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Tax & Business Alert

DECEMBER 2016

DON'T LET CAPITAL LOSSES GET YOU DOWN

No one wishes to lose money on an investment. But, if it happens to you, don't let it get you down. You may be able to lower your tax bill to cheer yourself up.

THE BRIGHT SIDE

A capital loss occurs when you sell a security for less than your "basis," generally the original purchase price. The upside is that you can use capital losses to offset capital gains you realize in that same tax year.

When your capital losses exceed your capital gains, you can use up to $3,000 of the excess to offset wages, interest and other ordinary income ($1,500 for married people filing separately). Then you can carry the remainder forward to future years until it's used up.

WASH SALE RULE

Years ago, investors realized they could sell a security to recognize a capital loss for a given tax year and then — if they still liked the security's prospects — buy it back immediately. To counter this strategy, Congress imposed the wash sale rule, which disallows losses in situations where an investor sells a security

and then buys the same or a "substantially identical" security within 30 days of the sale, before or after.

Waiting 30 days to repurchase a security sold at a loss is one way to achieve your goals without running afoul of the wash sale rule. But there may be times when you'd rather not be forced to sit on the sidelines for a month. Instead, you might consider doubling up on a position in which you have a loss and then waiting 31 days to sell the original stake — a strategy that

MUTUAL FUND MATTERS

In some cases, rather than invest in a single security, you may wish to identify a mutual fund or exchange-traded fund with a similar investment sector, strategy and size. If you're buying mutual funds, however, it pays to know when the next capital gains distribution will occur and how large it will be. If the distribution is sufficiently large and the date is imminent (they often occur in December), you might want to delay your purchase to avoid incurring a sizable tax liability.

also avoids a wash sale violation because the purchase occurs more than 30 days before the sale.

STRATEGIC RESEARCH

If you don't want to sit on the sidelines or double up on a position, there's often an alternative. With a little research, you might be able to identify a security you like just as well as, or better than, the old one. Say you own stock in a networking equipment company that has lost value since you bought it. After researching the industry, you discover that the company's chief competitor is more attractively valued and has better growth prospects.

Your solution is now simple and straightforward: Simultaneously sell the stock you own at a loss and buy the competitor's stock, thereby avoiding violation of the "same or substantially identical" provision of the wash sale rule. In the process, you've added to your portfolio a stock you believe has more potential or less risk.

SEEK PROFESSIONAL ADVICE

If you incur a capital loss, please contact us. We can discuss your options to use it to reduce your taxes and reposition your portfolio. ■

IRS CONTINUES TO ENFORCE "REASONABLE" SHAREHOLDER-EMPLOYEE SALARIES

If you're a shareholder-employee of an S corporation, you more than likely considered the tax advantages of this entity choice. But those very same tax advantages also tend to draw IRS scrutiny. And the agency has made clear that its interest in S corporations — including possible audits — will continue.

WHAT'S THE PROBLEM?

The IRS pays particular attention to S corporations because, as you well know, shareholder-employees of these organizations aren't subject to self-employment taxes on their respective shares of the company's income. This differs from, say, general partners in a partnership.

To better manage payroll taxes, many S corporations minimize shareholder-employee salaries (which are subject to payroll taxes) and compensate them mostly via "dividend" distributions. If this holds true for you, the IRS may take a close look at your salary to determine whether it's "unreasonably" low. The agency views overly minimized salaries as an improper means of avoiding payroll taxes.

If its case is strong enough, the IRS could recharacterize a portion of distributions paid to you and other shareholder-employees as wages and bill the employer and/or employee for unpaid taxes, interest and possibly even penalties.

HOW DO YOU DEFINE IT?

By following certain guidelines, your business can ensure salaries paid to you and other shareholder-employees have a higher likelihood of meeting the agency's typical standards of reasonableness.

For starters, do some benchmarking to learn how S corporations of similar size (as indicated by capital value, net income or sales) in your industry and geographic region are paying their shareholder-employees. In addition, pay close attention to certain traits held by your shareholder-employees. These include:

- Background and experience,
- Specific responsibilities,
- Work hours,
- Professional reputation, and
- Customer relationships.

The stronger these traits are, the higher the salary should be in the eyes of the IRS. Shareholder-employee salaries should be fairly consistent from year to year, too, without dramatic raises or cuts.

WHO CAN HELP?

As your S corporation battles with its competitors and strives to meet its strategic goals, you may not be thinking all that much about the form of your compensation. But, rest assured, the IRS is paying attention. We can examine the reasonableness of the salaries that you and other shareholder-employees are receiving and help minimize the chances of an examination or audit. ■

AGE 50 OR OLDER? CATCH-UP CONTRIBUTIONS ARE FOR YOU

Are you in your 50s or 60s and thinking more about retirement? If so, and you're still not completely comfortable with the size of your nest egg, don't forget about "catch-up" contributions. These are additional amounts beyond the regular annual limits that workers age 50 or older can contribute to certain retirement accounts.

Catch-up contributions give you the chance to take maximum advantage of the potential for tax-deferred or, in the case of Roth accounts, tax-free growth.

401(K) FEATURE

Under 2016 401(k) limits, if you're age 50 or older, after you've reached the $18,000 maximum limit for all employees, you can contribute an extra $6,000, for a total of $24,000. If your employer offers a Savings Incentive Match Plan for Employees (SIMPLE) instead, your regular contribution maxes out at $12,500 in 2016. If you're 50 or older, you're allowed to contribute an additional $3,000 — or $15,500 in total for the year.

But, check with your employer because, while most 401(k) plans and SIMPLEs offer catch-up contributions, not all do.

IRA BENEFITS

Another way to save more after age 50 is through a traditional IRA or a Roth IRA. With either plan, those 50 or older generally can contribute another $1,000 above the $5,500 limit for 2016. Plus, you can make 2016 IRA contributions as late as April 18, 2017.

The benefits of making the additional contribution differ depending on which account you're considering. With a traditional IRA, contributions may be tax deductible, providing you with immediate tax savings. (The deductibility phases out at higher income levels if you or your spouse is covered by an employer retirement plan.)

Roth contributions are made with after-tax dollars, but qualified withdrawals are tax-free. By contributing to a Roth IRA and taking the tax hit up front, you won't lose any of the income to taxes at withdrawal, provided you're at least 59½ and have held a Roth IRA at least five years. However, be aware that the ability to contribute to a Roth IRA is phased out based on income level.

Another option if you'd like to enjoy tax-free withdrawals is to convert some or all of your traditional IRA to a Roth IRA — but you'll also take an up-front tax hit.

SELF-EMPLOYED LIMITS

If you're self-employed, retirement plans such as an individual 401(k) — or solo 401(k) — also allow catch-up contributions. A solo 401(k) is a plan for those with no other employees. You can defer 100% of your self-employment income or compensation, up to the regular yearly deferral limit of $18,000, plus a $6,000 catch-up contribution in 2016. But that's just the employee salary deferral portion of the contribution.

You can also make an "employer" contribution of up to 20% of self-employment income or 25% of compensation. The total combined employee-employer contribution is limited to $53,000, plus the $6,000 catch-up contribution.

SQUIRREL AWAY

The year's almost over, but you still have time to squirrel away a few extra dollars. ■

7 LAST-MINUTE TAX-SAVING TIPS

Where did the time go? The year is quickly drawing to a close, but there's still time to take steps to reduce your 2016 tax liability. Here are seven last-minute tax-saving tips to consider — you just must act by December 31:

1. Pay your 2016 property tax bill that's due in early 2017.
2. Pay your fourth quarter state income tax estimated payment that's due in January 2017.
3. Incur deductible medical expenses (if your deductible medical expenses for the year already exceed the applicable floor).
4. Pay tuition for academic periods that will begin in January, February or March of 2017 (if it will make you eligible for a tax deduction or credit).
5. Donate to your favorite charities.
6. Sell investments at a loss to offset capital gains you've recognized this year.
7. Ask your employer if your bonus can be deferred until January.

Keep in mind, however, that in certain situations these strategies might not make sense. For example, if you'll be subject to the alternative minimum tax this year or be in a higher tax bracket next year, taking some of these steps could have undesirable results.

To make absolutely sure which of these tips are right for you, and learn whether there are other beneficial last-minute moves you might make, please contact our firm. We can help you maximize your tax savings for 2016. ■