 for joint filers. However, these amounts are reduced for high-income taxpayers. For 2016, the reduction equals

25 cents for each dollar of AMT income above $119,700 for single filers and $159,700 for joint filers.

YEAR-END MOVE: Have your personal situation assessed. Depending on the results, you may shift certain tax preference items or deductions to 2017 to reduce AMT liability for 2016.

There are just two AMT rates: 26% on AMT income up to $186,300 in 2016 and 28% on AMT income above that threshold. Note that the top AMT rate is lower than the top regular income tax rate of 39.6%.

Tip: If you are normally in a high tax bracket and expect to pay the AMT in 2016, but not in 2017, you might decide to accelerate taxable income into this year. Accordingly, the extra income will be taxed at the 26% or 28% AMT rate in 2016, as opposed to being taxed at a higher rate in 2017. Consider all the relevant factors.

Charitable Donations

Generally, you can deduct the full amount you donate to qualified charitable organizations, as long as you meet the strict substantiation requirements spelled out in the tax law. However, be aware that other limits may apply to charitable deductions, including the "Pease rule" (see page 2).

YEAR-END MOVE: Absent extenuating circumstances, increase your charitable gifts before 2017. However, be sure to meet the strict record-keeping requirements in the law. For instance, a written acknowledgment from the charity is required for monetary gifts of $250 or more.

Furthermore, if you donate property held for longer than one year, you can generally deduct an amount equal to the property's fair market value (FMV). Otherwise, the deduction is limited to your "basis" (generally, the cost), in the property. Note that additional rules may apply to gifts of property. For instance, the annual deduction for gifts of property generally cannot exceed 30% of your adjusted gross income (AGI).

If you plan to donate securities to a charity, it is often advantageous to give assets that have appreciated in value over time. As a result, you can deduct the FMV of the securities while the appreciation remains untaxed forever.

Tip: If you donate by credit card late in December, you can still write off the donation on your 2016 return—even if you do not actually pay the credit card charge until 2017.

Pease and PEP Rules

Two recent tax law changes can reduce the tax benefits available to high-income taxpayers, but timely year-end action may minimize the consequences.

1. Pease rule: Under this rule, named for the congressman who initially introduced the legislation, most itemized deductions—including those claimed for charitable donations, gifts, state and local taxes, and mortgage interest—are reduced by 3% of the excess above an annual threshold based on your filing status (not to exceed 80% of total deductions).

2. PEP rule: The personal exemption phaseout (PEP) rule generally reduces personal exemptions by 2% for every $2,500 of AGI (or a fraction thereof) above the Pease rule thresholds.

YEAR-END MOVE: Analyze your exposure to the Pease and PEP rules. In some cases, you may be able to lower your AGI or shift deductions to your tax advantage. For example, you might postpone large charitable gifts to next year to avoid a reduction under the Pease rule in 2016.

The thresholds for the Pease and PEP rules are shown below.

Filing status	Threshold for 2016
Single	$259,400
Joint	$311,300
Married filing separately	$155,650
Head of household	$285,350

Tip: Certain itemized deductions—typically, those with built-in floors—are not affected by the Pease rule. However, all personal exemptions, including those claimed for dependents, are subject to the PEP rule.

Medical and Dental Expenses

For 2016, you may deduct only unreimbursed medical and dental expenses exceeding 10% of your AGI. For taxpayers who are age 65 or older, the threshold is 7.5% of AGI.

Usually, you have no control over when medical or dental expenses occur. At other times, however, you may be able to schedule elective expenses, such as arranging physical examinations or dental cleanings, to your benefit.

YEAR-END MOVE: Move non-emergency expenses into the optimal tax year for claiming deductions. For instance, if you are near or have already surpassed the AGI threshold this year, you could accelerate elective expenses into 2016. Otherwise, you might as well delay expenses to 2017, when at least you will have a chance at a deduction.

For this purpose, count unreimbursed medical and dental expenses paid for your immediate family, as well as other tax dependents such as an elderly parent or in-law. Paying these expenses may help you qualify for a deduction or boost an existing write-off.

Tip: Under current law, this is the last year in which taxpayers who are age 65 or older will benefit from the lower 7.5%-of-AGI floor. It is set to increase to 10%-of-AGI in 2017.

Education Expenses

The tax law provides certain tax benefits to parents of children in college, but within limits. Thanks to the PATH Act, you can choose between a tax credit and a deduction in 2016.

YEAR-END MOVE: When appropriate, pay qualified expenses for next semester by the end of the year. Generally, the costs will be eligible for either tax break in 2016, even though the semester does not begin until 2017. Thus, you may be able to increase your credit or deduction amount, subject to annual limits.

Typically, you may benefit from either the American Opportunity Tax Credit (AOTC) or the Lifetime Learning Credit (LLC). The enhanced maximum AOTC of $2,500, permanently preserved by the PATH Act, can be claimed for qualified expenses of each student. Conversely, the maximum LLC is $2,000 and is available only on a per-family basis. Thus, the AOTC is usually preferable to parents.

Both credits are subject to phaseouts based on modified adjusted gross income (MAGI). Similarly, the tuition deduction is either $4,000 or $2,000, based on your MAGI. The deduction is completely phased out at a MAGI of $80,000 for single filers and $160,000 for joint filers.

Tip: The tuition deduction, which has expired and been extended several times, was revived by the PATH Act. It is currently scheduled to expire again after 2016.

Lastly, you should consider making a contribution to your state's 529 plan as well, which provides tax-sheltered earnings growth as well as a state tax deduction (although not all states provide a deduction).

Miscellaneous

- You may deduct annual state sales taxes (based on an IRS table or actual receipts) in lieu of deducting state and local income taxes. This alternative deduction, which had expired and been revived several times in the past, was made permanent by the PATH Act.
- In some cases, you may consolidate outstanding personal debts into home equity debt. Interest on personal debts is not tax deductible, but you can generally deduct mortgage interest paid on the first $100,000 of home equity debt in most states, no matter how the proceeds are used.
- Prepay state and local taxes when it suits your needs (Alternative Minimum Tax may apply). For instance, if property taxes are due on January 1, 2017, a payment in December may increase your 2016 deduction.
- Miscellaneous expenses, including unreimbursed employee business expenses, are deductible only in excess of 2%-of-AGI. As with medical and dental expenses, you might arrange to pay qualified expenses (e.g., tax assistance fees) before 2017 to boost your deduction for 2016.
- Generally, you may claim a dependency exemption for a child under age 19, or a full-time student under age 24, if you provide more than half of the child's annual support. If needed, you might be extra-generous with support around the holidays to clear the half-support mark.
- The PATH Act restores the 10% residential energy credit, capped at $500, for energy-saving improvements, but only for those made through 2016.
- You may be liable for an estimated tax penalty if you fail to pay the required tax during the year. But you can avoid the penalty by paying enough to satisfy a "safe harbor" of 90% of current tax liability or 100% of the previous year's tax liability (110% if your AGI was above $150,000).

BUSINESS TAX PLANNING

Section 179 Deductions

Under Section 179 of the tax code, a business may currently deduct, or "expense," the cost of qualified new or used property placed in service during the year, up to an annual limit. The maximum deduction is phased out on a dollar-for-dollar basis above an annual threshold.

The maximum Section 179 deduction was scheduled to be slashed from $500,000 to $25,000 after 2014, but the PATH Act permanently preserves the generous higher allowance, retroactive to 2015, with future inflation indexing. The table below lists the maximum Section 179 allowances in recent years.

Tax year	Deduction limit	Phaseout threshold
2007	$125,000	$500,000
2008–2009	$250,000	$800,000
2010–2015	$500,000	$2 million
2016	$500,000	$2.01 million

YEAR-END MOVE: Maximize the tax benefits for buying qualified property. As long as the property is placed in service this year, the cost is deductible on your 2016 tax return. Depending on your situation, you might amend your 2015 return to recover Section 179 benefits for last year.

Note that the Section 179 deduction cannot exceed the taxable income from all your business activities. This could limit your deduction for 2016.

Tip: Depreciation deductions may still be available for costs that cannot be expensed under Section 179. For these purposes, the Section 179 deduction is claimed first.

Depreciation Deductions

Generally, a business may claim depreciation deductions for qualified property over a cost recovery period, based on the Modified Accelerated Cost Recovery System (MACRS). In addition, the PATH Act preserves the 50% "bonus" depreciation for qualified property placed in service from 2015 through 2017. This bonus depreciation deduction is now scheduled to decrease to 40% in 2018 and 30% in 2019 before expiring.

YEAR-END MOVE: Your business should cash in on this tax break while it can. Factor in all the tax ramifications for your business before purchasing property at the end of the year.

Note that bonus depreciation may be claimed in conjunction with Section 179 (see above). However, unlike deductions claimed under Section 179, bonus depreciation is not available for used property.

Tip: MACRS deductions are generally reduced if business property (other than real estate) placed in service during the last quarter of the year—the period spanning October 1 through December 31—exceeds 40% of the cost of assets placed in service during the entire year.

Business Start-up Costs

The tax law allows a small-business owner to claim a first-year deduction of up to $5,000 for qualified start-up costs. Any remaining expenses that qualify must be amortized over 180 months. However, the $5,000 write-off is phased out on a dollar-for-dollar basis for start-up costs exceeding $50,000.

YEAR-END MOVE: Make sure that you are officially "open for business" before the end of the year. Otherwise, you will not be entitled to the current $5,000 deduction in 2016. The actual event that triggers an opening will vary according to the type of business you are operating and your particular circumstances.

Generally, start-up costs are expenses that would be deductible as business expenses. This includes investigatory expenses such as the following items:

- an analysis or survey of potential markets, products, labor supply, transportation facilities, etc.
- advertisements for the opening of the business
- salaries and wages for employees who are being trained and their instructors
- travel and other necessary costs for securing prospective distributors, suppliers, or customers or clients
- salaries and fees for executives and consultants or for similar professional services

Tip: Previously, you had to make a proactive election to currently deduct start-up costs. But this tax treatment is now automatic. Ensure that your 2016 tax return is filed in a timely fashion to capitalize on this tax break.

Credit for Small Employer Pension Plan Startup Costs

You may be able to claim a tax credit for part of the costs of starting a SEP, SIMPLE, or qualified plan. The credit equals 50% of the cost to set up and administer the plan, and educate employees about the plan, up to a maximum of $500 per year for each of the first 3 years of the plan.

Small Employer Health Insurance Credit

Under the Affordable Care Act (ACA), the controversial health care legislation enacted in 2010, a qualified small business may be eligible for a credit if it pays for health insurance coverage for its employees. For 2016, the business must have 25 or fewer full-time employees or full-time equivalents (FTEs) with average annual wages of less than $51,800. The credit is eliminated if either of these two limits is exceeded.

Note: To qualify for a credit in 2016, an employer must obtain health insurance through the Small Business Health Options Program (SHOP). The SHOP Marketplaces are similar to the individual health insurance exchanges established by states. The small employer health insurance credit may only be claimed for two consecutive years beginning after 2013.

YEAR-END MOVE: Be careful to observe the limits for claiming the credit. However, be aware that sole proprietors, partners in a partnership, 2%-or-more owners of S corporations and 5%-or-more business owners, as well as their family members, do not count as full-time employees for this purpose. This rule may give your business some added flexibility.

Currently, the credit is equal to 50% of the nonelective contributions made on behalf of employees. Prior to 2014, it was limited to 35% of those contributions.

Business Bad Debts

Even in the best of times, your business may have difficulty collecting payments for certain goods or services it has provided. At the very least, however, the business should be able to salvage some tax relief on its 2016 tax return.

YEAR-END MOVE: Step up collection efforts at the end of the year. For instance, you may issue a series of dunning letters to debtors asking for payment or hire a collection agency. If you are still unable to collect the unpaid amounts after making a concerted effort, you can generally write them off as business bad debts.

Generally, business bad debts are deducted from taxable income in the year they become worthless. To qualify as a business bad debt, a loan or advance must have been created or acquired in connection with your business operation and result in a loss to the business entity if it cannot be repaid.

Tip: Keep detailed records of all your collection activities—including letters, telephone calls, e-mails and collection agency work. This documentation can help support your position claiming worthlessness of the debt if the IRS ever challenges the bad-debt deduction claimed on your 2016 return.

Miscellaneous

- Purchase routine business supplies before the end of the year. As a general rule, your company can deduct the costs in 2016, even if the supplies are not used until 2017.

- Losses claimed by S corporation shareholders are limited to the basis in the stock plus the corporation's outstanding debt to the shareholder. Thus, you might decide to make a capital contribution or loan money to the corporation before year-end to increase your basis for loss-deduction purposes.

- A company may deduct 100% of business travel costs and 50% of entertainment and meal expenses. To increase your current deduction, accelerate trips planned for 2017 into 2016. Note that a company can deduct 100% of the cost of a holiday party as long as the entire workforce is invited.

- If you buy a heavy-duty vehicle such as an SUV, van, or truck, for business purposes you may be able to claim accelerated depreciation and avoid the usual "luxury car" limits.

- As a general rule, repairs are currently deductible, while capital improvements must be depreciated over time. Based on guidelines established by recent regulations, plan accordingly. For instance, take care of minor repairs before next year to increase your deduction for 2016.

- An accrual-basis company operating on a calendar tax year may deduct bonuses in 2016 if it pays them within two and a half months of the close of the tax year (but not bonuses for certain business owners). Conversely, employees are not taxed on the bonuses until 2017, when they are received.

- Comply with the employer mandate for health insurance under the ACA. The shared responsibility requirement was extended in 2016 to businesses with between 50 and 99 full-time employees or FTEs. Also, be aware that penalties for failures have increased.

Capital Gains and Losses

The tax law requires investors to use net capital gains and losses from securities sales to offset each other. If you have an excess loss for the year, it may offset up to $3,000 of ordinary income before being carried over to the next year. A net long-term capital gain is taxed at a maximum rate of 15% or 20% if you are in the top ordinary income tax bracket of 39.6%. Short-term capital gains are taxed at ordinary income rates.

YEAR-END MOVE: Examine your investment portfolio. Depending on the results, you might "harvest" capital losses to offset gains realized earlier in the year or harvest capital gains that will be partially or wholly absorbed by prior losses.

Be aware of even greater preferential tax treatment for long-term capital gains. Notably, a 0% rate applies to taxpayers in the lowest two regular income tax brackets of 10% and 15%, such as young children or retired individuals. And, even if capital gains push you into a higher tax bracket, you still benefit from the 0% rate on the portion of the gains up to the top of the income threshold for the 15% tax bracket.

Tip: Under the "kiddie tax," unearned income above $2,100 realized by a child under age 19, or a dependent full-time student under age 24, is generally taxed at the parents' top tax rate. Keep an eye on this threshold.

Net Investment Income Tax

An additional 3.8% tax applies to the lesser of your net investment income (NII) or the amount by which your modified adjusted gross income (MAGI) exceeds $200,000 for single filers and $250,000 for joint filers. (These amounts are not indexed for inflation.) The definition of NII includes interest, dividends, capital gains and income from passive activities, but not Social Security benefits, tax-exempt interest, and distributions from qualified retirement plans and IRAs.

YEAR-END MOVE: Reduce your exposure to the NII tax in 2016. For instance, depending on your situation, you might use one or more of the following techniques:

- Add municipal bonds ("munis") to your portfolio. Interest income from munis does not count as NII, nor is it included in the calculation of MAGI.
- Establish a charitable remainder trust (CRT). With a CRT, you qualify for a current tax deduction while the income is sheltered from the NII tax.
- Become active in a passive activity. For example, if you own a business and meet the tax law requirements for material participation, the business income may be exempted from the NII tax.
- Consider an investment in a tax-deferred annuity that "leapfrogs" your highest-earning years when the NII tax is likely to apply.

Tip: Of course, these decisions should not be made in a vacuum. Coordinate tax-saving strategies with other aspects of your financial and investment plans.

Required Minimum Distributions

As a general rule, you must receive required minimum distributions (RMDs) from qualified retirement plans and IRAs after attaining age 70½. The amount of the distribution is based on IRS-approved life expectancy tables and your account balance at the end of last year.

YEAR-END MOVE: Make sure you receive the necessary RMDs before the end of 2016. Otherwise, you must pay a stiff tax penalty equal to 50% of the required amount (less any amount you have received), in addition to the regular tax liability.

However, be aware of this special exception: If you are still working and not a 5%-or-more owner of a business you are employed by, you can postpone RMDs from the employer's qualified plan until you actually retire. This rule does not apply to RMDs from IRAs or plans of other employers.

Tip: RMDs are not treated as NII for purposes of the 3.8% tax. Nevertheless, an RMD may still increase your MAGI used in this tax calculation.

IRA Contributions and Roth IRA Conversions

Although contributions to traditional IRAs may be tax deductible, deductions are phased out for active participants in employer-sponsored retirement plans. Future distributions are taxed at ordinary income rates reaching up to 39.6%.

Further, contributions to Traditional IRAs and Health Savings Accounts (HSAs), can be made up until April 15th to obtain an above-the-line tax deduction.

Conversely, Roth IRA contributions are never tax deductible, but qualified distributions from a Roth IRA in existence at least five years are 100% tax-free. Taxation of other distributions is based on special "ordering rules." Contributions to Roth IRAs through April 15th may be applied to the previous tax year.

YEAR-END MOVE: This may be the year it finally makes sense for you to convert some or all of the funds in your traditional IRAs into a Roth. The transfer is currently taxable, but can provide future tax-free benefits. A conversion is especially advantageous if you expect to be in a higher tax bracket in your retirement years than you are now.

Nevertheless, a Roth IRA conversion increases your MAGI for purposes of the NII tax. To reduce your overall tax liability, you might arrange a series of Roth IRA conversions over several years instead of converting all the funds this year. Manage your tax brackets accordingly.

Tip: The conversion tax is based on the value of the assets on the date they are transferred to the Roth IRA. If the value declines substantially after conversion, you still have until the tax return due date for 2016, plus extensions, to recharacterize a Roth back into a traditional IRA.

Estate and Gift Taxes

Estate-tax planning has gone down a long and winding path. Legislation enacted in 2001 gradually increased the estate-tax exemption, while severing it from the lifetime gift exemption, and reduced the top estate-tax rate. Then the estate tax was repealed entirely, but only for 2010, after which it was reinstated. Currently, as shown by the following table, the tax law provides a reunified estate- and gift-tax exemption of $5 million (indexed to $5.45 million in 2016) and a top 40% estate-tax rate.

Tax Year	Maximum estate-tax exemption	Top estate-tax rate
2002	$1 million	50%
2003	$1 million	49%
2004	$1.5 million	48%
2005	$1.5 million	47%
2006	$2 million	46%
2007–2008	$2 million	45%
2009	$3.5 million	45%
2010	Not applicable	Repealed
2011	$5 million	35%
2012	$5.12 million	35%
2013	$5.25 million	40%
2014	$5.34 million	40%
2015	$5.43 million	40%
2016	$5.45 million	40%

YEAR-END MOVE: Update your estate plan to reflect existing law. For instance, wills and trusts may be revised to accommodate the rule allowing portability of the estate-tax exemption.

Under the "portability" provision for a married couple, the unused portion of the estate-tax exemption of the first spouse to die may be carried over to the estate of the surviving spouse. This tax break is now a permanent part of the tax code.

Tip: The annual gift-tax exclusion allows you to give up to $14,000 to a recipient in 2016 ($28,000 for joint gifts by a married couple) without any gift tax, thereby reducing your taxable estate.

Miscellaneous

- Sell real estate on the installment basis. For payments over two years or more, you can defer tax until payment is received. Also, this method may effectively reduce the overall tax liability.
- Under the "wash sale rule," you cannot deduct a loss on securities sales if you acquire substantially identical securities within 30 days. The simplest way to avoid this result is to wait at least 31 days before you repurchase the same or similar securities.

- Contribute up to $18,000 to a 401(k) in 2015 ($24,000 if age 50 or older). If you clear the 2016 Social Security wage base of $118,500 and promptly allocate the payroll tax savings to the 401(k), you can increase your deferral with no further reduction in your take-home pay.
- Invest in passive income generators (PIGs). Generally, you can only use losses from passive activities (e.g., most real estate investments) to offset income from passive activities, with limited exceptions. With a PIG, you can absorb more of your passive activity losses.
- The PATH Act permanently preserves the tax exclusion for distributions from an IRA to a qualified charity by taxpayers age 70½ or older. The limit is $100,000 per taxpayer.
- New temporary regulations could have a major impact on valuations of transfers of business interests for estate- and gift-tax purposes. Arrange a consultation as soon as possible if this might affect you.

CONCLUSION

This year-end tax-planning letter is based on the prevailing federal tax laws, rules and regulations. Of course, it is subject to change, especially if major tax-reform provisions are enacted before the end of the year.

Finally, remember that this letter is intended to serve only as a general guideline. Your personal circumstances will likely require a careful examination. We will be glad to schedule a meeting with you to provide assistance with all your tax-planning needs.

Very truly yours,

LCS&Z, LLP

This year-end tax-planning letter is published for our clients, friends and professional associates. It is designed to provide accurate and authoritative information with respect to the subject matter covered. IRS Circular 230 requires us to inform you that the information contained in this letter is not intended or written to be used for the purpose of avoiding any penalties that may be imposed under federal tax law and cannot be used by you or any other taxpayer for the purpose of avoiding such penalties. Before any action is taken based on this information, it is essential that competent, individual, professional advice be obtained.