2014 YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

INTRODUCTION

With the end of the year rapidly approaching, it's time to consider planning moves that could reduce your 2014 taxes. Year-end planning is particularly challenging this year because a host of popular ***individual tax breaks expired at the end of 2013.*** Congress has traditionally retroactively extended the vast majority of these temporary tax breaks after they expired. However, ***as we complete this letter,*** Congress has not yet extended these tax provisions. **Planning Alert!** Some are predicting that Congress may address these expired tax breaks in an "extender's bill" in its lame-duck session after the November elections. However, others believe Congress may not address these expired tax breaks until early 2015. We closely monitor Congressional tax legislation, so ***please call our firm*** if you need a ***status report.*** **Tax Tip!** Due to the uncertainty of the status of these expired tax provisions, we believe the best approach for year-end planning is to be ***prepared to act quickly near the end of 2014*** in case Congress retroactively restores these expired tax breaks. Consequently, the first segment of this letter highlights the expired individual tax breaks that could be retroactively extended.

Although the prospect of Congress extending these expired tax breaks beyond 2013 is uncertain, there are many *traditional* year-end tax planning strategies that can help lower your 2014 taxable income, and postpone the payment of your taxes to later years. Therefore, we are sending you this letter to remind you of these time-tested, year-end planning strategies. This letter also highlights *new* tax planning opportunities available to individuals because of recent law changes. **Tax Tip.** Many tax provisions impacting your 2014 income tax liability are affected by your adjusted gross income, modified adjusted gross income, or taxable income. We ***highlight prominently*** in this newsletter the various ***income thresholds,*** **etc.,** ***affecting your tax liability.***

Caution! Tax planning strategies suggested in this letter may subject you to the alternative minimum tax (AMT). For example, many deductions are not allowed for AMT purposes, such as: personal exemptions, the standard deduction, state and local income taxes, and real estate taxes. Also, the AMT can be triggered by taking large capital gains, having high levels of dividend income, or exercising incentive stock options. Therefore, ***we suggest that you call our firm before implementing any tax planning technique discussed in this letter.*** You cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the AMT and any state income tax) with and without that strategy. **Please Note!** This letter contains ideas for Federal income tax planning only. ***State income tax issues are not addressed.***

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SELECTED **INDIVIDUAL TAX BREAKS THAT EXPIRED** ***AFTER 2013***

Summary Of Selected Individual Tax Breaks That Expired *After 2013.* There is an ever-expanding list of temporary tax breaks that expire every few years. However, even though Congress often waits until the last minute, it has *historically* extended most of the more popular provisions. Unfortunately, Congress has yet to extend a host of tax breaks that ***expired at the end of 2013,*** including: School Teachers' Deduction (Up to $250) For Certain School Supplies; Deduction For State And Local Sales Taxes; Deduction (Up to $4,000) For Qualified Higher Education Expenses; Qualifying Tax-Free Transfers Directly From IRAs To Charities For Those Who Are Age 70½ Or Older; Increased Charitable Deduction Limits For Qualifying Conservation Easements; $500 Credit For Qualified Energy-Efficient Home Improvements; Deduction For Qualified Home Mortgage Insurance Premiums; Income Exclusion For Principal Residence Mortgage Cancellations; and Temporary 100% Exclusion Of Gain From Sale Of "Qualified Small Business Stock." **Planning Alert!** If recent history is a guide, Congress will likely extend these provisions eventually, but there is no guarantee. Our firm will monitor the status of these expired provisions closely. Please call us if you want an up-to-date report. **Tax Tip.** Some believe that Congress will extend these items during the lame-duck session after the November mid-term election. Others believe that Congress will not take up "extenders" legislation until early 2015. If you are hoping to take advantage of any of these expired tax breaks for 2014, be ***prepared to act quickly near the end of 2014*** in case Congress passes an "extender's bill" late in the year. The following provides more details for several ***expired tax breaks*** that warrant special attention as extender's legislation works its way through Congress:

- **Tax-Free IRA Payments To Charities If You Are Age 70½ Or Older.** For the past several years, we have had a popular rule that allows taxpayers, who have reached age 70½, to have their IRA trustee contribute up to $100,000 from their IRAs directly to a qualified charity, and ***exclude the IRA distribution from income.*** The IRA transfer to the charity also counts toward the IRA owner's "required minimum distributions" (RMDs) for the year. To qualify, the check from your IRA must be made out "directly" to your designated charity. In addition, if the contribution is $250 or more, you must get a timely, qualifying receipt from the charity for the charitable contribution. **Planning Alert!** Qualifying taxpayers have commonly used this temporary tax break as they plan for their year-end RMD. As we approach the end of 2014, please call our firm if you want a status report on this provision.

- **Income Exclusion For Discharge Of Qualified Principal Residence Indebtedness.** The provision allowing you to exclude income from the discharge of all or a portion of a mortgage (not exceeding $2 million) that you incurred to purchase, construct, or substantially improve your principal residence, ***expired after 2013.*** **Planning Alert!** This temporary tax break has been popular with taxpayers who are negotiating home mortgage work-outs with the bank (which may include a "short-sale" of the residence). If you are in that situation and want to know the status of this provision before finalizing your negotiations with the lender, feel free to call us.

- **Credit For Energy-Efficient Improvements To Your Residence.** The temporary 10% credit (with a life-time cap of $500) for qualified energy-efficient improvements to your "principal residence" ***expired after 2013.*** **Planning Alert!** The current 30% credit for installing a ***qualifying solar water heater, solar electric generating property, geothermal heat pump,*** or ***small wind energy property*** is not ***currently scheduled to expire until after 2016.*** This 30% credit applies if you install the qualifying energy-efficient property in or on property located in the U.S. that you use as a residence. The residence does ***not*** have to be your ***"principal residence."*** So, installations for a second residence or vacation home may qualify. The 30% credit also applies to the on-site installation costs. **Planning Alert!** The credit ***is not allowed*** with respect to ***"investment"*** property such as a "rental property." However, you may possibly receive a business energy credit for qualifying energy-efficient improvements to rental property or other business property, where the property is not a "passive activity" and the credit is not limited under the passive activity rules. Also, expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) ***do not qualify.*** **Tax Tip.** If you are the initial purchaser of your newly-constructed residence that contains qualifying energy-efficient components (e.g., solar water heater, solar electric generating property, geothermal heat pump), you should ask the builder to provide you with a reasonable allocation of the cost of the home attributable to the qualified energy property (including labor costs for on-site preparation, assembly, and installation of the property). **Caution!** To ***take the 30% credit for 2014,*** the property must ***actually be installed*** no later than ***December 31, 2014.***

NEW AFFORDABLE CARE ACT "SHARED RESPONSIBILITY TAX" AND "PREMIUM TAX CREDIT"

Individuals Without Qualified Health Care Coverage May Face A "Shared Responsibility Tax" (SR Tax). Starting in 2014, the Affordable Care Act (ACA) requires individuals to maintain qualified health care coverage, or pay a ***Shared Responsibility Tax ("SR Tax")*** with their individual income tax returns. Therefore, ***when filing the 2014 income tax return*** (e.g., Form 1040), individuals generally must pay an ***SR Tax*** if the individual, the individual's spouse or dependents are not covered by a ***"Qualified Health Plan"*** (i.e, a health plan or insurance policy providing "minimum essential coverage"). However, there will be ***no SR Tax*** for individuals who qualify for a specifically-designated ***exemption.*** The IRS says that an individual cannot avoid the *SR Tax* for someone who may be claimed as a dependent, simply by failing to claim that person as a dependent on the individual's tax return. For example, if you and your spouse file a joint return and you each have qualified employer-provided health care coverage, but your dependent child is not covered by a qualified health plan, you could be liable for the *SR Tax* for your child even if you do not claim the child as a dependent on your tax return. Consequently, to avoid the *SR Tax*, an individual (and anyone the individual may claim as a dependent) generally must either: **1)** Be covered under a ***"qualified health plan"*** (discussed below), or **2)** Qualify for a specific ***"exemption"*** (discussed below) from the tax.

- **What Must Individuals Report On Their 2014 Individual Income Tax Returns?** The ***SR Tax*** is computed on a monthly basis and, therefore, generally applies for each "month" an individual is not covered by a *qualified health plan*, and does not qualify for an *"exemption*." Beginning with the 2014 income tax return (e.g., Form 1040), individuals will essentially have three alternative reporting requirements: **1)** If you, your spouse, and anyone you could claim as a dependent ***all were covered*** by a ***qualified health plan*** (discussed below) for ***every month*** of 2014, you will check a box on the 2014 income tax return, and you will not be subject to the *SR Tax*; **2)** If you, your spouse, or anyone you could claim as a dependent ***were not covered*** by a ***qualified health plan*** for ***every month*** of 2014 and no *"exemptions"* are available, the amount of your ***SR Tax*** is determined by completing a worksheet contained in the *"instructions"* to new ***Form 8965,*** and that amount will be reported as an additional tax on your Form 1040; **3)** If you, your spouse, or anyone you could claim as a dependent ***were not covered*** by a ***qualified health plan*** for ***every month*** of 2014 but at least one of you qualifies for an ***"exemption"*** (discussed below), a new Form 8965 ("Health Coverage Exemptions") must be filed with your return to disclose and claim the "exemption(s)." **Please Note!** If an individual is *"exempt"* from the SR Tax for some months, but not for others, the individual is required to: **1)** File a new Form 8965 to claim an exemption from the tax for the months that are exempt, and **2)** Use the worksheet contained in the Form 8965 instructions to compute the *SR Tax* for the other months.

- **What Constitutes A "Qualified Health Plan" (i.e., Minimum Essential Coverage)?"** A ***"Qualified Health Plan"*** is generally defined as any health plan or health insurance policy that provides the individual with "minimum essential coverage." The IRS website states that: *"The **vast majority of coverage** that people have today counts as **minimum essential coverage."*** [Emphasis added].Thus, the vast majority of employer-sponsored plans, government plans (e.g., Medicare, Medicaid, etc.), insurance policies purchased on the individual insurance market, and insurance acquired through the new government exchanges ("Marketplace") will qualify.

- **Who Is "Exempt" From The SR Tax?** Individuals are generally ***exempt*** from the ***SR Tax*** if they fall into any of the following groups: **1)** Individuals in the U.S. illegally; **2)** Members of certain religious sects; **3)** Members of Federally-Recognized Indian tribes; **4)** Incarcerated individuals; **5)** Certain U.S. Citizens living abroad; **6)** Individuals with income below the threshold for filing an income tax return; **7)** Individuals who fail to have "qualified health plan coverage" for less than 3 months during a year; **8)** Individuals whose available health insurance is considered "unaffordable" because it would cost more than 8% of the individual's household income; and **9)** Individuals qualifying for a *"hardship exemption"* (discussed below). **Caution!** Some of these exemptions require an individual to first apply for (and obtain) an "exemption certificate" from the Marketplace, while others are simply claimed without an exemption certificate when the income tax return is filed. The ***Instructions*** to new ***Form 8965*** ("Health Coverage Exemptions") contain a chart listing which exemptions require a "certificate," and which do not. The ***Form 8965 Instructions*** also describe each of these exemptions in detail. **Tax Tip.** Applications for an "exemption certificate," if required, may be obtained at www.HealthCare.gov.

- **Examples Where "Hardship" Exemption Certificate May Be Issued.** The Department Of Health & Human Services (HHS) has released a listing of more than a dozen possible situations where they may provide a ***"Hardship" Exemption Certificate,*** including: You were evicted in the past 6 months or were facing eviction or foreclosure; You received a shut-off notice from a utility company; You recently experienced domestic violence; You had medical expenses you couldn't pay in the last 24 months which resulted in substantial debt; You experienced unexpected increases in necessary expenses due to caring for an ill, disabled, or aging family member; Your individual insurance plan was cancelled and you believe other Marketplace plans are unaffordable; You experienced another hardship in obtaining health insurance; and others.

  - ●● **Obtaining A "Hardship Exemption" Certificate.** In most cases, individuals seeking a "hardship" exemption must obtain an exemption certificate by submitting a form entitled ***"Application for Exemption from the Shared Responsibility Payment for Individuals who Experience Hardships"*** to: Health Insurance Marketplace – Exemption Processing, 465 Industrial Blvd., London, KY 40741.This application form may be obtained on-line at www.HealthCare.gov. The Application states: *"We'll follow-up with you **within 1–2 weeks** and let you know if we need additional information. If you get this exemption, we'll give you an **Exemption Certificate Number** that you'll **put on your federal income tax return."*** [Emphasis added]. **Tax Tip.** If you or anyone in your household does not have insurance coverage during 2014 and you think one of these hardship exemptions may apply, we suggest you begin the application process as soon as possible. If your application is approved, be sure to provide our firm with your exemption certificate.

- **Amount Of The "SR Tax."** The amount of the *SR Tax* is determined using a worksheet contained in the new Form 8965 Instructions. This *SR Tax* applies for ***each month*** that you, your spouse, or your dependents are not covered by a *qualified health plan* (and do not otherwise meet an exemption). Although the *SR Tax* is determined on a monthly basis, the ***maximum amount*** for the ***entire 2014 tax year*** is the ***greater of:*** **1)** ***$95*** per uninsured ***adult member*** of the household, plus ***$47.50*** per uninsured member of the household ***under age 18***, ***not to exceed $285,*** or **2)** ***1% of "household income" in excess*** of the ***income threshold required for filing a Form 1040 return.*** However, the *SR Tax* cannot exceed the national average premium for "bronze" level health insurance offered through the Marketplace. ***For example,*** assume a single individual (under age 65) who: **1)** Was uninsured for the ***entire 2014 year*** and does not qualify for an "exemption," and **2)** Earned ***$70,150*** (which is also the person's "*household income*"). The ***SR Tax*** for 2014 would be ***$600.*** **Planning Alert!** Spouses filing a joint return are jointly liable for any *SR Tax* on the return, including any *SR Tax* due for qualifying dependents. The amount of the excise tax increases for ***2015,*** and increases again in ***2016.***

Individuals Purchasing Health Insurance On New Government Exchanges ("Marketplace") May Qualify For New "Refundable" Premium Tax Credit ("PTC"). As discussed above, a *"qualified health plan"* (for purposes of avoiding the *Shared Responsibility Tax*) includes individual health insurance coverage purchased through the ***"Marketplace." Beginning in 2014,*** *ACA* provides for a tax credit (the ***"premium tax credit"*** or ***"PTC")*** for eligible low-and-middle income individuals who purchase individual or family health insurance through the *Marketplace.* The *PTC* is "refundable." This generally means that, to the extent the credit exceeds the taxes that you would otherwise owe with your individual income tax return without the credit, the IRS will actually send you a check for the excess. However, unlike the classic refundable credit which is paid directly to the taxpayer, the *PTC* is generally (but not always) paid ***in advance directly to the insurer.*** These advance payments directly to the insurance company are generally referred to as ***"Advance Payments"*** of the *PTC*. **Observation!** It has been reported that a large majority of individuals who purchased health insurance during 2014 from the Marketplace were awarded *Advanced Payments* of the PTC.

- **Who Qualifies For The "Premium Tax Credit" (PTC)?** An individual *generally* qualifies for the *PTC* ***for 2014*** only if the individual's ***"household income"*** for ***2014*** is ***at least 100%*** and ***not more than 400%***

of the ***"2013"*** Federal Poverty Line (FPL) for the individual's family size. ***For example,*** a family of four could qualify for at least some *PTC* ***with "2014" household income of up to $94,200!*** For purposes of the ***PTC,*** your **"*household income"*** starts with your ***adjusted gross income*** on your income tax return (plus the adjusted gross income of any person who you properly claim as a dependent and who is required to file an income tax return), and then certain exclusions from income on the return are added back. Tax-free social security benefits, tax-exempt interest, and the foreign earned income exclusion are ***added back*** to your ***adjusted gross income in determining "household income."***

- **Individuals Must Reconcile Their "Advance Payments" Of The 2014 PTC With Their "Actual" PTC.** For 2014, *Advance Payments* of the *PTC* were determined by the Marketplace based on the ***"projected"*** 2014 household income of the individual. However, an individual is ultimately entitled to a PTC based on the individual's ***"actual"*** 2014 household income. Therefore, all individuals who received *Advance Payments* for 2014 ***are required to file*** a ***2014 income tax return*** to reconcile: **1)** The amount of the ***"actual"*** PTC (based on the individual's ***"actual"*** *2014 household income*) with **2)** The ***Advance Payments*** of the *PTC* (which were determined by the Marketplace based on the individual's ***"projected"*** *2014 household income*). If the individual's ***"actual"*** PTC for the 2014 taxable year ***exceeds*** the ***Advance Payments*** made to the insurance company, the excess is treated as a "refundable" tax credit (i.e., to the extent the credit exceeds the taxes the individual otherwise owes without the credit, the IRS will actually send the individual a check for the excess). On the other hand, if an individual's ***Advance Payments*** for the 2014 taxable year exceed the ***"actual"*** *PTC*, the excess will be an ***"additional tax liability"*** on the 2014 income tax return. In this latter situation, there may be a dollar cap on the "additional tax liability," if the individual's actual household income is less than 400% of the Federal Poverty Line for 2013.

- **IRS Releases New Forms For Computing, Reporting, And Reconciling The PTC.** Any individual who purchased health insurance for 2014 through the Marketplace should receive a new ***Form 1095-A*** (*"Health Insurance Marketplace Statement"*) by January 31, 2015. This form contains the amount of the gross monthly premium paid to the insurance company, as well as the amount of the monthly ***Advance Payments*** of the individual's *PTC.* This information will be used to complete new ***Form 8962*** ("Premium Tax Credit") which reconciles the individual's *Advanced Payments* of the PTC with the *"actual"* PTC*,* as discussed above. **Tax Tip.** If an individual purchased heath insurance through the Marketplace but received no *Advance Payments* of the PTC, new Form 8962 will be used to compute the amount (if any) of the actual PTC, based on the individual's 2014 household income. **Note!** If you, your spouse, or a dependent purchased health insurance through the Marketplace during 2014, ***please bring us a copy of Form 1095-A along with your other tax information*** when we prepare your 2014 tax return.

RECENT TAX INCREASES MAKE TRADITIONAL TAX PLANNING STRATEGIES MORE VALUABLE

Traditional year-end tax planning typically includes strategies that lower your current taxable income and postpone the payment of taxes to later years. The classic technique to accomplish both of these goals is to ***defer the recognition of taxable income*** to later years, and to ***accelerate deductible expenses*** into the current tax year. With every increase in tax rates, these strategies become even more valuable. And indeed, last year, the ***American Tax Relief Act ("ATRA") of 2012*** ushered in a series of permanent tax increases for higher-income individuals, including: **1)** An **increased *top tax bracket of 39.6%*** (up from the previous 35%); **2)** A ***new .9% Additional Medicare Tax;*** and **3)** A ***new 3.8% tax*** on net investment income. As you evaluate the year-end tax planning strategies we discuss in this letter, be sure to consider the recent increase in tax rates discussed below. **Planning Alert!** The ***3.8% Net Investment Income*** Tax (discussed in the ***"Tax Planning For Investment Income"*** segment of this letter), and the .9% Additional Medicare Tax ***are in addition to*** the ***"statutory" tax rates*** discussed in the following segment and therefore increase an individual's effective marginal tax rates:

Highest Statutory "Ordinary" Income Tax Rate For Individuals Is 39.6%. Last year, ATRA increased the highest statutory income tax rate to 39.6% (up from a top rate of 35%) for higher income individuals. ***For 2014,*** the 39.6% bracket applies to ***taxable income*** of an individual ***in excess of*** the following thresholds: ***$457,600*** for married couples ***filing joint returns*** ($228,800 if married filing separate returns); ***$406,750*** for ***single filers;*** and ***$432,200*** for ***heads of households.*** These income thresholds are adjusted for inflation after 2013.

- **The 39.6% Rate Creates New Marriage Penalty.** The income thresholds for the 39.6% tax bracket have created a new marriage tax penalty. For example, if a married couple files a 2014 joint return and each spouse has taxable income of $400,000, their joint taxable income of $800,000 will generally be taxed at 39.6% to the extent it exceeds the $457,600 threshold for married individuals filing joint returns (i.e., $342,400 will be taxed at 39.6%). By contrast, if the individuals were not married and each filed as single, neither would be subject to the 39.6% tax rate because neither would have exceeded the $406,750 taxable income threshold that triggers the 39.6% rate for single individuals.

Highest Statutory "Income Tax" Rate For Estates And Trusts Is 39.6%. Last year, *ATRA* also increased the highest statutory income tax rate for income taxed to a trust or estate from 35% to 39.6%. For 2014, the 39.6% rate applies to trust or estate taxable income ***exceeding $12,150.*** **Tax Tip!** The income threshold for taxing an individual at 39.6% (e.g., $406,750 for 2014, if single) is substantially higher than the income level for taxing a trust or estate at 39.6% (i.e., $12,150 for 2014). Consequently, the recent tax rate increases have created an additional tax incentive for distributing trust or estate income to an individual beneficiary where the beneficiary's income is taxed in a lower tax bracket.

- **Tax Tip!** If you want the trust's or estate's taxable income to be taxed to the beneficiary, the income generally must be distributed by the end of the current taxable year of the trust or estate. For example, assume you want the income of a calendar-year trust taxed to the beneficiary for 2014. The trust must generally distribute the income (to the extent the trust document allows the distribution) to the beneficiary ***no later than December 31, 2014.*** **Planning Alert!** The distribution may be ***made within the first 65 days of 2015*** if the trustee makes an ***affirmative election*** (by checking the appropriate box on the trust's 2014 income tax return) to treat the distribution as though made in 2014.

Highest Statutory Long-Term Capital Gain And Qualified Dividend Rate Is 20%. Last year, *ATRA* increased the highest statutory rate for long-term capital gains and qualified dividends from 15% to 20% for higher-income individuals. The 20% rate applies only for long-term capital gains or qualified dividends that would otherwise be taxed in the 39.6% bracket. For example, to the extent long-term capital gains of a single individual cause his or her taxable income to exceed $406,750 in 2014 (i.e., the income threshold for the 39.6% bracket), the capital gains will be taxed at 20%. Individuals with taxable income (including long-term capital gains and qualified dividends) below the 39.6% income threshold continue to have a maximum capital gains rate of 15%. **Caution!** The maximum rates of 28% on the gain from the sale of collectibles (e.g., works of art, antiques, etc.) and 25% on the gain attributable to straight-line depreciation taken on depreciable realty were not changed by *ATRA*, and continue to apply.

- **Zero Capital Gains Rate.** Lower-income individuals may actually have a long-term capital gains and qualified dividend tax **rate of *zero!*** The zero tax rate applies where the capital gain or dividend income would otherwise be taxed in the individual's 15% or 10% tax brackets (for 2014, taxable income up to $36,900 for single individuals and $73,800 for joint filers is taxed in the 15% bracket or below).

- **Trust And Estates.** For long-term capital gains and/or qualified dividends that would otherwise be taxed in the 39.6% bracket of a trust or estate (i.e., for 2014, where taxable income – including qualified dividends and long-term capital gains – exceeds $12,150), the statutory rate is 20%.

Don't Forget That The Phase Out Of Personal Exemptions And Itemized Deductions Creates Even Higher "Effective" Tax Rates. During most of the past two decades, higher-income individuals were subject to a phase-out provision that reduced their ***personal exemptions*** and ***itemized deductions*** as their income exceeded certain thresholds. All individuals were given a three-year reprieve from these phase-outs ***from 2010 through 2012. Beginning last year,*** *ATRA* reinstated these phase-out provisions. **For 2014**, the phase-outs apply to individuals with ***adjusted gross incomes*** exceeding the following threshold amounts: ***$305,050*** for married couples ***filing joint returns*** ($152,525 if married filing separately); ***$254,200*** for ***single filers;*** and ***$279,650*** for ***heads of households.*** **Tax Tip.** The phase-out provisions ***do not apply*** to the following itemized deductions: medical expenses, investment interest, gambling losses, casualty losses, and theft losses. **Caution!** Individuals whose itemized deductions and/or personal exemptions are reduced by these phase-out provisions will have higher "effective" tax rates than listed in the published statutory-rate schedules.

POSTPONING TAXABLE INCOME

Deferring income into 2015 is a good idea if you believe that your marginal tax rate for 2015 will be equal to or less than your 2014 marginal tax rate. In addition, deferring income into 2015 could increase various credits and deductions for 2014 that would otherwise be phased out as your adjusted gross income increases. **Tax Tip.** This tax planning strategy may generate unexpected tax benefits if, as many expect, Congress retroactively extends the income-sensitive tax breaks that expired at the end of 2013 (e.g., $4,000 qualified higher education expense deduction, deduction for home mortgage “insurance premiums”).

Deferring Income Could Help You Avoid The Recent Tax Increases. Deferring taxable income from 2014 to 2015 may reduce your exposure to the recent tax increases if, for example: **1)** The deferral of income causes your 2014 taxable income to fall below the thresholds for the new 39.6% tax bracket (i.e., $457,600 for joint returns; $406,750 if single), or **2)** As discussed in more detail below, if you have income subject to the 3.8% Net Investment Income Tax (3.8% NIIT) and the income deferral causes your 2014 modified adjusted gross income (MAGI) to fall below the thresholds for the new 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single). If, after considering these factors, you believe that deferring taxable income into 2015 will save you taxes, consider the following strategies:

- **Self-Employment Income.** If you are self-employed and use the cash method of accounting, consider delaying year-end billings to defer income until 2015. **Planning Alert!** If you have already received the check in 2014, deferring the deposit does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

- **Installment Sales.** If you plan to sell certain appreciated property in 2014, you might be able to defer the gain until later years by taking back a promissory note instead of cash. If you qualify for installment treatment, the gain will generally be prorated over the term of the note and is taxed to you as you collect the principal payments. This is called reporting your gain on the “installment method.” **Planning Alert!** Although the sale of real estate and closely-held stock generally qualify for this deferral treatment, some sales do not. For example, even if you are a cash method taxpayer, you cannot use this gain deferral technique if you sell publicly-traded stock or securities. Also, you may not want to take back a promissory note in lieu of cash if you believe this reduces your chances of getting paid. **Tax Tip.** Since the “installment method” essentially allows you to spread a single gain over several years, this could cause the individual’s income in the year of sale (and possibly subsequent years) to fall below the income thresholds that kick in the top 39.6% rate, or the top 20% capital gains rate. In addition, this could also prevent the individual’s income from exceeding the thresholds for the 3.8% NIIT (discussed in more detail below).

“Required Minimum Distributions” From Retirement Plans And IRAs. If you want to postpone the distribution (and therefore the taxation) of amounts in your traditional IRA or a qualified retirement plan as long as possible, there are several things to consider. First and foremost, it is critical that you name the appropriate beneficiaries, such as an individual or a “qualified trust.” If your estate is the beneficiary of your IRA or qualified plan account, your heirs will generally miss out on substantial tax deferral opportunities after your death. In addition to naming an individual or individuals as your beneficiary, you should also name a “contingent beneficiary” in case your primary beneficiary dies before you. If you do not name a qualified beneficiary or if your estate is your beneficiary and you die before reaching age 70½, your entire retirement account generally must be distributed and taxed within ***five years*** after the year of your death. This will cause your beneficiaries to lose valuable tax deferral options. **Planning Alert!** The rules for maximizing the tax deferral possibilities for IRAs and qualified plan accounts are complicated. We will gladly review your beneficiary designations and offer planning suggestions. However, here are some actions, relating to retirement plans and IRAs, that should ***be considered before the end of 2014:***

- **Post Mortem Planning For Retirement Plan And IRA Distributions.** If you are the beneficiary of an IRA or qualified plan account of someone that has died in 2014, there are certain planning techniques you should consider as soon as possible. **Tax Tip.** If the decedent named multiple beneficiaries or included an estate or charity as a beneficiary, we should review the situation as soon as possible to see if there is anything we can do to avoid certain tax traps. The rules for rearranging IRA beneficiaries for maximum tax deferral are complicated and are subject to rigid deadlines. Acting before certain deadlines pass is critical. If the owner died in 2014, the best tax results can generally be achieved by making any necessary changes ***no later than December 31, 2014.*** If you need assistance, please call our office as soon as possible so we can advise you.

- **<u>IRA Owners Who Attain Age 70½ During 2014.</u>** If you reached age 70½ at any time during 2014, you must begin distributions from a traditional IRA account ***no later than April 1st of 2015.*** A 50% penalty applies to the excess of the required minimum distribution over the amount actually distributed. In addition, if you wait until 2015 to take your first payment, you will still be required to take your second required minimum distribution no later than December 31, 2015, which will cause you to take two payments in 2015. This "bunching" of the first two annual payments into one tax year (2015) could cause your income to be taxed in a higher tax bracket and, therefore, result in more overall tax than if you received the first required payment in 2014. **<u>Tax Tip.</u>** If you reached age 70½ in 2014, and you own an IRA or other qualified retirement account, please call us and we will help you navigate these rules to your best advantage.

- **<u>Rollovers By Surviving Spouses.</u>** If an individual ***over age 70½*** died during 2014 and the beneficiary of the decedent's IRA or qualified plan is the surviving spouse, and the *surviving spouse* is ***over 59½,*** the surviving spouse should consider rolling the decedent's qualified plan or IRA amount into his or her name ***on or before December 31, 2014.*** If the decedent's retirement account is rolled into an IRA in the surviving spouse's name ***before 2015,*** then: **1)** Provided the surviving spouse has not reached age 70½, no distributions are required in 2015, and **2)** If the surviving spouse is at least 70½, the required minimum distribution in 2015 will be determined using the Uniform Lifetime Distribution Table that results in a smaller annual required payout. Therefore, ***converting the account into the surviving spouse's name*** on or ***before December 31, 2014,*** could substantially reduce the amount of the required minimum distribution for 2015 where the decedent was at least 70½. **<u>Planning Alert!</u>** If the surviving spouse is not yet 59½, leaving the IRA or qualified plan account in the name of the decedent may be the best option if the surviving spouse needs to withdraw amounts from the retirement account before age 59½. If the account is transferred into the spouse's name, and the spouse receives a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty unless made as a series of payments based on the surviving spouse's life expectancy.

<u>TAKING ADVANTAGE OF DEDUCTIONS</u>

<u>"Above-The-Line" Deductions Become Even More Important In Light Of Recent Tax Increases.</u> So-called ***"above-the-line"*** deductions reduce both your "adjusted gross income" (AGI) and your "modified adjusted gross income" (MAGI), while ***"itemized"*** deductions (i.e., below-the-line deductions) do ***not*** reduce either AGI or MAGI. Deductions that reduce your AGI (or MAGI) are particularly favorable because they not only reduce your taxable income, they also may free up other deductions (and tax credits) that phase out as your AGI (or MAGI) increases (e.g., itemized deductions, miscellaneous itemized deductions, personal exemptions, certain IRA contributions, certain education expense deductions and credits, adoption credit, etc.). In addition, "above-the-line" deductions could serve to reduce your MAGI below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8 % NIIT only applies if MAGI exceeds $250,000 if married filing jointly; $200,000 if single).

- **<u>"Above-The-Line" Deductions.</u>** ***"Above-the-line"*** deductions include deductions for IRA or Health Savings Account (HSA) contributions, health insurance premiums for self-employed individuals, qualified student loan interest, qualified moving expenses, alimony, and business expenses for a self-employed individual. **<u>Tax Tip.</u>** Unreimbursed employee business expenses are classified as *"miscellaneous itemized deductions"* and trigger two potential limitations: **1)** Aggregate "miscellaneous itemized deductions" are allowed only to the extent they exceed 2% of your AGI, and **2)** Any excess is included in "itemized deductions" which are phased out once your AGI exceeds certain thresholds (e.g., for 2014 – $305,050 for joint returns; $254,200 if single). However, if you arrange for your employer to reimburse you for your "qualified" employee business expenses under an ***"accountable reimbursement plan,"*** the reimbursement is excluded from your income (which is generally the equivalent of an "above-the-line deduction). **Note!** We can help you establish a qualifying *accountable reimbursement plan* with your employer.

- **<u>Accelerating "Above-The-Line" Deductions.</u>** As a cash method taxpayer, you can generally accelerate a 2015 deduction into 2014 by "paying" it in 2014. "Payment" typically occurs in 2014 if a check is delivered to the post office, if your electronic payment is debited to your account, or if an item is charged on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express) in 2014. **<u>Caution!</u>** If you post-date the check to 2015 or if your check is rejected, no payment has been made in 2014. **<u>Planning Alert!</u>** The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payment are not deductible in 2014.

<u>Accelerating "Itemized" Deductions Into 2014.</u> As mentioned above, although ***"itemized"*** deductions (i.e., *below-the-line* deductions) do ***not*** reduce your AGI or MAGI, they still may provide valuable tax savings. ***Itemized deductions*** generally include charitable contributions, state and local income taxes, property taxes, medical expenses, unreimbursed employee travel expenses, home mortgage interest, and gambling losses (to the extent of gambling income). However, if your itemized deductions fail to exceed your standard deduction in most years, you are not receiving maximum benefit for your itemized deductions. You could possibly reduce your taxes over the long term by bunching the payment of your itemized deductions in alternate tax years. This may produce tax savings by allowing you to itemize deductions in the years when your expenses are bunched, and use the standard deduction in other years. **<u>Tax Tip.</u>** The easiest deductions to shift from 2015 to 2014 are *charitable contributions*, *state and local taxes*, and your January, 2015 home *mortgage interest payment*. For 2014, the standard deduction is $12,400 on a joint return and $6,200 for single individuals. If you are blind or age 65, you get an additional standard deduction of $1,200 if you're married ($1,550 if single). **<u>Watch Out For AMT!</u>** Certain itemized deductions are not allowed in computing your alternative minimum tax (AMT), such as state and local taxes (including state income taxes) and unreimbursed employee business expenses. Before you accelerate 2015 itemized deductions into 2014, to be safe, we should calculate your taxes "with and without" accelerating the deduction so we can determine the AMT impact of this strategy.

- **<u>Option To Deduct Sales Tax Expired After 2013.</u>** For the past several years, taxpayers could "elect" to deduct "either" state and local ***income*** taxes or state and local ***sales*** taxes, as itemized deductions. This election has been particularly popular among residents who live in states with little or no state income taxes, or states where the state income taxes paid are generally less than the sales taxes paid. **<u>Planning Alert!</u>** This provision is included in the list of tax breaks that ***expired after 2013.*** However, if and when "extenders" legislation is passed by Congress, this provision will likely be included.

<u>"Bunching" Medical Expenses Even More Important Since The Deduction Threshold Increased From 7.5% To 10% Of AGI.</u> Prior to 2013, you were allowed an *itemized deduction* for un-reimbursed medical expenses (including un-reimbursed health insurance premiums) only to the extent your aggregate medical expenses exceeded ***7.5%*** of adjusted gross income (10% for alternative minimum tax purposes). ***Starting in 2013,*** the *Affordable Care Act* generally increased this threshold from 7.5% of adjusted gross income (AGI) ***to 10% of AGI.*** **<u>Exception For Seniors.</u>** If either you or your spouse is at least age 65 before the close of the year, the 7.5% of AGI threshold will continue to apply ***through 2016*** (whether you file a joint return or separate returns). **<u>Tax Tip!</u>** Consider accelerating as many elective medical expenses (i.e., braces, new eye glasses, etc.) into 2014 as possible if paying the expenses in 2014 will cause your deductible medical expenses to be above the 2014 AGI threshold and your medical expenses will not be in excess of the AGI threshold for 2015. **<u>Planning Alert!</u>** The 10% of AGI threshold for alternative minimum tax purposes has not changed.

- **<u>Qualified Long-Term Care Services.</u>** Generally, deductible medical expenses include the cost of maintenance or personal care services prescribed by a "licensed health care practitioner" for a "chronically ill" individual. However, you must meet certain requirements before you may deduct these types of expenses as medical deductions.

- **<u>IRS Medical Mileage Rate.</u>** The standard IRS medical deduction mileage rate for use of your vehicle for essential medical care purposes is ***23.5 cents per mile for 2014.***

<u>Take Advantage Of Health Savings Accounts (HSAs).</u> Qualifying contributions to health savings accounts (HSAs) are "above-the-line" deductions (i.e., fully deductible whether or not you itemize deductions), and distributions from the HSA for qualifying medical expenses are tax free. To qualify for an HSA, you must be covered by a qualifying "high deductible health plan" (HDHP). **For 2014,** if you have "family" coverage, your HDHP must have a minimum annual deductible of $2,500 ($1,250 for self only coverage). For 2014, your maximum contribution to an HSA is $3,300 ($4,300 if 55 or older) for self-only coverage, and $6,550 ($7,550 if 55 or older) for family coverage. **Tax Tip.** As long as you are covered by a qualifying high deductible health plan by ***December 1, 2014,*** you will be able to contribute up to the maximum 2014 contribution limitation (e.g., $6,550 for family coverage in 2014), subject to potential recapture rules.

Don't Miss Use-It-Or-Lose-It Deadline For Flex Plans. If you participate in a cafeteria or flexible savings account plan (flex plans), you can generally elect to make a pre-tax salary reduction contribution to the plan. You can then access that account to reimburse yourself tax free for qualified expenditures (e.g., medical expenses, dependent care assistance, adoption assistance). For most *calendar-year* plans, you must clean out your 2014 account by March 15, 2015, or forfeit any funds that aren't used for qualifying expenses.

Qualified Home Office Can Generate Valuable Tax Benefits. Qualifying for home office deductions (e.g., depreciation, insurance, utilities, repairs and maintenance) often takes careful planning. To qualify, your home office must be used ***"regularly and exclusively"*** as your ***"principal place of business."*** For example, your home office will generally be deemed your ***principal place of business*** if you use the office to perform ***management or administrative duties*** for your business ***and*** there is ***no other fixed location*** where you perform substantial management or administrative duties for that business. If you are an "employee" (as opposed to being self-employed), in addition to meeting these requirements, you must also establish that your home office is ***"for the convenience of your employer"*** (this generally means you're not provided an office at work). **Tax Tip.** The IRS says that if you have a qualifying home office, you can deduct the costs of traveling from your home office to another work location as a business expense. So, by having a qualified home office, you will generally have more deductible business travel expenses. **Note!** The ***"business standard mileage"*** rate for 2014 is ***56.0 cents*** per mile. Furthermore, if you're an employee who qualifies for home office deductions, you should ask your employer to reimburse your home office expenses. This reimbursement is ***excluded from your income*** if reimbursed under an ***"accountable reimbursement plan."*** **Planning Alert!** If you have a qualifying home office, you may elect to compute certain home office expenses using the following formula: $5.00 times the home office's actual square footage (not to exceed 300 square feet). Thus, the maximum deduction under this formula is $1,500 (300 square feet x $5.00). If you elect to use this safe harbor, you must generally forgo the "actual" expenses otherwise allocable to your home office (e.g., depreciation, maintenance, home insurance, utilities). However, you may deduct your entire qualified mortgage interest and property taxes as an itemized deduction. Also, you generally may not make this election if your home office expenses are reimbursed by your employer.

Planning Opportunities For Charitable Contributions. The following charitable-giving planning techniques may reduce your 2014 tax bill:

- **"Pay" Your Charitable Contribution In 2014.** A charitable contribution deduction is allowed for 2014 if the check is *mailed* ***on or before December 31, 2014,*** or the contribution is made by a credit card charge in 2014. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay the note or pledge.

- **Contributions Of Appreciated Property.** If you are considering a significant 2014 contribution to a qualified charity (e.g., church, synagogue, or college), it will generally save you taxes if you contribute *appreciated* long-term capital gain property, rather than selling the property and contributing the cash proceeds to the charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation. **Caution!** Your current year deduction for appreciated capital gain property is generally limited to 30% of your AGI, with a 5-year carryover of the excess. **Tax Tip.** If you want to continue to hold an investment position in stock that you contribute to charity, consider purchasing stock that is the same or similar to the appreciated stock you contributed. That way, you will have a higher "tax" basis in the replacement stock, without having to recognize the gain on the stock contributed to charity. **Planning Alert!** If you intend to use "loss" stocks to fund a charitable contribution, you should sell the stock first and then contribute the cash proceeds. This will allow you to deduct the capital loss from the sale, while preserving your charitable contribution deduction. If you contribute the loss stock directly to the charity, although you will get a charitable deduction equal to the value of the contributed stock, you will ***lose the capital loss*** deduction. **Tax Tip.** If you plan to contribute appreciated realty or stock for 2014, make sure that you begin the paperwork for the transfer early enough so that all documentation is completed by ***December 31, 2014.*** **Caution!** Be sure to satisfy the rigid documentation requirements discussed in the next segment. For example, contributions of property other than publically traded securities, generally require a "qualified appraisal" if the property is valued at more than $5,000.

IRS And The Courts Are Rigidly Enforcing The Documentation Requirements For Charitable Contributions! The IRS regulations provide that you may not take a deduction for a charitable contribution unless you strictly comply with the rigid documentation requirements imposed by the Internal Revenue Code. Over the last several years, there have been a series of Court cases disallowing an entire charitable contribution deduction because the taxpayer failed to satisfy one or more of the following documentation requirements:

- **Contributions Made In Cash.** In order to deduct a "cash" contribution to a charity, you must have a receipt, letter, or other written communication from the charity (showing the name of the charity, the date and the amount of the contribution). **Planning Alert!** If your cash contribution is $250 or more, you ***must also satisfy*** the ***"Mandatory Documentation Requirements For Contributions Of $250 Or More,"*** discussed below.

- **Contributions Made By Check, Debit Card, Or Charge Card.** If you make a contribution by check, you are required to have either a receipt described above for ***"Contributions Made In Cash,"*** a copy of the cancelled check, or some other bank record (e.g., a bank statement). If your contribution is by debit card or by charge card, you are required to have either a receipt as described above for ***"Contributions Made In Cash,"*** or a bank record (e.g., a bank statement, credit card statement, etc.). **Planning Alert!** If your contribution is $250 or more, you ***must also satisfy*** the ***"Mandatory Documentation Requirements For Contributions Of $250 Or More,"*** discussed below.

- **Mandatory Documentation Requirements For Contributions Of $250 Or More.** If you contribute ***$250 or more*** (whether by cash, check, charge card, or property) to a charity, you are allowed a deduction ***only if*** you receive a ***"qualifying written receipt"*** from the charity by the time you file your return (a cancelled check is not enough) **and** the return is timely filed. The ***qualifying written receipt*** must contain the following information: **1)** The amount of cash and a description (but not value) of any property other than cash you contributed to the charity, **2)** A statement as to whether the charity provided you with any goods or services in return for your contribution, and **3)** A description and good faith estimate of the value of any goods or services, if any, the charity provided to you (or, if applicable, a statement that the goods and services consisted solely of intangible religious benefits). ***In addition,*** for all noncash contributions, the receipt must contain the date of the charitable contribution and a description of the property contributed.

- **Property Contributions Of More Than $500.** If you contribute non-cash property of a similar type ***valued over $500***, you must not only ***satisfy*** the ***"Mandatory Documentation Requirements For Contributions Of $250 Or More,"*** discussed above, but you must also maintain and report with your return certain additional information including the date you acquired the property, your basis in the property, your valuation method, etc. **Planning Alert!** If you are claiming a deduction of ***more than $500*** for a ***vehicle, a boat, or an airplane*** that you contributed to charity, the law also requires that you obtain a *Form 1098-C* in order to deduct your contribution.

- **Property Contributions Of More Than $5,000.** You must obtain a ***qualified appraisal*** for contributions of property ***valued in excess of $5,000***, unless the property is: **1)** Securities for which market quotations are readily available, or **2)** Non-publicly traded stock valued at $10,000 or less. Furthermore, you must also ***satisfy*** the ***"Mandatory Documentation Requirements For Contributions Of $250 Or More,"*** discussed above.

- **Contributions Of Clothing And Household Items.** Even if you meet the previously-discussed documentation requirements, you are not allowed a deduction for charitable contributions of ***clothing or household items*** unless the items are in ***"good used condition or better."*** **Tax Tip.** You should consider contributing your clothing and household items to charities that have a policy of accepting only items that are in good condition.

<u>Maximizing Your Home Mortgage Interest Deduction.</u> If you are looking to maximize your 2014 itemized deductions, you can increase your home mortgage interest deduction by paying your January, 2015 payment ***on or before December 31, 2014.*** Typically, the January mortgage payment includes interest that was accrued in December and, therefore, is deductible if paid in December. **<u>Planning Alert!</u>** Make sure that you send in your January, 2015 mortgage payment early enough in December for your lender to actually receive it before year-end. That way, your lender will be sure to reflect that last payment on your 2014 Form 1098, and we can avoid a matching problem on your 2014 return.

Here are some other planning strategies for the interest deduction you should consider:

- **<u>Look For Deductible "Points."</u>** Points paid in connection with the purchase or improvement of your ***principal residence*** are immediately deductible. Points are deductible even if the bank labels them as something else. For example, points include "loan-processing fees," "loan premium charges," or "loan origination fees" so long as they don't represent fees for services, etc. (e.g., appraisal, title, inspection, attorneys' fees, credit checks, property taxes, or mortgage insurance premiums).

- **<u>Remember To Deduct Seller-Paid Points.</u>** If you bought a house this year and negotiated for the seller to pay your points at closing, the IRS says you can deduct those seller-paid points as though you paid them yourself.

- **<u>Pay Off Personal Loans First.</u>** If you have both home mortgage loans and other personal debt, pay off the personal debt first because interest on personal debt is generally not deductible but home mortgage interest is generally deductible. This will maximize your interest deduction.

<u>Pay Careful Attention To The Payment Of Your State And Local Income Taxes.</u> If you anticipate deducting your state and local income taxes, consider paying them (fourth quarter estimate and balance due for 2014) and any property taxes for 2014 ***prior to January 1, 2015*** if your tax rate for 2014 is higher than or the same as your projected 2015 tax rate. This will provide a deduction for 2014 (a year early) and possibly against income taxed at a higher rate. **<u>Caution!</u>** If you expect your 2014 AGI to be above the threshold for phasing out "itemized deductions" (e.g., above $305,050 for joint returns; $254,200 if single), but expect your 2015 AGI to be below those thresholds, accelerating your tax payment into 2014 may not be advisable. **<u>Planning Alert!</u>** State and local income and property taxes are not deductible for AMT purposes. Consequently, you should not employ this tactic without carefully calculating the alternative minimum tax impact. Also, "overpayment" of your 2014 state and local income taxes is generally not advisable if a refund in 2015 from a 2014 overpayment will be taxed at a higher rate than the rate that applied to the 2014 deduction. **Please consult us before you overpay state or local income taxes!**

<u>TAX PLANNING FOR INVESTMENT INCOME (INCLUDING THE 3.8% NIIT)</u>

<u>Planning With The 3.8% Net Investment Income Tax (3.8% NIIT).</u> As mentioned previously, the ***Affordable Care Act*** (*ACA*) imposed a *new* ***3.8% Net Investment Income Tax (3.8% NIIT)*** on *net investment income* of higher-income individuals. This tax applies to individuals with modified adjusted gross income (MAGI) exceeding the following ***"thresholds"*** (which are ***not indexed*** for future inflation): ***$250,000*** for ***married filing jointly; $200,000*** if ***single;*** and ***$125,000*** if ***married filing separately.*** The 3.8% NIIT is imposed upon ***<u>the lesser of</u>*** an individual's: **1)** Modified adjusted gross income (MAGI) in excess of the ***threshold,*** or **2)** Net investment income. ***Trusts and estates*** are also subject to the ***3.8% NIIT*** on the ***lesser of*:** **1)** The adjusted gross income of the trust or estate in excess of $12,150 (for 2014), or **2)** The undistributed net investment income of the trust or estate.

As expected, the NIIT generally applies to the traditional types of investment income, such as interest, dividends, annuities, royalties, and capital gains. However, the 3.8% NIIT also applies to "business" income that is taxed to a "passive" owner (as discussed in more detail below) unless the "passive" income is subject to S/E taxes. If you believe that the 3.8% NIIT may apply to you, consider the following planning techniques:

- **<u>Shifting To Investments That Generate Tax-Exempt Income.</u>** Fortunately, the following types of income are ***not subject*** to the *3.8% NIIT*: ***tax-exempt bond interest;*** gain on the sale of a principal residence *otherwise excluded* from income under the ***home-sale exclusion*** rules (i.e., up to $250,000 on a single return, up to $500,000 on a joint return); and ***distributions from qualified retirement plans*** (e.g., 401(k) plans, IRAs, §403(b) annuities, etc.). **<u>Tax Tip.</u>** Investments that generate tax-exempt income (e.g., tax exempt municipal bonds) potentially provide higher-income individuals with a double benefit: **1)** The interest will not be included in the individual's MAGI, thus reducing the chance that the individual will exceed the income thresholds for the 3.8% NIIT, and **2)** The tax-exempt interest itself is exempt from the 3.8% NIIT as well as from Federal income taxes. **<u>Planning Alert!</u>** Although taxable distributions from qualified retirement plans (e.g., IRAs, 401(k) plans, etc.) are exempt from the 3.8% NIIT, the taxable distributions will increase your "modified adjusted gross income" (MAGI). Therefore, to the extent the taxable distributions cause your MAGI to exceed the MAGI thresholds for the 3.8% NIIT (e.g., $250,000 for joint returns; $200,000 for singles), the distributions could cause your other "net investment income" (e.g., dividends, interest, capital gains, rents, passive income) to be hit with the 3.8% NIIT.

- **<u>Roth IRAs (Including Roth IRA Conversions).</u>** Tax-free distributions from a Roth IRA are exempt from the 3.8% NIIT, and do not increase your MAGI (and, thus will not increase your exposure to the 3.8% tax). Therefore, these tax-favored features should be factored into any analysis of whether you should contribute to a Roth IRA. However, if you are considering converting a traditional IRA into a Roth, the income triggered in the year of conversion would increase your MAGI and, therefore, may increase your exposure to the 3.8% NIIT on your *net investment income*. **<u>Planning Alert!</u>** If you want a Roth conversion to be ***effective for 2014,*** you must transfer the amount from the regular IRA to the Roth IRA ***no later than December 31, 2014*** (you do not have until the due date of your 2014 tax return). **<u>Caution!</u>** Whether you should convert your traditional IRA to a Roth IRA can be an exceedingly complicated issue, and this new 3.8% NIIT is just one of many factors that you should consider. ***Please call our firm*** if you need help in deciding whether to convert to a Roth IRA.

- **<u>"Tax-Deferred" Investments.</u>** The 3.8% NIIT does not apply to earnings generated by a ***tax-deferred annuity*** (TDA) contract ***until the income is distributed.*** Thus, after first considering the economics, investing in a TDA in your higher-income years may allow you to defer the annuity income until later years when your MAGI is below the 3.8% NIIT thresholds.

- **<u>"Passive" Income.</u>** *"Net Investment Income"* for purposes of the 3.8% NIIT generally includes net income from a business activity if you are a "passive" owner (unless the income constitutes *self-employment* income that is subject to the 2.9% Medicare tax). You will generally be deemed a "passive" owner if you do not "materially participate" in the business as determined under the traditional "passive activity loss" rules. For example, under the *passive activity loss* rules, you may be a *"passive"* owner unless you spend more than 500 hours working in the business during the year or meet one of the other "material participation" test. Furthermore, subject to limited exceptions (e.g., qualified real estate professionals, rentals to a business in which you are not passive), *rental income* is generally deemed to be "passive" income under the *passive activity loss* rules, regardless of how many hours you work in the rental activity. If you believe you have "passive" income from an activity, please contact our firm. We will gladly evaluate your situation to determine whether there are steps you could take before the end of the year to avoid "passive" income classification, and thus, reduce your exposure to the 3.8% NIIT.

<u>Traditional Year-End Planning With Capital Gains And Losses.</u> Generally, net capital gains (both short-term and long-term) are potentially subject to the 3.8% NIIT. This could result in an individual who is taxed in the 39.6% ordinary income tax bracket paying tax on his or her ***net long-term capital gains*** at a ***23.8%*** rate (i.e., the maximum capital gains tax rate of 20% plus the 3.8% NIIT). This individual's ***net short-term capital gains*** could be taxed as high as ***43.4%*** (i.e., 39.6% plus 3.8%). Consequently, traditional planning strategies involving the timing of your year-end sales of stocks, bonds, or other securities are more important than ever. The following are time-tested, year-end tax planning ideas for sales of capital assets. **<u>Planning Alert!</u>** Always consider the ***economics of a sale or exchange first!***

- **<u>Planning With Zero Percent Tax Rate For Capital Gains And Dividends.</u>** Long-term capital gains and qualified dividends that would be taxed (if ordinary income) in the 15% or lower ordinary income tax bracket, are taxed at a zero percent rate. For 2014, taxable income up to $73,800 for joint returns ($36,900 if single) is taxed at the 15% rate, or below. **Tax Tip.** Taxpayers who have historically been in higher tax brackets but now find themselves between jobs, recently retired, or expecting to report higher-than-normal business deductions in 2014, may temporarily have income low enough to take advantage of the zero percent rate for 2014. If you are experiencing any of these situations, please call our firm and we will help you take advantage of this zero percent tax rate for long-term capital gains and qualified dividends.

●● **Lower-Income Retirees.** The zero percent rate for long-term capital gains and qualified dividends is particularly important to lower-income retirees who rely largely on investment portfolios that generate dividends and long-term capital gains. Furthermore, gifts of appreciated securities to lower-income donees who then sell the securities could reduce the tax on all or part of the gain from 15% or 20% to zero percent. **Caution!** If the donee is subject to the so-called *kiddie tax*, this planning technique will generally not work.

- **Timing Your Capital Gains And Losses.** If you have already recognized capital gains in 2014, you should consider selling securities ***prior to January 1, 2015*** that have declined in value. These losses will be deductible on your 2014 return to the extent of your recognized capital gains, plus $3,000. **Tax Tip.** These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as the: $2,500 American Opportunity Tuition Tax Credit, $1,000 child credit, $13,190 adoption credit, etc. **Planning Alert!** If, within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the “wash sale” rules (although the disallowed loss will increase the basis of the acquired stock). **Tax Tip.** If you are afraid of missing an upswing in the market during this 60-day period, consider buying shares of a different company in the same sector. Also, there is *no* wash sale rule for *gains*. Thus, if you decide to sell stock at a gain in order to take advantage of a zero capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

- **Making The Most Of Capital Losses.** Some investors may still have substantial loss carry forwards coming into 2014. If your stock sales to date have created a *net* capital loss exceeding $3,000, consider selling enough appreciated securities ***before the end of 2014*** to decrease your net capital loss to $3,000. Stocks that you think have reached their peak would be good candidates. All else being equal, you should sell the short-term gain (held 12 months or less) securities first. This will allow your *net* capital loss (in excess of $3,000) to offset your short-term capital gain, while preserving favorable long-term capital gain treatment for later years. **Planning Alert!** Your *net* short-term capital gains can be used to free up a deduction for any “investment interest” you have incurred (e.g., interest you have paid on your margin account). If you eliminate your short-term capital gains by recognizing your short-term capital losses, you may be restricting your ability to deduct your investment interest. **Tax Tip.** If you are considering selling “loss” investments held 12 months or less, and you also have short-term capital gains and investment interest expense, please call our office. We will help you determine a strategy that will maximize your tax savings.

- **Year-End Mutual Fund Purchases.** If you are thinking about buying mutual fund shares near year-end, watch out for a common tax trap. Mutual funds typically distribute income, including capital gains, near the end of each year. If you invest in the fund near the end of the year, but on or before the record date for this payout, you generally will be taxed on a year-end distribution as if you had held the fund all year. This, in essence, treats a return of your investment as a taxable distribution. **Practice Alert!** With the increased tax rates on both long-term and short-term capital gains, this can be a costly mistake. Therefore, before investing, you should determine the amount and timing of any year-end payout and the record date for such distributions.

PLANNING WITH RETIREMENT PLANS

Consider Contributing The Maximum Amount To Your Retirement Plan. As your income rises and your marginal tax rate increases, deductible retirement plan contributions generally become more valuable. Also, making your deductible contribution to the plan as early as possible generally increases your retirement benefits. As you evaluate how much you should contribute, consider the following:

- **IRA Contributions.** If you are married, even if your spouse has no earnings, you can generally deduct in the aggregate up to $11,000 ($13,000 if you are both at least age 50 by the end of the year) for contributions to your and your spouse's traditional IRAs. You and your spouse must have *combined earned income* at least equal to the total contributions. However, no more than $5,500 ($6,500 if at least age 50) may be contributed to either your IRA account or your spouse's IRA account for 2014. If you are an active participant in your employer's retirement plan during 2014, your IRA deduction is reduced ratably as your adjusted gross income increases from **$96,000 to $116,000** on a joint return (**$60,000 to $70,000** on a single return). However, if you file a joint return with your spouse and your spouse is an active participant in his or her employer's plan and you are not an active participant in a plan, your IRA deduction is reduced as the adjusted gross income on your joint return goes from **$181,000 to $191,000.** **Planning Alert!** Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. For 2014, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **$181,000 to $191,000** on a joint return or from **$114,000 to $129,000** if you are single. **Planning Alert!** Unlike the rule for traditional IRA contributions, the amount you may contribute to a Roth IRA is reduced if your adjusted gross income falls within these phase-out ranges regardless of whether you or your spouse is a participant in another retirement plan. In addition, contributions to a Roth IRA are not deductible.

- **Workers At Least Age 70½.** If you are age 70½ or older, you ***cannot*** make a contribution to a traditional IRA for yourself. **Tax Tip.** If you are working, age 70½ or older, have a spouse under age 70½, and otherwise qualify, you can make a deductible IRA contribution to a separate traditional IRA for your spouse (not to exceed your compensation) even where the spouse has no earned income. Also, if you otherwise qualify, you can contribute to a nondeductible Roth IRA even after you reach age 70½ as long as you have sufficient earned income.

- **Consider Contributing To Your Company's 401(k) Plan.** If you are covered by your company's 401(k) plan, consider putting as much of your compensation into the plan as allowable. The maximum amount of compensation you can defer into the 401(k) plan for 2014 is $17,500 ($23,000 if you're at least age 50 by the end of 2014). Deferring the maximum compensation amount into the plan is particularly appealing if your employer offers to match your contributions.

- **Seek Advice Before Taking Money From Your IRA Prematurely!** If you are experiencing financial distress and are considering withdrawing funds from your IRA to fill the financial void, ***be extremely careful!*** There can be a 10% penalty for withdrawing funds from your IRA on top of any income tax on the distribution. However, there are specific exceptions to the 10% distribution penalty (although you generally must still include the amount distributed in your taxable income). For example, you can generally withdraw funds from your IRA without penalty if: **1)** You have reached age 59½, **2)** You have been medically determined to be disabled, **3)** You are using the funds for qualified education expenses, **4)** You are receiving unemployment benefits and you use the funds for medical insurance premiums, or **5)** You take substantially equal payments over your life expectancy. **Planning Alert!** These rules are exceedingly technical and if not properly followed, can result in a 10% penalty in addition to any income tax due on the distribution. Please call our firm if you need to access your IRA funds and we will help you determine if you qualify for one of these exceptions to the penalty.

MISCELLANEOUS YEAR-END TAX PLANNING OPPORTUNITIES

Before wrapping up your *traditional* year-end planning review, here are several more strategies you might consider:

Exercising Incentive Stock Options (ISOs) Could Trigger AMT. Exercising an incentive stock option (ISO) in 2014 can generate a 2014 alternative minimum tax (AMT) if the difference between the stock's value and the exercise price is substantial. **Tax Tip.** If you exercised an ISO **in 2014** and the stock you acquired has declined in value since the date of exercise, it may be possible to eliminate or reduce your 2014 AMT tax liability if you sell the stock ***on or before December 31, 2014.*** Please check with us if you have exercised incentive stock options during 2014 and the price of the stock has fallen since the date of exercise.

Consider Increasing Withholding If Facing An Estimated Tax Underpayment Penalty. If you have failed to pay sufficient estimated taxes during 2014 potentially causing an estimated tax underpayment penalty, ***increasing your withholdings before the end of 2014*** may solve the problem. Any income tax withholding (including withholdings at the end of 2014 from a year-end bonus or IRA distribution) is generally deemed paid 1/4 on April 15, 2014; June 16, 2014; September 15, 2014; and January 15, 2015. Therefore, amounts ***withheld on or before December 31, 2014*** may reduce or eliminate your penalty for underpaying estimated taxes. **Tax Tip.** If you are a higher-income individual with ***investment income*** that will trigger the ***3.8% NIIT*** for 2014, the additional NIIT could subject you to the underpayment penalty if you haven't adjusted your estimated tax payments or withholdings to cover the 3.8% NIIT and do not otherwise meet one of the exceptions to the penalty (i.e., paying in 110% of last year's tax). Increasing your withholdings on or before December 31, 2014 could eliminate the penalty. **Planning Alert!** If you take an IRA distribution and have taxes withheld from the distribution to avoid an underestimate penalty, you must roll the distribution (unreduced by the withheld taxes) into an IRA within 60 days of the distribution to avoid paying taxes (and possibly a 10% penalty) on the IRA distribution. Also, you are allowed to take a distribution from an IRA and roll it over into a new IRA, ***only one time per year*** (beginning with the date you received the distribution). Please call our firm before you initiate an IRA distribution in order to increase your tax withholdings.

Certain Estates Have Until December 31, 2014 To File "Late" Estate Tax Returns In Order To Make "Portability" Election. Over the years, gift and estate taxes have generally been imposed only on estates and aggregate lifetime gifts exceeding a certain dollar amount (the "exclusion amount"). For 2014, the lifetime estate and gift tax *exclusion amount* is $5.34 million, and will be adjusted annually based on inflation. For individuals ***dying after 2010,*** the executor of a deceased spouse's estate may *elect* for any of the *"deceased spousal unused exclusion" (DSUE) amount* to be added to the *"exclusion amount"* of the *surviving spouse*. This is sometimes referred to as the "portability election." **Caution!** To make the "portability" election, IRS says that the deceased spouse's estate ***must timely file a properly-completed estate tax return (Form 706).*** This filing is required even if the deceased spouse's estate is not large enough to otherwise require the filing of an estate tax return. An estate tax return generally must be filed ***within 9 months*** of a decedent's death, unless the estate timely obtains a 6-month filing extension. **Good News!** The IRS has announced that it ***will generally allow estates of individuals who died in 2011, 2012, or 2013*** (who were not otherwise required to file a Form 706) ***to file a "late" Form 706 to make the portability election,*** provided the ***return is filed before 2015.*** **Planning Alert!** If you think you or someone in your family may benefit from this time-sensitive relief, please call our firm for additional information.

Consider Utilizing The $14,000 Annual Gift Tax Exclusion. You can reduce your estate without using any of the your $5.34 million exclusion amount and without making taxable gifts by making annual gifts up to the annual gift tax exclusion amount of $14,000 per donee. Your spouse can do the same, bringing the total gifts that can be made free of gift tax and without using any of the unified exclusion amount to $28,000 per donee. **Planning Alert!** If you make your 2014 gift by check, the IRS says that the donee must actually "deposit" the check ***by December 31, 2014*** in order to utilize the $14,000 annual gift tax exclusion amount for 2014. Therefore if gifts are made near the end of the year, you should consider making the gifts using a cashier's check which should constitute a gift when the check is delivered.

Make Sure You Comply With The Filing Requirements For Same-Sex Marriages. Last year, the IRS ruled that: **1)** It will ***recognize as married for Federal tax purposes*** same-sex couples who were married in a state, the District of Columbia, a U.S. territory, or a foreign country that authorizes "same-sex" marriages, **regardless of the couple's current domicile** (i.e., "state of celebration" rule), but **2)** It will ***not recognize as married for Federal tax purposes*** same-sex or opposite-sex couples who have entered into a *registered domestic partnership*, *civil union*, or other *similar formal relationship* recognized under state law ***"that is not denominated as a marriage under the laws of that state."*** **Practice Alert!** Under this ruling, legally-married same-sex couples will be treated as married for all Federal tax purposes**, including for income, gift and estate tax purposes.** Thus, the IRS says that legally-married, same-sex couples who file an ***"original"*** income tax return ***after September 15, 2013*** must file as married filing jointly or married filing separately.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this letter represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of the provisions discussed may apply to a specific situation.

Disclaimer: Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of promoting, marketing, or recommending to another party any transaction or matter addressed herein. The preceding information is intended as a general discussion of the subject addressed and is not intended as a formal tax opinion. The recipient should not rely on any information contained herein without performing his or her own research verifying the conclusions reached. The conclusions reached should not be relied upon without an independent, professional analysis of the facts and law applicable to the situation.