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"The welfare of the masses is always the alibi of tyrants."
— *Albert Camus*

"…the Constitution is a limitation on the government, not on private individuals…it does not prescribe the conduct of private individuals, only the conduct of the government…it is not a charter for government power, but a charter of the citizen's protection against the government."
— *Ayn Rand, Atlas Shrugged*

Tax and Financial Strategies

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Wealth Creation Strategies

Attention Clients!

In lieu of mailing a postcard, here are our year-end reminders:

- You will receive our exclusive "Tax Prep" package in early January. Please look for it and tell us NOW if your address has changed, as the package (mailed third class) will NOT be forwarded by the post office.
- E-mail Doug NOW to determine what we need for year-end tax planning (usually an estimate of full-year income and deductions by category and type). Our list of clients for whom we must do Roth conversion planning alone is huge!
- We should be open between Christmas and New Year's this year, but just in case (and we all know stuff happens!) don't wait until the last minute.
- If you drive for business, take an odometer reading on 12/31/15, and take one now in case you forget to do this later!
- You should begin to receive your OLDs (Official Looking Documents) like W-2s, 1099s and *new* 1095s in mid-January. Decide now on a safe place to store them (like inside our Tax Prep package) so you don't spend hours searching for these documents later. Send us all the OLDs that you have by mid-February— they will be safe with us.
- Those with rental properties, businesses and, especially, corporations and partnerships should start sending us "chunks" of information (such as income and categorized expenses for such rentals, businesses and entities) by mid-January.
- If you started a new business during 2015, be sure to apply for a business license with your city. Los Angeles is one of many diligently going after new businesses who fail to get a required license.
- Corporations: be sure to reimburse yourself from your corporation for any health insurance premiums you personally paid and send the total of all such insurance paid during 2015 NOW to Kristin Ericson—needed to complete W-2s accurately. (And, reimburse yourself by 12/31/15 for any personally-paid corporate expenses, including mileage.)

Should You Install Solar?

Ideas On Reducing Power Consumption

Rooftop solar panel installations usually didn't make economic sense until recently, even after accounting for the 30% federal tax credit and utility, state and/or local rebates. But with the price of solar panels having plummeted by at least half since 2008, the price of power skyrocketing due to various mandates and both home buyers and appraisers now ascribing reasonable value to most used non-leased solar panels, solar is now economically sensible for many. Whether solar makes sense for you is a function of your net out-of-pocket installation costs after tax credits and other subsidies, your power usage, your cost per **kWh (kilowatt hour)** of purchased power (which varies tremendously from area to area), how long you intend to live in the house and, if you sell your home before your savings exceeds the cost, the increased value of your home ascribed to the solar panels (or, if you move out and rent the home, the increased rental income). Leasing (briefly discussed below) is *generally* not a good choice.

Why have we not yet discussed solar energy for homeowners in *Wealth Creation Strategies*? First, the unknowns and variables are huge, making possible recommendations and generalizations difficult. Second, the analysis is extremely complex. This article has been five months in the making, there are still areas on which the experts we consulted disagree and it still may be incomplete. Third, we have a visceral distaste for government subsidies. The 30% tax credit for solar installation purchases for one's main home (good for installations completed by Decem-

ber 31, 2016, with no cap and no limitations based on income), is subsidized by *other* taxpayers. Such subsidies are also a subtle way other people incentivize you to spend your money and reallocate resources from more efficient uses to less efficient ones. They were, for years, the only reason solar *might* make any economic sense for rooftops; even today, except in very sunny climates, oil, gas, coal, hydroelectric and nuclear generally use fewer resources and are, therefore, cheaper than solar. Fourth, *other utility rate payers* subsidize those with solar because non-solar utility customers pay nearly all fixed costs of the utility company; essentially, solar panel owners are using the electrical grid but not paying "their share" of fixed costs of building, operating, maintaining and upgrading that grid. Fifth, solar energy makes better economic sense when mass produced via giant solar farms, not with individually mounted rooftop units costing two to four times in overall resources. Consider the price per square foot of installing a hundred square feet vs. hundreds of thousands of square feet of practically anything, not to mention the cost of workers' comp for employees on rooftops vs. ground level. And last, the same government that subsidizes can also impose taxes and penalties on those who accepted and relied on those subsidies. Spain was one of the first countries to heavily subsidize and mandate the use of solar energy, going so far as to promise attractive energy payments for excess energy produced (under a "net metering" scheme) for 25 years. It now taxes rooftop solar panel owners about 8 cents per kWh and no longer pays for any excess power they produce. (For an excellent description of Spain's solar energy problems—including the heavy debt created by borrowing to subsidize rooftop solar installations and what can go wrong with government "guarantees," especially when debt becomes unpayable—see http://instituteforenergyresearch.org/analysis/tough-times-may-be-ahead-for-residential-solar-panels/ and http://www.nytimes.com/2014/01/06/world/europe/spains-solar-pullback-threatens-pocketbooks.html?_r=0.) It shouldn't surprise anyone if something similar happens here, substantially reducing the cost savings from installing solar.

The fatal conceit

For government to take people's hard-earned wealth and subsidize one source of energy over that which consumer-kings would otherwise choose requires a level of knowledge it cannot have. A classic example involved U.S. energy policy in the 1970s, when several science groups thought the U.S. was running out of natural gas. As a result of certain Congressmen thinking they know what they cannot know, Congress prohibited the construction of new power plants using this relatively clean-burning fuel and about half of our modern coal-fueled power plants were subsequently built, burdening us with a legacy of relatively dirty air in some cities. But because of entrepreneurial finds, innovation and private ownership of minerals beneath privately-owned land ("mineral rights," unique to the United States *), natural gas became plentiful relative to oil and the price for natural gas per BTU (a measure of energy output) plummeted to less than half (and at times, one-tenth) of oil and coal. The lesson is not that we need smarter people in government and regulatory bureaus; the lesson is no one is that smart and we should let the markets work (let the price mechanism allocate scarce resources according to consumer-king preferences). When people are allowed to freely buy and sell what they want, the price signals of the marketplace guide their consumption and production. **

The geniuses running energy policy have mandated the use of "alternative energy" far beyond what buyers and sellers would demand and use in the marketplace of voluntary interaction (and way beyond what birds would prefer if they had a choice before being mangled in wind turbines—see, for example, http://savetheeaglesinternational.org/new/us-windfarms-kill-10-20-times-more-than-previously-thought.html, or fried to a crisp flying over solar farms—see, for example, http://news.heartland.org/newspaper-article/2015/06/04/wind-solar-facilities-killing-millions-birds-other-animals, estimated to be at least in the hundreds of thousands yearly). As a result of this artificial selection of one power source over another, the price of electricity has skyrocketed for everyone. The increases have been, however, uneven across the country. Say what you will about the Los Angeles Department of Water and Power (and there is no doubt about endemic corruption), its prices aren't in the stratosphere relative to many nearby areas despite a spate of recent price increases. Solar may not make sense for many LA DWP customers, especially for those who might still be able to decrease personal power consumption in other ways, but seems to make sense for many So Cal Edison customers.

Save on solar by reducing power use first

The best way to reduce the cost of a solar installation is to first reduce your power consumption, as power consumption determines the number of solar panels needed. While my wife Marty and I have been unable to decrease consumption at home over the last decade (it's been stable since improvements made in the early 2000s), our office usage has dropped by 45% over the last eight years, from about 20,000 kWh to less than 11,000 kWh per year. Installing double-pane windows, replacing the old drafty front door and adding insulation to the attic—it's probably R-35 up there—may each have dropped usage by about 2,000-2,500 kWh yearly. At an average cost of 17 cents per kWh (we're in the LA DWP area) our return *of* investment was likely two years for the front door, four or five years for the added insulation and ten years for the windows (which also improved the looks). Less energy-intensive computers, air conditioner, copier and lights, as well as leaving the lights off more often have no doubt also helped, along with stick-on window thermometers on both sides of the office that help us decide when to open and close windows vs. use air or heat.

While power rates will continue to increase and there may not be a lot more we can do to further decrease

energy use (although we're working on a some additional ideas both at home and office), at our current average cost solar panels might not yet be worth the net cost. On the other hand, the five-year depreciation for business/rental property-use solar panels does make it attractive, even without a tax credit for these types of properties. Anything you can do, however, to decrease energy use will not only save money if you don't install solar, but also will save on solar by decreasing the number of required solar panels to meet your power needs.

The costs and resale value of solar energy systems

The costs of installing solar vary based on roof type, materials, shading, whether you want micro-inverters (a more efficient inverter, required to convert the sun's DC energy to AC) and ultra-high efficiency panels from Sunpower (up to 50% more efficient than "standard" panels), as well as whether your house requires an electrical panel upgrade. At the risk of confusing the reader because we are billed for kilowatt hours (kWh) used and solar energy systems are measured in kilowatts (kW), the cost for a system putting out 10,000 kWh per year (which requires a 6.7 kW system under "excellent" solar conditions) might cost $27,000 or less, while one putting out 20,000 kWh per year (which requires a 13.25 kW system under such conditions) should run $47,000 or less. Note that the larger the system, the lower the cost per kilowatt, accelerating the return of investment for larger installations. Subtract from these figures any tax credits, rebates or other subsidies to estimate your net cost before savings on utility bills.

Solar now seems to make sense where there is heavy energy use (think: air conditioning) and/or energy costs are on the higher side. The breakeven on a purchase appears to be as few as five years or less for those paying 30-38 cents per kWh, which Southern California Edison customers are paying, to seven to ten years for those paying closer to 17 cents. Even twelve years wouldn't be a bad deal, especially if you remain in the home. If you stay in your home for the duration of the life of the solar energy system, 25-40 years, you could have decades of nearly "free" energy.

A crucial question for those who sell before recouping all of their costs via savings on utility bills is: what is the resale value? Some internet sites claim solar energy systems are worth as much as $6,000 per kilowatt (that kW measure mentioned above) for a home resale, which could make the resale value greater than the original cost. Such estimates are likely provided by unscrupulous solar sales people and other solar puffers, not dissimilar to a new car dealer inflating the likely resale value of a car for sale. Based on interviews with several qualified home appraisers and real estate brokers, we estimate the value of five-year-old panels at about $5,000-$8,000 for a typical 1,600-2,000 square foot home and $10,000-$15,000 for a typical 3,000 square foot home (extrapolate from these figures for other homes). Solar panel installations are likely worth more in pricier areas (perhaps as high as 70% net of the credit, but I wouldn't rely on such an estimate without doing further research in your locale). If you spend $40,000 and capture a federal tax credit worth up to $12,000, your net cost is $28,000. If you save $3,000 per year and the system is worth $10,000 to a buyer down the road, your breakeven is only ($28,000 - $10,000 = $18,000 / $3,000 =) six years. If you spend $24,000, with a tax credit worth as much as $8,000 your net cost is as low as $16,000. If the system is worth $6,000 at the time of sale of your home and you save $2,000 yearly, your breakeven is only ($16,000 - $6,000 = $10,000 / $2,000 =) five years. And, these estimated breakeven periods don't even count the seemingly inevitable increase in power rates.

Solar panels don't need much maintenance—the best estimates seem to be a few hundred dollars per year if you don't get on the roof to clean them yourself. In general, they last about 25-40 years and lose ½ percent of their power per year if you don't maintain them; inverters (the gizmo that converts the DC energy produced by solar panels to usable AC) run about $1,000 to $1,500 and typically conk out in 12-15 years (typical systems have one or two inverters).

Buying solar may now make sense, especially for larger families, those who prefer to keep their home ice cold during hot summer months, those with a pool filter running all year and, *perhaps*, before the federal tax credit expires at the end of 2016.

Solar energy systems can also make sense for multi-residential and commercial properties, especially those where separate metering isn't possible, leaving tenants no financial incentives to conserve. And, even though the expected life of the panels is 25-40 years, five-year depreciation is allowed, accelerating the tax savings, reducing the effective cost.

Caveats and other thoughts to consider before taking the plunge

1. Leasing a solar energy system is much riskier than purchasing one, but generally only if you sell your home before the lease is up. Even if you don't *plan* to sell, stuff happens. Because you must buy out your lease or a potential buyer must agree to the lease and the leasing company must agree to transfer the lease to the new buyer, the value of a home with a solar lease can be less than one without solar panels. Negotiations with leasing companies have seriously delayed escrow closings and have even cost sales.
2. If you can't pay cash, be careful with financing. We cannot yet recommend "PACE" (Property Assessment Clean Energy) loans, as there seem to be serious issues with resales of homes with such liens. The best option may require taking out a 2nd trust deed or HELOC (home equity line of credit), or a refinancing of the entire loan. *** (If you do this, please consider taking out a 15-year loan; be sure to re-read our articles on the subject in issues # 37 and # 49 of *WCS* at http://www.dougthorburn.com/newsbyedition.php.)
3. While reducing power usage before going solar reduces the number of

solar panels you should purchase (thereby reducing the cost of your solar installation), there are reasons you may want to buy more panels than your current power usage dictates. One, if you're going to have kids or the kids aren't yet teenagers, you may not have experienced the waste of power kids and teens alike are capable of: leaving lights on, keeping doors to the outside open and running TVs all day and night. Your power use and, hence, need for solar panels, may increase (although you could leave room on the roof for adding additional panels later). Two, you can eliminate anger in using extra power: you don't care if your spouse or kids leave the refrigerator, outside doors or windows open. Arguing and, worse, divorce is much costlier than the price of a few extra panels. Three, for pleasure: you or your spouse may prefer 72 degree temps inside rather than 78.

4. There is a wide range in the quality of solar panels and installation, even among "reputable" companies. Buyer beware: be sure to do your homework. Google the name of the provider and both the words "reviews" and "complaints" to get an idea of their integrity. In the process of researching this article, we believe we found some good solar installers in Southern California; keep in mind there is power in numbers for us consumers, and we will track consumer satisfaction for any installers recommended. (We can also recommend several excellent appraisers, who helped us determine after-market value of solar panel installations for this article.)
5. The type of panel and its efficiency depends on the local climate. A very different panel is required for a hot and dry climate than for one that is cool and damp. Be sure to carefully research the type of panel needed for your region.
6. When the federal tax credit expires, will your solar company survive? Your warrantee is only as good as the installer or manufacturer.
7. When the tax credit expires, will the price of solar energy systems drop by enough to compensate for the loss of the credit? Prices could drop due to decreased demand. A previous issue of *WCS* points out that credits serve to artificially increase demand and, therefore, prices. The converse is also true: prices drop without "easy money" such as subsidies. (Easy money such as "liar" loans fueled the housing bubble; today, government-subsidized loans fuel price increases in college tuition, while third-party insurance with low deductibles and tax credits for "insurance" fuel price increases for medical services, supplies, equipment and the insurance itself.) If the cost of solar installations drops by 30%, whether you buy now with the credit or later without, the credit becomes irrelevant, except for the savings on power bills in the interim.
8. If consumer taxpayers think the credit will expire, there could be a surge in demand towards the end of 2016, which might result in a reduction in the quality of panels, installation and service. This could also cause prices to firm up if not increase. If you're planning on installing solar, you may want to act quickly.
9. According to one of our recommended solar energy system installers, starting delays are the biggest complaint among customers. If you can, include a penalty in your contract for a late start and/or a late completion date.
10. If your federal income tax is zero and stays there, the tax credit is worthless. If your tax is $2,000 without the credit and the credit is $8,000, the $6,000 remainder will be carried over from year to year until used up. For example, if your yearly income tax is $1,000, you will save only that $1,000 per year; it would take eight years to realize the full benefit of an $8,000 federal solar tax credit. If you die, any unused credit is permanently lost.
11. Some of you may ask if it would be better to replace an older, relatively inefficient central air conditioning unit with a more efficient unit. I calculated the approximate cost of power used by an air conditioning unit by assuming the additional power consumed during the hot months is all air conditioning. I then calculated the savings from new units with various efficiency ratings and compared with the cost of the new units. In every case I looked at, the breakeven period (cost of new unit divided by savings) is so long I concluded it is never worth replacing central air conditioning systems until they're ready, or at least close to ready, for the scrap heap. Take this into account when deciding on the number of panels when purchasing solar.
12. Regardless of what you do, do your own cost analyses for other older power-consuming items. LED lights are now cheap enough to make heavy-use incandescent bulbs (those lighting up kitchens, family rooms and desks, for example) worth replacing. Save the old incandescent bulbs and use them to replace burnt-out bulbs in lower-use fixtures. Consider other savings techniques, including plugging "vampire" devices (electronics that use power even when turned off) into power strips or surge protectors and turning the power strips off when not in use. Keep the fridge and freezer full; cut the tops off of milk cartons, fill them with water (and refill as needed) and put them in partly empty freezers, as this helps keep the air in the freezer colder, just as the cold Pacific Ocean helps keep United States coastal temperatures much more moderate than inland (water retains "heat energy"). And of course, set the hot water heater on a lower temperature.

* This was one component of why the United States was at the forefront of resource development, replacing coal as the primary means of creating energy for modern civilization. Without private ownership of sub-surface mineral rights, our air would much dirtier and our standards of living would be much lower. You didn't learn this in school.

** This includes the price of true pollutants—not CO_2, which pseudo-environmentalists have decided is a pollutant, yet without which earth would be void of plants and, therefore, life. If this anthropogenic climate change skeptic is wrong and CO_2 is a "pollutant," it is likely one on which puny little man has no appreciable effect and can't possibly change without turning off the lights on civilization.

*** Interest paid may be tax deductible on such loans.

Disincentives to Produce More: a 1,276,300% Tax Rate

Several years ago, we mentioned we'd no doubt find numerous new exorbitant tax rates due to the "Affordable Care" Act. We knew the Act would add to disincentives to improve one's lot (by keeping income low)—thereby aggravating the "income inequality" that many supporters of this experiment in Mussolini-style central planning decry—but not even we thought marginal tax rates could become this high. Consider, too, that your work effort provides value to others. Taxation creates massive disincentives to provide others with value in the form of goods and services, without which consumption beyond primitive levels isn't possible.

During our first season with real-life numbers, we found a number of clients subject to 60-80% tax rates on "chunks" of income. Such exorbitant rates were due partly to income and Social Security/Medicare (or Self-Employment) taxes, but more so due to refundable tax credits like the Earned Income Tax Credit, Child Tax Credit and American Opportunity Credit (for undergraduate college students). Two health-coverage mandated related credits created heretofore unseen tax rates: (1) the Premium Tax Credit, which is a credit received if your tax return-reported income is low enough and you obtained health "insurance"* through the "marketplace" and (2) the Excess Advance Premium Tax Credit Repayment, triggered by receiving too much advanced premium tax credit for health "insurance" based on income estimates previously provided to the "marketplace."

The biggest tax rate shocker we saw was in a not-quite Medicare aged couple with no kids or tuition and, therefore, none of the credits above except for that based on health "insurance" and, due to age, a high cost of insurance. Some of the subsidy they received during the year as reduced monthly premium payments had to be repaid; because most of their income was generated via a Roth conversion, we could control how much credit they would have to repay. All we had to do was decide how much of the Roth conversion to recharacterize (undo), which reduced the income, which in turn reduced the Credit Repayment.

While running the numbers to make this decision, we crossed a particular threshold **: Adjusted Gross Income (AGI) of $62,055. The credit repayment due was $1,385. One dollar of additional income—bringing the AGI to $62,056—increased the repayment to $14,148! We've seen one dollar of additional income increase the tax by several hundred dollars, but never before by $12,763. Hence, a 1,276,300% marginal tax rate. How's that for a disincentive to earn an extra $1! ***

Unfortunately, most taxpayers have no control over their income once the year has passed and many will be stuck with extraordinary high marginal tax rates on "chunks" of their income. If more people paid the total insurance cost up front they would understand what a fraud this Act really was and demand free market changes, which we estimate would lower all medical costs by 50-80%. As former House Majority Leader Nancy Pelosi said, we mortals would find out what's in the bill only after they passed it. We're still discovering these surprises five years later.

* Insurance requires coverage and payment for unforeseen events and variable pricing based on risk. What is called "insurance" today is more akin to prepaid health care of an "all you can eat" variety and a new type of tax. The "marketplace" is a mandated creature of government and is, therefore, not a true free-market exchange. An excellent discussion of what real health insurance entails can be found at http://fee.org/freeman/health-insurance-is-illegal/.

** Repayment breakpoints vary based on family size. The total cost of insurance for this couple was high due to age and zip code; your repayment and breakpoints will likely be dramatically different from theirs.

*** Or even $20-30,000, which is also subject to income and payroll taxes. Say you earn $20,000 extra. You pay $12,763 plus $1,500 regular income tax plus $3,060 SE or payroll taxes (and any applicable state income tax), creating an 87% + tax bracket on that $20,000 "chunk" of income.

Tax Considerations Encourage Negative Behaviors

How Bankruptcy and Working Less Can be, Financially, Better Choices

Tax law can incentivize taxpayers to act in less moral ways. Two timely examples illustrate this point.

Non-repayment of debt is something we've seen on and off for decades, but which has occurred more frequently since the economic downturn beginning in 2008. There are three main ways debt can be expunged: one, bankruptcy; two, a compromise with lenders; three, lenders stop trying to collect. Generally, having debt expunged results in taxable "**cancellation of debt**" (**COD**) income, reported by lenders on Form 1099-C. However, such income can be excluded from taxable income in several ways, including bankruptcy and insolvency (to the extent one's assets are worth less than one's debts).

When debt is expunged via bank-

ruptcy, debtors are allowed to keep certain assets. The three key ones other than minimal personal effects and tools of one's trade are equity in one's home up to an amount determined by state law, up to $1.4 million in non-inherited IRAs and all of any "ERISA" qualified pensions. These comprise most non-IRA retirement funds and defined benefit pension income (the kind that's paid only until death, at which point the payment also dies). This is how O.J. Simpson, Lovelock Correction Center inmate # 1027820, kept his Florida home and lifetime NFL pension, despite bankrupting most of the $33 million judgment for the Brown and Goldman families and going to prison. Regardless of the fact that Simpson likely had some $10 million in net worth when his home and present value of his pension are included (the pension being an income stream that continues until death, for which a value can be determined using actuarial tables), if he had no other assets he could have excluded any and all COD income forgiven pursuant to his bankruptcy.

Excluding COD income *outside* of bankruptcy requires that one must be insolvent, meaning one's "net worth" is zero. This means your debts exceed your assets, *including* equity in one's home, retirement plans and the present value of all pensions. COD income can be excluded only to the extent of negative net worth. Under this rule, O.J. would not be able to exclude COD income to the extent his net worth is positive—which, as we've seen it is, big -time. (While O.J. preserved his pension, he subsequently lost his home in a foreclosure.)

Here's the dilemma for ordinary mortals: let's say you owe consumer debt of $90,000. You are married, own a home in Florida or California with $100,000 net equity, *or* you have a pension paying $10,000 per year (the kind that disappears at death and you have at least 12 years to live per actuarial tables), *or* an IRA worth $100,000. You could compromise with the creditor and pay $30,000, in which case you'll end up with $60,000 of COD income. Because you are not insolvent (you have $100,000 net equity *or* the present value of the $10,000 per year income stream, worth at least $100,000, *or* the IRA, worth $100,000), the COD income is taxable. The $60,000 of COD income could easily generate $20,000 of income tax. Or, you could declare bankruptcy, keep your home or pension or IRA and exclude the $60,000 of COD income, owing zero income tax on the debt forgiveness. Not too many people would bother negotiating, regardless of the size of their IRA or pension. Declare bankruptcy, keep the whole wad and the lender gets nothing.

A recent Tax Court case worsened things. Previously, no one thought a *future expected* pension like O.J.'s counted as an asset when determining insolvency. Except for the present value of a future pension your net worth could be zero and you would have been considered insolvent. The Tax Court ruled that the present value of not only a current, but also a *future* pension must be included in the determination of solvency. The present value of even a $30,000 per year pension expected to begin payments ten years hence at age 60 for the duration of one's life, determined by IRS-approved actuarial tables to be 25.2 years, is roughly (using the "standard" discount rate for this purpose, 5%) $211,759. Few if any have net debts exceeding that figure; therefore, nearly everyone with a pension is technically solvent and would, therefore, pay tax on any COD income that we previously thought could be excluded under insolvency rules. Bankruptcy may be the only option under which tax can be avoided on COD income. The more moral or ethical way to deal with the unpayable debt in the example above costs $30,000 plus perhaps $20,000 in tax; the less moral way costs nothing.*

The second tax consideration that might cause us to do something no rational person would ever otherwise do is to discourage an adult child from earning more than the personal exemption amount ($4,000 in 2015). Economic growth has been sluggish over the last seven years, with the labor force participation rate plummeting from 68% back to 1970s levels of 62%.** This has caused many 20-somethings to stay in school and, even if not in school, to continue to live or move back in with their parents. The parents, then, have a moral dilemma: encourage an adult child to find work, or discourage work so the adult can be claimed as a dependent on the parents' tax return.

The income tax rules allowing parents to claim a child, for whom they provide at least one-half of support, as their dependent require that the child be under age 19, age 19-23 *and* a full-time student for at least five months during the year, OR age 24 or over but earning less than the personal exemption amount. For 2015, a non-student over 18 or full-time student over 23 who earns $4,000 or more cannot be claimed on his or her parents' tax return, even when the parents provide more than half the adult child's support.

Depending on the parents' tax bracket, the federal and California state income tax savings for claiming the adult child is in the range of $900 to $1,400 if the child's income is less than $4,000 (the savings could be up to $330 less in other states) and zero if the child's income is $4,000 or more. Do you really want such a child to earn $4,001, or even $5,000? Due to the additional Social Security/Medicare (or Self-Employment) tax payable by the child, breakeven for the family as a unit may not even occur until the child's income exceeds nearly $6,000 or more.*** From a purely income tax standpoint we may recommend that the parents discourage the child from working more. Yet, when work is a large part of self-fulfillment and self-esteem for a young adult, who can take pride in providing goods and services to others, isn't it morally reprehensible to discourage this?

The tax cost of the child earning more than the personal exemption amount worsens if the child is a part-time student age 19-23 or over 23 with net tuition. The Lifetime Learning Credit is the education credit for less than half-time undergraduate students and for those who have completed their first four years of college. The

credit goes with the dependency deduction regardless of who pays the qualifying tuition and is 20% of net tuition (tuition paid after grants and scholarships, up to $10,000), for a maximum $2,000 credit. If they can claim the child, the parents get the full allowable credit (phasing out at joint filers' incomes exceeding $110,000 and, for others, $55,000). If the child's income equals or exceeds $4,000, the parents lose the right to claim the child as their dependent and, with that, the Lifetime Learning Credit. The child claims the credit, but as the credit cannot exceed tax liability, which is zero on income up to about $10,000 for a single filer, the credit may be worthless. Income tax is only $800 for single taxpayers earning roughly $18,000 of income; only at income levels of $26,000 (the point at which the income tax is roughly $2,000) does a single filer get the full benefit of the maximum allowable $2,000 credit.

Our tax system incentivizes us to do things that, in the long run, each serve to do their small part in helping to destroy the morals of a great civilization. The problem is, small parts add up and pervasive immorality can destroy an otherwise great country.

* Remember: when you borrow money, the lender is taking you at your word that you will repay it; you have a legal and moral obligation to do so. On the other hand, we fully understand we live in the real world and that, at times, bankruptcy is unavoidable; we have recommended that bankruptcy be considered even by clients who were reluctant to go that route.

** The low reported "unemployment rate" is an artifact of so many workers giving up looking for employment or going on Social Security disability (SSDI); these workers are no longer counted as "unemployed."

*** At which point Self-Employment tax or the total employer-employee Social Security/ Medicare tax is about $900.

New Rules Allow Deferred Longevity Annuities in IRAs

Retirees are required to begin withdrawing from retirement accounts at age 70 ½. Many of you would rather not take such withdrawals, or at least reduce them, because you don't need the funds. In every year but one since 2006 there has been one way of reducing withdrawals: donate all or part of **Required Minimum Distributions** (**RMDs**) to charity. However, the funds are no longer yours; some retirees would prefer to keep all of their funds and reduce RMDs now because they plan on increasing withdrawals later in life.

Beginning for tax year 2015, there's a limited way of deferring such withdrawals using "deferred longevity annuities." The rules allow the use of up to 25% of IRA account balances, up to $125,000, to purchase such annuities. RMDs are not calculated and paid on annuitized funds; when the annuitant reaches age 79 to 86 (based on the account owner's preference), the annuity payments must begin, effectively increasing the RMD.

Say you have a $400,000 traditional IRA. Using IRS tables, your RMD at age 71 is $15,151. If instead you invest $100,000 of that IRA in a deferred longevity annuity, the annuity is excluded from the RMD calculation. The RMD on the "other" $300,000 is $11,363 and your $100,000 longevity annuity remains intact until later in life, when the annuity withdrawals begin. *

One of the risks ** with a longevity annuity, as with other annuities, is you may die before receiving payouts. Deferred longevity annuities were created to offset the risk of living too long and running out of retirement funds. The rules do allow for a compromise: some policies allow a return of premiums as a death benefit. This gives annuitants the option of leaving money to heirs if they die before the annuity begins paying, or before the cost of the annuity has been paid out. Of course, annuities with such a death benefit offer lower payments than those without such a benefit. You see how this works? There's give and take, costs and benefits, to everything!

* Because these annuities are relatively new and insurers don't know how to price the policies and hedge longevity risk, there are only about a dozen who issue such policies. Search for QLAC (Qualified Longevity Annuity Contract) to get a list of providers who will offer quotes. You might want to hedge your own risks and buy smaller contracts from two or more companies. Note that at age 65 you might be able to purchase a $40,000 per year payout beginning at age 85, which sounds great—and is, but only if you live that long and then collect for more than a few years.

** A full discussion of risks can be found in the Top Story of issue # 49 of *WCS*, "The Pros, Cons and Other Features of Annuities."

A Convoluted End to Tax Season, Future Edition

Everyone knows April 15 is the "normal" end of tax season, when tax returns must be filed or extended and taxes must be paid to avoid late payment penalties. However, when April 15 falls on a weekend, the Season ends the following Monday, which would (obviously) be April 16 or 17. Well, it used to be so.

In 2005, Washington, D.C. established April 16 as a legal holiday called "Emancipation Day." When April 16 is a Saturday, the preceding Friday is the observed holiday; when April 16 is a Sunday, the following Monday is the observed holiday. Under a federal statute enacted decades ago, legal holidays observed in Washington, D.C. have a nationwide impact. One effect is on the last day of the tax filing season: if April 16 is a Monday, the end of tax season is Tuesday, April 17; if April 15 is a Friday the end of tax season is moved to the following Monday, April 18. Since April 15, 2016 is a Friday, the filing season for 2015 tax returns ends April 18, 2016.

It gets even crazier for residents of Massachusetts and Maine, which observe a state holiday, Patriot's Day,

on the third Monday of April. For years in which April 15 is a Friday (like 2016), the third Monday is April 18 which, therefore, extends their filing season to April 19. Because they "can" elect to carry their income tax returns to local offices in their state and their states celebrate the state holiday on April 18, they get four extra days to file and pay 2015 taxes. However, because such residents *must* make 2016 estimated tax payments to a depository in Connecticut, which does not observe Patriot's Day, the first 2016 estimated tax payment must be made on or before the ordinary due date for income tax returns to be timely—which in 2016 is April 18.

Got that?

It's so complicated the IRS issued an entire document (Revenue Ruling 2015-13) to analyze the applicable laws and make these determinations in anticipation of the 2016 filing season when, as noted, April 15 falls on a Friday. (If determining the end of tax season is this complicated, the lay person can only imagine how complex tax law is.) So, while most of us will have an extra three days, residents of MA and ME will have four extra days to file and pay 2015 taxes, but not 2016's first estimates. But please, don't take advantage of it. We'd like to be done by April 15, regardless.

Tax Filing Deadlines for 2017 Forward

Changes in Due Dates for Partnerships, Corporations and Foreign Financial Assets Reporting Forms

Due dates for filing tax returns starting in 2017 have been changed for partnership, C-corporations and FBAR (FinCEN—reports of foreign financial accounts) returns. These are rational and welcome changes.

Beginning in 2017 (NOT in 2016), partnership returns, currently due April 15 with a five month extension to September 15, will be due March 15 with a six-month extension to September 15. Because partnership income flows through to individual returns due April 15 (October 15 for those with extensions), this change makes sense. However, because more partnerships will likely go on extension, this will create more paperwork. (While Doug's crusade nearly three decades ago to create paperless extensions was implemented by California, it was not accepted at the federal level, although the requirement to obtain a "2nd extension" for individual returns on August 15 was eliminated.)

C-corporations are increasingly rare for small players, as S-corporations became much more popular when a number of rules were changed in the late 1990s. The few reporting on a calendar year are currently due March 15; beginning in 2017 these will be due April 15, with a five month extension to September 15. The S-corporation deadline, which is how most small corporations are taxed, will remain March 15, with a six month extension to September 15.

FBAR returns report foreign financial assets (described in great detail in the Top Story of issue # 49 of *Wealth Creation Strategies*) to the Financial Crimes Enforcement Network (FinCEN). These reports are currently due June 30, with no extension and a possible $10,000 late filing penalty. Under the new filing regime beginning in 2017, they will be due April 15 with a six-month extension. While this a much more rational approach than the current one, the idea that we have to tell the government what we own and where, with draconian penalties for failure to report even when income from such accounts is fully reported (or nearly so), should make anyone who thinks this is still a free country question their assumptions.

Penalties for Non-Filing of 1099s Increased—Again

Congress recently approved steep increases in penalties* for the failure to file Form 1099 information returns. There are dozens of such forms, but the relevant ones for those of you with businesses and rental properties are those required for payments of $600 or more per calendar year to non-corporate entities, generally for services rendered (i.e., not payments subject to most states' sales tax laws), rents, or any amount paid in the course of business to medical or law corporations. The penalty per non-filed 1099, which was a mere $10 some years ago, has been increased way beyond inflation, even surpassing that for college tuition (which has outpaced medical costs by a considerable margin and without any measurable increase in quality). The penalty was quintupled to $50 in the 1990's, to $100 in the 2000's, recently to $150 and, continuing to wildly outpace inflation, is again being increased to $250 beginning in 2016 for 2015 filings with a maximum possible penalty of more than $3 million. Somewhere along the trajectory the penalty began to be applied both to the 1099 sent to the government and the copy sent to the payee, effectively doubling these figures. The penalty is lowered for required 1099s filed within 30 days of the due date, January 31, 2016 to $50 (up from $30) and to $60 if filed by July 31, 2016.

Our unique 1099 flowchart (which illustrates when you are required to file) and our 1099 worksheet are mailed to all clients with the "tax prep" package. We also send a separate "1099 package" to those of you who have filed or we expect to file such forms. As always, be sure to send us completed worksheets as early as possible.

* To help pay for the "Affordable" "Care" Act.