The Individual Investor's Guide to Personal Tax Planning 2016

By AAII Staff

Article Highlights

- Covers information for 2016 and 2017 taxes, including rates, exemptions and deductions.
- Inflation adjustments are 0.8% for many line items, though the changes differ for some. Not all thresholds, deductions, credits and exemptions are changing in 2017.
- The new Specific Tax Guidelines section covers the rules regarding filing status, Medicare Part B premiums and IRA rollovers.

The most significant change to the tax code since the original publication of last year's tax guide was the renewal of several so-called tax extenders in late 2015.

The Consolidated Appropriations Act, 2016 (H.R. 2029), reinstated the ability to donate up to $100,000 per tax year from a traditional individual retirement account to a qualified charity. These qualified charitable distributions (QCDs) can be taken in lieu of a required minimum distribution for the same dollar amount. See "The Tax Advantages of Qualified Charitable Distributions From IRAs" in the October 2016 *AAII Journal* for more information.

The appropriations bill also reinstated the ability to deduct state and local sales taxes. Those living in areas with both sales and income taxes can choose to take the higher deduction, but cannot deduct both the state and local sales tax and income tax deductions. Premiums paid or accrued for qualified mortgage insurance receive the same tax treatment as mortgage interest. Parity between qualified transportation and qualified parking benefits was restored with monthly limitations of $255 for both 2016 and 2017. These tax extenders will remain in place as long as new legislation does not alter the tax code.

Depending on your income and expenses, your tax bill for 2016 may not differ much from your 2015 tax bill. In 2017, your tax bill should not be significantly different either, as long as your taxable income, expenses and deductions remain similar to 2016.

The Internal Revenue Service made modest inflation adjustments for 2017, but not every line item was changed. The tax brackets for individuals will increase by approximately 0.8% next year across marital statuses. The standard deduction will rise by a similar amount (except for heads of household, who will have a 0.5% increase). The personal exemption does not change next year. The alternative minimum tax (AMT) exemption amount will rise by either 0.7% or 0.8%, depending on a taxpayer's filing status.

Those saving for retirement should take note that the contribution limits will not change in 2017. Workers will continue to be limited to contributing $18,000 to their 401(k) or similar type of workplace retirement plans (plus an additional $6,000 for those age 50 or older). Deductible IRA contributions will remain capped at $5,500 (plus an additional $1,000 for those age 50 or older).

The threshold for deducting health care expenses will rise to 10% of adjusted gross income (AGI) for everyone, including those over age 65, in 2017. Also effective in 2017, the penalty for not having health insurance will be indexed to inflation.

The maximum limit on wages subject to Social Security taxation will rise 7.3%, to $127,200, in 2017.

The additional tax for failing to file a tax return within 60 days of the due date of such return is now the lesser of $205 (increased from $135) or 100% of the unpaid tax. The penalty applies to tax forms required to be filed

A special note of thanks goes out to Mark Luscombe, a principal federal tax analyst for tax content and software provider Wolters Kluwer, CCH (CCHGroup.com) for previous assistance in answering detailed questions about the tax code. Sources of information used for this year's guide include CCH, "J.K. Lasser's Your Income Tax 2017" (John Wiley & Sons, 2017) and the Internal Revenue Service, Healthcare.gov, Medicare and the Social Security Administration.

Table 1. An Overview of Tax Changes in the Coming Years

	2016	2017	2018
Long-Term Capital Gains Rate			
Tax Bracket Equals 39.6%*	20%	20%	20%
Tax Brackets 25%–35%*	15%	15%	15%
Tax Bracket 15% or Below	0%	0%	0%
Qualified Dividends Rate			
Tax Bracket Equals 39.6%*	20%	20%	20%
Tax Brackets 25%–35%*	15%	15%	15%
Tax Bracket 15% or Below	0%	0%	0%
Marginal Income Tax Rates			
Top Bracket	39.6%	39.6%	39.6%
Sixth Bracket	35%	35%	35%
Fifth Bracket	33%	33%	33%
Fourth Bracket	28%	28%	28%
Third Bracket	25%	25%	25%
Second Bracket	15%	15%	15%
First Bracket	10%	10%	10%
Child Tax Credit	$1,000	$1,000	$1,000
Marriage Penalty Relief			
Standard Deduction (% of S.D. for singles)	200%	200%	200%
15% Tax Bracket (% of bracket for singles)	200%	200%	200%
Personal Exemption Phaseouts	$311,300	$313,800	$313,800**
Limitation on Itemized Deductions	$311,300	$313,800	$313,800**
AMT Exemption			
Single	$53,900	$54,300	$54,300**
Married Filing Joint	$83,800	$84,500	$84,500**
Head of Household	$53,900	$54,300	$54,300**
Estate Tax			
Exemption	$5.45 million	$5.49 million	$5.49 million**
Maximum Rate	40%	40%	40%

**3.8% net investment income tax (NII) surtax applies when AGI is above $250,000/$200,000.*
***Subject to change based on inflation.*

in calendar years after 2015.

Waivers will be allowed on the 60-day deadline for IRA rollovers if certain conditions are met. They include, but are not limited to, an error by the financial institution making or receiving the contribution, a misplaced distribution check, severe damage to the taxpayer's principal residence and serious illness. Written certification to a plan administrator or IRA trustee must be submitted by the taxpayer within 30 days after being able to make the contribution to take advantage of the waiver. See IRS Rev. Proc. 2016-47 (at www.irs.gov) for more information.

New cost-basis reporting rules went into effect on January 1, 2016, for variable-rate bonds (including inflation-adjusted bonds), stripped bonds and convertible bonds among other non-traditional bonds. Brokers will be required to report the cost basis for all purchases of these bonds after the aforementioned date. Previously, brokers were required to report the cost basis for traditional bonds, but not variable-rate and other more complex bonds, purchased on or after January 1, 2014.

This year's tax guide includes a new section, Specific Tax Guidelines. This section covers area of the tax code not covered elsewhere in this guide, such as the filing rules regarding marital status and money market funds with floating net asset values.

One of the proposals that president-elect Donald Trump campaigned on was lower taxes. His plan called for a maximum tax rate of 33% on individual income with a standard deduction of $30,000. The estate tax would be repealed. A full repeal of the Affordable Care Act would eliminate the so-called "Cadillac Tax," an excise tax on what are considered to be high-cost employee health care plans scheduled to take effect in 2018. Passing tax legislation, particularly comprehensive reform, is always difficult, however, due to ideological differences, special interests and fiscal concerns.

Regardless of what does or does not happen on the legislative front, one thing will be constant: You will still have to pay taxes. Furthermore, even a simplified tax code is still likely to be too complex; hence the need for tax guides. As has been the case in years past, our tax guide provides an overview of the tax rates and deductions likely to impact the majority of AAII members. Since there are many details, loopholes and pitfalls within the tax code, it is impossible for this guide to provide enough details to cover specific tax situations. If you have questions, consult a tax professional. It is your tax return, and the IRS will hold you responsible for any errors made on it.

Estimate Your Taxes on AAII.com

You can estimate your 2016 and 2017 tax liabilities on AAII.com. Our Tax Forecasting Worksheet allows you to enter your data on our website. The fillable PDF document will calculate the results.

Once you are finished, you can print a copy for your records. (Be sure to print the document if you want to preserve your work, since the document cannot be saved to AAII.com. See the inside front cover of this issue, opposite the Table of Contents, for more details.)

What's New?

Most individuals will continue to fall into the long-standing tax brackets of 10%, 15%, 25%, 28%, 33% and 35%. High-income earners will pay a 39.6% marginal tax rate on income. The 2017 dollar amounts defining each bracket have been revised upward to account for inflation, mostly by 0.8%.

Social Security is taxed at 6.2% for employees and 12.4% for those working in self-employed positions on the first $118,500 of wages. In 2017, the cap on maximum taxable earnings will rise to $127,200. The Wall Street Journal described the 7.3% increase as the largest one-year bump since 1983. Retirees younger than full retirement age who have claimed Social Security benefits can earn up to $15,720 without benefits being withheld. This limit will rise to $16,920 in 2017.

The AMT exemption is $83,800 for married couples filing jointly and $53,900 for single filers in 2016. In 2017, the exemption will rise to $84,500 and $54,300, respectively. The exemptions are indexed to the rate of inflation and will continue be raised accordingly in the future. This automatic increase is important because the AMT exemption was not previously indexed to inflation. Legislation had to be passed to prevent the AMT from ensnaring an ever-larger number of taxpayers.

The personal exemption phases out at income levels of $311,300 for married couples filing jointly and $259,400 for single filers for 2016. The phaseouts will increase to $313,800 and $261,500, respectively, in 2017. The total amount of exemptions that can be claimed by a taxpayer is reduced by 2% for each $2,500 or portion thereof by which adjusted gross income exceeds the threshold level. Married couples filing separate returns will see their exemptions reduced by 2% for each $1,250 of adjusted gross income that exceeds the threshold.

An adjustment for the so-called "marriage penalty" puts the standard deduction for married couples filing jointly at double the standard deduction for those filing single. Married couples filing jointly can claim a standard deduction of $12,600, and single filers can claim a standard deduction of $6,300 on their 2016 tax returns. In 2017, the standard deduction will rise to $12,700 and $6,350 for married and single filers, respectively.

The $1,000 maximum child tax credit is phased out for married couples filing jointly with modified adjusted gross income (MAGI) above $110,000 in 2016 ($75,000 for single parents). Neither the tax credit nor the phaseout are indexed to inflation, meaning both will be unchanged in 2017. If the child tax credit exceeds the tax liability, the difference will be paid to the taxpayer, subject to certain requirements. See IRS Publication 972 for more information.

Most taxpayers will not see a change in long-term capital gains and dividend tax rates, barring a drop into the lowest marginal tax bracket or a rise into the top marginal tax bracket. Long-term capital gains and qualified dividends are taxed at 15% if incurred for securities held within a taxable account. (There is no capital gains tax or dividend taxes for securities held within a retirement account, such as an IRA. See Robert Carlson's article, "Do's and Don'ts of IRA Investing," in the March 2010 *AAII Journal* for investments that can cause an unexpected tax problem; the article is available at AAII.com.) Collectibles, which include gold coins and bars, are taxed at a maximum 28% rate. Funds investing in precious metals, including exchange-traded funds, may also be subject to the collectibles tax rate. Check with the fund company if you have questions about the tax status. Short-term capital gains are taxed as ordinary income. If you are in the 10% or 15% tax bracket, long-term capital gains and qualified dividends are not taxed.

A 20% tax applies to long-term capital gains and dividends realized in taxable accounts by married couples filing jointly with incomes above $466,950 and single filers with incomes above $415,050 in 2016. The same higher tax rate will apply in 2017 to married couples filing jointly with incomes above $470,700 and single filers with incomes above $418,400. Married couples filing joint returns with net investment income and modified adjusted gross incomes above $250,000 and single filers with net investment income and modified adjusted gross incomes above $200,000 also must pay the additional 3.8% net investment income (NII) surtax on capital gains and dividends. Collectibles are taxed at a 28% rate, but are eligible for the 3.8% surcharge as well. The $250,000/$200,000 thresholds are not indexed to inflation and will remain the same in 2017.

Medical Insurance Mandate

The individual shared responsibility provision of the Affordable Care Act requires adults and children to have minimum essential health coverage. Both Medicare Part A and Medicare Part C (Medicare Advantage) qualify as minimum essential health coverage. Taxpayers who did not have qualifying coverage and did not qualify for an exemption in 2016 will be assessed a penalty of either the greater of 2.5% of household income above the gross income threshold for filing a tax return or $695 per adult ($347.50 per child) limited to a family maximum of $2,085. In 2017, the penalty will remain at 2.5% of household income above the gross income threshold for filing a tax return

Health Care Reform's Impact on Taxes

The tax impact of the Affordable Care Act includes surcharges, higher limits on medical expense deductions, changes to flexible savings account contributions and carryovers, and a penalty for not complying with the medical insurance mandate.

A 0.9% additional Medicare tax applies to wages, compensation and self-employment income above $250,000 for married persons filing jointly and qualifying widows(ers), $200,000 for single persons and heads of household and $125,000 for those who are married but filing separately. The tax applies to wages that are subject to the Medicare tax and does not depend on adjusted gross income. Should the additional tax not be withheld from wages (a situation that could occur for dual-income couples or individuals working more than one job), the tax could be subject to a penalty if not paid with estimated taxes or through additional withholdings (you can request that your employer increase the income tax withholding on your W-4). More information about the additional Medicare tax can be found on the IRS website at www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Questions-and-Answers-for-the-Additional-Medicare-Tax.

A 3.8% surtax on net investment income (NII) applies to the lesser of net investment income or modified adjusted gross income exceeding $250,000 for married persons filing jointly and qualifying widows(ers), $200,000 for single persons and heads of household and $125,000 for those who are married but filing separately. (These thresholds are not indexed for inflation.) Investment income subject to the tax includes, but is not limited to, taxable interest, dividends, non-qualified annuities, rents and royalties, capital gains and passive income from partnerships. Capital gains from the sale of one's primary residence are subject to the tax to the extent that the income exceeds the applicable home sale exclusion ($500,000 for joint filers and $250,000 for single filers). Excluded are tax-exempt interest (e.g., municipal bond interest payments), distributions from individual retirement accounts (IRAs) and distributions from qualified retirement plans [e.g., 401(k) plans]. The IRS has answers to common NII surtax questions at www.irs.gov/uac/Newsroom/Net-Investment-Income-Tax-FAQs.

Uninsured medical expenses must exceed 10% of adjusted gross income before they can be claimed as a deduction. The floor for individuals age 65 and older is 7.5% in 2016, but rises to 10% in 2017.

Flexible savings arrangement contributions for 2016 are limited to $2,550 annually. This limit is indexed to inflation, and will increase to $2,600 in 2017. At the election of their plan sponsors, employees can either carry over unused balances of $500 into the next plan year or take a grace period of up to two and a half months.

Failure to maintain minimum essential health coverage will result in a penalty. The penalty is based on a percentage of income or a per-person fee, whichever is higher. The percentage of income penalty is capped at the total yearly premium for the national average of a Bronze plan sold through the exchanges. The per-person fee is capped for the entire family.

In 2016, the penalty is 2.5% of household income above the gross income threshold for filing a tax return or $695 per adult ($347.50 per child) limited to a family maximum of $2,085. In 2017, the penalty will remain at the same levels even though the maximum is indexed to inflation.

or $695 per adult ($347.50 per child) limited to a family maximum of $2,085, even though it is now indexed to inflation. Visit www.irs.gov/aca and www.HealthCare.gov for more information. The latter website also has a calculator for determining whether or not a person or family qualifies for Medicaid or subsidies for purchasing insurance.

The mandate is on top of the additional Medicare tax and the NII tax. The 0.9% additional Medicare tax applies to wages, compensation and self-employment income above $250,000 for married persons filing jointly and $200,000 for single persons. The surtax on net investment income applies to married couples filing jointly and single filers with net investment income or modified adjusted gross income exceeding $250,000 and $200,000, respectively.

More information about these taxes can be found in the box above.

Medical Expenses

Those under the age of 65 at the end of 2016 can only deduct medical expenses exceeding 10% of adjusted gross income (AGI). Those age 65 or older at the end of 2016 can use the lower 7.5% floor in 2016. Effective January 1, 2017, all taxpayers—regardless of age—will only be able to deduct qualified medical expenses exceeding 10% of adjusted gross income.

Medical insurance premiums for the self-employed are deductible and can be used to reduce adjusted gross income on Form 1040.

Workers participating in flexible savings accounts (FSA) can carry over up to $500 of unused amounts into the next plan year if their plan sponsor allows them to. Plan sponsors have the choice of either offering employees the ability to carry over up to $500 or allowing employees a grace period of up to two and a half months. Dependent care is also eligible for the grace period option, but not the carryover option.

Contributions to a health savings account (HSA) are allowed for those covered by a high-deductible health care plan (HDHP) and not enrolled in

Medicare. The minimum annual deductible for self-only coverage is $1,300; it is $2,600 for family coverage. The maximum limits for annual deductible and other out-of-pocket expenses are $6,550 and $13,100, respectively. The minimums and maximum limits will be unchanged in 2017.

HSA contributions cannot exceed $3,350 for individual coverage and $6,750 for family HDHP coverage. In 2017, the maximum contributions will be $3,400 and $6,750 for individual and family coverage, respectively.

Inflation Adjustments for 2017

As previously stated, many deductions, exemptions and limits that are indexed to inflation will increase by approximately 0.8% from 2016 amounts to account for the low levels of inflation. The increases are not universal, however, and some line items will be unchanged in 2017.

For example, the standard deduction for married couples filing jointly will rise 0.8%, from $12,600 to $12,700, next year, whereas the standard deduction for heads of household will increase by $50, to $9,350, a 0.5% increase.

Pay attention to the details, because the inflation adjustments are not being made uniformly. The HSA contribution limit is rising for an individual with self-only coverage, but not for individuals with family coverage, as noted above.

At press time, the IRS had announced most of its 2017 adjustments. Numbers that had yet to be updated (such as the standard mileage deductions) are noted in the tables.

Capital Gains Reporting

Brokers are required to report the cost basis for stocks purchased after January 1, 2011; mutual fund, exchange-traded fund (ETF) and dividend reinvestment program (DRP) shares purchased after January 1, 2012; and options and traditional bonds bought and sold by their clients on or after January 1, 2014. If you bought a stock, fund, option or bond before the aforementioned dates, your broker is not required to report the cost basis.

As previously mentioned, certain debt instruments, particularly those that are more complex than traditional bonds, purchased after January 1, 2016, fall under the cost basis reporting rules. These include variable-rate bonds (including inflation-adjusted bonds), stripped bonds and convertible bonds. Excluded from this rule are debt instruments where the principal is subject to acceleration (e.g., mortgage-backed securities) and debt instruments with a fixed-maturity date not more than one year from their date of issue.

If you sold a capital asset in 2016, you will need to fill out Form 8949. See the special write-up in the "Cost Basis" box on page 12 for details on the rules.

For a complete tax guide to the buying and selling of your personal investments, go to our Personal Investments 2016 Tax Guide in the online version of this article.

Tax Software, Books and Guides

Although many of the 2017 numbers were updated by the IRS, if you use a software program (e.g., TurboTax), a book (e.g., "J.K. Lasser's Your Income Tax 2017") or a related aid, check for updates before filing. Doing so will help to ensure that you are using the most up-to-date forms and information.

Specific Tax Guidelines

Part of the complexity of the tax code is determining how taxes will be affected by certain situations. This section gives information on scenarios that potentially may be experienced by many individual investors.

Medicare Part B

The rule of thumb for how taxable income determines Medicare Part B premiums is that your modified adjusted gross income from two years prior will determine your premiums for the current tax year (e.g., 2017 premiums will be determined by 2015 income). See the box on page 13 for information about 2017 premiums.

Marriage, Widowhood and Divorce

Under the tax code, a couple is considered married for the whole year if, on the last day of the tax year, both people are married and living together, living together in a recognized common law marriage, married and living apart without being legally separated under a decree of divorce or separate maintenance, or separated under an interlocutory (not final) decree of divorce.

Widow(er)s are considered married for the whole year in which their spouse died and can file a joint return with their deceased spouse. (If there is a dependent child, other filing statuses may be preferable.) For widow(er)s who remarry before the end of the same tax year, a joint return can be filed with the new spouse. The deceased spouse's filing status would be married filing separately in this case.

A person's filing status may be single if they were widowed before the start of the calendar year and did not remarry before the end of the calendar year.

A person who becomes divorced under a final decree by the last day of the year is considered to be unmarried for the whole year.

Same-sex couples are treated as being married for federal tax purposes if they were married in a U.S. or a foreign jurisdiction whose laws authorize the marriage of individuals of the same gender. As such, same-sex spouses must file using either married filing separately or married filing jointly status (certain exceptions apply). Same-sex couples may be able to file amended tax returns using married filing separately or married filing jointly status for prior-year returns up to the statute of limitations (which is generally three years).

Those in common-law marriages are treated as being married for federal tax purposes if they are living together in a common law marriage recognized in the state where they now live or in the state where the common law marriage began.

Couples in domestic partnerships, civil unions or other similar formal

Cost Basis Reporting for Stocks, Bonds, Funds and Options

Brokers are required to report cost basis for stocks purchased on or after January 1, 2011; mutual fund, exchange-traded fund (ETF) and dividend reinvestment plan (DRP) shares purchased on or after January 1, 2012; and options and traditional bonds purchased on or after January 1, 2014. Brokers are also required to state whether any gain or loss on a sale is short-term or long-term. The rules do not apply to securities and funds purchased before the aforementioned dates.

Traditional bonds and debt instruments purchased on or after January 1, 2014, are subject to the reporting rules. The cost basis of and the proceeds for variable-rate bonds, inflation-indexed bonds, convertible bonds, stripped bonds and other complex debt instruments purchased on or after January 1, 2016, fall under the same reporting rules. Excluded are debt instruments where the principal is subject to acceleration (e.g., mortgage-backed securities) and debt instruments with a fixed-maturity date not more than one year from their date of issue.

Investors have the option of notifying their broker as to how market discounts or interest are treated. Brokers will follow a default method of amortizing bond premiums if not otherwise notified. The rules are complex and we suggest speaking with your brokerage firm about the application of the rules, as well as with a tax professional about the best tax treatment to use.

The type of option owned alters how cost basis is reported. Index options may be subject to different cost basis reporting rules. Again, we suggest speaking with your broker if you have questions about how the cost basis is reported.

A default accounting methodology known as first-in, first-out (FIFO) is used when the purchase of securities (other than a mutual fund or DRP shares) involves more than one transaction. The FIFO method treats the first shares purchased ("first in") as also being the first shares sold ("first out"). Depending on how the stock has performed, this treatment can result in a larger tax bill (the shares appreciated in value) or a bigger capital loss (the shares fell in value).

For mutual funds and DRP stocks, the adjusted basis must be reported in accordance with the broker's default method—average cost basis—unless you specify otherwise. As the name implies, the average purchase price for your shares, regardless of when they are acquired, is used to determine the cost basis. You can specify FIFO instead of average cost basis. Another option is specific identification. The specific identification method allows you to choose the specific shares that are sold. This treatment can also result in a larger or a smaller tax bill, depending on how the fund has performed relative to the purchase price of the selected shares. You may be able to use other methods such as highest-in, first-out (HIFO) or last-in, first-out (LIFO). Contact your broker, fund family or DRP program to determine what their default methodology is and what choices you have for selecting methodologies.

If you want your broker or fund family to use a specific methodology other than their default methodology (e.g., FIFO for stocks or average cost for mutual funds), you must notify them. In order to do this, you must provide written instructions to your broker or fund administrator detailing your intentions before the order is executed, not afterward.

Dustin Stamper at Grant Thorton's National Tax Office emphasized the importance of providing these instructions in writing. If you give your broker or fund family specific instructions and they report a different methodology to the IRS, the only way you can dispute what is on Form 1099-B is to provide a dated copy of your instructions. Stamper said that investors will not be able to retroactively determine which shares were sold; they must provide written instructions at or before the time the shares are sold.

relationships recognized but not denominated as marriage under state law are not considered to be married for federal tax purposes.

Money Market Funds With Floating NAVs

The Securities and Exchange Commission (SEC) requires some money market funds, particularly institutional prime money market funds and tax-free institutional money market funds, to use floating net asset values (NAVs). This means that their NAVs are not pegged to $1 per share, but rather can move above or below that benchmark.

The IRS responded to the SEC's ruling by saying "No gain or loss is determined for any particular redemption of a taxpayer's shares in a floating-NAV money market fund. Without a determination of loss, a particular redemption does not implicate the wash-sale rules." The wash-sale rules disallow a loss being claimed for tax purposes when an investment is sold and a substantially identical investment is purchased within 30 days of the sale.

IRA Rollovers

IRA rollovers are restricted to one per person per year. The limitation does not apply to trustee-to-trustee transfers, meaning you can move funds from broker to broker as many times as you would like. The key is that the funds are transferred directly from one broker to another without the assets being distributed to you. A check payable to you instead of the receiving custodian would trigger the 12-month rule.

Rollovers to or from a qualified plan [e.g., a 401(k) plan] are excluded from the rule. Roth IRA conversions are not subject to the one-year limitation and the IRS will disregard them in terms of applying the one-rollover-per-year limitation to other rollovers. Moving funds between Roth IRAs would, however, trigger the one-year waiting period if a check is made payable to you.

There is a 60-day deadline for completing a rollover. As previously stated, waivers to the deadline will be allowed if certain conditions are met, including, but not limited to, an error by the financial institution making or receiving the contribution, a misplaced distribution check, severe damage to the taxpayer's principal residence and serious illness. Written certification to a plan administrator or IRA trustee must be submitted by the taxpayer within 30 days after being able to make the contribution to take advantage of the waiver. See IRS Rev. Proc. 2016-47 for more information.

Pretax and aftertax contributions from defined-contribution plans, [e.g., 401(k), 403(b) and 457(b) plans] can be assigned to different accounts as long as directions are given to the plan administrator in advance of the distribution. See IRS Notice 2014-54 for more information and examples of various scenarios.

The IRS' Rollover Chart shows the types of retirement savings accounts funds can be rolled over from and into a different type of retirement savings account. The chart was recreated in the July 2016 *AAII Journal* ("IRA Rollover Chart: Rules Regarding Rollovers and Conversions.")

Be Vigilant About Tax Scams

The IRS continues to warn about tax scams. An ongoing common scam is a phone call requesting immediate payment, often accompanied by a threat of arrest or deportation. Hang up if you receive such a call; the IRS never initiates contact via a phone call or an email. If the IRS wants to contact you about a tax matter, you will receive a physical letter sent through the U.S. postal service.

Always restrict access to your Social Security number, monitor your credit reports regularly, and use anti-virus and firewall software on your computer. Filing your tax return as early as is reasonably possible can also help. Those in your retirement years should be especially on guard, as the fraudsters are targeting your demographic group. See the box on page 28 for more information on how to protect yourself against fraud attempts.

Income, Medicare Part B and Social Security

The premiums for Medicare Part B are determined by the amount of modified adjusted gross income (MAGI) reported. MAGI is adjusted gross income plus tax-exempt interest (e.g., interest from municipal bonds). Adjusted gross income (AGI) can be found on line 37 of IRS Form 1040. AGI includes the taxable portion of Social Security benefits plus taxable distributions from retirement accounts such as required minimum withdrawals (RMDs).

Medicare Part B premiums are determined by MAGI from two years prior. In 2017, the standard Medicare Part B premium will be $134.00 for individuals filing married joint returns with 2015 household MAGI of $170,000 or less. (Medicare says most people who receive Social Security benefits will pay $109.00 per month.) The monthly premium rises to $428.60 for 2015 MAGI above $428,000. Individuals filing as singles with 2015 MAGI of $85,000 or less will pay the standard premium of $134.00 (or $109.00), with a maximum premium of $428.60 for 2015 MAGI above $214,000. The premiums for various income levels can be found at www.medicare.gov (click on "Your Medicare Costs").

The calculation for how much of your Social Security benefits is taxed is based on combined income for the current tax year. The Social Security Administration defines combined income as: AGI + tax-exempt interest + one half of your Social Security benefits. The amount of benefits subject to taxation for the 2016 tax year is determined by your 2016 combined income. The table below shows how much of Social Security benefits are taxed.

Combined Income	Percent of SS Benefits Taxed
Below $25,000 Single & Head of Household Below $32,000 Married Filing Jointly	0%
$25,000 to $34,000 Single & Head of Household $32,000 to $44,000 Married Filing Jointly	up to 50%
Above $34,000 Single & Head of Household Above $44,000 Married Filing Jointly	up to 85% of benefits + other income

Useful Tax Numbers

Here is a list of the tax rates, deductions, exemptions, credits and other related items that may apply to your 2016 and 2017 taxes. These numbers reflect the changes made by the American Taxpayer Relief Act of 2012 (ATRA) and 2017 inflation adjustments announced by the IRS.

Standard Deduction

For 2016, the standard deduction is $12,600 for married couples filing a joint return, $6,300 for those who are single or those who are married filing separate returns and $9,300 for heads of household.

For 2017, the standard deduction will rise to $12,700 for married couples filing a joint return, $6,350 for those who are single or those who are married filing separate returns and $9,350 for heads of household.

Personal Exemptions

The 2016 personal exemption is $4,050. The exemption can be claimed for yourself, your spouse (if filing a joint return) and any qualifying dependents. The exemption will start to phase out at $311,300 for married couples filing jointly and $259,400 for single filers.

The personal exemption will stay at $4,050 in 2017. The phaseout levels will be raised to $313,800 for married couples filing jointly and $261,500 for single filers.

Individual Retirement Accounts and 401(k) Plans

The maximum allowed IRA contribution for 2016 is $5,500 ($6,500 for individuals age 50 or older). The contribution limits will remain unchanged in 2017. (These limits were last increased in 2013.) The additional catch-up contribution limit of $1,000 is not indexed to inflation and will also be unchanged next year. The contributions can be fully deducted for modified adjusted gross incomes (modified AGIs) below $98,000 and $61,000 for married filing joint and single household returns, respectively. The exemption is $184,000 for a person filing a married joint return who is not covered by a workplace retirement plan but whose spouse is. In 2017, the phaseout levels for deducting contributions will increase to $99,000 for married filing jointly and $62,000 for singles. It will be $186,000 for those married filing a joint return not covered by a workplace retirement plan but whose spouse is.

In 2016, the maximum annual contribution limit to a 401(k) plan or similar type of defined-contribution plan is $18,000 ($24,000 if you are age 50 or over). The maximum contribution limit remains the same in 2017. (The limit was last increased in 2015.)

In 2016, the maximum annual contribution for SIMPLE plans is $12,500 (those age 50 or over can make a maximum catch-up contribution of $3,000); in 2017, the maximum contribution will stay at $12,500. These amounts remain the same in 2017.

Qualified Plan Contributions

In 2016, the maximum annual contribution for qualified plans, including SEP and Keogh plans, is $53,000 or 25% of your compensation, whichever is less; in 2017, the maximum contribution will rise to $54,000 or 25% of your compensation, whichever is less.

Estate and Gift Tax Limits

Tax laws passed in 2010 and 2013 made the estate tax exemption both portable and indexed to inflation. The exemption is $5.45 million in 2016. In 2017, the exemption will rise to $5.49 million. This is a per-spouse exclusion and it is portable, meaning that if one spouse passes away, the surviving spouse can claim the exclusion, resulting in a total effective exclusion of $10.9 million in 2016 and $10.98 million in 2017. The large figures will prevent most families from having to pay estate taxes.

The estate tax rate is 40%. The step-up basis rule applies when an inherited asset is sold: The capital gain resulting from the sale is calculated as the difference between the proceeds at the time of the sale transaction and the value of the assets at the time of the inheritance.

Executors have to report the fair value of the property included in the gross estate to both the IRS and to the heirs. This law applies to property reported on estate tax returns filed after July 31, 2015. Beneficiaries claiming a basis for inherited property above the reported value may be subject to a 20% penalty.

The annual gift tax exclusion is $14,000 in 2016 and $28,000 for consenting couples. (You will need to file Form 709.) The exclusions will stay unchanged in 2017.

Required Minimum Distributions (RMDs)

Individuals age 70½ and older are required to take a distribution from their retirement accounts by December 31, 2016. These accounts include 401(k) plans, 403(b) plans, 457(b) plans, traditional IRAs, SEP IRAs, SARSEP IRAs, SIMPLE IRAs and Roth 401(k) plans. RMDs from defined-contribution plans, such as 401(k) plans, can be postponed beyond age 70½ for those who are still working, contributing to a defined-contribution plan and own less than 5% of the company. Roth IRA plans are exempt while the owner is alive.

If you turned 70½ in 2016, you have until April 1, 2017, to take your first RMD. You will need to take a second RMD during 2017 to satisfy that year's distribution requirement.

According to the IRS, "Generally, an RMD is calculated for each account by dividing the prior December 31st balance of that IRA or retirement plan account by a life expectancy factor that IRS publishes in tables in Publication 590-B, Distributions from Individual Retirement Arrangements (IRAs)."

Child Tax Credit

In 2016 and 2017, the maximum child tax credit for dependent children younger than 17 is $1,000. The credit was made permanent by the ATRA.

Kiddie Tax

The "kiddie tax" applies to children up to age 18 and could apply to children up to age 23—depending on how much earned income they have and whether or not they are full-time students.

Under the kiddie tax rules, children with investment income above a certain amount may have part or all of their investment income taxed at their parents' income tax rate.

The kiddie tax applies if the child is age 17 or younger by the end of the year. In 2016, the kiddie tax will apply if the child's total investment income exceeds $2,100. It will remain unchanged in 2017.

In addition, the kiddie tax can apply to older children, depending on how much earned income they have and whether or not they are full-time students.

- Starting in the year that your child turns 18, the kiddie tax will apply if your child's earned income (including salaries and wages, commissions, professional fees and tips) does not exceed half of the child's overall support.
- Starting in the year your child turns 19, the kiddie tax will apply if your child is a full-time student.
- The kiddie tax will stop applying in the year your child turns 24.
- The kiddie tax will also not apply if your child is married filing jointly.

Charitable Donations

Donations of clothing and other personal items must be in "good condition" or better in order to be deducted. Form 8283 must be filled out if your total deduction for all noncash contributions exceeds $500.

In addition, charitable contributions of cash (regardless of the amount) to any qualified charity must be supported by a dated bank record (such as a cancelled check) or a dated receipt from the charity that must include the name of the charity and the date and amount of the contribution.

Those age 70½ or older can distribute up to $100,000 from their traditional individual retirement account (IRA) to qualified charities in 2016 and 2017. The provision allowing qualified charitable distributions (QCDs) was permanently reinstated late in 2015. QCDs reduce required minimum distributions (RMDs). See "The Tax Advantages of Qualified Charitable Distributions From IRAs" in the October 2016 *AAII Journal* for more information.

Medicare

Taxpayers who itemize deductions can deduct (as a medical expense) the premiums they pay for Medicare Part B supplemental insurance and Medicare Part D prescription drug insurance. Premiums for voluntary coverage under Medicare Part A are only deductible by those over the age of 65 and not covered by Social Security.

Medicare Part B premiums are based on modified adjusted gross income (MAGI) as reported on returns from two years ago. As such, the Medicare Part B premium will be $134.00 in 2017 for taxpayers who file married joint returns with 2015 MAGI of $170,000 or less and single filers with 2015 MAGI of $85,000 or less. (Medicare says most people who receive Social Security benefits will pay $109.00 per month.)

Medical expenses must exceed 10% of adjusted gross income to qualify for deductions for those under the age of 65 in tax years 2016; the floor is 7.5% in 2016 for those age 65 or older. Those who will turn 65 on January 1, 2017, will be considered by the IRS to be 65 for the 2016 tax year. Effective January 1, 2017, the floor is 10% for everyone, including those age 65 or older. The lower 7.5% floor will be eliminated.

Itemized Deduction Phaseouts

The phaseout of itemized deductions (the "Pease" limitation) for taxpayers with adjusted gross income above a certain amount was reinstated by the ATRA. It applies to married filing jointly and single taxpayers with incomes of $311,300 and $259,400, respectively, or higher in 2016. For 2017, the phaseout levels will rise to $313,800 and $261,500, respectively.

Planning Considerations: Married taxpayers filing jointly will need to calculate whether taking the increased standard deduction or itemizing deductions will generate the most tax savings overall. When doing so, make sure to consider whether state law restricts the ability to itemize to only those who itemize for federal purposes. The higher deductions may also require more couples to pay alternative minimum tax (AMT).

Sales Tax Deduction

The provision allowing taxpayers who itemize deductions the option of choosing between a deduction of sales taxes or income taxes when claiming a state and local tax deduction was renewed at the end of 2015. Taxpayers cannot deduct both. The extension is permanent, barring a change by future legislation.

Tax-Exempt Interest Reporting

State and local governments are required to report interest paid on tax-exempt state and local bonds on Form 1099-INT, Interest Income. This amount must be shown on your tax return and is for information only.

Health Savings Accounts

The minimum annual deductible for self-only coverage is $1,300; it is $2,600 for family coverage. The maximum limits for annual deductible and other out-of-pocket expenses are $6,550 and $13,100, respectively. The minimums and maximum limits will be unchanged in 2017. HSA contributions cannot exceed $3,350 for individual coverage and $6,750 for family HDHP coverage. In 2017, the maximum contributions will be $3,400 and $6,750 for individual and family coverage, respectively.

More information on this can be found at AAII.com in the online version of this article.

Education Savings

The maximum Hope Scholarship Credit (the American Opportunity education credit) of $2,500 per year for the first four years of post-secondary education for tuition and related expenses (including books) was extended through 2017 by the ATRA. This credit can be claimed in both 2016 and 2017.

The Lifetime Learning credit can be claimed for education expenses beyond the fourth year of post-secondary education and for non-degree courses intended to improve job skills. The maximum credit is $2,000 annually and is subject to income phaseouts.

You can make nondeductible contributions to qualified tuition plans, also known as section 529 plans. (However, the contributions may be deductible from your state income tax, depending on where you live.) These accounts, offered by states or their designees, are maintained solely for the qualified higher education expenses of a beneficiary. Distributions are tax-free, provided that

The Tax Impact of Investing for and in Retirement

Various parts of the tax code govern how much can be saved for retirement, when withdrawals can be made and how much has to be withdrawn.

There are three big birthdays you should be aware of. At age 50, the maximum amount allowed to be contributed to retirement savings accounts increases ("catch-up contributions"). At age 59½, you can take withdrawals from all retirement accounts without incurring the 10% early withdrawal penalty. Finally, once you reach age 70½, you are no longer eligible to contribute to a traditional IRA and you must begin taking required minimum distributions (RMDs).

The tax code incentivizes savings for retirement. Workers can contribute up to $18,000 in 2016 and 2017 in a defined-contribution plan [e.g., a 401(k) plan]. A higher limit of $24,000 exists for workers age 50 or older. Taxpayers and spouses not covered by an employer retirement plan can contribute up to $5,500 ($6,500 for those age 50 or older) to a traditional IRA in both 2016 and 2017, though the deductions are subject to income phaseouts. Contributions to a tax-deferred retirement savings account reduce adjusted gross income (and thereby your tax liability) as long as they are within the designated limits. Again, contributions to a traditional IRA can no longer be made starting at age 70½.

Contributions to Roth IRAs and Roth 401(k) plans are not tax-deductible. Like traditional IRAs, up to $5,500 ($6,500 for those age 50 or older) can be contributed to a Roth IRA in both 2016 and 2017. The maximum contribution is subject to income phaseouts starting at $184,000 for married couples filing jointly and $117,000 for single filers in 2016. (The phaseouts will increase to $186,000 and $118,000, respectively, in 2017.)

Contributions to IRAs and Roth IRAs for the 2016 tax year can be made as late as April 17, 2017. When making a contribution for the previous calendar year, ensure your broker registers the deposit correctly.

Withdrawals from retirement accounts are considered to be taxable income unless taken from a Roth IRA, a Roth 401(k) or similar types of accounts. RMDs are required from most retirement accounts starting at age 70½. (The first RMD can be taken as late as April 1 of the calendar year following the year you turned age 70½, though the second RMD must be taken by December 31 of that same year.) The percentage of retirement savings subject to the RMD increases every year. Roth IRAs are exempt from RMDs, but Roth 401(k) plan savings are not. [A Roth 401(k) can be rolled to a Roth IRA, however.] Those who are still working, contributing to an employer-sponsored retirement plan and own less than 5% of the company they work for can delay the first RMD from a defined-contribution plan until April of the year they retire.

A discussion of all the tax aspects of investing for and in retirement is beyond the scope of this guide. Those seeking greater detail should read IRS Publications 590-A and -B on Individual Retirement Arrangements.

the distributions are used to pay qualified expenses.

The ATRA made the $2,000 per beneficiary contribution limit to a Coverdell Education Savings Account permanent. The contributions are not deductible, but they grow tax-free in the IRA. Coverdell accounts may be used to fund qualified elementary, secondary and higher education expenses. However, the amount that can be contributed is limited for higher-income taxpayers.

Investment Strategies: 2017 and Beyond

Republican control of the White House and Congress does not guarantee that tax reform will be forthcoming. Though the ATRA and the Consolidated Appropriations Act, 2016, provided clarity in terms of current legislation, any long-term agreement on the federal budget and debt reduction could include changes to the tax code.

Though we cannot predict what the politicians in Washington will do, or when they will do it, there are strategies that make sense regardless of the legislative environment. Listed below are traditional tax planning strategies that can help keep your tax bill down. It is important, however, to keep in mind that your goals and risk tolerance, not just the income tax impact of an investment, should drive your investment decisions.

Consider Roth IRA Conversion Opportunities

You have the option of converting all or part of your traditional IRA into a Roth IRA, regardless of your adjusted gross income. Roth IRAs can provide certain advantages: The converted assets can be withdrawn tax-free at any time, future earnings are also tax-free (with some limitations) and Roth IRA owners are not required to take any minimum distributions in retirement. The downside, however, is that the conversion amount is taxable in the year it occurs.

While the benefits of a Roth IRA conversion could be considerable, taxpayers must carefully weigh the up-front tax costs against the long-term tax advantages. For more on this, see "Retirement Plans: Evaluating the New Roth IRA Conversion Opportunity" by Christine Fahlund in the November 2009 *AAII Journal* and "New Rules for Converting to a Roth IRA" by William Reichenstein, Alicia Waltenberger and Douglas Rothermich in the January 2010

(continued on page 25)

2016 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	9,275	$0 + 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
190,150	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

For Married Taxpayers Filing Joint Returns and Surviving Spouses

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	18,550	$0 + 10%	$0
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

For Married Taxpayers Filing Separate Returns

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	9,275	$0 + 10%	$0
9,275	37,650	$927.50 + 15%	$9,275
37,650	75,950	$5,183.75 + 25%	$37,650
75,950	115,725	$14,758.75 + 28%	$75,950
115,725	206,675	$25,895.75 + 33%	$115,725
206,675	233,475	$55,909.25 + 35%	$206,675
233,475	—	$65,289.25 + 39.6%	$233,475

For Individuals Filing as Head of Household

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	13,250	$0 + 10%	$0
13,250	50,400	$1,325.00 + 15%	$13,250
50,400	130,150	$6,897.50 + 25%	$50,400
130,150	210,800	$26,835.00 + 28%	$130,150
210,800	413,350	$49,417.00 + 33%	$210,800
413,350	441,000	$116,258.50 + 35%	$413,350
441,000	—	$125,936.00 + 39.6%	$441,000

Capital Gains and Qualified Dividends

	Taxpayers in 15% Bracket or Below (%)	Taxpayers in the 25% to 35% Brackets* (%)	Taxpayers in the 39.6% Bracket* (%)
Short-Term Capital Gains	taxed as income	taxed as income	taxed as income
Long-Term Capital Gains**	0	15	20
Qualified Dividends	0	15	20
Collectibles***	28 maximum	28 maximum	28
Real Estate Unrealized Gain (Section 1250 Property)	15 maximum	25 maximum	25 maximum

**May also be subject to the 3.8% net investment income (NII) surtax.*
***For investments held longer than one year.*
****Includes art, rugs, jewelry, precious metals or gemstones, stamps or coins, fine wines and antiques.*

Kiddie Tax

Unearned Income of Minor Children (under age 19 and ages 19–23 in certain circumstances)	
First $1,050	0%
Next $1,050	child's rate
Over $2,100	parent's rate

2016 Allowable Tax Benefits

Standard Deduction

Under Age 65	
Married, Filing Joint	$12,600
Single	$6,300
Married, Filing Separate	$6,300
Head of Household	$9,300

Additional—Age 65 or Older	
Married (or Qualifying Widow)	$1,250
Single	$1,550

Additional—Blind	
Married (or Qualifying Widow)	$1,250
Single	$1,550

Personal Exemption

$4,050

Maximum Child Tax Credit

$1,000 per child under age 17 at the end of the year

Standard Mileage Deductions

Business Standard Mileage Rate	54.0 cents
Medical Standard Mileage Rate	19.0 cents
Moving Standard Mileage Rate	19.0 cents
Charitable Serv Standard Mile Rate	14.0 cents

Deductible IRA Contribution

If taxpayer and spouse NOT covered by employer-sponsored plan:

If younger than 50	$5,500
If 50 or older	$6,500

Maximum 401(k) Employee Contribution

If younger than 50	$18,000
If 50 or older	$24,000

Self-Employed Medical Insurance Premium Deduction

100%

Annual Gift Tax Exclusion (per person)

$14,000

Estate Tax Exclusion

$5.45 million

2016 Other Tax Items

2016 Social Security Tax Rates

	Employers & Employees	Self-Employed	Wage Limits
Social Security	6.20%	12.40%	$118,500
Medicare	1.45%	2.90%	no limit
Total	7.65%	15.30%	

2016 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 10.0% of AGI (7.5% if age 65 or older)
- Miscellaneous itemized deductions above 2.0% of AGI
- Uninsured casualities or theft losses above 10.0% of AGI
- Contributions to qualified charities
- You can itemize either state and local income taxes or state and local sales taxes, but not both

2016 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through witholding or estimated tax payments):

AGI $150,000 or less ($75,000 married filing separate)

- 100% of prior tax liability or
- 90% of current year tax liability

AGI $150,000 or greater ($75,000 married filing separate)

- 110% of prior year tax or
- 90% of current year tax liability

2016 AMT Exemption Amount

Single	$53,900
Married, Filing Joint	$83,800
Married, Filing Separate	$41,900
Head of Household	$53,900

2016 Tax Benefit Phaseout Levels

Personal Exemption

	AGI Phaseout Level
Married, Filing Joint	$311,300
Single	$259,400
Married, Filing Separate	$155,650
Head of Household	$285,350

Itemized Deduction ("Pease" Limitation)

	AGI Phaseout Level
Married, Filing Joint	$311,300
Single	$259,400
Married, Filing Separate	$155,650
Head of Household	$285,350

IRA Deductibility

For those covered by employer retirement plan [$5,500 maximum contribution per taxpayer; if 50 or older, maximum is $6,500]

	Modified AGI* Phaseout Level
Married, Filing Joint	$98,000
Single	$61,000
Married, Filing Separate	$0**
Head of Household	$61,000
Married, Filing Joint not covered by pension plan, but spouse is	$184,000

Roth IRA Eligibility

Maximum $5,500 nondeductible contribution; if 50 or older, maximum is $6,500

	Modified AGI* Phaseout Level
Married, Filing Joint	$184,000
Single	$117,000
Married, Filing Separate	$0
Head of Household	$117,000

Coverdell Education Account

$2,000 maximum nondeductible contribution per beneficiary; withdrawals are tax-free for qualified education expenses

	Modified AGI* Phaseout Levels
Married, Filing Joint	$190,000 to $220,000
Single	$95,000 to $110,000
Married, Filing Separate	$95,000 to $110,000
Head of Household	$95,000 to $110,000

**Modified AGI starts with your AGI (adjusted gross income) and adds back certain tax-exempt amounts including any IRA deductions.*
***$61,000 if strict criteria are met.*

Tax Forecasting Worksheet

This worksheet is designed for estimation purposes only and does not cover all the possible adjustments that may be required to arrive at actual taxable income (for example, Social Security benefits may be taxable in some circumstances) or to compute final income tax liability (for example, lump-sum distribution tax on retirement distributions). It should be adequate for most purposes and is a good starting point for discussions with your tax adviser, who can assist you in making exact calculations.

Go to www.aaii.com/files/PDF/TaxGuide2016/worksheet.pdf for an online worksheet that calculates the math for you.

		2016	2017
Income			
1.	Salaries per Form W-2		
2.	Non-qualified dividends and interest income		
3.	Net business income (losses)		
4.	Net capital gains and qualified dividend income[a]		
5.	Other gains (losses)		
6.	Passive income (losses) (subject to limitations)		
7.	Other income, including 85% of Social Security benefits, if applicable		
8.	**Total income** (sum of lines 1 – 7)	$	$
Adjustments			
9.	Alimony paid		
10.	Keogh contributions		
11.	Deductible IRA contributions		
12.	Moving expenses (job-related, subject to limitations)		
13.	Other ____________		
14.	**Adjusted gross income (AGI)** (subtract lines 9 – 13 from line 8)	$	$
Deductions			
15.	Medical and dental expenses (excess over 10% of line 14; in 2016 only, 7.5% if age 65 or older) or self-employed health insurance		
16.	State and local income taxes (or sales taxes)		
17.	Real estate and property taxes (non-business property)		
18.	Home mortgage interest		
19.	Investment interest (limited to investment income)		
20.	Charitable contributions		
21.	Casualty or theft losses (excess over $100 plus 10% of line 14)		
22.	Miscellaneous expenses (excess over 2% of line 14)		
23.	**Total deductions** (sum of lines 15 – 22)	$	$
	OR 23a. Standard deduction,[b] if greater (lines 15-23 must all show $0.00)	$	$
24.	**Personal exemptions** ($4,050 in 2016 and 2017)[b]		
25.	**Regular taxable income** (subtract lines 23 and 24 from line 14)	$	$
26.	**Regular tax** (see tax rate tables)[a]		
27.	**Tax credits**		
28.	Regular tax (net) (subtract line 27 from line 26)		
29.	Alternative minimum tax[c]		
30.	Other taxes (self-employment tax, household help, and so forth)		
31.	**Total tax** (sum of lines 28, 29, and 30)		
32.	**Total withholding and estimated tax payments**	$	$
33.	**Balance due** (refund) (subtract line 32 from line 31)	$	$

a. *If your taxable income includes net capital gain and qualified dividend income, you may be eligible for a tax rate on that income that is lower than the tax rate that applies to your other income. Refer to IRS Form 1040, Schedule D.*

b. *The standard deduction and personal exemptions are not allowed when calculating the alternative minimum tax (AMT).*

c. *Use IRS Form 6251 as a worksheet and review the discussion on AMT in the online version of this article.*

2017 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income Over ($)	Taxable Income But Not Over ($)	The Tax Is	Of the Amount Over
0	9,325	$0 + 10%	$0
9,325	37,950	$932.50 + 15%	$9,325
37,950	91,900	$5,226.25 + 25%	$37,950
91,900	191,650	$18,713.75 + 28%	$91,900
191,650	416,700	$46,643.75 + 33%	$191,650
416,700	418,400	$120,910.25 + 35%	$416,700
418,400	—	$121,505.25 + 39.6%	$418,400

For Married Taxpayers Filing Joint Returns and Surviving Spouses

Taxable Income Over ($)	Taxable Income But Not Over ($)	The Tax Is	Of the Amount Over
0	18,650	$0 + 10%	$0
18,650	75,900	$1,865.00 + 15%	$18,650
75,900	153,100	$10,452.50 + 25%	$75,900
153,100	233,350	$29,752.50 + 28%	$153,100
233,350	416,700	$52,222.50 + 33%	$233,350
416,700	470,700	$112,728.00 + 35%	$416,700
470,700	—	$131,628.00 + 39.6%	$470,700

For Married Taxpayers Filing Separate Returns

Taxable Income Over ($)	Taxable Income But Not Over ($)	The Tax Is	Of the Amount Over
0	9,325	$0 + 10%	$0
9,325	37,950	$932.50 + 15%	$9,325
37,950	76,550	$5,226.25 + 25%	$37,950
76,550	116,675	$14,876.25 + 28%	$76,550
116,675	208,350	$26,111.25 + 33%	$116,675
208,350	235,350	$56,364.00 + 35%	$208,350
235,350	—	$65,814.00 + 39.6%	$235,350

For Individuals Filing as Head of Household

Taxable Income Over ($)	Taxable Income But Not Over ($)	The Tax Is	Of the Amount Over
0	13,350	$0 + 10%	$0
13,350	50,800	$1,335.00 + 15%	$13,350
50,800	131,200	$6,952.50 + 25%	$50,800
131,200	212,500	$27,052.50 + 28%	$131,200
212,500	416,700	$49,816.50 + 33%	$212,500
416,700	444,550	$117,202.50 + 35%	$416,700
444,550	—	$126,950.00 + 39.6%	$444,550

Capital Gains and Qualified Dividends

	Taxpayers in 15% Bracket or Below (%)	Taxpayers in the 25% to 35% Brackets* (%)	Taxpayers in the 39.6% Bracket* (%)
Short-Term Capital Gains	taxed as income	taxed as income	taxed as income
Long-Term Capital Gains**	0	15	20
Qualified Dividends	0	15	20
Collectibles***	28 maximum	28 maximum	28
Real Estate Unrealized Gain (Section 1250 Property)	15 maximum	25 maximum	25 maximum

**May also be subject to the 3.8% net investment income (NII) surtax.*
***For investments held longer than one year.*
****Includes art, rugs, jewelry, precious metals or gemstones, stamps or coins, fine wines and antiques.*

Kiddie Tax

Unearned Income of Minor Children (under age 19 and ages 19–23 in certain circumstances)	
First $1,050	0%
Next $1,050	child's rate
Over $2,100	parent's rate

2017 Allowable Tax Benefits

Standard Deduction

Under Age 65	
Married, Filing Joint	$12,700
Single	$6,350
Married, Filing Separate	$6,350
Head of Household	$9,350

Additional—Age 65 or Older	
Married (or Qualifying Widow)	$1,250
Single	$1,550

Additional—Blind	
Married (or Qualifying Widow)	$1,250
Single	$1,550

Personal Exemption

$4,050

Maximum Child Tax Credit

$1,000 per child under age 17 at the end of the year

Standard Mileage Deductions

Business Standard Mileage Rate	53.5 cents
Medical Standard Mileage Rate	17.0 cents
Moving Standard Mileage Rate	17.0 cents
Charitable Serv Standard Mile Rate	14.0 cents

Deductible IRA Contribution

If taxpayer and spouse NOT covered by employer-sponsored plan:

If younger than 50	$5,500
If 50 or older	$6,500

Maximum 401(k) Employee Contribution

If younger than 50	$18,000
If 50 or older	$24,000

Self-Employed Medical Insurance Premium Deduction

100%

Annual Gift Tax Exclusion (per person)

$14,000

Estate Tax Exclusion

$5.49 million

2017 Other Tax Items

2017 Social Security Tax Rates

	Employers & Employees	Self-Employed	Wage Limits
Social Security	6.20%	12.40%	$127,200
Medicare	1.45%	2.90%	no limit
Total	7.65%	15.30%	

2017 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 10.0% of AGI (including those age 65 or older)
- Miscellaneous itemized deductions above 2.0% of AGI
- Uninsured casualities or theft losses above 10.0% of AGI
- Contributions to qualified charities
- You can itemize either state and local income taxes or state and local sales taxes, but not both

2017 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through witholding or estimated tax payments):

AGI $150,000 or less ($75,000 married filing separate)

- 100% of prior tax liability or
- 90% of current year tax liability

AGI $150,000 or greater ($75,000 married filing separate)

- 110% of prior year tax or
- 90% of current year tax liability

2017 AMT Exemption Amount

Single	$54,300
Married, Filing Joint	$84,500
Married, Filing Separate	$42,250
Head of Household	$54,300

Revised 12/13/2016.

2017 Tax Benefit Phaseout Levels

Personal Exemption

	AGI Phaseout Level
Married, Filing Joint	$313,800
Single	$261,500
Married, Filing Separate	$156,900
Head of Household	$287,650

Itemized Deduction ("Pease" Limitation)

	AGI Phaseout Level
Married, Filing Joint	$313,800
Single	$261,500
Married, Filing Separate	$156,900
Head of Household	$287,650

IRA Deductibility

For those covered by employer retirement plan [$5,500 maximum contribution per taxpayer; if 50 or older, maximum is $6,500]

	Modified AGI* Phaseout Level
Married, Filing Joint	$99,000
Single	$62,000
Married, Filing Separate	$0**
Head of Household	$62,000
Married, Filing Joint not covered by pension plan, but spouse is	$186,000

Roth IRA Eligibility

Maximum $5,500 nondeductible contribution; if 50 or older, maximum is $6,500

	Modified AGI* Phaseout Level
Married, Filing Joint	$186,000
Single	$118,000
Married, Filing Separate	$0
Head of Household	$118,000

Coverdell Education Account

$2,000 maximum nondeductible contribution per beneficiary; withdrawals are tax-free for qualified education expenses

	Modified AGI* Phaseout Levels
Married, Filing Joint	$190,000 to $220,000
Single	$95,000 to $110,000
Married, Filing Separate	$95,000 to $110,000
Head of Household	$95,000 to $110,000

**Modified AGI starts with your AGI (adjusted gross income) and adds back certain tax-exempt amounts including any IRA deductions.*
***$62,000 if strict criteria are met.*

2017 Tax Planning Calendar

Tax and financial planning are activities best pursued year-round. Although the timing of some activities is critical, you should review all tax considerations from the perspective of your specific needs and establish an individualized planning calendar.

If the last day for filing a return, paying tax or performing other activities falls on a Saturday, Sunday or legal holiday (in the District of Columbia), you have until the next day that is not a Saturday, Sunday or legal holiday to perform that act. Use the following list to remind yourself of important activities and dates:

First Quarter

General

- Complete Form W-4, Employee's Withholding Allowance Certificate, and adjust withholding, if needed.
- Evaluate before-tax and voluntary aftertax contributions to retirement plans.
- Apply for a Social Security number for any child who does not have one.

January 17

- Pay fourth-quarter 2016 estimated tax voucher if you did not pay your income tax for the year through withholding, or if you did not pay enough through withholding. You do not have to make this payment if you file your 2016 return and pay any tax due by January 31, 2017.
- Make quarterly defined-benefit Keogh contribution for preceding year.

January 31

- File your income tax return (Form 1040) for 2016 if you did not pay your last installment of estimated tax by January 17. Filing your return and paying any tax due by February 1 prevents any penalty for late payment of last installment.
- Make sure you have recieved a Form W-2 from each employer you worked for in 2016.

Second Quarter

April 1

- Comply with required minimum distribution (RMD) rules for qualified retirement plans if you attained age 70½ in the previous year. (This deadline does not change when April 1 falls on a weekend—as it does in 2017—or on a holiday.)

April 17

- Make prior-year IRA and Coverdell Education Savings Account contributions.
- Make prior-year Keogh or SEP plan contribution (unless you applied for an extension of time to file your return).
- Make quarterly defined-benefit Keogh contribution for the current year.

April 18

- File individual and gift tax returns (or apply for an extension); residents of Massachusetts and Maine also file on April 18. If you want an automatic six-month extension of time to file the return, file Form 4868; or, you can get an extension (until October 16) by phone or over the Internet if you pay part or all of your estimate of income tax due with a credit card.
- File Schedule H (Form 1040) with your tax return if you paid cash wages of $2,000 or more in 2016 to a household employee.
- Report federal unemployment (FUTA) tax on Schedule H if you paid total cash wages of $1,000 or more in any calendar quarter of 2015 or 2016 to household employees.
- Pay first-quarter estimated tax if you are not paying your 2017 income tax through withholding or you will not pay enough that way.

June 15

- Pay second-quarter estimated tax voucher if you are not paying your income tax for the year through withholding, or if you are not withholding enough.

Third Quarter

July 17

- Make quarterly defined-benefit Keogh contribution for the current year.

September 15

- Pay third-quarter estimated tax voucher if you are not paying your income tax for the year through withholding, or if you are not withholding enough.

Fourth Quarter

General

Begin your year-end tax planning:

- Project your current year and next year tax liabilities.
- Evaluate the applicability of the AMT and other taxes.
- Adjust withholding, if necessary.
- Evaluate year-end capital transactions.
- Establish a separate Keogh plan for self-employment income.
- Comply with minimum distribution rules for qualified plans.

October 16

- If you extended your individual tax return, file your 2015 income tax return and pay any tax, interest and penalties due.
- Make quarterly defined-benefit Keogh contribution for the current year.

December 29 (December 31 is a Sunday)

- Comply with required minimum distribution (RMD) rules for qualified retirement plans. Can delay if obtained age 70½ during 2017.

Throughout the Year

- Re-evaluate your long-term strategies.
- Evaluate your tax and financial strategy for receiving discretionary and mandatory retirement plan distributions.
- Rebalance investment portfolio and re-evaluate your uses of debt.
- Consider making gifts up to the annual gift tax exclusion.
- Evaluate passive loss exposure and potential investment shifts.
- If you have excess cash flow, consider how to invest those funds.
- Optimize mix of interest expense items.
- Consider making charitable contributions of property.
- Consider ways to fund your children's education.
- Evaluate your mix of portfolio and passive income.

2017 Federal Legal Holidays (in the District of Columbia)

January 2	New Year's Day (observed)
January 16	Birthday of Martin Luther King Jr.
February 20	Washington's Birthday
April 17	D.C. Emancipation Day (observed)
May 29	Memorial Day
July 4	Independence Day
September 4	Labor Day
October 9	Columbus Day
November 10	Veterans Day (observed)
November 23	Thanksgiving Day
December 25	Christmas Day

(continued from page 16)

AAII Journal (both available at AAII.com). Though the articles discuss the one-time 2010 option for delaying the taxes from the conversion, their suggestions regarding whether to convert or not continue to be applicable. You may also want to consult a tax adviser.

You cannot convert required minimum distributions (RMDs) from your traditional IRA for a particular year (including the calendar year in which you reach age 70½) to a Roth IRA. IRS Publication 590-A explains the rules for Roth IRA conversions and Publication 590-B covers the rules for RMDs.

Take Advantage of Lower Marginal Rates

Deferring income that is taxed at higher ordinary tax rates makes sense. Most taxpayers will pay long-term capital gain tax rates of 0% or 15%. For married couples filing jointly with income above $466,950 and single filers with income above $415,050 in 2016, the long-term capital gains rate is 20%. In 2017, the 20% long-term capital tax rate will apply to married couples filing jointly and single filers with incomes above $470,700 and $418,400, respectively. Short-term capital gains, in contrast, are taxed at ordinary income tax rates and run as high as 39.6%. The 3.8% net investment income (NII) surtax—which went into effect on January 1, 2013—applies to taxpayers with income above the $250,000/$200,000 thresholds. This tax applies to both short- and long-term capital gains, as well as taxable interest, dividends, non-qualified annuities, rents and royalties and passive income from partnerships. The NII surtax is not indexed to inflation, and the $250,000/$200,000 thresholds are effective for both 2016 and 2017.

Similar rules apply to qualified dividends. For married couples filing jointly with income above $466,950 and single filers with income above $415,050 in 2016, dividends are taxed at 20%. In 2017, the 20% qualified dividend tax rate will apply to married couples filing jointly and single filers with incomes above $470,700 and $418,400, respectively.

Though tax considerations should never be the primary reason for selling a security, if you have large positions in either gifted or inherited stocks, or stocks received from a sale of a business, you should consider whether it makes sense to sell shares over a period of time to take advantage of the long-term capital gains rates and use the proceeds from selling the stock to diversify your portfolio. This is particularly the case if a large portion of your wealth is concentrated in just a few securities.

Use Losses Carefully

While tax considerations should not drive your investment decision, you can take advantage of losses in holdings that you would prefer to either sell or reduce from an investment standpoint.

Capital losses first reduce capital gains: long-term losses reduce long-term gains first, and short-term losses reduce short-term gains first. Any long-term losses left over reduce short-term gains, and vice versa. If you still have losses remaining after offsetting capital gains, you can reduce your "ordinary" income by up to $3,000. Losses not used this year can be carried forward to future years until they are used up. For more information, see "Capital Pains: Rules for Capital Losses" by Julian Block in the September 2010 *AAII Journal* (at AAII.com).

When planning, make sure you don't run afoul of the wash-sale rules. If you sell an investment at a loss and then acquire a substantially identical security during the 30-day period before or 30-day period after the sale, the loss will be disallowed. If your loss is disallowed by the wash-sale rule, you can increase the cost basis of the new position of the substantially identical security by the amount of the disallowed loss. The holding period for the new position is also adjusted to include the holding period of the position sold at the disallowed loss. You cannot adjust the cost basis or holding period if you acquire the investment in an IRA or Roth IRA, however. For information, see "Keeping Transactions Clean From the Wash-Sale Rules" by R. Kevin Trout in the December 2014 *AAII Journal* (available online at AAII.com).

Be Aware of Holding Period for Qualified Dividends

In order to qualify for the reduced 15% (20% for higher earners) tax rate on qualified dividends, a 61-day holding period must be satisfied. Specifically, the stock must be owned for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. The ex-dividend date is generally two trading days prior to the stock's record date.

Not all dividends are qualified. Qualified dividends are paid by common stocks. Dividends on preferred stock count as qualified dividends, unless the paying firm or mutual fund tells you otherwise. However, if dividends are due to periods totaling more than 366 days, the holding period you must satisfy is longer: Preferred stock must be owned for at least 91 days during the 181-day period that begins 90 days before the ex-dividend date in order for the dividend to qualify for the lower tax rate.

Real estate investment trust (REIT) distributions and master limited partnership (MLP) distributions do not qualify for the discounted taxed rate. Contact the investor relations department of the specific company if you have questions about the tax treatment.

Consider the Impact of Taxes on Mutual Fund Investments

Selecting tax-aware managers of mutual funds may be important to maximizing your aftertax rate of return in your taxable investment portfolio.

You may choose when to sell specific shares of the fund and may, therefore, create long-term versus short-term capital gains, as long as you notify the fund family or your broker in writing with specific instructions. But you don't control the investments within the fund. Should an equity manager fail to extend the holding period on a stock, it could cost you as much as 19.6% of your gain (39.6% ordinary rate for short-term capital gains versus the 20% long-term capital gains rate).

Some mutual fund dividends can be treated as qualified dividends and eligible for the reduced tax rate, while others will not qualify. Dividends paid by stocks held by the fund and passed through to the shareholder are eligible for the qualified dividend tax treatment. However, capital distributions and bond interest are not. These payments are reported on Form 1099, which specifies the type of distribution.

You can read more on mutual fund distributions in the online version of this article.

Reconsider Taxable Versus Tax-Free Bonds

Interest from tax-free municipal bonds is generally exempt from federal income taxes, unlike the interest from taxable bonds, which is taxed as income. Like any bond, credit quality matters, as you want to ensure that the issuer will not default. Changing yields can also alter the aftertax yield advantage, making municipal bonds more or less attractive to taxable bonds.

Additionally, private-activity bonds (a type of tax-free bond) could increase your exposure to the alternative minimum tax since their interest income is taxable for purposes of the alternative minimum tax. There are exceptions, including qualified 501(c)(3) bonds, New York Liberty bonds and Gulf Opportunity Zone bonds. Furthermore, the interest on qualified bonds issued in 2009 and 2010 is not subject to the alternative minimum tax. Check with the bond issuer to find out the bond's tax status.

You should review your bond and money market accounts to make sure that you are earning the highest aftertax return. But don't forget to consider the state tax implications of switching from tax-free to taxable bonds before making any final portfolio decisions.

Consider Increasing Retirement Savings

Increasing retirement savings makes sense from a financial planning standpoint and, depending on your adjusted income, may reduce your tax bill. You have until April 17, 2017, to make an IRA contribution for the 2016 tax year. See the box on page 16 for yearly contribution limits to various types of retirement plans.

Where's My Money? Tracking Your Refund 24/7

If you are expecting a refund on your 2016 income tax, you can check on its status if it has been at least four weeks since the date you filed your return by mail, or 24 hours if you filed electronically. You will need to supply the following information: your Social Security number or IRS Individual Taxpayer Identification number, your filing status and the exact whole-dollar refund amount as it is shown on your return.

You can check the status of your refund in two ways:

- On the Internet, go to www.irs.gov and click on "Refunds" and then "Where's My Refund."
- By telephone (for automated information), call 800-829-4477.

If you are unable to get information on your refund through either of these two automated services, you can call the IRS for assistance at 800-829-1040.

The IRS website also allows you to start a trace for lost or missing refund checks, or to notify the IRS of an address change when refund checks go undelivered. Taxpayers can avoid undelivered refund checks by having refunds deposited directly into a personal checking or savings account. This option is available for both paper and electronically filed returns.

Review Tax Implications of Taxable Versus Tax-Deferred Accounts

The spread between capital gains and ordinary income rates has important implications with respect to your asset allocation between taxable and tax-deferred (retirement) accounts.

For example, from a tax perspective, holding individual stocks in tax-deferred accounts and bonds in taxable accounts could be expensive because the long-term gains resulting from stocks held in tax-deferred plans such as IRAs or 401(k) plans will be taxed at ordinary rates when taken as a distribution. By reversing that structure, taxable bonds and other tax-inefficient assets will be shielded from taxation in the deferred accounts, while equities will enjoy the reduced rates for capital gains in personal accounts.

Tax-free municipal bonds should, of course, remain outside of retirement accounts. Individuals should also consider the cost of commissions and taxes, current cash flow needs, and the 0.9% additional Medicare tax and 3.8% NII surtax before making any investment moves between taxable and tax-deferred accounts.

Protect Social Security Benefits

If you are receiving Social Security benefits, you may have to pay taxes on them if your combined income (primarily your adjusted gross income plus any tax-exempt interest income plus half of your Social Security benefits) exceeds certain levels.

To protect your benefits, watch the amount of interest you receive from municipal bonds, since this amount is included in your modified adjusted gross income when determining the Social Security benefit taxability. In addition, you may want to delay taxable distributions from a retirement plan or IRA.

Conclusion

It is important to remember that taxes are not the key to investment planning. However, one thing is certain: There will be more tax changes coming, and everyone should consider how the changes directly affect their overall tax and investment strategies.

Tax Planning Strategies

All Taxpayers: Determine Where You Are at the End of the Year

At the end of each year, you should take the time to assess your tax situation. Doing so will give you the opportunity to shift certain items around, should that be beneficial in terms of your tax liability. Taking a few initial steps now and using year-end planning strategies can result in significant tax savings.

Here are the basic steps you should take to help start your personal tax planning:

- Estimate your income, deductions, credits and exemptions for 2016 and 2017 using the Tax Forecasting Worksheet (page 20 and a fillable PDF on AAII.com);
- Identify items that you can shift from 2016 into 2017 and beyond (or vice versa);
- Determine your marginal tax rate—the rate at which your next dollar of income will be taxed—for 2016 and 2017;
- Determine how much tax you owe and when you must pay it to avoid underpayment penalties;
- Determine whether you are subject to the alternative minimum tax (AMT);
- Consult with your tax professional, and then take the actions needed to make the best of your tax situation.

To minimize your taxes, consider both short-term and long-term tax planning issues and strategies. Starting early will give you extra time to obtain additional information about items that concern you and to investigate additional ideas for tax savings or deferral. The Tax Forecasting Worksheet on page 20 (and fillable PDF on AAII.com) will provide a starting point for evaluating the tax effects of various strategies.

Avoiding Tax Underpayment Penalties

Make sure you determine your 2017 tax liability as early as possible, as well as the due dates for paying those taxes (including the self-employment tax and the alternative minimum tax), so that you avoid underpayment penalties.

Federal tax law requires the payment

of income taxes throughout the year as you earn your income. This obligation may be met through withholding, quarterly estimated tax payments or both. If you do not meet this obligation, you may be assessed an underpayment penalty.

If your total tax due minus the amount you had withheld is less than 10% of your total tax due, you will not be assessed an underpayment penalty. The disadvantage of overpaying throughout the year, though, is that you are in effect making an interest-free loan to the government. However, the underpayment penalty can be high, and it is calculated as interest on the underpaid balance until it is paid, or until the regular filing date for the final tax return, whichever is earlier.

You can avoid underpayment tax penalties by adopting one of the safe harbor rules. The basic rule is to pay the required amount by the end of the year through withholding and quarterly estimated payments. The required amount will be one of the following, depending on your individual situation:

- 90% of the current year's tax liability;
- 100% of the prior year's tax liability (increases to 110% for taxpayers who had 2016 adjusted gross income in excess of $150,000, or $75,000 for those married filing separately); or
- 90% of the tax liability based on a quarterly annualization of current year-to-date income (See IRS Form 505 and IRS Publication 505 for worksheets).

Penalties are based on any underpayment, which is the difference between the lowest amount required to be paid by each quarterly payment date and the amount actually paid by that date. The annual required amount, based on either of the first two alternatives, is paid in equal installments. In the case of the third method, which is based on annualized income, the amount due each quarter is based on actual income received for each installment period. The third method is typically more beneficial if you do not earn income evenly throughout the year (e.g., you operate a seasonal business) or had an unexpected increase in income because it allows for lower required payments in the early quarters.

Income tax payments made through withholding from your paycheck (or from your pension or other payments) are given special treatment. The IRS treats income tax that is withheld as having been paid equally throughout the year (unless you prefer to use actual payment dates). This lets you make up for underpaid amounts retroactively because amounts withheld late in the year may be used to increase the amounts paid in earlier quarters.

State and Local Rules: Many states have underpayment rules that vary from the federal requirements.

Timing: Income & Deductions for Taxpayers Not Subject to AMT

You have opportunities to reduce

Protecting Yourself Against Tax Scams

The Internal Revenue Service continues to warn about con artists posing as IRS agents. Often initiating contact thought a telephone call, the fraudsters claim back taxes and/or penalties are owed. Payment is usually immediately demanded and threats of arrest, the suspension of a driver's licenses or—in the case of when the victim is assumed to be an immigrant—deportation are made. Though sounding very convincing, these calls are scams.

Another scam involves identify theft. Criminals obtain Social Security numbers and then file false returns under the victims' identities in order to receive refunds. When the victim later tries to file a legitimate return, it can be rejected by the IRS.

Other current tax scams are commonly pitched as opportunities to realize a larger refund. They can involve being urged to falsify income, falsely claim fuel tax credits, use tax shelters that sound too good to be true and hiding income offshore. Some criminals will also pose as tax preparers for the sole purpose of engaging in identify theft.

There are steps you can take to protect yourself:

- File your tax return as quickly as is reasonably possible.
- Guard your identity. Be careful about who you give your Social Security number to, do not carry your Social Security number in your wallet and use anti-virus and firewall software on your computer. Varying your passwords is also a good idea; password management programs such as Dashlane and LastPass can help.
- Never click on a link in an email to visit a financial institution such as a bank or the IRS. Go directly to the website using a known URL.
- Use anti-virus and firewall software.
- Regularly check your credit reports to ensure the information is accurate. Consumer Reports recommends using AnnualCreditReport.com.
- Realize that if a tax service or proposal sounds too promising to be true, it is probably is.
- Never trust a tax preparer who does not give you your return to review. It's best for you to personally file your own returns.
- Understand that the IRS will never call to demand immediate payment or call you about taxes being owed without previously having mailed a bill. The agency will also give you the opportunity to question or appeal any outstanding balance or penalty.

If you suspect you are a victim of identity theft or financial fraud, act immediately. Call your banks, brokerage firms, credit card companies, the major credit bureaus and, in the case of tax fraud, the IRS. If your Social Security number is compromised, fill out IRS Form 14039 and continue to file your taxes as you normally would.

your taxes if you can control the timing of either your income or expenses. However, it is important to make sure you understand whether you may be subject to the alternative minimum tax (AMT) before adopting these strategies. (See the online version of this article for more information.)

Income

Your income is generally taxed in the year of receipt, so having the ability to control when you receive it affords a strategic tax planning opportunity. Deferring income until a later year will, in most cases, delay the payment of tax. You cannot defer taxation by merely delaying receipt of the income if the funds are available to you and the time of payment is subject to your unrestricted discretion. Any decision to defer income must be weighed with the lost time value of the money and other risks that could alter or forfeit your right to the income.

The timing of bonuses, recognition of capital gains from the sale of stocks, and the exercise of non-qualified stock options are all events that can easily be delayed into a subsequent year. Consider the deferral of compensation through the use of various retirement plans and deferred-compensation arrangements. If you operate a business or collect rental income and report that income on the cash receipts and disbursements method, you have an opportunity to delay or accelerate the billing to your customers or tenants and determine the timing of the related income.

Deductions

You can reduce taxes by controlling the payment of deductible expenses. If paid by December 31, you may deduct certain expenses that are due the following year on your current year tax return. This strategy helps when you have a higher tax liability in the current year than you expect to have in the coming year. Again, you must balance this decision with the time value of money and other inherent risks.

For example, if you pay a deductible expense in December 2016 instead of April 2017, you reduce your 2016 tax instead of your 2017 tax, but you also lose the use of your money for three-and-one-half months. Generally, this will be to your advantage, unless you have an alternative use for the funds that will produce a very high return in that three-and-one-half-month period. You must decide whether the cash used to pay the expense early should be used for something more urgent or more valuable than the accelerated tax benefit.

For those who will pay 2017 estimated taxes based on their 2016 tax liability, reducing your 2016 taxes has another advantage: Your 2017 estimated tax payments may be smaller.

State Taxes

If accelerating deductions makes sense for you and you choose to claim a deduction on your state and local income taxes, you may want to prepay the balance on your estimated state tax liability in December 2016, rather than waiting until 2017. This secures that deduction on your 2016 tax return, even though the payment might not be required by the state until January 17, 2017, or April 17, 2017.

Charitable Contributions

If you are planning on making a gift to a charity in 2017, consider making the gift in 2016 to accelerate the tax benefit of the contribution. However, it is important to note that certain limitations exist with respect to deductions for charitable contributions.

You should also consider the benefits of gifting appreciated stock to a charity. If you donate long-term appreciated stock directly to the charity, you get a deduction for the full fair market value of the stock, whereas if you sell the stock first and donate cash, you only get a deduction for the aftertax cash donated. (If you have an unrealized loss in the stock, however, it might be more beneficial from a tax standpoint to sell the stock and then donate the cash proceeds. Doing so would give you deductions for both the capital loss and the charitable donation.)

When making a gift to charity, you must have an appropriate record of the gift in order to properly support the deduction. In addition, cash contributions of any amount must be supported by a written record, either in the form of a bank record (for example, a cancelled check) or a written receipt from the charity. The record must include the name of the charity, the date and the amount of the contribution.

Prepaid Interest

A cash basis taxpayer may not deduct prepaid interest before the tax year to which the interest relates. However, there is some flexibility to prepay year-end interest that is due early in the following year. For example, if a mortgage payment is due on January 10, a taxpayer can accelerate the deduction of the portion of the interest relating to the period up to January 1 by mailing the check in December.

The most significant interest deductions currently available are for home mortgage interest and for investment interest expense to the extent of current-year investment income. Interest paid in relation to investments that earn a tax-free return is not deductible.

Medical Expenses

If the timing of certain medical and dental expenditures is flexible and your overall medical expenses are high in the current year, you may want to accelerate the timing of these expenses.

Because unreimbursed medical expenses are only deductible to the extent that they exceed 10% of adjusted gross income (7.5% for those age 65 and older in 2016; 10% in 2017 for everyone), it is best from a tax standpoint to incur expenses—such as replacement eyeglasses or contact lenses, elective surgery, dental work and routine physical examinations—in a year in which you have already gone over (or in which the added expenses would take you over) the 10% threshold.

Miscellaneous Itemized Deductions

Miscellaneous itemized deductions are only deductible to the extent that they exceed 2% of adjusted gross income.

(continued on page 34)

had an average real return of 5.8% compared to 3.8% for the 60/40 portfolio. Commodities, real estate, U.S. small-cap stock and non-U.S. stocks—all missing in the 60/40 portfolio—were helpful contributors in the seven-asset portfolio during inflationary years. Commodities, clearly, were the most helpful.

If you believe that inflation will remain low for a very long period of time, stay with a two-asset, 60/40 portfolio. However, if you believe that inflation will rear its ugly head again, it would be wise to build a portfolio that has demonstrated an ability to defend itself against inflation. This would require a portfolio with a wider variety of asset classes—including real estate, commodities and small-cap U.S. stocks. In short, build a broadly diversified portfolio.

Go to AAII.com to see to return data for the S&P 500 during years with high inflation, as well as a chart showing the year-by-year trend in inflation. ➤

Craig L. Israelsen, Ph.D., teaches as an executive-in-residence in the Personal Financial Planning Program at Utah Valley University in Orem, Utah. He is the developer of the 7Twelve Portfolio (www.7twelveportfolio.com) and the author of three books, including "7Twelve: A Diversified Investment Portfolio With a Plan" (John Wiley & Sons, 2010). Find out more at www.aaii.com/authors/craig-israelsen.

(continued from page 29)

This category is large but includes:

- Tax preparation fees such as tax preparation software, tax publications and any fee paid for electronic filing; and
- Investment fees, custodial fees, trust administration fees and other expenses paid for managing your investments that produce taxable income.

Accelerating miscellaneous itemized deductions only benefits taxpayers who accumulate expenses sufficient enough to exceed the 2% threshold. If possible, it may be advantageous to pay these types of expenses in one year if, because of the 2% floor, you would not receive a benefit of the deduction in each of the two consecutive years.

Timing Caution for Taxpayers Subject to AMT

The alternative minimum tax (AMT) was originally designed to ensure that everyone would pay his or her fair share of income taxes. The measure has since evolved into a separate tax regime that required a permanent fix in the ATRA to prevent from it ensnaring millions of Americans.

The wisdom of conventional tax planning advice to defer income and accelerate certain types of deductions may not hold true if an individual expects to be subject to the AMT. Accordingly, during the tax planning process, it is critical that you determine whether you are subject to the AMT in both the current year and the following year.

If you are continuously subject to the AMT, avoid investing in private-activity (municipal) bonds. Income from these bonds is taxable for AMT purposes. (There are exceptions, including qualified 501(c)(3) bonds, New York Liberty bonds and Gulf Opportunity Zone bonds. Also, the interest on qualified bonds issued in 2009 and 2010 is not subject to the alternative minimum tax. Check with the bond issuer for the bond's tax status.) Furthermore, you should be aware that unusual combinations of income and deductions might require AMT planning that runs contrary to conventional tax-planning advice.

Although the exercise of an incentive stock option (ISO) does not give rise to regular taxable income for the employee, the difference between the exercise price and the market price of a stock must be recognized for AMT purposes for the year in which the option is exercised. Accordingly, the exercise of incentive stock options with a large bargain element often causes a tax liability under the alternative minimum tax regime.

The AMT arena is extremely complex, so generalizations are difficult to make. If you think you may be subject to the alternative minimum tax, you should consult with a tax professional to determine how best to minimize your exposure to it.

Year-End Estate and Gift Tax Planning

Year-end planning from an estate planning perspective typically involves ensuring that "annual exclusion" gifts are completed by the end of a calendar year.

Under the federal gift tax system, each donor is permitted to make non-taxable gifts of a certain amount each year to any donee. These gifts are called "annual exclusion" gifts and do not count against the donor's lifetime gifts exemption. The annual gift tax exclusion level is $14,000 for 2016 and will stay at this level in 2017. To the extent that it is not used, the annual exclusion evaporates at the end of each calendar year.

Annual transfers that take advantage of this exclusion can both diminish the donor's estate tax liability and improve the lives of the recipients. These gifts can take many forms (cash, stocks, real estate, partnership interests) and can be given outright through Uniform Transfers to Minors accounts, and even through a trust—provided it contains special provisions designed to allow the gift to qualify for the annual exclusion. ➤

AAII staff Charles Rotblut, CFA, Jean Henrich, Kate Peltz and Annie Prada contributed to this guide.