DJH Capital Management, LLC

Providing clients with sound, prudent advice.

Year–End Tax Planning Guide (2016)

This guide is intended to make you aware of strategies you can employ with the goal of reducing your tax liability. This is not intended as personal financial advice as we only offer personal financial advice as a part of a comprehensive financial plan to our clients. Please consult a tax professional for tax advice particular to your situation.

Table of Contents

Reason for this Guide

Developing a tax efficient strategy to minimize tax liability begins with understanding the tax formula (see below). We strongly recommend working with a competent tax professional, however, prudent tax strategy can begin with **YOU** understanding this simple formula. Even an introductory level of understanding can greatly enhance any interaction with your tax professional.

The primary purpose of this guide is to **inform** you of how your tax liability is determined and **introduce** strategies and methods in order to legally reduce it. Working through the logic in each section will give you enough knowledge to reasonably determine your taxable income so that you can anticipate your tax liability. We understand that a fair amount of financial decisions are made (or not) during tax season. This guide will hopefully equip you to make better decisions.

Tax Formula for Individual Taxpayers

Income Broadly Defined	**$xx,xxx**	Section A
Less: Exclusions	(x,xxx)	Section B
Gross Income	**$xx,xxx**	Section C
Less: Deductions for AGI	(x,xxx)	Section D
Adjusted Gross Income	**$xx,xxx**	
Less: Greater of Itemized Deductions or Standard Deduction	(xx,xxx)	Section E
Less: Personal & Dependency Exemptions	(xx,xxx)	
Taxable Income	$xx,xxx	Section F
Tax on Taxable Income	$x,xxx	
Less: Credit for Taxes Withheld	(x,xxx)	Section G
Less: Credit for Estimated Tax Payments	(x)	
Less: Other Tax Credits	(x,xxx)	
Tax Due (or Refund Due)	**$xxx**	

Section A: "Income Broadly Defined"

The IRS considers any increase in wealth as **"income broadly defined"**. This is important to understand as to not omit any items that may be reported to the IRS (one of the easiest ways to get audited!). Examples of sometimes omitted items reported to the IRS are cancellations of debt (Form 1099-C) and distributions from qualified accounts (Forms 1099-R, 1099-SA). In some cases, there are exclusions (subject to qualification) that can reduce the amount of income you have in this category. ***See Section B for more detail.***

<u>Things to consider:</u>

- Did you receive any Form 1099s during this year? If so, make sure you add those to your W-2 income to get an accurate picture of your gross income.
- Did you sell any property? A primary residence, rental property, land, or business assets? Gathering documentation from all **<u>increases in wealth</u>** will help you avoid omitting what may be reported to the IRS.

Section B: "Exclusions"

Are there increases in wealth that can be excluded? Yes, of course. Here are some examples of common exclusions:

- Cash or property received by inheritance
- Employee salary deferrals to some retirement plans
- Qualified distributions from ROTH IRA
- Gifts
- Interest from municipal bonds
- Scholarships (not room and board)
- Life insurance proceeds
- Gain on the sale of principal residence

<u>Things to consider:</u>

- This may be a good time to increase your retirement plan contributions. Did you know you can defer up to $18,000 (for 2016) of your pay which will reduce your taxable income "dollar for dollar"? This delays the taxation until 70 ½ allowing you to receive tax deferred growth during that time.
- Since there are several exclusions you could qualify for based on activity during the year, we recommend listing all the increases (from Section A) and marking the possible exclusions (from Section B) on a sheet of paper or spreadsheet.

Section C: "Gross Income"

The most common item included in gross income will be your year-end pay stub or more specifically Form W-2. This should be sent by your employer by Jan 31st, however you can make an estimation of what this will be as your tax will revolve around a few areas on the Form W-2:

- All compensation (e.g. wages, tips, bonuses) – Box 1
- Federal withholding (calculated from your form W-4) –Box 2
- Salary deferrals to a qualified retirement plan (capped at retirement plan limits) – Box 12

Things to consider:

- Taking some time to estimate these items, can help you **approximate** your tax liability. It won't be perfect, but should be close enough for you to determine if you should:

    - accelerate capital losses in your investment portfolio (to reduce income);
    - make cash/property donations (to increase deductions);
    - accelerate state or local tax payments (to increase deductions);
    - defer income (e.g. bonuses) until next year (to reduce income)

All these actions can help to reduce tax liability.

Section D: "Deductions for Adjusted Gross Income"

Harder to claim, but remarkably effective in reducing taxpayer liability, are **above the line deductions**. The reality is that above the line deductions are adjustments to your gross income and serve as "dollar for dollar" reductions in your gross income. Here is a partial list to consider:

- Moving expenses
- Rental expenses **(certain rules apply)**
- Alimony paid
- College Tuition
- HSA and IRA contributions
- Student loan interest
- Self –Employment taxes (for business owners)

Due to limitations for these items, many tax payers shy away from opportunities that could be used to reduce tax liability. Our recommendation is to use this as means to start asking more questions!

Things to consider:

- If you own a rental property, how many days was it used as a rental? As personal? Answers to these questions in the planning process determine how expenses and income is treated (e.g. reporting it on Schedule C or E).
- Should you make a spousal contribution to an IRA? A non-working spouse can use the working spouse's income to possibly make a deductible contribution to an IRA.
- Personal and dependent exemptions also work to reduce adjusted gross income…how many can you claim? Did you provide support for family member for a large portion of year?

Section E: "Deductions from Adjusted Gross Income"

Below the line deductions from adjusted gross income can be of two varieties: either the standard deduction or itemized deductions. Generally speaking, a tax payer that has a mortgage and makes charitable contributions probably should consider itemizing. Usually property tax, mortgage interest and charitable contributions exceed the standard deduction ($6,300 for single filers and $12,600 for married filing joint in 2016) in any given year.

Things to consider:

- Have you made all your charitable contributions? Non-cash contributions like clothes and household goods count also!
- Have a business credit card account? Now would be a good time to look through the year's transactions to check for unreimbursed expenses.
- Have you received a property tax bill in the mail? Tax payments to local or state taxing entities can be used as itemized deductions (on Schedule A). Just make sure to mail the check by December 31st!
- Making an extra mortgage payment helps by allowing your do deduct the interest in the year payment is made.

Section F: "Taxable Income"

One of the stated goals of this guide was to help you approximate your tax liability. Having a reasonable expectation of what this number is before the filing deadline will help reduce your level of stress or anxiety. Also, knowing whether you will receive a refund or have to pay may affect other decisions you need to make.

Things to consider:

- At this point, you probably have a long list of additions, subtractions and "unknowns". We recommend the use of a spreadsheet to calculate your taxable income estimate. Why? Because as you receive more documentation, these numbers may change. Making the change on a spreadsheet will be more effective than the ole "chug and plug" method prone to human error.
- The next step is to use the tax table below (for 2016) to estimate your taxes:

Tax Brackets and Rates 2016

Rate	Single	Married Filing Jointly	Head of Household
10%	$0 - $9,275	$0 - $18,550	$0 - $13,250
15%	$9,275 - $37,650	$18,551 - $75,300	$13,251 - $50,400
25%	$37,651 - $91,150	$75,301 - $151,900	$50,401 - $130,150
28%	$91,151 - $190,150	$151,901 - $231,450	$130,151 - $210,800
33%	$190,151 - $413,350	$231,451 - $413,350	$210,801 - $413,350
35%	$413,351 - $415,050	$413,351 - $466,950	$413,351 - $441,000
39.6%	$415,050+	$466,950+	$441,001+

Examples for Person filing "Single" or "Married Filing Joint"

Column A	Column B	Column C	Column D
Bracket	**If Taxable income is over**	**But Not Over**	**Tax Calculation**
10%	$0	$9,275	10% of such amount
15%	$9,275	$37,650	$927.50 plus 15% of amount exceeding $9,275
25%	$37,650	$91,150	$5,183.75 plus 25% of the amount exceeding $37,650
28%	$91,150	$190,150	$18,558.75 plus 28% of the amount exceeding $91,150
33%	$190,150	$413,350	$46,278.75 plus 33% of the amount exceeding $190,150
35%	$413,350	$415,050	$119,934.75 plus 35% of the amount exceeding $413,350
39.6%	$415,050	---------	$120,934.75 plus 39.6% of the amount exceeding $415,050

Column A	Column B	Column C	Column D
Bracket	**If Taxable income is over**	**But Not Over**	**Tax Calculation**
10%	$0	$18,550	10% of such amount
15%	$18,550	$75,300	$1,855 plus 15% of amount exceeding $18,550
25%	$75,300	$151,900	$10,367.50 plus 25% of the amount exceeding $75,300
28%	$151,900	$231,450	$29,517.50 plus 28% of the amount exceeding $151,900
33%	$231,450	$413,350	$51,791.50 plus 33% of the amount exceeding $231,450
35%	$413,350	$466,950	$111,818.50 plus 35% of the amount exceeding $413,350
39.6%	$466,950	---------	$130,578.50 plus 39.6% of the amount exceeding $466,950

Figure in 3 Steps:

1. Find taxable income range in table for your tax status (in columns B & C);
2. Subtract taxable income from lower number in range (in column B);
3. Use tax calculation (in Column D). This is tax liability.

Taxable Income of $100,000 (Single)….

(100,000 – 91,150) x .28 = 2,478 +18,558.75 or **$21,036.75 in tax liability**

Taxable Income of $100,000 (MFJ)….

(100,000 – 75,300) x .25 = 6,175 +10,367.50 or **$16,542.50 in tax liability**

Section G: "Tax Credits"

You may be wondering why this was left as the last item when it could reduce the tax you pay. **First**, the tax liability you have is calculated from taxable income, and credits subsequently reduce that number. **Next**, you may not qualify for certain credits each tax year because many are largely determined by your adjusted gross income (AGI). **Finally**, in conservatively estimating your tax due, refundable credits such as, taxes paid, are better to use. These can be a combination of: (1) estimated tax payments you have made quarterly, and/or (2) federal taxes withheld (this amount will be in Box 2 on your Form W-2) by your employer. Both of these are fully refundable, meaning if you over estimate or over withhold, the money will be returned.

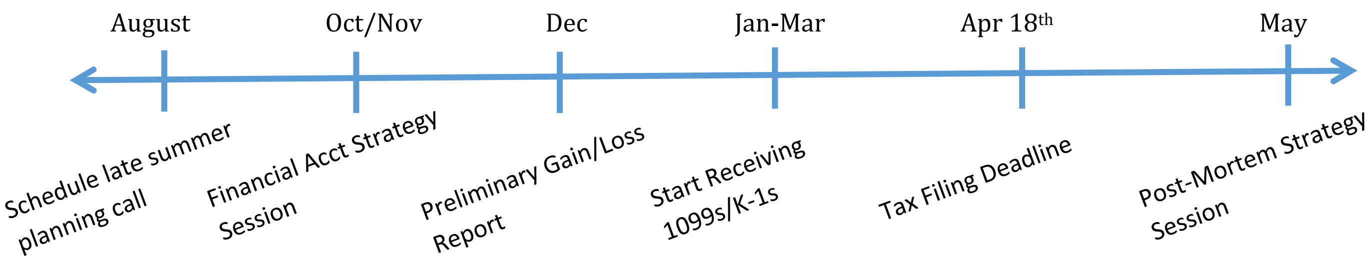
- Take your estimated tax liability from Section F example;
- Add the number from Box 2 of your W-2 (if available) or year-to-date amount withheld on your last paystub for the year;
- The result will be your approximate tax due (negative numbers indicate tax refunds)

Things to consider:

- A secondary goal of this guide is to minimize the amount the government returns to you in the form of a refund in any given year. Therefore, you should plan to complete a form W-4 every tax year to adjust your tax withholding if you are receiving large tax refunds. We find that most clients end up with more money per pay period that can be used for their financial goals such as saving, investing or reducing debt.

Recommended Tax Timeline

Our experience shows that developing a planned tax strategy not only saves money but reduces the stress and anxiety associated with the process. We have a recommended tax timeline from our years of working with clients.



- **Late Summer Planning call** – Ideally this session involves the client, the tax professional and the financial professional to strategize about the client's tax situation. Late summer appointments tend to be a time less hectic for tax professionals. Also, enough activity has taken place to have a meaningful conversation about updates to the client's situation.
- **Financial Account Strategy Session** – This session involves the client and the financial professional in order to determine which positions in the taxable portfolio could be harvested for capital gains or losses. Ideally this is in concert with any portfolio rebalancing that occurs.
- **Review Preliminary Gain Loss/Report** – Clients should be in possession of a report that shows all positions in taxable accounts and the year-to-date gain or loss position to help solidify decisions to harvest positions.
- **Receipt of Tax Documents** – The first quarter of the New Year will bring a constant barrage of tax forms to complete the client's tax return. Ideally, these forms should be collected and stored in a safe place (e.g. document vault) for easy access by the tax and financial professional.
- **Tax Filing Deadline**– Whether you decide to file an extension or not, this is a key date as to avoid the failure to file and failure to pay penalties the IRS imposes on delinquent or tardy tax payers.
- **Post-Mortem Strategy Session** – This session involves the client and the financial professional discussing any ways to improve the level of service provided and address any concerns the client may have.