2016 Individual Tax & Estate Planning Update

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Agenda

- Review of Current Tax Rates and Deductions
- Identity Theft
- Individual Income Tax Planning Opportunities
  - Tax Extenders
  - Retirement Planning
  - Family Planning
- Foreign Reporting
- Estate Tax Planning Opportunities
  - Exemptions
  - Remove Assets
  - Life Insurance

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2016 Tax Rates and Deadline

- Income tax rates are unchanged from 2015: 10, 15, 25, 28, 33, 35 and 39.6 percent (although start of each bracket continues to be adjusted upward for inflation each year).
- Tax rates for qualified dividends and net long-term capital gains are also unchanged, ranging from 0 to 20 percent.
- Emancipation Day will shift the filing and payment deadline from 4/15/17 to 4/18/17.

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Individual Income Tax Brackets

Rate	2016 (MFJ)	2017 (MFJ)
10%	$0 - $18,550	$0 - $18,650
15%	$18,551 - $75,300	$18,651 - $75,900
25%	$75,301 - $151,900	$75,901 - $153,100
28%	$151,901 - $231,450	$153,101 - $233,350
33%	$231,451 - $413,350	$233,351 - $416,700
35%	$413,351 - $466,950	$416,701 - $470,700
39.6%	$466,951 and above	$470,701 and above

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Individual Income Tax Brackets

Individual Income Tax Rate of 39.6% applies:

Filing Status	2016	2017
MFJ	$466,951	$470,701
HOH	$441,001	$444,551
Single	$415,051	$418,401
MFS	$233,476	$235,351
Estates/Trusts	$12,400	$12,500

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Capital Gain/QDI Rates

- Qualified Dividend Income (QDI)
- Long Term Capital Gain

Tax Bracket	Capital Gains Rate
10% & 15%	0%
25%, 28%, 33%, 35%	15%
39.6%	20%

Individual Tax Deductions

Filing Status	Standard Deduction	Itemized Deduction Phase Out Begins	Personal Exemption	Personal Exemption Phase Out Begins
Single	$6,300	AGI > $259,400	$4,050 per exemption	AGI > $259,400
Married Filing Joint	$12,600	AGI > $311,300	$4,050 per exemption	AGI > $311,300
Married Filing Separate	$6,300	AGI > $155,660	$4,050 per exemption	AGI > $155,660
Head of Household	$9,300	AGI > $285,350	$4,050 per exemption	AGI > $285,350

Individual Tax Deductions

- Pease Limitation on Itemized Deductions
  - Reduced by 3% when the amount of AGI exceeds certain thresholds
  - Can not reduce itemized deductions by more than 80%
  - Reductions include charitable contributions, qualified residence interest, state and local income/sales tax, property taxes, unreimbursed employee business expenses, and other misc. expense
  - Does not include medical, investment interest, gambling loses, or casualty/theft losses
  - Not applicable to AMT

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Individual Tax Deductions

- Personal Exemption Phase Out
  - Begins to be reduced at same AGI thresholds as the Pease limitation on itemized deductions
  - Reduced by 2% for each $2,500 when the amount of AGI exceeds certain thresholds
  - Not applicable to AMT

Net Investment Income Tax

- Net Investment Income Tax (NII)
  - Tax equal to 3.8% of the lesser of:
    - Net investment income or
    - The excess of MAGI over the applicable threshold
      - $250,000 for MFJ
      - $125,000 for MFS
      - $200,000 for all others

Net Investment Income

- Net Investment Income (NII) is the excess of:
  - Gross income from interest, dividends, royalties, rents and annuities
    - ➢ Other than income derived in the ordinary course of an active trade or business
  - Other gross income from a business that is a passive activity
  - Net gain attributable to the disposition of property
    - ➢ Other than property held in an active trade or business
- Over properly allocable deductions

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Net Investment Income

- Net Investment Income does not include:
  - Distributions from IRA or qualified plans
  - Gain on the sale of an interest in a partnership or S corporation in which there is material participation
  - Income from a trade or business in which there is material participation (i.e. S Corporation income)
  - Real Estate Professionals
  - Income from rentals to an activity which the taxpayer materially participates (recharacterization)
  - Tax Exempt Income

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Planning to Mitigate NII

- Shift taxable investments to tax-free
- Grouping activities
- Convert passive income to active income (beware of SE trap!)
- Consider alternative business structures
- Reduce AGI
  - Shift or defer income with LKE and installment sales
  - Tax-exempt income
  - Tax-deferred investments

Additional Medicare Tax

- Tax equal to 0.9% of wages and self-employment income in excess of:
  - $250,000 for joint returns
  - $125,000 for married filing separate
  - $200,000 for all others

(Self-employed do not get the 0.9% as an above-the-line deduction or an adjustment to gross income)

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Alternative Minimum Tax

Watch out for:

- Large state, local, sales, property tax deductions
- Large LT capital gains or qualified dividends
- Significant differences in Tax and AMT depreciation
- Large miscellaneous itemized deductions
- R&D in activities where you don't materially participate
- Exercise of ISOs
- Large number of dependents
- Tax-exempt income from private activity bonds or that is not exempt for state tax purposes

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Basis Reporting

- An executor must file information return reporting value of certain property included in a estate and must file a statement to each beneficiary.

- Statement shows basis of property to be used for future taxable events.

Identify Theft

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Identity Theft Facts (Tax Related)

- Cost per year = $53 billion
- 1 minute = 19 new victims
- Time for victims to reclaim identities = 44 months
- Fraudulent refunds paid last year = $6 billion

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Type of Tax Return ID Theft

- Refund Related
- Employment Related
- Stolen deceased taxpayer SSN
- Unscrupulous tax return preparer
- Phone scams
- Phishing emails

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Signs of Identity Theft

- E-filing rejection because of duplicate EIN
- Taxpayer receives information from an employer unknown to them.
- Taxpayer receives correspondence, bill or refund from IRS to confirm they filed return before return is actually filed
- Taxpayer receives a notice from IRS indicating wages not earned, SS benefits adjusted/denied
- Taxpayer receives notice from IRS that they may be a victim

Steps Specific for Tax Related ID Theft

- Complete FTC ID Theft Affidavit
- File Police Report
- Create ID Theft Report by combining Affidavit + Police Report
- File online complaint with FBI Internet Crime Complaint Center
- File Form 14039
- Contact IRS Identity Protection Specialized Unit
- Report incident to PA Attorney General's Office
- Report incident to PA Dept. of Revenue

Steps Specific for Tax Related ID Theft

- Replace credit, debit cards
- Change all logins, PINS, passwords
- Contact credit agencies – obtain credit report and place Fraud Alerts on accounts

IRS Actions

- IP PIN - 6 digit number assigned to eligible taxpayers to help prevent the misuse of their SSNs on fraudulent federal income tax returns
  - Required use beginning 1/1/16, if assigned
- Truncating SSNs on letters and notices
- Victims allowed to request a redacted copy of the fraudulent return that was filed.
- Restricted delivery of number of refunds deposited into one account.

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Common IRS Letters Related to ID Theft

- **Letter 5071C** - IRS received return with your name and SSN and taxpayer needs to confirm identity through idveriify.irs.gov website or by phone

- **Letter CP01A** – taxpayer identified as ID theft victim and is assigned IP PIN

- **Letter CP01F** – taxpayer identified as possible ID theft victim and letter invites him/her to get an IP PIN

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Best Practices to Protect Personal Information

- Secure information at home and work
- Protect personal computers
- Secure wireless networks
- Create strong passwords and change them frequently
- Double check URL before entering personal information
- Log out of websites before closing browser

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Best Practices to Protect Personal Information

- Encrypt/password protect sensitive documents
- Check for “lock” icons on websites
- Set online account settings to send email/text if attempted login by unrecognized computer
- Put passwords on all credit card and bank accounts
- Check credit reports annually
- Consider ID theft protection services (Lifelock)

Individual Income Tax Planning Opportunities

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Tax Extenders

Protecting Americans from Tax Hikes Act of 2015

Singed into Law on December 18, 2015

- Following items were made permanent:
    - State/Local Sales Tax Deduction
    - American Opportunity Tax Credit
    - Lower earned income threshold for Child Tax Credit
    - Increase in phase out amount for those who qualify for the Earned Income Tax Credit (EITC)
    - Teachers' Classroom Expense Deduction
    - Parity for Transit and Parking Benefits
    - Charitable Distributions from IRAs for those over 70 ½
    - Section 179 Expense

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Tax Extenders

- These items expire on December 31, 2016:
  - Principal residence cancellation of debt discharge income exclusion (up to $2 million)
  - Mortgage Insurance Premiums deduction
  - Qualified Tuition and related expenses
  - Nonrefundable non-business energy property credit for qualified energy improvements and property placed in service before January 1, 2017

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Tax Extenders

- These items expire on December 31, 2019
  - Work Opportunity Tax Credit
  - Bonus Depreciation
    - 50% for 2016 and 2017
    - 40% for 2018
    - 30% for 2019

Retirement Planning

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Retirement Planning

- Tax-Advantaged Retirement Savings Plans:
  - Tax-Deferred: 401(k)s and other employer plans, SEP-IRAs, Traditional IRA
  - Tax-Free: Roth IRAs

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Retirement Planning

2016 Maximum Elective Contribution Limits

	Regular	Catch-Up (if age 50 or older)
401(k), 403(b), 457(b), and SAR-SEP Plans	Lesser of $18,000 or 100% of participant's compensation	$6,000
SIMPLE 401(k) and SIMPLE IRA Plans	Lesser of $12,500 or 100% of participant's compensation	$6,000
Traditional and Roth IRA	Lesser of $5,500 of 100% of earned income	$1,000

Retirement Planning

2016 Maximum Pension Limitation

	Regular	Catch-Up (if age 50 or older)
Individual 401(k) Plans	$53,000	$6,000
SEP IRA Plans	$53,000	n/a
Max Annual Benefit for a Defined Benefit Plan	$215,000	n/a
Annual Compensation Limit	$265,000	n/a

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Retirement Planning

- Limits on Roth IRAs
  - Need earned income to contribute
  - AGI phased out to contribute directly by:
    - 2016
      - MFJ – $194,000
      - Single - $132,000
    - 2017
      - MFJ - $196,000
      - Single - $133,000

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Retirement Planning

- Advantages of Roth IRAs
  - Tax-free growth
  - Qualified distributions are tax free
    - Principal is always withdrawn tax free
    - Growth potentially tax free
      - 5 year rule, and either
      - After 59½; due to disability; after death; first-time homebuyer
      - 10% early withdrawal penalty unless one of exceptions applies
  - No Required Minimum Distributions

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Retirement Planning

Back-door Roth Strategy is "simply":

Making a non-deductible IRA contribution (no income limit applies), followed by a subsequent Roth conversion

Cautions:

1. Other pre-tax IRAs are aggregated with the non-deductible IRA and could result in unexpected tax liability
2. Step Transaction Doctrine

Retirement Planning

- Taxable Roth conversions/partial conversions:
  - Estimate current marginal tax rate on conversion
  - Estimate anticipated future tax rate
    - Attempt to project a future tax liability in light of different classes of income
    - Future withdrawals may be by a surviving spouse or much younger beneficiary
    - Deathbed planning – prepay income tax

Retirement Planning

- May want to recharacterize because the value of the Roth IRA dropped substantially since conversion, or circumstances have changed in some other way
  - Recharacterizations can be made up until the extended due date of the return for the year the conversion was made, regardless of date of filing
    - If already filed return, then amend to reflect recharacterization
    - Waiting period to reconvert is until the next calendar year after the original conversion, or until the 30^{th} day after recharacterization

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Retirement Planning

- Qualified charitable distribution (QCD) from IRAs for those at least 70½ years – made permanent by PATH Act
  - Married individuals filing a joint return could exclude up to $100,000 donated from each spouse's own IRA ($200,000 total).
  - The donation satisfies any IRA required minimum distributions for the year.
  - The amount excluded from gross income isn't deductible.
  - Donations from an **inherited IRA** are eligible if the beneficiary is at least age 70 ½.
  - Donations from a **SEP or SIMPLE IRA** aren't eligible.
  - Donations from a **Roth IRA** are eligible.

Family Tax Planning

Family and Education Tax Breaks

- Child and Adoption Credits
- Child care expenses
- IRAs for Teens
- 529 plans
- Educational Savings Accounts (ESAs)
- Education Credits and Deductions

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Are You Eligible for these 2016 Tax Breaks?

Tax Break	Single Filer MAGI Phase-out Begins	Joint Filer MAGI Phase-out Begins
Child Credit (1 child)	$75,000-$95,000	$110,000-$130,000
Adoption Credit	$201,010-$241,010	$201,010-$241,010
Child Care Credit	$15,000-$43,000	$15,000-43,000
ESA Contribution	$95,000-$110,000	$190,000-$220,000
American Opportunity Credit	$80,000-$90,000	$160,000-$180,000
Lifetime Learning Credits	$55,000-$65,000	$110,000-$130,000
Student Loan Interest Deduction	$65,000-$80,000	$130,000-$160,000

NOTE: Child Care Credit doesn't phase out altogether but the minimum credit percentage of 20% applies to AGIs above $43,000.

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IRAs for Teens

- 2016 contribution limit is the lesser of $5,500 or 100% of earned income
- Consider giving children or grandchildren the the amount they are eligible to contribute (keep gift tax in mind)

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Section 529 Plans

- Contributions aren’t deductible but assets grow tax-deferred
- PA taxpayers can deduct contributions of $14,000 per year per beneficiary from PA taxable income
- Distributions used to pay qualified expenses
- Can make tax-free rollovers to another qualifying family member
- Estate planning benefits – can front-load five years of annual gift tax exclusions and make a $70,000 contribution (or $140,000 if you split the gift with your spouse)

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Section 529 Plans

Improvements to 529 Plans per PATH Act:

- Expanded definition of Qualified Higher Education Expenses to include computer equipment and technology.

- Modifies rules to treat any distribution from an account as coming only from that account.

- Treats refunds of tuition paid with distributions from an account as a qualified expense if such amounts are re-contributed within 60 days.

Foreign Reporting FBAR/FACTA

FBAR – Form 114

- Individuals who have ownership of or signature authority over foreign accounts.
  - Authority over means ability to withdraw
  - Account(s) in aggregate > $10,000 any day
  - Must be filed electronically through FinCEN
  - Beginning with tax year 2016, the form will be due 4/15/17 with 6 month extension available.
  - Penalties: if non-willful, up to $10,000; if willful, up to greater of $100,000 or 50% of account balances plus possible criminal penalties

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FACTA – Form 8938

Individuals that have an interest in specified foreign assets

- Reporting thresholds depend on filing status and living in U.S. versus living abroad
- Must be filed with income tax return
- Due by due date, including extension, for an income tax return
- Penalties: Up to $10,000 for failure to disclose and an additional $10,000 for each 30 days of non-filing after receipt of IRS notice up to $60,000 plus possible criminal penalties

Estate Tax Planning Opportunities

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Estate Planning Ideas

- **Estate Tax**
  - 40% rate
  - 2016 exemption: $5.45 million
  - 2017 exemption: $5.50 million

- **Gift Tax**
  - Follows estate tax rate and exemption
  - Annual exclusion is $14,000 per recipient ($28,000 per recipient if spouse elects to split)
    - Same for 2016 and 2017
    - Use it by December 31, no carryover

- **GST** – Follows estate tax rate and exemption

Estate Planning Ideas

- Reduce/eliminate taxes
  - In the simplest terms, 3 main options:
    - Exemptions – use both if married
    - Removal of assets from estate
    - Life insurance used to replace assets given to charity and/or pay remaining estate taxes

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Estate Planning Ideas

- Exemption Portability - Upon first death of spouse, estate can elect to permit the surviving spouse to use remaining exemption
    - Must be elected on estate tax return even if no tax due
    - Doesn't apply to GST tax exemption
    - Only available for the most recently deceased spouse

- Provides flexibility after death - absent planning

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Estate Planning Ideas

- Remove assets from estate
  - Appreciating assets are best to give away
  - Annual gifts $14,000/$28,000
  - Unlimited gifts to charity
  - Medical/educational expenses paid directly to provider
  - 529 Plans - $70,000 in one year but can be elected to spread out over 5 years

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Estate Planning Ideas

- Consider both estate and income tax goals
- Plan gifts to grandchildren carefully
- Gift interests in business and FLP interests – use valuation discounts
- Use trusts – can provide tax savings while preserving some control

Estate Planning Ideas

- Life Insurance - move to Irrevocable Life Insurance Trust (ILIT)
- Intentionally Defective Grantor Trusts (IDGTs)
- Trusts as S-corporation shareholders
- Qualified Personal Residence Trust (QPRT)
- Grantor Retained Annuity Trust (GRAT)
- LLC/LLP/LP/FLP
  - Discounts are being limited for lack of control and minority interest (section 2704)
  - Projected to be effective January 2017
- Charitable Trusts
  - CRAT, CRUT

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Irrevocable Life Insurance Trusts (ILITs)

- Used to purchases insurance, usually on the life of the grantor
- Trust is the owner of the Insurance policy and therefore the proceeds are not included in the grantor's estate
- Grantor makes gifts to trust each year to cover premiums
  - Gift tax return may be required
  - Crummey powers
  - GST exemption allocation
- ILITs are taxed as grantor trusts, but often no income is received and therefore an annual income tax return is not required

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Intentionally Defective Grantor Trusts (IDGTS)

- Federal income tax consequences are to the grantor and trust is treated as if nonexistent
- Estate, gift and GST – treated differently
- Irrevocable
- Trustee should be someone other than the grantor, can be spouse
- Grantor retains a power that will not result in the trust becoming “defective” for estate taxes

Intentionally Defective Grantor Trusts (IDGTs)

- Powers creating grantor trust – in general
  - Grantor's retained interest exceeds 5% of trust's value
  - Exercise power of disposition of beneficial enjoyment of the trust's assets
  - Possess certain administrative powers allowing them to engage in certain transactions with trust
  - Power to revest title property in the trust to grantor
- Common powers creating IDGTS
  - Power of substitution – grantor has right to reacquire assets in exchange for assets of equal value
  - Power to borrow assets without secured loan and/or no interest payments

Trusts As Owners of S-Corp Stock

Eligible Shareholders

- Voting Trusts
  - Each Beneficiary is treated as a shareholder and must meet the eligibility tests
- Revocable Trusts
- Grantor Trusts
  - Deemed owner is treated as a shareholder
- Trust whose grantor status was terminated by reason of grantor's death
  - Limited to 2 years and 2 ½ months after Date of Death

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Trusts As Owners of S-Corp Stock

Eligible Shareholders

- Estates
  - Eligible shareholder during administration of the estate
  - Administration cannot be "unreasonably prolonged"
- Revocable Trust after the death of the grantor with Section 645 Election
  - Limited to 2 years and 2 ½ months after Date of Death
- Other trusts receiving stock by will
  - Limited to 2 years and 2½ months of the trust becoming a shareholder
- QSSTs and ESBTs

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Trusts As Owners of S-Corp Stock

- QSST – Qualified Subchapter S Trust
  - Can have only one current income beneficiary (CIB), who must be a citizen or resident of U.S.
  - Any corpus distributions made during the CIB's life must be made to that beneficiary
  - Income interest must terminate upon the earlier of the death of the CIB or termination of the trust
  - If the trust terminates during the lifetime of the CIB, the trust assets must be distributed to the CIB
  - Annual income must either be distributed, or required to be distributed, to the CIB

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Trusts As Owners of S-Corp Stock

- QSST – Election
  - Election must be made within 2½ months of the trust becoming a shareholder
  - If transfer is due to death, the election can be delayed an additional 2 years
  - Beneficiary may make the election
  - A separate election must be made for every S-Corp in which the trust has an interest

- Cannot be a foreign trust

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Trusts As Owners of S-Corp Stock

- QSST – Tax treatment - Federal
  - Portion of the trust that consists of S-Corp stock is treated as grantor trust – owned by beneficiary, taxed to the beneficiary (not the grantor)
  - Portion of the trust that consists of all other assets will be taxed as a simple or complex trust based on the terms of the trust

Trusts As Owners of S-Corp Stock

- ESBT – Electing Small Business Trust
  - All beneficiaries must be individuals, estates or charitable organizations
  - The trust is not a QSST or a trust exempt from income taxation
  - The beneficiary may not have acquired interest in the ESBT by purchase (this is different from the trust acquiring the S-corp stock by purchase)
  - Trustee must timely elect ESBT treatment

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Trusts As Owners of S-Corp Stock

- ESBT – Election
  - Election must be made within 2½ months of the trust becoming a shareholder
  - If transfer is due to death, the election can be delayed an additional 2 years
  - The trustee makes the election
  - Only one election must be made and covers all S-Corps in which the trust has an interest
- Cannot be a foreign trust

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Trusts As Owners of S-Corp Stock

- ESBT – Tax Treatment – Federal
  - Portion of the trust that consists of S-Corp stock is taxed at the trust level, regardless of distributions
  - S-Corp income is taxed at the highest individual tax rate
  - Expenses related to S-Corp income (state taxes, etc.) can offset S-Corp income
  - Income distributed is not taxable to beneficiaries
  - Portion of the trust that consists of all other assets will be taxed as a simple or complex trust based on the terms of the trust

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Qualified Personal Resident Trust (QPRT)

- Removes personal residence from estate now
- Can continue to live in home for a period of time – usually 10-15 years
- When term is up, residence transfers to the beneficiaries
- If wish to stay longer, pay rent
- Leverages estate exemption

Grantor-retained annuity trusts (GRATs)

- Objective is to transfer property at a reduced gift-tax cost while removing post-gift appreciation from the estate of the grantor.
- Grantor creates an irrevocable trust and transfers assets to the trust. The grantor reserves right to a fixed annual payment from the GRAT for a term of years using the current Applicable Federal Rates.
- The annuity payments can consist of either earnings from the property transferred or to the extent there is none, a portion of the original property transferred.
- The intent is that the property is appreciating faster than the Applicable Federal Rate used to calculate the annuity stream.

Grantor-retained annuity trusts (GRATs)

- At end of term, the grantor's interest in the GRAT terminates and the remaining assets are transferred to remainder beneficiaries or further held in trust.
- The grantor needs to outlive the term of the trust, otherwise any remaining assets are included in the grantor's taxable estate.

Grantor-retained annuity trusts (GRATs)

- Gift value is determined by taking the total current value of assets and subtracting the actuarial value of the future annuity payments
- A gift tax return should be filed, even for a zero-GRAT or near zero-GRAT to get the statute of limitations running
- An annual valuation should be used if annuity payments are to be satisfied by non-cash assets
- Trust is taxed as a grantor trust for federal purposes
  - Eligible S-Corp shareholder
  - All income taxed to grantor

Partnership Interests

- Typically LLC or FLP
- Transfer now but can keep some control
  - Managing member or GP
  - Sale or transfer – need approval
- Large discounts expiring
- Asset Protection

Charitable trusts

- Formal trust document must be created
- Trustee is named
- Charitable deduction may be available in the year created equal to the present value of the charity's portion
- A portion of the trust will be paid to charity and a portion of the trust will be paid to a non-charitable beneficiary
- If the non-charitable beneficiary is not the donor, a gift tax return may be required

Charitable trusts

- Charitable Remainder Annuity Trust (CRAT)
  - Non-charitable beneficiary receives a specific dollar amount paid at least annually
  - Amount must be between 5% and 50% of initial value
  - No additional contributions are allowed into the trust
- CRUTs and CRATs
  - Value of the remainder interest must be at least 10% of the initial value

Tax Treatment of CRUTs and CRATs

Federal purposes

- Income earned and retained in the trust is not taxed
- Distributions to non-charitable beneficiaries draws out income
- Income ordering rules
  - Ordinary income
  - Capital gains
  - Tax exempt income
  - Corpus

Life Insurance

- Life Insurance can be helpful
  - Pay estate taxes
  - Equalize assets passing to children who are not involved in family business
  - Proceeds generally income tax free
  - Proceeds can be excluded from estate tax with proper planning
  - Should not be the owner of the policy
  - 3 year rule does not apply to new policies

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Thank You

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