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Easing Tax, Financial & Realty Solutions

2014 Year-end Tax Newsletter

Tax season is just around the corner and now is a great time to make the most of your tax planning opportunities to minimize your tax outlay in 2015. In particular, taxpayers should be aware of new taxes for high-income individuals, health care coverage considerations and the expiration of some important tax deductions.

As a tax professional, I understand these critical issues and the problems they can pose on you. My goal is to ensure that you always receive superior tax and financial advice, even after tax season is over. It is imperative that we meet to discuss how these potential changes may affect your tax and financial situation. This may reveal the need for a change in your current tax and financial strategy.

Here are some year-end planning ideas that are worth considering. Not all actions may apply to your particular situation, but you will likely benefit from many of them.

- **Watch Out For Tax On Net Investment Income (NIIT)**

  The 3.8% net investment income tax became effective in 2013. This tax applies to single filers with modified adjusted gross income (AGI) of more than $200,000 and joint filers whose modified AGI exceeds $250,000. The range of investment income subject to the 3.8% tax is broad – including interest, dividends, capital gains, rental and royalty income, non-qualified annuities and businesses that are considered "passive activities." Medicare surcharge of .9% may also apply to earnings.

  Consider investing in tax-exempt municipal bonds since the bond interest is not included in net investment income for surtax purposes. If selling appreciated property, structuring a late-year sale of appreciated property as an installment sale gives you the opportunity to spread your gain over more than one tax year.

- **Don't Overlook The Alternative Minimum Tax (AMT)**

  The AMT is a separate tax calculation that is aimed at ensuring high-income taxpayers pay a minimum amount of tax. However, it increasingly affects middle-income taxpayers and you may be surprised at some of the triggers that subject you to the AMT. These triggers generally include items that can provide you with substantial deductions, such as:

  - Paying high state or local taxes;
  - Cashing in stock options;
  - Spending home equity line dollars on something other than a home improvement;
  - Reporting business depreciation on your return;
  - Reporting many miscellaneous deductions; or

- Even having a large number of dependents

The AMT exemption increased for 2014, to $52,800 for single taxpayers (up from $51,900) and to $82,100 for married couples filing jointly (up from $80,800). There are several ways to plan for the AMT; for example, you can lower taxable income through retirement account contributions or by managing the capital gains or dividends you receive.

- **Plan For Gains And Manage Losses**

Hold off selling appreciated securities before year-end until you've passed the 12-month mark. You'll secure more favorable long-term capital gain tax treatment on the sale. Accelerate capital losses to offset capital gains without significantly changing your investment position, consider selling securities with a loss and replacing them with the securities of another company in the same industry having similar prospects. Wait 31 days and then sell your original securities at a loss.

Taxpayers who are subject to the new 39.6% top rate on income now face a 20% rate on capital gains and dividends, up from 15%. Taxpayers in the 10% and 15% income brackets have a zero capital gains rate and those in the middle will continue to pay 15%.

- **Income Deferral/Acceleration**

Deferring income is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2014.

- Defer/receive bonuses before January
- Hold/sell appreciated assets
- Accelerate income to use available carry-forward losses
- Hold/redeem U.S. Savings bonds
- Accumulate/declare special dividend
- Postpone/complete Roth conversions
- Delay/accelerate debt forgiveness income
- Minimize/maximize retirement distributions
- Enter info/sell installment contracts
- Delay/accelerate billable services
- Structure/avoid mandatory like-kind exchange

- **Deductions and Credits Acceleration/Deferral**

- Bunch itemized deductions into 2014 and take standard deductions in 2015
- Pay bills in 2014/postpone payments until 2015
- Pay last state estimated tax installments in 2014/delay payment until 2015
- Accelerate economic performance/postpone performance
- Watch AGI limitations on deductions/credits
- Match passive activity income and losses
- Donate to charity appreciated securities that you've held for more than a year.

- **Maximize And Bunch Deductions**

One way to deduct more of your medical and miscellaneous expenses is to bunch two years of expenses into one year so you exceed the applicable deduction floor. Consider scheduling and paying for doctor's appointments in 2014 if it would put you over the 10% (7.5%) of AGI deduction threshold in 2014. Paying 2015 professionals dues, subscriptions and investment management fees in late 2014 could help you surpass the 2% of AGI threshold and gain a deduction for portion of your miscellaneous expenses.

Further you could increase your itemized deduction for taxes by making any January 2015 estimated state or local income tax payment in 2014 or by having your employer withhold more state or local income tax from your last few paychecks. However, these strategies may not be appropriate if you are subject to AMT in 2014.

- **Charitable Giving**

The rules permitting an itemized deduction or contributions to qualified organization have not changed for 2014. Instead of making a cash contribution to charity, consider donating appreciated securities that you've held for more than one year. You generally may claim a charitable deduction equal to the full fair market value of the donated securities subject to certain limitations and restrictions. And you avoid the capital gains tax that would apply if you sold the securities first and then donated the proceeds. Be sure you keep all the required supporting documentation for your contributions in case the IRS audits your return.

- **Take Education Tax Credit**

The American Opportunity Tax Credit was extended through 2017.The credit provides a tax break of up $2,500 for qualified college expenses. The Act also made permanent several education-related tax options, including a $2,000 maximum contribution amount for Coverdell education savings accounts, which can be used to pay certain elementary, secondary and post-secondary expenses.

- **Seize Retirement Plan Opportunities**

There's still time to make contributions to retirement accounts. We urge you to take full advantage of your retirement contribution options for the possible tax benefits now and the income security later. Below are the contribution limits for 2014:

- **Traditional or Roth IRA:** $5,500 ($6,500 if you're 50 or older)
- **SEP IRA / Defined Contribution/Profit Sharing Plans:** $52,000
- **SIMPLE IRA:** $12,000 ($14,500 if you're 50 or older)
- **401(k) / 403(b) / 457:** $17,500 ($23,000 if you're 50 or older)

Note that there are income limits for contributing to the above-mentioned retirement plans.

- **Do a Roth IRA Conversion**

If you believe a Roth IRA is better than a traditional IRA, and want to remain in the market for the long term, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA if eligible to do so. You may also consider converting if your income in 2014 is significantly lower (i.e., due to job loss, business losses, etc.) than your

anticipated income in 2015. Keep in mind, however, that such a conversion will increase your adjusted gross income for 2014.

If you converted assets in a traditional IRA to a Roth IRA earlier in the year, the assets in the Roth IRA account may have declined in value, and if you leave things as-is, you will wind up paying a higher tax than is necessary. You can back out of the transaction by recharacterizing the rollover or conversion, that is, by transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA via a trustee-to-trustee transfer. You can later reconvert to a Roth IRA.

- **Estate and Gift Taxes**

The current allowable tax free transfer amount is set to $5.34 million for individuals ($10.68M for married couples) for 2014. The allowable annual gift exclusion is $14,000. Taking advantage of this annual exemption can help reduce your gift and estate tax burden if you believe your estate will exceed the maximum federal exemption amount.

- **Consider New Developments in Health Care**

Following the rollout of the Affordable Care Act, some taxpayers may be eligible for a premium tax credit if they buy health care coverage through the government's Health Insurance Marketplace, fall within certain income limits or meet other qualifications.

If you didn't have minimum essential health care coverage in 2014, you may have to pay either $95 per person ($47.50 for a child under 18) limited to a family maximum of $285 or 1% of your yearly household income that's above a certain filing threshold. This penalty will rise in 2015.

Flexible spending accounts (FSA) can help you lower taxes by setting aside pretax dollars to cover medical bills. In the past, you may have been reluctant to contribute to FSAs because you risked losing money you didn't spend by year-end. You can now contribute up to $2,500 to an FSA in any year, and new rules allow you to carry over as much as $500 from one year to the next.

- **Anticipate Expiring Tax Benefits**

Beneficial tax provisions that expired at the end of 2013 include a deduction for state and local general sales taxes, one for teachers' out-of-pocket expenses and an above-the-line deduction for tuition and some related expenses. Those over age 70½ can no longer exclude from income any distributions made from individual retirement accounts to qualified charitable organizations. In addition, if your home has gone through a foreclosure or short sale, you will now have to pay taxes on the amount of any mortgage forgiveness. This rule may not apply if you are insolvent.

We do not know whether the Congress will act to renew these laws this year, so it is best to prepare for any contingency to help reduce your tax bill. Now is the optimum time to engage in short and long-term planning to meet your financial goals.

- **DOMA Decision's Impact On Same-Sex Couples Tax Returns**

If you are a member of a married same-sex couple, then the U.S. Supreme Court's decision to strike down the Defense of Marriage Act could have a substantial effect on many aspects of your financial life. You may want to consider filing an amended income tax return if you now qualify

for deductions or credits available to married couples under federal law. Since same-sex couples are now eligible for the estate tax exemption available to surviving spouses, it may also be time to review your estate planning.

- **Report of Foreign Bank and Financial Assets**

  If you own a bank account or other financial assets located in a foreign country, you may have a responsibility under the Foreign Account Tax Compliance Act (FATCA) or the Bank Secrecy Act to disclose your ownership to the IRS. The new Form 114 replaces TD F 90-22.1 and is due to Treasury Department by June 30 of the following year. The form must be filed electronically. Failure to report foreign financial assets may result in substantial penalties starting at $10,000.

- **Maximizing Business Deductions and Credits**

  Make the Most of "Expensing"
  Think about purchasing equipment (with a loan if necessary) if you'll be able to claim the Sec 179 for the equipment in 2014. But if your total asset purchases in 2014 are already close to the $25,000 limit, you may want to postpone buying additional items until 2015.

  Accelerate Deductions
  Plan to pay vendors to include expenses in 2014. Look at having equipment or vehicle repairs done or purchasing supplies before year-end if these expenses would be incurred in 2015 anyway. Note that the IRS has issued new guidelines clarifying the difference between an immediately deductible repair and an improvements which must generally be capitalized and deducted over several years.

  Establishing a Retirement Plan.
  If you own a business, you may contribute to a retirement plan for yourself and any eligible employees on a tax-deductible basis. There are several types of tax-favored plans that may meet your needs. To qualify for a tax deduction in 2014, your retirement plan generally must be in place before the end of the year. Exception are IRA and SEP plans which can be set up through April 15, 2015.

  Small Employer Health Insurance Credit
  In 2014, a credit for up to 50% of the cost of employee health insurance coverage purchased through the SHOP marketplace is available to eligible small business with no more than 25 full-time equivalent employees and average annual wages of no more than $50,000 per employee. To qualify you must contribute at least 50% of the total premium cost.

  Employee Tax Free Fringe Benefits
  Businesses can provide valuable fringe benefits are tax free to employees and tax deductible by the firm. For instance, $245/monthly free or reduced cost parking, educational assistance and qualified employee discounts.

  Section 179 and Bonus Depreciation.
  In 2014, expensing election limit under Section 179 has been reduced to $25,000 but only if the total amount of qualified asset purchases does not exceed $200,000. The 50% bonus depreciation expired at the end of 2013.

  Working from Home

The IRS recently provided an optional safe-harbor method that makes it easier to determine the amount of deductible home office expenses. Starting in tax year 2013, the new rules allow taxpayers to deduct $5 per square foot of home office space (up to 300 square feet). In addition, deductions such as interest and property taxes allocable to the home office are still permitted as an itemized deduction for taxpayers using the safe harbor.

Consider Incorporating
In addition to the creditor protection it provides business owners, doing business as corporation can carry certain other advances. Many small business owners choose to elect to be tax as S-Corporation. An S-Corporation generally pays no tax on its earnings (no double taxation). Instead, the owners report their share of corporate earnings on their individual returns.

The information above is not meant, and should not be relied on, as advice for any person's specific tax situation. Each item above is a very condensed version of the rules and details have been omitted for brevity. There are literally hundreds of other changes, extensions and deletions to be considered for tax planning.

As always, year-end tax planning doesn't occur in a vacuum. It must take into account each taxpayer's particular situation and planning goals, with the aim of minimizing taxes to the greatest extent possible. While many taxpayers will come out ahead by following the traditional approach of for deferring income and accelerating expenses, others, including those with special circumstances, should consider their options carefully. In such situations, taxpayer should keep in mind that most traditional techniques for deferring income and accelerating expenses can be reversed to achieve the opposite effect.

Should you have any questions regarding the above, please don't hesitate to contact us. Call us today at (415) 362-8921 to schedule an appointment.

Thank you for your business and your continued support.

Sincerely,

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