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Year-End Tax Planning Strategies

Waiting until just before April 15 to start thinking about your taxes may prove to be a costly mistake. Preparing a draft of your tax return before the end of the year will provide you with a more complete picture of what you are likely to owe, and it may leave you with enough time to reduce your tax liability by contributing to tax-advantaged savings accounts or qualifying for deductions. Advance tax planning is especially important if your circumstances have changed over the past year due to events such as marriage, divorce, the birth of a child, or the death of a family member.

Deferring income into the next tax year and accelerating deductions into the current year can reduce your adjusted gross income (AGI). Lowering your AGI could make you eligible for certain tax breaks that phase out at higher income levels, such as personal exemptions and education credits. Here are some strategies that may help you trim your tax bill:

Defer income. Discuss with your employer the possibility of deferring some of your income by postponing payment of all or part of your annual bonus or salary until January.

Buy on credit. Accelerate deductions by making tax-deductible purchases before the end of the year using a credit card. This will allow you to take the deduction in the current year, but pay for the purchases later.

Prepay state and local taxes. If you pay state and local taxes before the end of the calendar year, you may deduct these payments on your Federal tax return.

Donate to charity. By donating appreciated assets held for more than a year to charity, you avoid paying taxes on the gains, and you can still deduct the full value of the assets.

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Understanding Interest Rates and Your Financial Situation

When discussing bank accounts, investments, loans, and mortgages, it is important to understand the concept of interest rates. Interest is the price you pay for the temporary use of someone else's funds; an interest rate is the percentage of a borrowed amount that is attributable to interest. Whether you are a lender, a borrower, or both, carefully consider how interest rates may affect your financial decisions.

The Purpose of Interest

Although borrowing money can help you accomplish a variety of financial goals, the cost of borrowing is interest. When you take out a loan, you receive a lump sum of money up front and are obligated to pay it back over time, generally with interest. Due to the interest charges, you end up owing more than you actually borrowed. The trade-off, however, is that you receive the funds you need to achieve your goal, such as buying a house, obtaining a college education, or starting a business. Given the extra cost of interest, which can add up significantly over time, be sure that any debt you assume is affordable and worth the expense over the long term.

To a lender, interest represents compensation for the service and risk of lending money.

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Year-End Tax Planning Strategies

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Charitable contributions of cash, personal property, or miles driven are also tax deductible, provided the charity receives the gifts by the end of the year.

Qualify for a medical expenses deduction. After adding up your medical expenses, you may discover that they are close to the AGI threshold that would allow you to claim a deduction. To qualify, look for ways to accelerate your health care purchases, such as buying an advance supply of prescription drugs, investing in medical equipment, or scheduling an elective surgery before the end of the year.

Offset gains with losses. If you have been thinking about selling assets that have declined in value, now may be the time to act. Sale of capital losses can be used to offset realized capital gains. In addition, up to $3,000 in losses can be offset against ordinary income. If losses exceed this amount, they can be carried forward to future tax years. Keep in mind, however, that short-term capital gains taxes apply to the sale of assets held for less than a year, which could make selling these investments less attractive.

Transfer capital gains and income to children. If you are a higher income taxpayer and wish to sell assets held for more than a year, it may make sense to gift these assets for subsequent sale to a child or another family member in a lower tax bracket. When gifting to children under the age of 19 (or 24 for full-time students), be aware that these gifts may be subject to the kiddie tax. You can also reduce your gift and estate tax liabilities by making tax-exempt gifts of up to $14,000 per beneficiary.

Save for retirement. Contribute the maximum dollar amount, or at least enough to receive the full employer match, to your 401(k) account. If your employer has added the Roth feature to your company 401(k) plan, consider whether moving to this after-tax option would save you money in the long run.

Review your flexible spending account (FSA). If you have an FSA through your employer, check to see if all the funds have been spent. If there is cash left over in the account, consider using the money for qualified purchases, such as prescription drugs, eyeglasses, or contact lenses. If you do not currently have an FSA, consider whether you would benefit from joining your employer's flexible spending plan for the coming year. The money in this account may be withdrawn tax free for qualified medical and childcare expenses, but all funds must be used before a certain date or the money will be forfeited.

Prepay your mortgage bill. If you make your January 2017 mortgage payment by December 31, 2016, you are permitted to deduct the interest charge on your 2016 tax return.

Before acting on these tax-savings strategies, it is important to consider your potential alternative minimum tax (AMT) liability. It may not be possible to avoid the AMT, a parallel tax system which has its own set of rates and does not allow most exemptions and deductions. Knowing, however, whether you are likely to owe taxes under the AMT can help you plan your deductions to prevent increasing the amount you owe in taxes. It is especially important to plan carefully when exercising incentive stock options, as doing so can trigger the AMT.

Decisions about whether to delay income and accelerate expenses will, of course, depend on your particular situation. If, for example, your tax bracket is likely to be higher in the coming year due to a change in circumstances, it may not be worthwhile to delay income. For specific guidance on year-end tax planning, contact one of our qualified tax professionals. $

How Much Do You Really Know About Estate Planning?

Take this true/false quiz and find out.

( ) 1. A **will** provides for the distribution of your assets as intended.

( ) 2. One disadvantage of **probate** is that your private assets become a matter of public record.

( ) 3. If you use the **marital deduction,** unlimited assets may pass to your spouse tax free.

( ) 4. The **applicable exclusion amount** effectively exempts an estate of $3,000,000 from Federal tax.

( ) 5. **Qualified retirement plan** benefits and 50% of all property owned in **joint tenancy** with your spouse with right of survivorship are included in your gross estate.

( ) 6. Federal estate tax must be paid 12 months after the estate tax return is filed.

( ) 7. The highest Federal estate tax rate is 40%.

( ) 8. A **qualified terminable interest property trust (QTIP trust)** can help provide a surviving spouse with lifetime income.

( ) 9. An **irrevocable life insurance trust (ILIT)** can provide liquidity to help pay Federal and state estate taxes.

( ) 10. The **annual gift tax exclusion** limit cannot be exceeded for educational and medical needs.

( ) 11. With charitable giving, you can receive an immediate income tax deduction for the value of a **remainder interest** gifted to a charity.

( ) 12. A properly designed trust will eliminate the need for a **will**.

( ) 13. In valuing a business, the future earning capacity of the company can be accurately determined using valuation formulas.

( ) 14. Owners of small corporations may prefer a **cross-purchase buy-sell agreement** because they receive an increase in basis with a cross-purchase plan.

( ) 15. Changes in tax laws and changes in a person's family situation are valid reasons for updating an estate plan.

Answers:

While this quiz is designed to test your general knowledge about estate planning, its larger purpose is to stimulate your thinking about the issues that may need your attention. Let's see how you did.

1. **True.** However, contract assets, such as qualified retirement plans and life insurance policies, will pass according to the terms of the contract.

2. **True.** Probate is always a public proceeding.

3. **True.** In using the marital deduction, you can pass unlimited assets to your spouse without paying estate taxes at your death.

4. **False.** The applicable exclusion amount is $5,450,000 for each individual in 2016. Through the "portability" of the Federal estate tax exemption, if one spouse dies without making full use of his or her exemption from Federal estate and gift taxes, the surviving spouse has the right to utilize whatever exemption amount the deceased spouse did not use.

5. **True.** All property, of which an individual is considered the owner, is included in the gross estate.

6. **False.** The Federal estate tax return, if required, must be filed—and the tax paid—within nine months of death. The Internal Revenue Service (IRS) may extend the time for payment due to "reasonable cause."

7. **True.** The top rate can be as high as 40% in 2016.

8. **True.** A QTIP trust can provide lifetime income for a surviving spouse, with the creator of the trust determining the ultimate disposition of the trust assets.

9. **True.** The proceeds of an irrevocable life insurance trust are not included in the decedent's gross estate, and such a trust is typically used to help provide liquidity for estate taxes.

10. **False.** Gifts in excess of the annual gift tax exclusion can be made without gift tax implications provided the donor pays the expense *directly* to the service provider (e.g., a college or a hospital).

11. **True.** In gifting a remainder interest, the future value of the gift is discounted to a present value. A deduction is allowed for the present value of the future (remainder) gift on the current year's income tax return.

12. **False.** A trust is not a substitute for a will; some matters, such as appointing guardians for minor children, can only be done through a will.

13. **False.** One valuation method is based on an estimate of future earnings, but estimating the future earning capacity of a company involves a good deal of speculation.

14. **True.** One of the advantages of a cross-purchase buy-sell agreement is that the remaining shareholders receive a "step-up" (increase) in basis.

15. **True.** Changes in tax laws and changes in a person's family situation are typically the primary reasons for updating an estate plan. $

Understanding Interest Rates and Your Financial Situation

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In addition to giving up the opportunity to spend the money right away, a lender assumes certain risks. One obvious risk is that the borrower will not pay back the loan in a timely manner, if ever. Inflation creates another risk. Typically, prices tend to rise over time; therefore, goods and services will likely cost more by the time a lender is paid back. In effect, the future spending power of the money borrowed is reduced by inflation because more dollars are needed to purchase the same amount of goods and services. Interest paid on a loan helps to cushion the effects of inflation for the lender.

Supply and Demand

Interest rates often fluctuate, according to the supply and demand of credit, which is the money available to be loaned and borrowed. In general, one person's financial habits, such as carrying a loan or saving money in fixed-interest accounts, will not affect the amount of credit available to borrowers enough to change interest rates. However, an overall trend in consumer banking, investing, and debt can have an effect on interest rates. Businesses, governments, and foreign entities also impact the supply and demand of credit according to their lending and borrowing patterns. An increase in the supply of credit, often associated with a decrease in demand for credit, tends to lower interest rates. Conversely, a decrease in supply of credit, often coupled with an increase in demand for it, tends to raise interest rates.

The Role of the Fed

As a part of the U.S. government's monetary policy, the Federal Reserve Board (the Fed) manipulates interest rates in an effort to control money and credit conditions in the economy. Consequently, lenders and borrowers can look to the Fed for an indication of how interest rates may change in the future.

In order to influence the economy, the Fed buys or sells previously issued government securities, which affects the Federal funds rate. This is the interest rate that institutions charge each other for very short-term loans, as well as the interest rate banks use for commercial lending. For example, when the Fed sells securities, money from banks is used for these transactions; this lowers the amount available for lending, which raises interest rates. By contrast, when the Fed buys government securities, banks are left with more money than is needed for lending; this increase in the supply of credit, in turn, lowers interest rates.

Lower interest rates tend to make it easier for individuals to borrow. Since less money is spent on interest, more funds may be available to spend on other goods and services. Higher interest rates are often an incentive for individuals to save and invest, in order to take advantage of the greater amount of interest to be earned. As a lender or borrower, it is important to understand how changing interest rates may affect your saving or borrowing habits. This knowledge can help with your decision-making as you pursue your financial objectives. $

Retirement Plan Rollover Options for Non-Spouse Beneficiaries

If you participate in an employer-sponsored qualified retirement plan, such as a defined benefit plan, 401(k) plan, employee stock ownership plan (ESOP), 403(b) plan, or 457(b) plan, you may have chosen a beneficiary to receive your account balance in the event of your death. If you are married, the law requires that your spouse be named the primary beneficiary of your account, unless he or she waives that right in writing. However, if you are unmarried, or your spouse has waived his or her right, you may wish to name a parent, sibling, child, domestic partner, other relative, friend, or trust as the beneficiary. As of 2010, non-spouse beneficiaries of inherited retirement plan accounts are permitted to roll over these assets into Individual Retirement Accounts (IRAs) on a tax-free basis.

The provision allowing rollovers by non-spouse beneficiaries was included in the Pension Protection Act of 2006 (PPA '06) and initially went into effect on January 1, 2007. Prior to this time, only the spouse of the deceased account owner was permitted to defer taxation on the account by rolling over the funds to an inherited IRA, while any non-spouse beneficiary was required to take a lump sum distribution from the account. Non-spouse beneficiaries were thereby obligated to pay taxes on the full amount received and to declare the income on their personal tax return, potentially creating a challenging tax situation. Starting in 2007, non-spouse beneficiaries were allowed to make the same tax-free rollovers as spouses.

However, under the PPA, tax-qualified employer-sponsored retirement plans were not required to offer direct rollovers to non-spouse beneficiaries. Consequently, many non-spouse beneficiaries did not have access to these tax-free rollovers, unless the plan sponsors had voluntarily chosen to provide the option.

Congress closed this gap in the Worker, Retiree and Employer Recovery Act of 2008 (WRERA), through a provision mandating employer-sponsored retirement plans to offer the rollover option to non-spouse beneficiaries in plan years beginning after December 31, 2009. The WRERA provision also stipulates that beneficiaries who do not opt for a direct rollover, and instead choose to take distributions in the form of a cash lump sum, will be subject to mandatory 20% income tax withholding rules. As a result of IRS Notice 2008-30, non-spouse beneficiaries may also choose to roll over retirement account funds into an inherited Roth IRA subject to taxation.

Under the rules, non-spouse beneficiaries are permitted to directly roll over funds inherited from employer-sponsored retirement plans into inherited IRAs. According to the IRS, retirement plan distributions to a non-spouse beneficiary are subject to many of the same rules that apply to other eligible rollover distributions. Retirement plan sponsors must offer a non-spouse beneficiary the option of making a direct rollover, or a trustee-to-trustee transfer, of eligible rollover distributions to an inherited IRA. This means the transfer is made from the retirement plan to the IRA, and not to the beneficiary.

Other restrictions apply. The rollover must be made to a new IRA, not one already owned by the non-spouse beneficiary, and the new IRA must bear the name of the deceased, not the beneficiary. The rollover must be completed by December 31 of the year following the account holder's death. In addition, beneficiaries are not permitted to make additional contributions to the inherited IRA. The beneficiary must have the same basis in the inherited IRA as the deceased account owner, and the beneficiary may not combine the basis in the inherited IRA with the basis in his or her own IRAs.

After the rollover has occurred, the beneficiary must begin receiving distributions under the beneficiary distribution rules. The beneficiary will not owe taxes on the inherited IRA assets until he or she starts to receive distributions.

These rule changes, which provide important options to non-spouse beneficiaries of employer-sponsored qualified retirement plan accounts, apply to all retirement plans as of 2010. For more information about your employer-sponsored retirement plan, consult the benefit plan administrator at your company. $

Take Time for a Credit Checkup

The Fair Credit Reporting Act of 1970 has stood the test of time, and the Consumer Credit Reporting Reform Act has provided additional protection to the American consumer. If you take the time to understand the credit reporting system and monitor the "health" of your own credit profile, it will be time well spent.

Credit bureaus collect objective financial data for use by bankers, retailers, credit card issuers, and landlords. In a typical file, data is provided by creditors and gathered from public records. It includes tax liens, bankruptcy information, outstanding loans, and details of credit card history, including the credit limit on each card, purchases, balances, and payment record.

Most people are not aware of the financial paperwork and personal information accumulating in the files of consumer reporting agencies. The Fair Credit Reporting Act of 1970 provides some control over the harm third-party reports can do. Specifically, consumers have the right to request and to be told what is in their files, and inaccurate information must then be corrected or deleted.

Many consumers strive to live within their means and take great pride in paying their bills on time. When they apply for credit, such as a mortgage, however, they may discover some shocking news: Their credit report contains errors that prohibit them from obtaining the credit they need. Typical errors that can appear in a credit report include the following:

- Mistakes involving your name and a similar name
- Inclusion of someone else's credit problems in your file
- Incorrect balances on current credit accounts
- Closed accounts listed as current
- Accounts of ex-spouses still listed with yours
- An inaccurate Social Security number

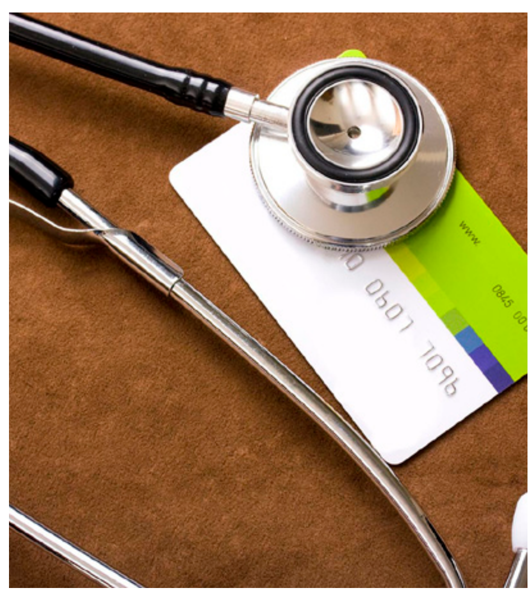
Those who question the reliability of such evidence are allowed by Federal law to obtain one free credit report per year from each of the three major credit reporting companies: TransUnion, Equifax, and Experian. Further, the major credit reporting bureaus offer programs that provide the most active credit-seeking consumers with ongoing access to their files for a small fee.

For your convenience, the three consumer reporting companies have set up a central website and a toll-free telephone number through which you can order your free annual report from each company. To order, visit annualcreditreport.com or call 1-877-322-8228.

If you discover that your credit report jeopardized credit or loan approval, you have the right to know the "nature and substance" of the information at no cost. The denying creditor must disclose which company prepared the report, including its address. Should there be incorrect information, the agency must re-investigate and then confirm, correct, or delete the information accordingly. If the re-investigation proves the information is accurate, brief explanations of extenuating circumstances can be added. Lists of those who have received files within the past six months or the past two years, if for employment purposes, are also available to the consumer.

Should corrections be necessary, all of the requesting parties can be sent an updated version by the reporting agency. It is important to note that if you find a discrepancy in your report with one bureau, making the correction with that *one* doesn't correct them *all*, since each agency has its own independent database.

Protecting your credit history is a necessity since a good record can help you secure the money you need to meet your financial goals. With identity theft on the rise, it is more important than ever to remain vigilant about your personal credit report. Taking the time for periodic checkups can go a long way toward helping to protect your good name. $



Charitable Giving: Good for the Heart *and* Your 1040!

It may be better to give than to receive, but it may be even better to give and see your generosity rewarded. Charitable giving can play a valuable role in your financial and tax strategies. A well-planned gift to charity could provide an income tax deduction and a reduction of estate taxes. Your donation could also help you maintain financial security, exercise control over assets both during your lifetime and after death, as well as provide for your heirs in the manner you choose.

To accomplish all of these objectives, you need to develop a plan tailored to your individual circumstances. The following strategies can be used to create a giving plan that is both beneficial and appropriate for you.

When planned properly, **gifts of appreciated property** to charity may allow you to avoid the capital gains tax you would have owed when the asset was sold and may also allow you to receive an income tax deduction, usually worth the **fair market value (FMV)** of the property. Also, by removing that asset from your estate, you may reduce your potential estate tax burden.

If you wish to make a gift of property to a charity but also retain some control over it, a **charitable remainder trust (CRT)** may be an appropriate vehicle. A CRT is most effective when funded by an appreciating asset, such as real estate or stock in a family-owned business. After the property is transferred to the trust, the trust continues to provide income to the beneficiaries for a period of time, after which the remainder of the trust is donated to the charity. You avoid capital gains taxes on the assets you donated, and you receive a tax deduction on any interest earned by the remainder. Also, by removing the remaining value of the asset from your estate, you may reduce your potential estate tax liability. In short, you obtain the tax benefits of giving while postponing receipt of the gift by the charity.

If you wish to give to a charity without giving an asset away permanently, consider a **charitable lead trust (CLT)**. Through a CLT, you essentially give the charity the use of an asset and the right to any income generated for a predetermined time. After the specified time has lapsed, the asset can revert to you or be given to whomever you choose. Appropriate assets might be income-producing stocks and bonds, your rare book collection, or a painting that you transfer to a museum for a certain length of time. You may receive a current income tax deduction for the value given to charity; however, the trust pays income tax on its income. If a CLT is created upon your death, estate tax liability may be reduced.

Early tax planning can help you make the most of your charitable giving opportunities and allow you to take advantage of additional benefits. Be sure to consult your team of qualified tax, legal, and financial professionals for specific guidance. $

Dividing Your Estate: A Practical Approach

When planning the division of your assets, you may believe in a policy of "share and share alike." This is perhaps the easiest method to avoid conflicts or complaints of favoritism. But does *equality* necessarily equate with *fairness*? Especially when you consider such factors as age, talents, skills, interests, needs, and degrees of material success.

An alternate approach to estate equalization is a division of assets that recognizes and supports the uniqueness and differences in the abilities and needs of your children, even at the risk of creating conflict. Through your estate plan, you have a chance to provide a degree of thoughtful and calculated support that your children may not otherwise experience.

Let's look at the following scenarios:

1. Disparity in Age: Assume you have two children, ages 22 and 14. Should you split your estate in half, even though your 22-year-old son has a private school education and college degree, while your 14-year-old son has just started high school?

2. Income and Net Worth: Your daughter becomes a partner in an investment banking firm and quickly builds up significant assets, while your son becomes an artist who is dependent on the sale of his artwork to make a living. Should you leave your estate in equal parts to your son and daughter?

3. Previous Giving: You have given your 24-year-old daughter $100,000 worth of stock in your business as an inducement for her to work with you. You have not, however, given your 18-year-old daughter a similar gift. Should you still divide the assets in your estate equally?

4. Investments Given to Children: You have given one child stock in Company ABC that has risen in value to $300,000, and another child stock in Company XYZ, which has gone bankrupt. How should you then allocate the balance of your assets?

In all of the above examples, an equal division of property has the potential to create or perpetuate unequal results. Of course, you may choose to divide your assets equally; however, it's important to be aware of all your options in estate planning.

Listen First

There are ways for you to achieve more equitable results. First, communicate with your children. You may choose to speak with each child individually or hold a family meeting. (You may serve as proxy for your young children.) Help them to express their hopes, dreams, and expectations, as well as their concerns and frustrations. By listening, you may gain the valuable insight needed to divide your estate without causing undue conflict or resentment. The decisions may be difficult, but in the long run, your estate plan may provide a certain degree of thoughtful support for your children. $