

# tax report

NOVEMBER 2016



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## Tax Tips for Year-end

As 2016 winds down, it's a good time to review your tax situation and to make sure that you are taking advantage of available tax-saving strategies. Here are some suggestions.

### Contribute More to Retirement Accounts

One of the best ways to reduce your income tax bill is to contribute to a retirement account — whether through your employer's retirement savings plan or an individual retirement account (IRA). For 2016, the IRS dollar limit on elective salary deferrals to 401(k), 403(b), and most 457 plans is \$18,000, plus an additional \$6,000 for those 50 and older. (Your employer's plan may have additional limits.) Also, you may contribute up to \$5,500 (\$6,500 if you're age 50 or older) to an IRA.\* Contributions to traditional IRAs are generally deductible, though the deduction is phased out above certain income levels if you or your spouse contributes to a retirement plan at work.

### Prepay State and Local Taxes

The IRS generally will allow you to deduct any state income taxes paid during 2016 as an itemized deduction. If you would normally wait until January of next year to pay the fourth installment of estimated state income tax for 2016, consider paying it before the end of 2016. That way, you may include the payment in your 2016 itemized deductions. Similarly, you might consider paying 2017 real estate taxes before the end of 2016 to further increase your itemized deductions. Note, however, that these strategies will not be beneficial if you are subject to the alternative minimum tax.

### Contribute to an HSA

If you are covered by a high-deductible health plan and meet other eligibility requirements, you may make deductible contributions to your health savings account (HSA) at any time up until your federal income tax return due date (without extensions). Generally, for 2016, the limits are \$3,350 for self-only coverage and \$6,750 for family coverage.



### Capital Gains and Losses

If you have incurred capital losses in 2016, consider selling appreciated stocks that you no longer want to hold so that you can offset the losses against the gains. Capital losses can be used to offset capital gains, *plus* an additional \$3,000 of ordinary income (\$1,500 if married filing separately) annually. You may also carry forward unused capital losses to future tax years, subject to the same limitations.

Please contact us if you'd like to discuss these and other strategies to potentially reduce your tax bill. ■

\* The IRA contribution can't exceed your (and your spouse's) taxable compensation for the year.

## New Filing Dates

For the 2016 calendar year, businesses must file their W-2 forms and 1099-MISC forms reporting nonemployee compensation payments earlier than in prior years, and there will be no extensions for electronic filing.

Under the new rules, both paper and electronically filed 2016 Forms W-2 (as well as the W-3 transmittal form) must be filed with the Social Security Administration by January 31, 2017. Additionally, both paper and electronically filed 2016 Forms 1099-MISC that are used to report non-employee compensation must be filed with the IRS by January 31, 2017.

Both of these new filing dates coincide with the deadlines for *distributing* Forms W-2 and Forms 1099-MISC to employees and nonemployees, respectively.

Please contact us for more details.

## short takes

### Tax Credit for Plug-in Electric Vehicles

The IRS allows a tax credit of up to \$7,500 for qualified plug-in electric vehicles. However, the amount of the credit begins to phase out in the second calendar quarter following the one in which the manufacturer sells its 200,000<sup>th</sup> qualifying vehicle for use in the United States after 2009. To find out what the current amount of the credit is for a particular automobile, you can check the IRS's list at [www.irs.gov/businesses/qualified-vehicles-acquired-after-12-31-2009](http://www.irs.gov/businesses/qualified-vehicles-acquired-after-12-31-2009).

### Spousal IRAs

If you don't have earnings from work but your spouse does, you may still be able to make contributions to an individual retirement account (IRA). Under the tax law's spousal IRA rules, a nonworking spouse may contribute up to \$5,500 (in 2016) to a traditional or Roth IRA (plus an additional \$1,000 if age 50 or older) *provided* his/her working spouse has earned income equal to or greater than the sum of the couple's combined IRA contributions. The couple must file jointly. Contributions to a traditional IRA are potentially tax deductible, though income-level phaseouts may apply if the working spouse participates in an employer-sponsored retirement plan.

*The general information 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 particular situation.*

## A Reminder About Beneficiary Designations

Three recent IRS rulings\* are a reminder to properly designate the beneficiaries on any individual retirement accounts (IRAs) you own. Failure to do so may cause your beneficiaries to incur an unnecessary tax bill.

### Required Minimum Distributions

Traditional IRA owners must begin taking annual required minimum distributions (RMDs) from their accounts after they turn 70½. These payments, which typically represent taxable income to the IRA owner, are generally made



over the IRA owner's life expectancy.

RMD rules also apply after an account owner's death. Where the goal is to give younger heirs the option of stretching out RMD payments — and the accompanying income taxes — for as long as possible, beneficiary designations need to be properly completed.

### The Rulings

The IRS rulings involved an IRA owner who had initially named three trusts as beneficiaries of his IRAs but then subsequently transferred the IRAs to a second IRA custodian, inadvertently failing to name the trusts as beneficiaries on the new set of forms.

After the account owner's death, the trustees recognized the error and persuaded a state court to issue an order *retroactively* reforming the second set of beneficiary forms to mirror the first. Nevertheless, the IRS determined that the law required it to give effect to only those beneficiary forms in place on the date of death. As a result, a shorter distribution schedule applied. ■

\* IRS Private Letter Rulings 201628004, 201628005, and 201628006 (July 8, 2016)

## Tax Benefits of Making a QCD

At the end of 2015, Congress permanently extended the rule allowing taxpayers to exclude from taxable income certain individual retirement account (IRA) distributions made directly to a qualified charity. Otherwise known as qualified charitable distributions, or QCDs, such transfers can provide individuals who were already planning to make a charitable gift with several tax benefits.

### How It Works

To use the QCD strategy, you must:

- Be 70½ or older
- Transfer no more than \$100,000 per year
- Transfer from an IRA and *not* an employer-sponsored retirement account
- Have the funds *directly* transferred from the IRA to a qualified charity

Generally, a *qualified* charity is one that is authorized to receive tax-deductible contributions.

### Tax Benefits

If all requirements are met, the QCD will count toward satisfying your required minimum distribution (RMD) obligation for the year. This is where the more subtle tax benefits of the contribution come into play. If you were to follow the typical procedure — withdrawing the RMD and then writing a check to the charity — the RMD amount would have to be included in your adjusted gross income (AGI) and then claimed as a charitable contribution deduction.

By taking the RMD as a QCD — that is, transferring the RMD, or a portion of it, directly to the charity — the QCD is never included in AGI. Therefore, it is effectively deducted whether or not you itemize your deductions, which may benefit you if you claim the standard deduction. Also, by reducing your AGI, you may reduce the taxable portion of your Social Security benefits, as well as income-related adjustments to Medicare Part B and D premiums. ■

# Hobby or Business?

If you're an individual hoping to make a little extra money from your hobby by turning it into a business, you'll want to know what expenses you can deduct at tax time. Generally, deductions are allowed for ordinary and necessary *business* expenses. However, the tax law restricts deductions for expenses related to a *hobby* — an activity that is not engaged in for profit.

## Profit-making Objective

To qualify as a business, an activity must be conducted for the *primary* purpose of making a profit. There are two ways to meet this requirement. First, you may show that the business has generated a profit in at least three out of five consecutive years (two out of seven years for breeding, training, showing, or racing horses). Alternatively, you may show that you conducted the activity in a businesslike manner — i.e., that you had a profit-making objective.

Factors the IRS will consider in determining whether you have a profit-making objective include:

- How the activity is conducted
- Your expertise and that of any advisors
- The time and effort put into the activity
- Whether you expect that assets used in the activity will appreciate in value
- Your success in other similar or dissimilar activities
- Your history of income/loss with respect to the activity
- The amount of any profit
- Your financial status
- The presence of personal pleasure or recreation

## Case in Point

Recently, the U.S. Tax Court applied these factors to a taxpayer who was engaged in a patent business and also had a side business in which he refurbished classic Plymouths.\* During the tax year in question, the taxpayer necessarily incurred expenses for advertising, travel, storage, building a garage, and specialized equipment. Applying the factors above, the court noted that the taxpayer:

- Conducted the automobile activity in a businesslike — albeit unsophisticated — manner
- Had experience operating a business and expertise relating to restoring old Plymouths
- Spent a substantial amount of time advertising and traveling in furtherance of the business
- Contracted with third parties to manufacture necessary parts

Finally, the court noted that the taxpayer's patent business was undergoing a downturn during the tax year in question, and he therefore lacked extra funds to spend on an expensive hobby. Based on its review, the court found that the petitioner's primary motive had been to make a profit.

## Hobby Loss Rules

If you cannot demonstrate that your activity is a business, it will be considered a hobby. You must declare the income from the hobby, and you may deduct your expenses, subject to two limitations. First, your deduction for hobby expenses cannot exceed the activity's gross income. So if your hobby income is \$7,000 but your expenses are \$9,000, you may claim no more than \$7,000 in expenses. You may not use the additional \$2,000 to offset other income.

Second, any hobby expenses you aren't otherwise allowed to deduct as personal expenses are deductible only to the extent they — when combined with other "miscellaneous" expenses — exceed 2% of your adjusted gross income.

Running your activity in a businesslike manner can help you avoid these restrictions. ■

\* *Main v. Comm'r*, TC Memo. 2016-127 (July 5, 2016)

## Calendar of Filing Dates



### NOVEMBER

**10 Employers:** Deferred due date for Form 941, if timely deposits were made.

### DECEMBER

**15 Corporations:** Pay fourth installment of 2016 estimated tax.

### JANUARY

**16 Individuals:** Pay last installment of 2016 estimated tax with Form 1040-ES. Or file 2016 income tax return and make full payment of any balance due by January 31, 2017.

**31 Employers:** Distribute copies of Form W-2 for 2016 to employees and also file copies with the Social Security Administration.

**31 Businesses:** Distribute Forms 1099 (or other information statements) to recipients of certain payments made in 2016. See us for more details.

**31 Employers:** File Forms 1099-MISC if you are reporting nonemployee compensation payments in box 7.

**31 Employers:** File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due.

**31 Employers:** File Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, for 2016.



# Tax Breaks for Military Personnel

A number of provisions throughout the tax code provide military service members with special tax breaks. Following are some of the more notable ones.

## Deadline Extensions

Some members of the military, such as those who serve in a combat zone, can obtain automatic extensions of important tax deadlines, including deadlines for filing their personal income tax returns and paying taxes. Eligibility also extends to other individuals in combat zones, such as members of the Red Cross and the Merchant Marine, as well as to qualified military personnel serving in direct support of military operations in a combat zone.

## Income Exclusions

Generally, gross income does not include any “qualified military benefit,” which includes a long list of items, such as qualifying educational assistance,

housing allowances, medical benefits, moving and storage expenses, and veterans benefits.

## Combat Pay

Additionally, certain combat zone pay is not subject to federal income taxes,

and a person who serves in support of a combat zone may also qualify for this exclusion. Note, however, that combat pay is generally subject to both Social Security and Medicare taxes.

## Homeowner Tax Breaks

Homeowners generally may exclude as much as \$250,000/\$500,000 (single/married filing jointly) of gain from the sale of a home if they have owned and used the home as their principal residence for two of the five years prior to sale. Qualified members of the Armed Forces may suspend the five-year test period for up to 10 years while they (or their spouses) are serving on qualified extended duty.

These are just a handful of the many tax provisions enacted to benefit members of the military. Call us if we can help you determine your eligibility for these provisions and others. ■

