

## TAX ALERT: 2016 COST-OF-LIVING ADJUSTMENTS: MINIMAL CHANGES FROM 2015

**Abstract:** The IRS has issued its cost-of-living adjustments (“COLAs”) for 2016. Since inflation remains low, many COLA amounts remain the same as last year or were increased modestly. This article provides an overview of 2016 amounts related to individual income taxes, the alternative minimum tax, education- and child-related tax breaks, retirement plans, and gift and estate taxes.

### 2016 cost-of-living adjustments: Minimal changes from 2015

The IRS has issued its COLA amounts for 2016. Since inflation remains low, many COLA amounts are the same as last year or were increased modestly. It helpful to know the 2016 amounts as you evaluate 2015 year-end tax planning strategies.

### Individual income taxes

The 2016 tax-bracket thresholds increases for each filing status and these increases are more significant for taxpayers in the higher brackets.

2016 ordinary income tax brackets				
Tax rate	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
10%	\$0 - \$9,275	\$0 - \$13,250	\$0 - \$18,550	\$0 - \$9,275
15%	\$9,276 - \$37,650	\$13,251 - \$50,400	\$18,551 - \$75,300	\$9,276 - \$37,650
25%	\$37,651 - \$91,150	\$50,401 - \$130,150	\$75,301 - \$151,900	\$37,651 - \$75,950
28%	\$91,151 - \$190,150	\$130,151 - \$210,800	\$151,901 - \$231,450	\$75,951 - \$115,725
33%	\$190,151 - \$413,350	\$210,801 - \$413,350	\$231,451 - \$413,350	\$115,726 - \$206,675
35%	\$413,351 - \$415,050	\$413,351 - \$441,000	\$413,351 - \$466,950	\$206,676 - \$233,475
39.6%	Over \$415,050	Over \$441,000	Over \$466,950	Over \$233,475

The personal and dependency exemption also increases for 2016. This exemption is subject to a phaseout, which reduces exemptions by 2% for each \$2,500 (or portion thereof) by which a taxpayer's adjusted gross income (AGI) exceeds the applicable threshold (2% of each \$1,250 for married filing separately filings). For 2016, the AGI threshold phase out amounts are \$259,400 (singles), \$285,350 (heads of households), \$311,300 (married filing jointly), and \$155,650 (married filing separately). The exemption phases out completely at \$381,900 (singles), \$407,850 (heads of households), \$433,800 (married filing jointly), and \$216,900 (married filing separately).

Your AGI also may affect itemized deductions. An AGI-based limit reduces certain otherwise allowable deductions by 3% of the amount by which a taxpayer's AGI exceeds the applicable threshold (not to exceed 80% of otherwise allowable deductions). For 2016, the thresholds are \$311,300 (up from \$309,900) if married filing jointly, \$285,350 (up from \$284,050) for heads of households, \$259,400 (up from \$258,250) for singles and \$155,650 (up from \$154,950) for married filing separately taxpayers.

## AMT

The alternative minimum tax (AMT) is a separate tax system that limits or eliminates some deductions, and increases taxable income by certain tax preference items. AMT was designed to ensure that taxpayers do not use deductions, credits, losses or exemptions to completely avoid tax. AMT for the tax year is the excess of the taxpayer's tentative minimum tax over regular tax liability.

Like the regular tax brackets, the AMT brackets are annually indexed for inflation. For 2016, the threshold for the 28% bracket increased modestly from 2015 for all tax filing categories.

2016 AMT brackets				
Tax rate	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
26%	\$0 - \$186,300	\$0 - \$186,300	\$0 - \$186,300	\$0 - \$93,150
28%	Over \$186,300	Over \$186,300	Over \$186,300	Over \$93,150

Some AMT income is exempt from the AMT, and these AMT exemptions and exemption phase outs are indexed each year. The exemption amounts for 2016 are \$53,900 for singles and heads of households and \$83,800 if married filing jointly (\$41,900 for married filing separately), increasing by \$300 and \$400, respectively, over 2015 amounts. The inflation-adjusted exemption phase out amounts for 2016 are \$119,700 (singles and heads of households), \$159,700 (married filing jointly), and \$79,450 (married filing separately). The exemption is completely phased out in 2016 when AMT income reaches \$335,300 (singles), \$494,900 (married filing jointly), and \$247,450 (married filing separately).

## Education and adoption tax credits

The maximum benefits of various education and adoption tax credits generally remain the same for 2016. But most of these breaks are also limited based on a taxpayer's modified adjusted gross income (MAGI). Taxpayers having MAGIs that are within the applicable phaseout range are eligible for a partial break. These breaks are eliminated for those having MAGIs exceeding the top of the range.

The MAGI phaseout ranges generally remain the same or increase modestly for 2016, depending on the break. For example:

***The American Opportunity tax credit.*** The American Opportunity tax credit provides a 100% credit (first \$2,000) for qualified tuition and related expenses plus 25% of the next \$2,000 for a maximum of \$2,500 per eligible student for the first four years of a student post-secondary education. The MAGI phase out ranges for this education credit remain the same for 2016: \$160,000–\$180,000 for joint filers, and \$80,000–\$90,000 for other filers.

***The lifetime learning credit.*** The lifetime learning credit is 20% of the amount of qualified tuition expenses paid on the first \$10,000 of tuition. Unlike the American Opportunity tax credit, the lifetime learning credit is calculated per taxpayer (not per eligible student) if the student is enrolled in one or more courses at a qualified educational institution. For 2016, the MAGI phaseout range for this education credit (maximum \$2,000 per tax return) increases only for joint filers, to \$111,000–\$131,000 (up \$1,000). The phaseout range remains at \$55,000–\$65,000 for other filing categories.

***The adoption credit.*** A nonrefundable tax credit is available for qualified adoption expenses for each eligible child. This credit phases out ratably and the MAGI phase out range for this credit increases for 2016 — by \$910, to \$201,920–\$241,920. The maximum credit also increases by \$60, to \$13,460 for 2016.

(Note: Married couples filing separately generally aren't eligible for the adoption tax credit.)

These are only a few of the education- and child-related breaks that may benefit you. Even if your MAGI is too high to qualify for a break for your child's education, explore whether your child might be eligible.

## Retirement plans

Retirement-plan-related limits remain unchanged for 2016:

Type of limitation	2015 limit	2016 limit
Elective deferrals to 401(k), 403(b), 457(b)(2) and 457(c)(1) plans	\$18,000	\$18,000
Annual benefit for defined benefit plans	\$210,000	\$210,000
Contributions to defined contribution plans	\$53,000	\$53,000
Contributions to SIMPLEs	\$12,500	\$12,500
Contributions to IRAs	\$5,500	\$5,500
Catch-up contributions to 401(k), 403(b), 457(b)(2) and 457(c)(1) plans	\$6,000	\$6,000
Catch-up contributions to SIMPLEs	\$3,000	\$3,000
Catch-up contributions to IRAs	\$1,000	\$1,000
Compensation for benefit purposes for qualified plans and SEPs	\$265,000	\$265,000
Minimum compensation for SEP coverage	\$600	\$600
Highly compensated employee threshold	\$120,000	\$120,000

Your MAGI may reduce or even eliminate your ability to take advantage of IRAs. Most IRA-related MAGI phaseout range limits remained unchanged in 2016:

**Traditional IRAs.** MAGI phaseout ranges apply to the deductibility of contributions if the taxpayer (or his or her spouse) participates in an employer-sponsored retirement plan:

- For married taxpayers filing jointly, the phaseout range is specific to each spouse based on whether he or she is a participant in an employer-sponsored plan:
- For a spouse who participates, the 2016 phaseout range limits remain the same as 2015: \$98,000–\$118,000.
- For a spouse who does not participate, the 2016 phaseout range limits increase by \$1,000, to \$184,000–\$194,000.
  - For single and head-of-household taxpayers participating in an employer-sponsored plan, the 2016 phaseout range limits remain the same as 2015 - \$61,000–\$71,000.

Taxpayers with MAGIs within the applicable range are permitted to deduct a partial contribution while those with MAGIs exceeding the applicable range may not deduct any IRA contribution.

But a taxpayer whose deduction is reduced or eliminated may make *nondeductible* traditional IRA contributions. The \$5,500 contribution limit (plus \$1,000 catch-up contributions if applicable and

reduced by any Roth IRA contributions) still applies. Nondeductible traditional IRA contributions may be beneficial if your MAGI is also too high for you to contribute (or fully contribute) to a Roth IRA.

**Roth IRAs.** Whether you participate in an employer-sponsored plan does not affect your ability to contribute to a Roth IRA. However MAGI limits may reduce or eliminate your ability to contribute:

- For married taxpayers filing jointly, the 2016 phaseout range limits increase by \$1,000, to \$184,000–\$194,000.
- For single and head-of-household taxpayers, the 2016 phaseout range limits also increase by \$1,000, to \$117,000–\$132,000.

You may make a partial Roth IRA contribution if your MAGI falls within the applicable range, but no contribution is permitted if your MAGI exceeds the top of the range.

(Note: Married taxpayers filing separately are subject to much lower phaseout ranges for both traditional and Roth IRAs.)

### **Gift and estate taxes**

The unified gift and estate tax exemption and the generation-skipping transfer (GST) tax exemptions are both adjusted annually for inflation. For 2016, the amount is \$5.45 million (up from \$5.43 million for 2015). The annual gift tax exclusion remains at \$14,000 for 2015.

### **New Year, the same or similar numbers**

With inflation in check this year, many 2016 COLA amounts have not changed or were modestly increased. , If you are unsure how these 2016 inflation-adjusted changes may affect your year-end tax planning or retirement planning, please contact us.