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A tax, business, and financial planning newsletter for our clients and friends

CLIENT'S tax & financial UPDATE
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Eight Ways To Plan For Tax-Free Income

When you're evaluating potential sources of income, you should also be keeping an eye on their tax consequences. This is especially important if you're near a tax bracket that will adversely effect your tax picture in April. Fortunately, there are alternatives that can lower the tax bite. Here are some to consider.

Consider a real estate tax shelter. When you buy income producing real estate for investment purposes, you can take a depreciation write-off for the cost of the property and improvements against your income. Your taxable rental income will then be reduced by the amount of your depreciation deduction. This deduction is a tax-sheltered source of income, since depreciation is a non-cash expense.

Shelter business income with tax-deferred retirement plans. Up to $53,000 a year can be contributed to a *defined contribution plan*. A person who is 50 years of age or older may make an additional "catch-up" contribution of $6,000 to a 401(k) and certain simplified employee plans (SEP). **Strategy:** If you are older than age 45, consider setting up *defined benefit plans*. Defined-benefit plans may permit larger contributions than defined contribution plans because you fund a specific amount and have fewer years in which to do so. In some instances, contributions can exceed $200,000 per person.

Plan for tax-free Social Security. Not all of your social security benefits may be subject to tax. To determine how much is taxable, you must look to all of your sources of income. If you and your spouse earn less than $32,000 ($25,000 for an individual),

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taxPOINTS

Expensing election. Businesses can elect to expense as an option to depreciating, $500,000 of equipment purchases placed in service. This is often referred to as a Section 179 deduction. This election begins to be phased out for businesses with more than $2,000,000 of equipment purchases in any one year.

Student loan interest deduction is allowed on student loans. The deduction may be taken even if you don't itemize your deductions. The amount of interest you can deduct is $2,500. **Limit:** The deduction is phased out for single taxpayers with an adjusted gross income of over $50,000 and for married taxpayers with an adjusted gross income over $100,000.

Charitable driving deduction standard mileage rate is 14 cents per mile for 2016.

Transfer personal assets in parcels to avoid gift tax. **Example:** A married couple owns real estate worth $140,000. They would like to transfer it to their child. They can transfer 20% of the real estate each year to take advantage of their annual joint $28,000 gift tax exclusion. After five years, the transfer will be complete, and no gift tax will be due.

How Quickly Your IRA or 401(k) Will Grow

Here's a chart that shows how fast $1 contributed to an IRA or 401(k) plan at the end of each year will grow at various compound interest rates over different periods of time. You can use this table to determine the value of your IRA or 401(k) plan at a future date. For example, assume that you contribute $6,000 a year for the next ten years at an 8% average rate of return. Based on these assumptions, the chart shows that $1 would grow by a factor of 14.4865. Multiply your $6,000 contribution by that factor to determine that your IRA or 401(k) plan would be worth $86,919.

AVERAGE RATE OF RETURN				
Year	**4.00%**	**6.00%**	**8.00%**	**10.00%**
1			1.0000	1.0000
5	5.4164	5.6370	5.8666	6.1051
7	7.8982	8.3938	8.9228	9.4871
10	12.0062	13.1808	14.4865	15.9374
15	20.0236	23.2760	27.1521	31.7724
20	29.7780	36.7856	45.7619	57.2749
25	41.6460	54.8646	73.1059	98.3470

What To Do If You Can't File On Time

You can get an automatic extension until October 15, 2016 to file your tax return. All that's necessary is that you notify the IRS by filing Form 4868 no later than April 15, 2016.

Important: An extension of your filing date is not an extension of the time when you must pay your taxes. You must estimate the amount of tax you owe and attach a check for that amount to Form 4868 and mail it by April 15. If you don't pay your tax until the extended due date, you'll be charged interest and penalties for the late payment.

Try to estimate your tax as accurately as you can. If you underestimate your tax bill, you'll be charged interest on the underestimated amount, and if you underestimate by more than 10%, you'll be charged a penalty as well as interest.

You generally cannot get a filing extension beyond six months, but there may be an exception if you are living out of the country.

Get All Your Deductions For Job Search Expenses

You can deduct the costs of looking for a new job as miscellaneous itemized deduction subject to the 2% of Adjusted Gross Income limitation. Even if you do not wind up with a new job, you can still deduct these expenses:

- Newspapers and business publications that you buy for their employment ads.
- Fees you pay to career consultants, recruiters, employment agencies, and resume writers.
- Resume preparation costs such as typing, printing, envelopes and postage.
- Miscellaneous transportation costs such as taxi fares or parking costs for job interviews.
- Telephone calls made in connection with your job search.
- Out-of-town travel expenses including transportation, hotels, and 50% of the cost of all meals.
- Legal and accounting fees for tax advice about employment contracts.

Strong Solutions For Credit Problems

Even the best of customers sometimes fall past-due. You should have an established credit policy so you can handle these problems when they occur. Here are some typical solutions.

1. Ship C.O. D. only.

2. Get a personal guarantee of payment from a company officer.

3. Shut off a customers' credit until all back bills are paid in full.

It's just as important to watch for signs that customers' credit might be weakening. Here are some typical signs.

- Sudden increase in purchases
- Frequent changes to new banks
- Weak excuses for payment slowdown
- Reluctance to reveal financial information
- Annoyance at attempts to collect
- Factoring of accounts receivable
- Lowered credit agency rating
- Erratic pattern of payments
- Unresponsiveness to collection attempts

How To Borrow Interest-Free From Your IRA

The rules for taking money from an IRA are quite clear. Any amount you withdraw is subject to income tax in the year in which the money is distributed to you. If you receive distributions before you reach the age of 59-1/2 (except for death or disability), those distributions are subject to a 10% penalty.

However, there is a little-known exception to these rules that lets you withdraw any amount you wish from your IRA tax-free and penalty-free. In effect, you can use your IRA as your own private loan company and borrow from it without paying interest.

Be very careful, however, because you must return the funds to the IRA from which you withdrew them or you must rollover the withdrawn funds into another IRA within 60 days of the date you withdrew the money. Furthermore, you can only "borrow" from your IRA once a year using this technique.

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then all of your social security benefits may be exempt from tax.

Open an IRA and contribute to it each year. Even if you can't deduct and IRA contribution, income from individual retirement accounts is tax-deferred. You pay income tax only when you withdraw your funds, usually when you're retired and in a lower tax bracket. Meanwhile, the interest from your IRA investments keeps compounding.

Contributions to a Roth IRA are not deductible. However, all Roth IRA withdrawals may be tax free. Provided you are at least 59 1/2 years old, you can take tax-free withdrawals from a Roth IRA after five years.

Use the interest from life insurance. When you cash in a life insurance policy, you'll be taxed on the interest that's been accumulated. But there is a way to use certain policies to avoid taxes and enhance your cash flow. Some life insurance policies actually allow you to "borrow" against the annual interest they generate. For example, $20,000 invested in a life insurance policy that pays 6% a year will generate $1,200 in interest which is available for you to "borrow". You will have to pay a modest amount of interest to the insurance company for the "loan", but the loan proceeds won't be taxable.

Look at annuities. Another insurance-based option is the tax deferred annuity. Sometimes called single-premium deferred annuities, these are investments you can make with an insurance company at a specified rate of interest. Unlike life insurance policies, however, you can't borrow against this income until you cash in the investment. But it's only when you cash in the annuity that you pay tax on the income.

Consider municipal bonds. There's no federal income tax on interest earned from municipal bonds, which are usually sold at $5,000 minimum with maturities anywhere between 30 days and 30 years. If you're investing a smaller sum, or prefer that experts manage this part of your portfolio, you can invest in municipals, through specialized mutual funds. If you're looking for rapid turnover without the risk of long-term changes in the value of your investment, there are mutual funds which invest only in very short-term municipals that mature in 60 days. You can usually buy into these funds at a lower minimum – between $1,000 and $5,000 – and can often write checks against your account.

Whichever way you invest in municipals, however, you do need to keep an eye on the state tax. Interest from municipals is exempt from state tax, but only when the bonds are issued in the state where you live. If you're in Massachusetts, for example, and invest in DesMoines municipals, you won't pay federal income tax on the interest, but you will be liable for Massachusetts state income tax.

Buy U.S. Treasury Bonds. When you buy U.S. Treasury bonds, your tax situation is exactly the opposite of the situation with municipal bonds. Regardless of where you live, you'll have to pay federal tax on the interest from Treasury bonds, but all U.S. Government securities are exempt from state tax.

Management Tip

Speed up collections by sending slow-paying accounts several small invoices instead of one large invoice. Customers who have financial problems may hold up payment of bigger invoices (usually those over $2,500) but will often approve smaller bills for payment when they are received.