

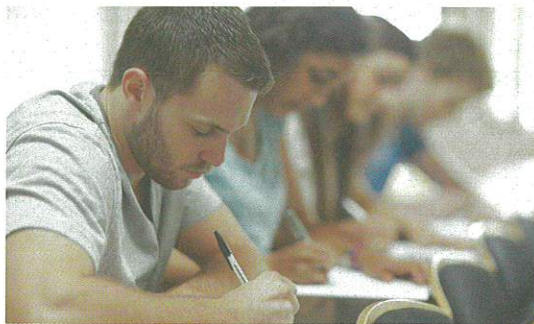
tax report

MARCH 2017



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Coordinating College Tax Breaks



The American Opportunity Tax Credit (AOTC) can be a valuable tax credit for students (and their parents) who have paid college expenses. However, to make the best use of the AOTC, eligible taxpayers may need to coordinate the credit with other education tax breaks.

AOTC Basics

The AOTC is available for the first four years of post-secondary education. It is equal to 100% of the first \$2,000 of qualifying expenses (generally, tuition and fees) and 25% of the next \$2,000, for a total credit of up to \$2,500 for each eligible student. The AOTC is phased out for higher income taxpayers.

Using the AOTC with a 529 Plan

Section 529 college savings plans benefit taxpayers through *income exclusion* rather than a tax credit. Generally, withdrawals from a 529 college savings plan are tax free if they do not exceed the account beneficiary's qualified higher education expenses for the year.

Though taxpayers may not “double-dip” — use the same qualified expenses for both the AOTC and the Section 529 income exclusion — they should look to use both tax breaks to

their advantage. As a dollar-for-dollar reduction of the final tax bill, the AOTC is generally more valuable. Eligible taxpayers should consider limiting 529 plan withdrawals and paying at least some qualified expenses out of pocket so that the AOTC may be claimed at the end of the year. Some planning may be necessary; for example, room and board is a qualified expense for Section 529 plan purposes but not for the AOTC.

Using the AOTC with Scholarships

Similarly, the Treasury Department recently advised* that many recipients of Pell grants and other scholarships may be losing money by failing to properly coordinate their use of the AOTC with their scholarship and grant awards. Generally, students may choose to allocate such awards in either of two ways for tax purposes:

- To qualified tuition and related expenses, making the scholarships *excludable* from taxable income but also *reducing* the student's AOTC-eligible expenses, or
- To living expenses, such as room and board, rendering the award *includable* in the student's taxable income and therefore *not reducing* AOTC-eligible expenses.

Since many students would benefit more from the credit than the income exclusion, they should consider claiming at least a portion of their qualified tuition and related expenses for the AOTC. However, each family's situation will be unique. ■

* *Fact Sheet: Interaction of Pell Grants and Tax Credits: Students May Be Foregoing Tax Benefits by Mistake*, Treasury Department, www.treasury.gov

Your Tax Refund

Are you expecting a tax refund this year? Consider using the funds to further your long-term financial goals.

Pay Down High-interest Debt

Credit card debt is typically accompanied by a high rate of interest, which continues to accrue on any principal and interest left unpaid at the end of each month. And personal credit card interest is not tax deductible.

Save for College

If you make contributions to a Section 529 college savings plan, any earnings will be tax deferred, and all distributions will be tax free if applied to qualifying education expenses.

Save for Retirement

There are many choices among retirement savings vehicles, such as taxable investment accounts and traditional and Roth individual retirement accounts. You also might consider using your refund to pay current expenses and then contribute an equivalent amount to your employer-sponsored retirement plan.

short takes

Increase in Per Diem Rates for Business Travel

The IRS has increased the “high-low” per diem rates for lodging, meals, and incidental expenses incurred for business travel in the continental United States. These rates apply when an employer chooses to provide a per diem allowance to traveling employees instead of reimbursing them for actual expenses. The per diem allowance will not count as taxable income if it does not exceed the IRS’s published rates and the employee complies with substantiation requirements. Under the new IRS notice, the “high” rate (to be used for identified “high-cost” areas) is \$282 (up from \$275), and the rate for all other areas is \$189 (up from \$185).

Surviving Spouse Liable for Decedent’s Unpaid Taxes

A surviving spouse and executrix of her husband’s estate was recently held *personally liable* for the decedent’s unpaid federal income tax liability to the extent of the value of the assets she transferred to herself rather than using to pay the claim. Despite having knowledge of the tax claim (in excess of \$340,000), the surviving spouse took ownership of virtually all the estate assets. Federal law authorizes the imposition of personal liability on an estate representative where (1) he or she has knowledge of a federal claim, (2) he or she transfers assets from the estate before paying that claim, and (3) the estate is either insolvent at the time of the distribution or thereby rendered insolvent.

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.

Watch Out for the Kiddie Tax

Shifting income to your children to take advantage of their lower tax rates may appear to be a good idea, but make sure you first know how the “kiddie tax” rules apply.

How It Works

The kiddie tax rules come into play when a child has taxable *unearned* income (as opposed to *earned* income from a job) above a certain limit (\$2,100 in 2017). The rules affect children under age 18 and children who have *earned* income that is no more than half of their support and are either age 18 or full-time students under age 24.

Once the tax is triggered, the following rules generally apply:

- The child’s standard deduction is \$1,050 (in 2017).
- The next \$1,050 of unearned income is taxed at the child’s rate.



■ Unearned income exceeding \$2,100 is taxed at the parent’s rate.

Example: Cheryl is in the 25% bracket and her 15-year-old son, Dave, has no income other than \$2,400 in investment income. Dave’s standard deduction shields the first \$1,050, the 10% rate applies to the next \$1,050, and Cheryl’s marginal rate applies to the remaining \$300, for a total tax of \$180. Alternatively, if Cheryl had retained the investment income, she would have paid 25% of \$2,400, or \$600.

Is It Worth It?

Tax savings are possible, but consider that a second investment account may incur added expenses. Also, assets held in a child’s name may reduce future financial aid awards.

Talk to us about your specific situation and potential tax-favored alternatives, such as a Section 529 college savings account. ■

2017 Retirement Plan Limits

Low inflation rates have resulted in few cost-of-living adjustments being made to the contribution limits for retirement plans in 2017. Following are some highlights.

Defined contribution plans. The dollar limit on salary deferrals to 401(k), 403(b), and most 457 plans remains unchanged at \$18,000. Catch-up contributions (available to participants age 50 and older if their plan allows) remain capped at \$6,000.

The limit on total annual additions (employer and employee contributions plus any reallocated forfeitures) to a defined contribution plan account increased from \$53,000 to \$54,000.

SIMPLE IRAs. The limits on employee contributions and catch-up contributions remain at \$12,500 and \$3,000, respectively.

Individual retirement accounts (IRAs). The limits for contributions and catch-up contributions to traditional and Roth IRAs remain unchanged at \$5,500 and \$1,000, respectively.

Individuals who contribute to traditional IRAs and have access to a workplace

retirement plan (whether their own or through their spouse’s plan) will see minor changes in the income-level phaseout ranges that apply for purposes of making deductible contributions. The ranges, which are based on modified adjusted gross income, are:

■ \$62,000 to \$72,000 for single taxpayers and heads of household covered by a retirement plan at work (up from \$61,000 to \$71,000)

■ \$99,000 to \$119,000 for married couples filing jointly when the spouse contributing to the IRA is also covered by a workplace retirement plan (up from \$98,000 to \$118,000)

■ \$186,000 to \$196,000 for married couples filing jointly when the spouse contributing to the IRA is not the spouse with the workplace retirement plan (up from \$184,000 to \$194,000)

The new income-level phaseout ranges for Roth IRA contributions are \$186,000 to \$196,000 (married filing jointly) and \$118,000 to \$133,000 (single and head of household). ■

Understanding Health Savings Accounts

Health savings accounts (HSAs) — medical savings accounts available for those with qualifying high-deductible health plans (HDHPs) — are enjoying widespread use. However, HSAs operate under a number of technical rules, so here is a brief overview.

What Is an HDHP?

HSAs are available only to those with qualifying HDHPs. For both 2016 and 2017, a qualifying HDHP has an annual deductible of at least \$1,300 for individual coverage or \$2,600 for family coverage. (An HDHP may, however, have a lower deductible for preventive care.) Additionally, the sum of the annual deductible and other out-of-pocket expenses (other than premiums) for covered benefits may not exceed \$6,550 for individual coverage and \$13,100 for family coverage.

Note that employers may offer an HSA option along with an HDHP, or an eligible individual with an HDHP may choose to open an HSA at a financial institution or other provider. Therefore, self-employed individuals participating in a qualified HDHP may take advantage of an HSA.

Is Additional Coverage Allowed?

To qualify for an HSA, an individual (and the individual's spouse, with family coverage) generally may not have health coverage that is *not* an HDHP. However, there are exceptions. For example, additional coverage for accidents, disability, dental care, vision care, and long-term care is allowed.

Are HSA Contributions Tax Deductible?

HSA contributions are tax deductible, within certain limits. Similarly, any employer contributions to an employee's HSA are not included in the employee's income (up to the deduction limitation).

For 2017, the maximum deductible HSA contribution is \$3,400 for a person with self-only coverage under an HDHP (increased from \$3,350 in 2016) and \$6,750 for a person with family coverage (unchanged from 2016). Individuals age 55 and older may make additional

“catch-up” contributions to their HSA of up to \$1,000 per year. However, no contributions (nor any deductions) may be made for any month an individual is eligible for and enrolled in Medicare.

HSA contributions are taken as an “above-the-line” deduction, meaning that they reduce adjusted gross income and may therefore help the taxpayer qualify for certain other tax benefits. A taxpayer does not have to itemize to claim the deduction for HSA contributions — any deduction is *in addition* to the taxpayer's standard deduction or allowable itemized deductions.

How Are Account Earnings Taxed?

Many custodians of HSAs offer various investment options for contributions. Any interest or other investment income earned on the contributions is not taxed while the earnings remain in the account. Moreover, tax law does not require the HSA owner to take money out of an HSA each year, so funds can be left to accumulate if they are not needed for medical expenses.

Are Distributions Taxable?

No tax is due on funds withdrawn from an HSA as long as the money is used to pay qualified medical expenses for the account holder or his or her spouse and dependents. Generally, medical expenses that are allowed for the itemized medical expense deduction are qualified medical expenses for HSA purposes.

Qualified medical expenses do not include most health insurance premiums. Exceptions include premiums for qualified long-term care insurance and — for individuals over age 65 — Medicare premiums. However, premiums for supplemental Medicare policies (“Medigap”) are not qualified medical expenses.

Withdrawals not used for qualified medical expenses are taxable, and an additional 20% penalty generally would apply to withdrawals before the individual attains age 65, dies, or becomes disabled. ■

Calendar of Filing Dates



MARCH

15 Partnerships and S corporations: File 2016 calendar-year partnership return (Form 1065) or S corporation return (Form 1120S). For an automatic six-month extension, file Form 7004.

APRIL

18 Individuals: Most calendar-year taxpayers file 2016 income tax return (Form 1040, 1040A, or 1040EZ) with the IRS. For an automatic six-month extension, file Form 4868 and pay the estimated tax due.

18 Individuals: Pay the first installment of 2017 estimated tax.

18 Corporations: Calendar-year corporations file 2016 tax return (Form 1120) and pay any tax due. For an automatic five-month filing extension, file Form 7004 and deposit the estimated tax due.

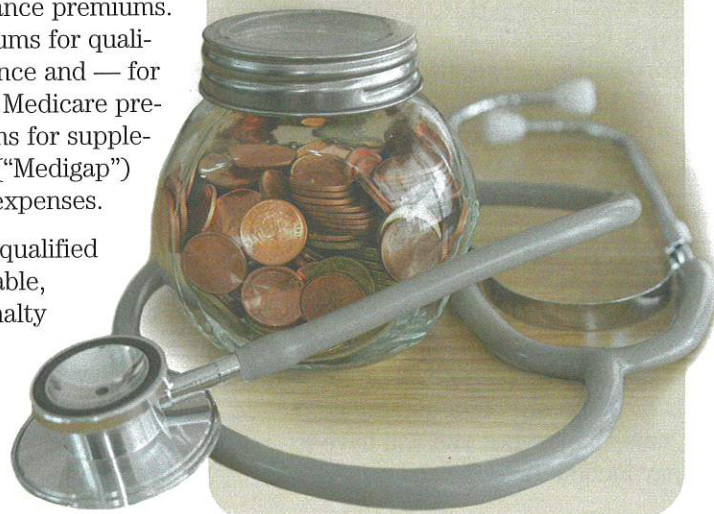
18 Corporations: Deposit first installment of 2017 estimated tax.

MAY

1 Employers: File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due for those who meet the safe harbor requirements.

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

15 Exempt organizations: File 2016 Form 990, 990-EZ, or 990-N, if the organization reports on a calendar-year basis.



How Are Withdrawals from Your Corporation Taxed?

If you are the owner-employee of a privately held C corporation, you should know that there is more than one way to extract money from a corporation — and some methods are more tax advantaged than others.

Dividend. The easiest method for making a withdrawal is to declare a dividend, but it is generally not tax efficient. The corporation will receive no deduction for the dividend payment, and you, as the recipient, will generally pay taxes on the amount you receive. However, assuming the dividend meets certain conditions, a favorable 15% tax rate (20% if you are in the 39.6% ordinary income tax bracket*) will apply.

Salary. If you take additional money out as salary, the company may deduct the compensation, assuming it is “reasonable.” But you will have to pay income taxes on the salary, and

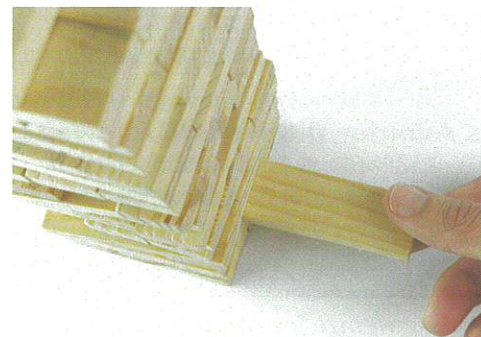
both you and the company will have to pay FICA taxes.

Consider the following additional alternatives.

Prior loans to the corporation.

If you previously loaned the company money, you generally may be repaid with interest without having the repayment treated as a dividend. However, in certain instances, such as when a loan has not been properly documented, the IRS may attempt to recharacterize repayment amounts as dividends.

Compensation to other family members. The corporation may deduct reasonable compensation paid to your children or other family members for services actually rendered. Your family members would pay income tax on the compensation they receive at their own rates, which may be much lower than yours.



Loans from the corporation. A loan made to you by the corporation is generally not taxable, provided the loan is properly documented and you make payments of interest and principal in a timely manner.

Fringe benefits. Certain fringe benefits — such as medical benefits, disability insurance, and qualifying group life insurance — may be both deductible by the corporation and nontaxable to you. Generally, the company must also provide the benefits to other company employees on a nondiscriminatory basis. ■

* An additional 3.8% tax on net investment income could apply to high-bracket taxpayers.