Bailey,Carr CPAs, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

Dear Client:

Employees generally are faced with a number of choices that can save taxes. To help our clients who are employees take advantage of these special tax saving opportunities, we have put together a list of items to consider.

Please review the list and contact us if you need additional information on one or more of the items.

*Consider taking out a **401(k) plan loan** instead of taking a distribution, if you need funds.* If you need money, you may be tempted to take a plan distribution, to the extent permissible, to satisfy an imminent financial need. If you are under age 59 1/2, this distribution may not only constitute taxable income, but it also will be subject to the 10% premature distribution tax. Thus, if your effective Federal and state income tax rate totaled 25%, you'd have a total tax rate of 35% and would only get use of 65 cents for every $1 distributed from your 401(k) account. A better way to get financial assistance is to borrow from your 401(k) plan, if your 401(k) plan has a loan feature. The amount that you can borrow is subject to certain plan and IRS limits, but you'll generally have five years to repay the loan (or longer, for a home loan), and the interest that you pay will go back into your account. This is a sound way to avoid immediate income taxation on the amount that you require to satisfy your financial need.

Dependent care FSAs. Some employers allow employees to set aside funds in dependent care FSAs. A $5,000 maximum annual contribution is permitted ($2,500 for a married couple filing separately). A dependent care FSA allows employees to use pre-tax dollars to pay for dependent care. In particular cases, participating in a dependent care FSA (for a dependent- qualifying child under age 13, or a dependent or spouse who is physically or mentally incapable of self-care and who has the same principal place of abode as the taxpayer for more than half of the tax year) can yield greater tax savings than foregoing participation and claiming a dependent care credit. Taxpayers who are eligible to participate in a dependent care FSA and are (a) in a high tax bracket and/or (b) have only one dependent and more than $3,000 of employment-related expenses, should use the FSA to pay for child care expenses. For these taxpayers, the FSA almost always provides greater federal tax savings than does the dependent care credit. State income tax savings also may apply. Additionally, participating in a dependent care FSA also saves you FICA taxes on the amount of the contribution.

However, dependent care FSAs are subject to the use-it-or lose it rule, but neither the grace period nor the up-to-$500 forfeiture exception applies. Thus, now is a good time to review expenditures to date and to project amounts to be set aside for next year.

2565 Brighton Henrietta Townline Road • Rochester, New York 14623 • Tel. (585) 272-9870 • Fax (585) 272-0041
www.BaileyCarrCPA.com

Health savings accounts. A health savings account (HSA) can be established only for the benefit of an "eligible individual" who is covered under a "high deductible health plan" or "HDHP." The HSA funds may be used to pay the "qualified medical expenses," including long- term care expenses, of an "account beneficiary." For purposes of determining whether the HSA has been established for the benefit of an "eligible individual" who is covered under an HDHP, an HDHP is (for 2017) a health plan:

(1) that has an annual deductible which is not less than-

 (i) $1,300 for self-only coverage, and
 (ii) $2,600 for family coverage, and

(2) for which the sum of the annual deductible and the other annual out-of-pocket (OOP) expenses required to be paid under the plan (other than premiums) for covered benefits does not exceed-

 (i) $6,550 for self-only coverage, and
 (ii) $13,100 for family coverage.

The maximum contribution an individual may make to an HSA, in 2017, is $3,400 for an individual with self-only coverage under an HDHP and $6,750 for an individual with family coverage under an HDHP. A "catch-up" contribution will increase each of these limits by $1,000 where the taxpayer is 55 or older by the end of 2017.

Within the IRS dollar limits, an "above-the-line" tax deduction (that is, not requiring the itemization of deductions) is allowed for an individual's contribution to a HSA. Contributions are deducted from the individual's total income in arriving at the individual's adjusted gross income (AGI). Employer contributions to an HSA under a cafeteria plan, on an employee's behalf, are neither included in the employee's income, nor subject to employment taxes. Similarly, an employee may contribute to an HSA under a cafeteria plan with pre-tax dollars. HSA earnings accumulate tax-free and may be carried over from year-to-year. Distributions to pay qualified medical expenses are also tax-free.

Increase 401(k) contributions. The pre-tax and Roth 401(k) contribution limit for 2017 is $18,000. Employees age 50 or older by year-end are also permitted to make an additional contribution of $6,000, for a total limit of $24,000 in 2017. If your employer makes a matching contribution to your contribution, your total retirement savings will increase even faster.

If you would like to discuss any of these matters in greater detail, please give me a call at your earliest convenience.

Very truly yours,

Bailey, Carr CPAs, P.C.

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