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Re: 2014 Year-End Tax Planning For Individuals

As 2014 draws to a close, we are still waiting for Congress to pass the popular tax benefits commonly referred to as "extenders." Although this is less than ideal for planning purposes, the good news is that much of the current Tax Code remains unchanged for the 2014 tax year and beyond.

TRADITIONAL TAX PLANNING

Traditional year-end planning techniques remain important for 2014. As always, tax planning requires a combination of multi-layered strategies, taking into account a variety of possible scenarios and outcomes. These income deferral/exclusion and deduction/credit acceleration techniques may be used to reduce your income tax liability:

Income Deferral/Exclusion:

- Receive bonuses earned for 2014 in 2015
- Minimize retirement distributions
- Postpone the redemption of U.S. Savings Bonds
- Delay Roth conversions to 2015
- Offset tax losses against current gains (loss harvesting)
- Sell appreciated assets in 2015
- Make tax-free gifts of $14,000 per recipient ($28,000 for married joint filers)
- Execute like-kind exchange transactions
- Complete installment sales to defer gain
- Defer billings and collections
- Declare any special dividends in 2015
- Defer corporate liquidation distributions until 2015

Deductions/Credit Acceleration:

- Bunch itemized deductions into 2014/Standard deduction into 2015
- Accelerate bill payments into 2014
- Pay last state estimated tax installment in 2014 instead of 2015
- Minimize the effect of AGI limitations on deductions/credits
- Make an IRA contribution before April 15, 2015 of up to $5,000 per individual (with catch-up contributions of an additional $1,500 available to individuals age 50 and older)
- Maximize net investment interest deductions
- Match passive activity income and losses

In addition to traditional year-end tax strategies, the following issues may also impact your year-end tax planning:

INFLATION-ADJUSTED TAXES AND PHASEOUT AMOUNTS

Many of the taxes and exemption phaseouts in the Code are adjusted for inflation annually, generally by the use of threshold amounts. Some of these taxes, and if applicable, inflation-adjusted amounts are:

Income Tax

The current tax structure includes income tax rates of 10, 15, 25, 28, 33, 35, and 39.6 percent. For 2014, the threshold amounts for these rates are:

- ***Married taxpayers filing jointly and surviving spouses:*** the maximum taxable income for the 10% tax bracket is $18,150; for the 15% bracket, $$73,800; for the 25% bracket, $148,850; for the 28% bracket, $226,850; for the 33% bracket, $405,100; and for the 35% bracket, $457,600. Amounts over $457,600 are taxed at 39.6%.
- ***Married taxpayers filing separately:*** the maximum taxable income for the 10% bracket is $9,075; for the 15% bracket, $36,900; for the 25% bracket, $74,425; for the 28% bracket, $113,425; for the 33% bracket, $202,550; and for the 35% bracket, $228,800. Amounts over $228,800 are taxed at 39.6%.
- ***Heads of households:*** the maximum taxable income for the 10% bracket is $12,950; for the 15% bracket, $49,400; for the 25% bracket, $127,550; for the 28% bracket, $206,600; and for the 33% bracket, $405,100; and for the 35% bracket, $432,200. Amounts exceeding $432,200 are taxed at 39.6%.
- ***Single filers (other than surviving spouses and heads of households):*** the maximum taxable income for the 10% bracket is $9,075; for the 15% bracket, $36,900; for the 25% bracket, $89,350; for the 28% bracket, $186,350; for the 33% bracket, $405,100; for the 35% bracket, $406,750. Amounts over $406,750 are taxed at 39.6%.

Additional HI (Medicare) Tax

Higher income individuals are subject to an additional 0.9 percent HI (Medicare) tax on wages received in connection with employment in excess of $200,000 ($250,000 for married couples filing jointly and $125,000 for married couples filing separately). To avoid an underpayment penalty related to this tax, you can instruct your employer to withhold an additional amount of federal income tax from your wages before year end.

Itemized Deduction Phaseout (Pease Limitation)

The Pease limitation on itemized deductions (named for the member of Congress who originally sponsored the legislation) reduces itemized deductions for higher-income taxpayers. For 2014, itemized deductions are reduced when AGI exceeds the following threshold amounts:

- $305,050 for married taxpayers filing jointly and surviving spouses;
- $279,650 for heads of households;
- $254,200 for single filers (other than surviving spouses and heads of households); and
- $152,525 for married taxpayers filing separately.

Personal Exemptions

The personal exemption phaseout requires higher-income taxpayers to reduce the amount of their personal exemptions when their AGI exceeds certain threshold levels. The same threshold limits used in the Pease limitation above apply to the personal exemption phaseout.

If the personal exemption phaseout kicks in, the total amount of exemptions that may be claimed is reduced by two percent for each $2,500 ($1,250 for married couples filing separately) or portion thereof, by which adjusted gross income (AGI) exceeds the applicable threshold.

Kiddie Tax

The net unearned income of certain children under the age of 24 can be taxed at the parent's marginal tax rate. This tax at the parent's rate is commonly referred to as the "kiddie tax." If the child's unearned income is less than an inflation-adjusted ceiling amount, the parent may be able to include the income on the parent's return, rather than filing a return for the child.

For tax years beginning in 2014, the inflation-adjusted amount used to reduce the net unearned income reported on a child's return that is subject to the kiddie tax is $1,000. The child’s income can be reported on the parent’s return if the child’s gross income is more than $1,000 and less than $10,000.

TAXES ON INVESTMENTS

Generally, taxable investment accounts are accounts other than retirement accounts, insurance contracts and annuities. When managing investments held in taxable accounts, the measure of success is the net return after taxes, rather than the gross return. The following taxes must be taken into account in order to achieve that objective:

Capital Gains Tax

Capital gains are taxed at a rate of zero percent for taxpayers in the 10 and 15 percent brackets; the 15 percent rate for taxpayers is applicable to those in the 25, 28, 33, and 35 percent brackets; and higher-income taxpayers that are subject to the 39.6 percent income tax rate pay 20 percent.

Tax on Dividend Income

Qualified dividends received from domestic corporations and qualified foreign corporations are taxed at the same rates that apply to capital gains. Certain dividends do not qualify for the reduced rates, including dividends paid by credit unions, mutual insurance companies, and farmers' cooperatives.

Net Investment Income Tax (NIIT)

The net investment income tax (NIIT) is a Medicare surtax of 3.8 percent imposed on the lesser of net investment income (NII) or modified adjusted gross income (MAGI) above a specified threshold. Distributions from IRAs, pensions, 401(k) plans, tax-sheltered annuities, and eligible Code Sec. 457 plans are excluded from NII and from the NIIT.

NII includes the following investment income reduced by certain investment-related expenses, such as investment interest expense, investment brokerage fees, royalty-related expenses, and state and local taxes allocable to items included in net investment income:

- Gross income from interest, dividends, annuities, royalties, and rents, provided this income is not derived in the ordinary course of an active trade or business;
- Gross income from a trade or business that is a passive activity;
- Gross income from a trade or business of trading in financial instruments or commodities; and
- Gain from the disposition of property, other than property held in an active trade or business.

Individuals are subject to the 3.8 percent NIIT if MAGI exceeds the following thresholds (not subject to inflation adjustment):

- $250,000 for married taxpayers filing jointly or a qualifying widower with a dependent child;
- $125,000 for married taxpayers filing separately; and
- $200,000 for single and head of household taxpayers.

NIIT is not imposed on income derived from a trade or business, nor from the sale of property used in a trade or business. Therefore, you should carefully differentiate income derived from an active business from passive investment income in order to shield the business income from the NIIT.

ALTERNATIVE MINIMUM TAX

You should not ignore the possibility of being subject to the AMT, as doing so may negate certain year-end tax strategies. For example, if income and deductions are manipulated to reduce regular tax liability, AMT for 2014 may increase because of differences in the income and deductions allowed for AMT purposes.

The alternative minimum tax (AMT) exemption amounts are annually adjusted for inflation. For 2014, the AMT exemption amounts are:

- $82,100 for married taxpayers filing jointly and surviving spouses;
- $52,800 for unmarried taxpayers and heads of household, other than surviving spouses; and
- $41,050 for married taxpayers filing separately.

Exemptions for the AMT are phased out as taxpayers reach high levels of alternative minimum taxable income (AMTI). Generally, the exemption amounts are phased out by an amount equal to 25 percent of the amount by which an individual's AMTI exceeds a threshold level. For 2014, the threshold levels for calculating the exemption phaseout are:

- $156,500 for married taxpayers filing jointly and surviving spouses (complete phaseout at $484,900);
- $117,300 for unmarried taxpayers and heads of household, other than surviving spouses (complete phaseout at $328,500); and
- $78,250 for married taxpayers filing separately (complete phaseout at $242,450).

The AMT rates are 26 percent, and 28 percent on the excess of alternative minimum taxable income (AMTI) over the applicable exemption amount. For tax years beginning in 2014, the taxable excess income above which the 28 percent tax rate applies is $182,500 for married taxpayers filing jointly and unmarried individuals other than surviving spouses; and $91,250 for married taxpayers filing separately.

EXPIRED TAX BENEFITS

The following temporary individual tax benefits, known as "tax extenders," expired on December 31, 2013. These benefits are likely to be extended, probably for two years, as in the past. However, if Congress fails to act, some of the benefits that will not be available in 2014 are:

- Above-the-line deduction of up to $250 for certain expenses of elementary and secondary school teachers, including books, supplies, computers, and software
- Above-the-line deduction for qualified tuition and related expenses
- Credit for residential energy property
- Credit for two- or three-wheeled plug-in electric vehicles
- Exclusion from gross income for discharges of indebtedness on qualified principal residences
- Exclusion from gross income of qualified charitable distributions from individual retirement plans for individuals aged 70½ or older
- Itemized deduction for mortgage insurance premiums as qualified residence interest
- Itemized deduction for State and local general sales taxes in lieu of State and local income taxes
- Special 100 percent exclusion of gain on sale of qualified small business stock acquired after 09-27-2010 and before 01-01-2014
- Special 60 percent exclusion for gain on sale (attributable to periods through 12/31/2018) of qualified small business stock of an empowerment zone business (empowerment zone designations expire 12/31/13)
- Special rules for contributions of capital gain real property made for conservation purposes

In addition, the alternative motor vehicle credit for qualified fuel cell motor vehicles is set to expire at year-end, so there may be little time to take advantage of this energy-driven benefit.

TAX BENEFITS FOR FAMILIES

You should review your family's situation annually to make sure that you take advantage of any applicable child- or education-driven benefits, such as:

- Adoption credit
- Exclusion for adoption assistance programs
- Child and dependent care (CDC) credit
- Child tax credit (CTC) and the refundable (additional) CTC
- Earned income credit (EIC)
- American Opportunity Tax Credit (AOTC)
- Coverdell Education Savings Accounts (ESAs)
- Exclusion for educational assistance programs
- Scholarship programs
- Student loan interest deduction

SHARED RESPONSIBILITY PAYMENT

Beginning in 2014, some of the most far-reaching provisions of the health care reform legislation became effective:

- the requirement to carry "minimum essential health coverage" for yourself and your dependents (known as the "individual mandate");
- the ability to obtain coverage through an insurance exchange; and
- for qualified individuals, a special tax credit to help offset the cost of insurance.

If you fail to comply with the individual mandate to carry minimum essential health coverage, you are required to pay a penalty, called a "shared responsibility payment," for each month of noncompliance. The rules stipulate that a person has minimum essential coverage for a month if the person is enrolled under a plan providing such coverage for at least one day during any calendar month.

Some individuals are exempt from the individual mandate, including, but not limited to:

- individuals covered by Medicaid and Medicare;
- incarcerated individuals;
- individuals not lawfully present in the United States;
- health care sharing ministry members;
- members of an Indian tribe;
- members of a religion conscientiously opposed to accepting benefits;
- individuals whose minimum cost for the annual premiums is more than eight percent of their household income;
- individuals who are without coverage for fewer than 90 days (although only one period of 90 days is allowed in a year); and
- individuals with employer-provided health insurance that satisfies minimum essential coverage and affordability requirements.

The shared responsibility payment amount is either a percentage of the individual's income or a flat dollar amount, whichever is greater. The amount owed is 1/12th of the annual payment for each month that a person or the person's dependents are not covered and are not exempt. For 2014, the payment amount is the greater of:

- One percent of the person's household income that is above the tax return threshold for their filing status; or
- A flat dollar amount, which is $95 per adult and $47.50 per child, limited to a maximum of $285.

If you qualified for the tax credit that helps to offset the cost of coverage, you may have taken an advance payment of the credit. If so, you must reconcile the amount you received up front with the actual credit computed when your 2014 tax return is prepared.

Every tax situation is different and requires a careful and comprehensive plan. We can assist you in aligning traditional year-end techniques with strategies for dealing with any unconventional issues that you may have. Please call our office for an appointment.

Sincerely yours,

JGD & Associates LLP