From Ramping Up 401(k) Contributions to Charitable Gifts, Take Action Now

Year-End Tax Planning: Start ASAP and Save

by Alexandra Armstrong, CFP

Most people don't think too much about preparing their tax return until March or even later. By that time it's too late to take action to reduce your taxes for this calendar year. Therefore, we recommend you look at your tax situation now before you get too caught up in the holidays. Below we discuss some ways you can reduce your 2016 tax bill.

FEDERAL INCOME TAX SCHEDULE FOR 2016

	If Taxable Income: Is more than	If Taxable Income: But not more than	The tax is	Of the amount over
Married Filing Jointly	$ 0	$ 18,550	$ 0.00 +10%	$ 0
And Some Widow(er)s	18,550	75,300	1,855.00+15	18,550
	75,300	151,900	10,367.50+25	75,300
	151,900	231,450	29,517.50+28	151,900
	231,450	413,350	51,791.50+33	231,450
	413,350	466,950	111,818.50+35	413,350
	466,950	—	130,578.50+39.6	466,950
Single	$ 0	$ 9,275	$ 0.00+10%	$ 0
	9,275	37,650	927.50+15	9,275
	37,650	91,150	5,183.75+25	37,650
	91,150	190,150	18,558.75+28	91,150
	90,150	413,350	46,278.75+33	190,150
	413,350	415,050	119,934.75+35	413,350
	415,050	—	120,529.75+39.6	415,050

Understanding Marginal Tax Rates

Let's start with what your tax rate might be. At right you can see the tax schedule for 2016. For example, as you can see from this table, if you're married and you estimate your taxable income after all deductions as a married person is $75,300, your federal income tax will be $10,367.50 ($1,855 + 15 percent of $56,780 = $8,512.50). But if your income goes over $75,300 but is less than $151,900, any of this additional income will be taxed at 25 percent. So your goal would be to figure out how to keep it in the 15 percent bracket.

Long- and Short-Term Tax Rates

Long-term capital gains on securities (those held for more than one year) are currently taxed at a lower rate of between 0 percent and 20 percent. Taxpayers in the lowest two federal tax brackets (10 percent and 15 percent) will not be taxed on their long-term gains. All filers in the 25, 28, 33 or 35 percent tax brackets will pay 15 percent on long-term capital gains.

Those in the 33 percent bracket will probably be subject to an additional 3.8 percent net investment income tax, while those in the 35 percent bracket will definitely be subject to this additional tax. Individuals in the 39.6 percent tax bracket for ordinary income will pay 20 percent on long-term capital gains plus the 3.8 percent net investment income tax.

Gains from the sale of short-term holdings (those owned for one year or less) will be taxed as ordinary income — at a federal rate as high as 39.6 percent depending on your other sources of income.

Start by figuring out your year-to-date gains and losses, grouping the short-term and long-term transactions separately. If you don't have this information, ask your financial adviser to provide you with a gain/loss statement for this year to date. When you look at your capital gains/losses, remember to include carry-forward capital losses from last year's federal tax return. If your overall capital losses exceed your capital gains, you can deduct only up to $3,000 of that excess loss each year, but unused capital losses can be carried forward indefinitely to be used in future years.

Taking Tax Losses

There are two ways to take losses. You can sell the stock for a loss and if you still like it, you could repurchase it in 31 days (the Internal Revenue Service requires you to wait 30 days to do so to avoid erasing the tax loss, the so-called "wash rule").

If you're concerned about the stock moving up during the 30-day waiting period, alternatively you could double up on your position, wait 30 days and then sell the top-costing shares assuming they're still at a loss.

Obviously, you need to make the purchase before the end of November to take the loss. Trades done on the last business day of the year count for 2016, even if they don't settle until 2017.

Accelerating Deductions

You can accelerate itemized deductions, such as paying your January mortgage payment in December or donating either cash or goods to charity prior to year-end.

Make Charitable Donations Count

Whether you contribute cash, stock or other assets, it's important to adhere to the year-end deadlines for 2016 charitable contributions. In the case of noncash contributions, it's important to know how to determine the value of your donation.

If you donate cash to a charitable organization, you can deduct your donation in 2016 as long as you mail your check by Dec. 31. This is true even if the organization doesn't cash your check until 2017.

If you charge your donation to your credit card, your donation is treated as occurring on the date the charge occurs. This allows you to take a deduction this year and pay for it next year.

If you donate stock or other securities by mailing certificates, the date of mailing is the date of the donation. If you have the shares donated electronically, the date your brokerage statement shows it leaving the account is the date of the gift. Whether you mail the certificates or transfer them electronically, the value of your donation equals the average of the highest and lowest selling prices for that date.

When donating securities at year-end, we suggest you allow a couple of weeks for the process to be completed. Be aware that many securities firms won't guarantee that a security will be transferred by year-end unless they receive your instructions in early December.

If you donate stocks or other assets that have appreciated in value, note that you must hold them for more than one year to be able to deduct the full market value.

If you donate a stock you've held for one year or less, your deduction is limited to the cost of that asset.

Donations of clothing, household items and other goods can be deducted based on the fair market value of the goods. This is usually much lower than the price you paid for the items. You'll need to keep good records to show how you arrived at the value you use. Many charities such as the Salvation Army will give you suggested ranges for valuations of donations.

> **"It's important to adhere to the year-end deadlines for charitable contributions."**

We recommend you make an itemized list and take pictures of your donated items in case your tax return is audited.

If your charitable contributions are less than 20 percent of your adjusted gross income, you don't need to be concerned with the limits on charitable deductions.

For contributions composing a larger percent of AGI, your tax deduction may be limited. For cash contributions, your deduction is normally limited to 50 percent of your AGI. Your deduction could be limited to 30 percent in some cases depending on the charity or if a nonfinancial asset is used by the charity. Excess charitable deductions can be carried forward for up to five years.

Contribute the Maximum You Can to a Qualified Retirement Plan

In 2016, you can contribute the lower of $18,000 or whatever you earned to your 401(k) or 403(b) plan. If you're age 50 or older, you can add another $6,000 to that number. Contributing the maximum has two benefits: It lowers your taxable income and the money in the 401(k) compounds tax-deferred.

These contributions, however, must be made in the form of payroll deductions before year-end. If you request your contributions be increased now, you may still have time to obtain this tax advantage this year.

If your AGI is below $98,000 as a married person filing jointly or $61,000 as a single/head of household, you can make a tax-deductible contribution of $5,500 (or $6,500 if you are age 50 or older) to an Individual Retirement Account account. Contributions to an IRA for 2016 can be made anytime before the normal filing deadline of April 17, 2017, or when you file your 2016 tax return on extension, whichever date comes first.

Consulting Your Tax Adviser

This time of year is an excellent time for you to check in with your accountant about your situation. He or she can advise you as to whether you should be making estimated federal or state tax payments by year-end or in January based on the information you provide.

By taking some steps now, you should be able to reduce your tax bill somewhat. In addition, it will be easier for you to put together your tax information in January. Good luck! B

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The above examples are hypothetical and for illustrative purposes only. No specific investments were used in the examples. Actual results will vary.