The COMPASS Chronicle

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Highlighting important wealth management issues

16 Tax-Saving Moves To Make At The End Of '16

The national elections in November could result in political changes and legislation that might affect tax planning in 2017 and beyond. For now, though, it pays to focus on ways to reduce tax liability before the end of this year. Consider these opportunities:

1. Give cash to charity. If you keep the proper records, you generally can deduct contributions made as late as the last day of the year. But you'll need to know about special rules that may limit your deduction.

2. Harvest capital losses. If you sell securities at a loss before year's end, you can use those losses to offset your gains on other sales—including profits on assets you've held a year or less, which are taxed at full income rates. Excess losses can offset up to $3,000 of ordinary income, and you can carry forward additional amounts to future tax years.

3. Use your capital gains. Gains you've already realized could be absorbed by your losses, and profits on shares you've held more than a year qualify for long-term capital gain treatment, with a maximum tax rate of only 15%, or 20% if you're in the top ordinary income tax bracket.

4. Maximize the 0% rate. Even better than the usual 15% or 20% maximum tax rate, you can benefit from a 0% rate on long-term capital gains up to the top of the 15% tax bracket. If you're in a low-tax year (perhaps because you've suffered a business loss), this can let you take profits painlessly.

5. Minimize the NII surtax. The 3.8% surtax applies to the lesser of your net investment income (NII) or your modified adjusted gross income (MAGI) that exceeds $200,000 for single filers and $250,000 for joint filers. Consider taking steps to reduce your NII and MAGI to limit or eliminate this tax.

6. Buy dividend-paying stocks. Most dividends are taxed at the same preferential tax rates as long-term capital gains. However, to qualify for this tax break, you must meet a 61-day holding period.

7. Avoid wash sales. Under the rule covering these sales, you can't deduct a loss from selling securities if you acquire substantially identical shares within 30 days. To avoid this rule, you simply could wait at least 31 days to acquire similar securities.

8. Convert to a Roth IRA. If you have funds in a traditional IRA, you might transfer the funds to a Roth. Future Roth distributions are generally tax-free. You could string out taxable conversions over several years to reduce the tax bite.

9. Boost 401(k) contributions. Increasing deferrals to a 401(k) plan reduces your taxable income. There's a generous $18,000 deferral limit in 2016 ($24,000 if age 50 or over). Assets in your account compound on a tax-deferred basis.

10. Withdraw RMDs on time. If you are over age 70½, you generally have to take required minimum

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COMPASS Corner

Louis E. Conrad II, CFA®

The third quarter began with the capital markets still digesting the repercussions of the U.K.'s "Brexit" vote and ended with the Federal Reserve still unwilling to raise interest rates since their first increase in December 2015.

For the quarter, the S&P 500 Index generated a total return of 3.85%, while for the year-to-date period the index gained 7.84%. The MSCI EAFE Index, representing foreign stocks in the developed markets, came to life during the third quarter, increasing 6.43%. The index gained only 1.73% for the year-to-date period, however, due to global growth concerns early in the year and the "Brexit" vote in late June. The emerging markets have performed well this year, gaining 9.03% and 16.02%, respectively, during the third quarter and year-to-date periods.

Bonds generally fared less well for the quarter, after rallying at the beginning of the quarter in a "flight-to-quality" trade subsequent to the "Brexit" vote. The Barclays Capital U.S. Aggregate Bond Index, a broad representation of the U.S. bond market, produced a total return of just 0.46% for the third quarter, but generated a return of 5.80% for the first nine months of the year, assisted by a decline in interest rates during the period.

COMPASS believes that, barring some meaningful, unforeseen event, the Federal Reserve no longer has any excuses left and will be forced to raise interest rates in December to maintain credibility with investors.

Don’t Chase After The Market News

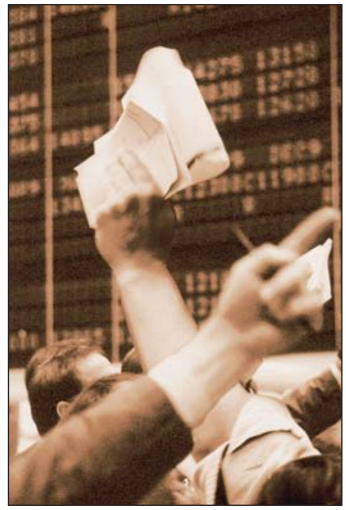
Did you read the newspaper today or check the news online? Invariably, the stock market will be heading up or down, with the movement triggered by anything from company earnings announcements to a change in economic indicators or even a political event such as Brexit. And, more often than not, financial pundits may respond by urging investors to buy or sell something.

But you can drive yourself crazy, if you haven’t already, by making stock market decisions based on what just has occurred or what you think will happen next. In fact, chasing after the news is a common investment mistake. There are at least four good reasons to avoid this temptation like the plague:

1. The stock market usually moves ahead of the news.

There was no “all clear” signal that the severe stock market downturn of 2008-2009 had abated. But the market hit bottom on March 9, 2009, and embarked on a long, profitable climb even as other financial news remained dire. Typically, stocks move about six months ahead of economic developments, reflecting the collective knowledge, trends, and inclinations of investors. If you try to beat the market by reacting to the latest news, you’ll probably be much too late to benefit.

2. You don’t have all the necessary information.



Markets tend to move based on the decisions of mutual fund managers or professional analysts who monitor and interpret financial data for a living. They have a lot more information than you do, and they get it much sooner than you—and millions of others like you—who will hear it on television or find it on the Internet. That puts you at a decided disadvantage.

3. You can’t believe all the hype.

In this electronic age, media reports are often prone to hyperbole, as the pressure to generate interest from a fickle public continues to increase. That could lead producers to overreact to news tidbits or sensationalize minor events. One small incident usually doesn’t portend a complete economic collapse, so take reports of impending doom with a grain of salt. It isn’t likely that the sky is falling!

4. Market timing is difficult, if not impossible.

To be successful at market timing, you have to be extremely skilled or lucky, or both. Over the long term, buying or selling based on what you hear or read almost never beats a consistent, methodical long-term approach. It’s better to make investment decisions based on financial particulars rather than on instincts and hunches.

Building a diversified portfolio combining stocks, bonds, and other investments can help you progress toward your financial goals—and it can help you stop worrying about what you hear on the news. ●

16 Tax-Saving Moves

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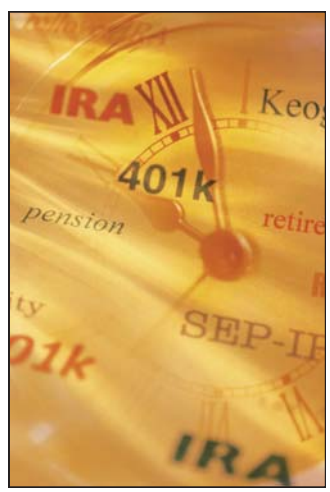
distributions (RMDs) from employer retirement plans and traditional IRAs each year. There’s a penalty of 50% of the required amount if you miss the December 31 deadline.

11. Donate stock to charity. Giving appreciated stock to charity normally gives you a deduction of the fair market value of property you’ve held more than a year—letting you avoid tax on your gains.

12. Beware the AMT. The alternative minimum tax (AMT) uses a complex roster of adjustments and tax preference items to snare many high-income investors. Postponing some preferences to 2017 could help you cut or avoid the AMT.

13. Bunch medical expenses. Generally, you only can deduct medical expenses that exceed 10% of your adjusted gross income (AGI) in 2016 (7.5% of AGI if you’re 65 or older). If you might clear that threshold this year, consider adding elective services or procedures to increase your deduction.



14. Shift income within the family. If you transfer taxable investments to a lower-taxed family member, the family may save tax overall. However, investment income above $2,100 received by a young child in 2016 generally is taxed at the parents’ top tax rate.

15. Use installment sale method. Generally, you can defer tax on the sale of real estate if you receive payments over two years or longer. That also could reduce the effective tax rate by keeping you below the thresholds for capital gains and the 3.8% surtax.

16. Be generous around the holidays. Finally, you can give each family member up to $14,000 in 2016 without paying any gift tax. Using this annual exclusion reduces the size of your taxable estate. ●