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Year-End Tax Planning for Individuals

Dear Clients,

Tax planning for the year ahead presents similar challenges to last year due to the unknown fate of the numerous tax extenders that expired at the end of 2014.

These tax extenders, which include the mortgage insurance premium deduction and the sales tax deduction that allows taxpayers to deduct state and local general sales taxes instead of state and local income taxes, may or may not be reauthorized by Congress and made retroactive to the beginning of the year.

In the meantime, let's take a look at some of the tax strategies that you can use right now, given the current tax situation.

Tax planning strategies for individuals this year include postponing income and accelerating deductions, as well as careful consideration of timing related investments, charitable gifts, and retirement planning.

General tax planning strategies that taxpayers might consider include the following:

•Sell any investments on which you have a gain or loss this year. For more on this, see Investment Gains and Losses, below.

•If you anticipate an increase in taxable income in 2016 and are expecting a bonus at year-end, try to get it before December 31. Keep in mind, however, that contractual bonuses are different, in that they are typically not paid out until the first quarter of the following year. Therefore, any taxes owed on a contractual bonus would not be due until you file a tax return for tax year 2016.

•Prepay deductible expenses such as charitable contributions and medical expenses this year using a credit card. This strategy works because deductions may be taken based on when the expense was charged on the credit card, not when the bill was paid.

For example, if you charge a medical expense in December but pay the bill in January, assuming it's an eligible medical expense, it can be taken as a deduction on your 2015 tax return.

•If your company grants stock options, you may want to exercise the option or sell stock acquired by exercise of an option this year if you think your tax bracket will be higher in 2016. Exercise of the option is often but not always a taxable event; sale of the stock is almost always a taxable event.

•If you're self-employed, send invoices or bills to clients or customers this year to be paid in full by the end of December.

Caution: Keep an eye on the estimated tax requirements.

<u>Accelerating Income and Deductions</u>

Accelerating income into 2015 is an especially good idea for taxpayers who anticipate being in a higher tax bracket next year or whose earnings are close to threshold amounts ($200,000 for single filers and $250,000 for married filing jointly) that make them liable for additional Medicare Tax or Net Investment Income Tax (see below).

In cases where tax benefits are phased out over a certain adjusted gross income (AGI) amount, a strategy of accelerating income and deductions might allow you to claim larger deductions, credits, and other tax breaks for 2015, depending on your situation.

The latter benefits include Roth IRA contributions, conversions of regular IRAs to Roth IRAs, child credits, higher education tax credits and deductions for student loan interest.

Caution: Taxpayers close to threshold amounts for the Net Investment Income Tax (3.8 percent of net investment income) should pay close attention to "one-time" income spikes such as those associated with Roth conversions, sale of a home or other large assets that may be subject to tax.

Tip: If you know you have a set amount of income coming in this year that is not covered by withholding taxes, increasing your withholding before year-end can avoid or reduce any estimated tax penalty that might otherwise be due.

Tip: On the other hand, the penalty could be avoided by covering the extra tax in your final estimated tax payment and computing the penalty using the annualized income method.

Here are several examples of what a taxpayer might do to accelerate deductions:

•Pay a state estimated tax installment in December instead of at the January due date. However, make sure the payment is based on a reasonable estimate of your state tax.

•Pay your entire property tax bill, including installments due in year 2016, by year-end. This does not apply to mortgage escrow accounts.

•It may be beneficial to pay 2016 tuition in 2015 to take full advantage of the American Opportunity Tax Credit, an above the line deduction worth up to $2,500 per student to cover the cost of tuition, fees and course materials paid during the taxable year. Forty percent of the credit (up to $1,000) is refundable, which means you can get it even if you owe no tax.

•Try to bunch "threshold" expenses, such as medical and dental expenses--10 percent of AGI (adjusted gross income) starting in 2013--and miscellaneous itemized deductions. For example, you might pay medical bills and dues and subscriptions in whichever year they would do you the most tax good.

Note: There is a temporary exemption of 7.5 percent through December 31, 2016 for individuals age 65 and older and their spouses.

Threshold expenses are deductible only to the extent they exceed a certain percentage of adjusted gross income (AGI). By bunching these expenses into one year, rather than spreading them out over two years, you have a better chance of exceeding the thresholds, thereby maximizing your deduction.

Health Care Law

If you haven't signed up for health insurance this year, do so now and avoid or reduce any penalty you might be subject to. Depending on your income, you may be able to claim the premium tax credit that reduces your premium payment or reduce your tax obligations, as long as you meet certain requirements. You can choose to get the credit immediately or receive it as a refund when you file your taxes next spring. Please contact the office if you need assistance with this.

Additional Medicare Tax

Taxpayers whose income exceeds certain threshold amounts ($200,000 single filers and $250,000 married filing jointly) are liable for an additional Medicare tax of 0.9 percent on their tax returns, but may request that their employers withhold additional income tax from their pay to be applied against their tax liability when filing their 2015 tax return next April.

High net worth individuals should consider contributing to Roth IRAs and 401(k) because distributions are not subject to the Medicare Tax.

If you're a taxpayer close to the threshold for the Medicare Tax, it might make sense to switch Roth retirement contributions to a traditional IRA plan, thereby avoiding the 3.8 percent Net Investment Income Tax as well (more about the NIIT below).

Alternate Minimum Tax

The Alternative Minimum Tax (AMT) exemption "patch" was made permanent by the American Taxpayer Relief Act (ATRA) of 2012 and is indexed for inflation. It's important not to overlook the effect of any year-end planning moves on the AMT for 2015 and 2016.

Items that may affect AMT include deductions for state property taxes and state income taxes, miscellaneous itemized deductions, and personal exemptions. Please call if you're not sure whether AMT applies to you.

Note: AMT exemption amounts for 2015 are as follows:

•$53,600 for single and head of household filers,

•$83,400 for married people filing jointly and for qualifying widows or widowers,

•$41,700 for married people filing separately.

Residential Energy Tax Credits

Non-Business Energy Credits
ATRA extended the non-business energy credit, which expired in 2011, through 2014 (retroactive to 2012); however, it has not been reauthorized by Congress. For years prior to 2015, taxpayers could claim a credit of 10 percent of the cost of

certain energy-saving property that was added to their main home.

Residential Energy Efficient Property Credits

The Residential Energy Efficient Property Credit is available through the end of 2016 to individual taxpayers to help pay for qualified residential alternative energy equipment, such as solar hot water heaters, solar electricity equipment and residential wind turbines. In addition, taxpayers are allowed to take the credit against the alternative minimum tax (AMT), subject to certain limitations.

Qualifying equipment must have been installed on or in connection with your home located in the United States.

Geothermal pumps, solar energy systems, and residential wind turbines can be installed in both principal residences and second homes (existing homes and new construction), but not rentals. Fuel cell property qualifies for the tax credit only when it is installed in your principal residence (new construction or existing home). Rentals and second homes do not qualify.

The tax credit is 30 percent of the cost of the qualified property, with no cap on the amount of credit available, except for fuel cell property.

Generally, labor costs can be included when figuring the credit. Any unused portions of this credit can be carried forward. Not all energy-efficient improvements qualify so be sure you have the manufacturer's tax credit certification statement, which can usually be found on the manufacturer's website or with the product packaging.

What's included in this tax credit?

•Geothermal Heat Pumps. Must meet the requirements of the ENERGY STAR program that are in effect at the time of the expenditure.

•Small Residential Wind Turbines. Must have a nameplate capacity of no more than 100 kilowatts (kW).

•Solar Water Heaters. At least half of the energy generated by the "qualifying property" must come from the sun. The system must be certified by the Solar Rating and Certification Corporation (SRCC) or a comparable entity endorsed by the government of the state in which the property is installed. The credit is not available for expenses for swimming pools or hot tubs. The water must be used in the dwelling. Photovoltaic systems must provide electricity for the residence and must meet applicable fire and electrical code requirement.

•Solar Panels (Photovoltaic Systems). Photovoltaic systems must provide electricity for the residence and must meet applicable fire and electrical code requirement.

•Fuel Cell (Residential Fuel Cell and Microturbine System.) Efficiency of at least 30 percent and must have a capacity of at least 0.5 kW.

Charitable Contributions

Property, as well as money, can be donated to a charity. You can generally take a deduction for the fair market value of the property; however, for certain property, the deduction is limited to your cost basis. While you can also donate your services to charity, you may not deduct the value of these services. You may also be able to deduct charity-related travel expenses and some out-of-pocket expenses, however.

Keep in mind that a written record of your charitable contributions--including travel expenses such as mileage--is required in order to qualify for a deduction. A donor may not claim a deduction for any contribution of cash, a check or other monetary gift unless the donor maintains a record of the contribution in the form of either a bank record (such as a cancelled check) or written communication from the charity (such as a receipt or a letter) showing the name of the charity, the date of the contribution, and the amount of the contribution.

Tip: Contributions of appreciated property (i.e. stock) provide an additional benefit because you avoid paying capital gains on any profit.

Investment Gains and Losses

This year, and in the coming years, investment decisions are likely to be more about managing capital gains than about minimizing taxes per se. For example, taxpayers below threshold amounts in 2015 might want to take gains; whereas taxpayers above threshold amounts might want to take losses.

Caution: In recent years, extreme fluctuations in the stock market have been commonplace. Don't assume that a down market means investment losses. Your cost basis may be low if you've held the stock for a long time.

If your tax bracket is either 10 or 15 percent (married couples making less than $74,900 or single filers making less than $37,450), then you might want to take advantage of the zero percent tax rate on qualified dividends and long-term capital gains. If you fall into the highest tax bracket (39.6 percent), the maximum tax rate on long-term capital gains is capped at 20 percent for tax years 2013 and beyond.

Minimize taxes on investments by judicious matching of gains and losses. Where appropriate, try to avoid short-term capital gains, which are usually taxed at a much higher tax rate than long-term gains--up to 39.6 percent in 2015 for high-income earners ($413,200 single filers, $464,850 married filing jointly).

Where feasible, reduce all capital gains and generate short-term capital losses up to $3,000.

Tip: As a general rule, if you have a large capital gain this year, consider selling an investment on which you have an accumulated loss. Capital losses up to the amount of your capital gains plus $3,000 per year ($1,500 if married filing separately) can be claimed as a deduction against income.

Tip: After selling a securities investment to generate a capital loss, you can repurchase it after 30 days. This is known as the "Wash Rule Sale." If you buy it back within 30 days, the loss will be disallowed. Or you can immediately repurchase a similar (but not the same) investment, e.g., and ETF or another mutual fund with the same objectives as the one you sold.

Tip: If you have losses, you might consider selling securities at a gain and then immediately repurchasing them, since the 30-day rule does not apply to gains. That way, your gain will be tax-free; your original investment is restored, and you have a higher cost basis for your new investment (i.e., any future gain will be lower).

<u>Net Investment Income Tax (NIIT)</u>

The Net Investment Income Tax, which went into effect in 2013, is a 3.8 percent tax that is applied to investment income such as long-term capital gains for earners above certain threshold amounts ($200,000 for single filers and $250,000 for married taxpayers filing jointly). Short-term capital gains are subject to ordinary income tax rates as well as the 3.8 percent NIIT. This information is something to think about as you plan your long-term investments. Business income is not considered subject to the NIIT provided the individual business owner materially participates in the business.

Please call if you need assistance with any of your long term tax planning goals.

Mutual Fund Investments

Before investing in a mutual fund, ask whether a dividend is paid at the end of the year or whether a dividend will be paid early in the next year but be deemed paid this year. The year-end dividend could make a substantial difference in the tax you pay.

Example: You invest $20,000 in a mutual fund at the end of 2015. You opt for automatic reinvestment of dividends. In late December of 2015, the fund pays a $1,000 dividend on the shares you bought. The $1,000 is automatically reinvested.

Result: You must pay tax on the $1,000 dividend. You will have to take funds from another source to pay that tax because of the automatic reinvestment feature. The mutual fund's long-term capital gains pass through to you as capital gains dividends taxed at long-term rates, however long or short your holding period.

The mutual fund's distributions to you of dividends it receives generally qualify for the same tax relief as long-term capital gains. If the mutual fund passes through its short-term capital gains, these will be reported to you as "ordinary dividends" that don't qualify for relief.

Depending on your financial circumstances, it may or may not be a good idea to buy shares right before the fund goes ex-dividend. For instance, the distribution could be relatively small, with only minor tax consequences. Or the market could be moving up, with share prices expected to be higher after the ex-dividend date.

Tip: To find out a fund's ex-dividend date, call the fund directly.

Please call if you'd like more information on how dividends paid out by mutual funds affect your taxes this year and next.

Year-End Giving To Reduce Your Potential Estate Tax

The federal gift and estate tax exemption, which is currently set at $5.43 million is projected to increase to $5.45 million in 2016. ATRA set the maximum estate tax rate set at 40 percent.

Gift Tax. For many, sound estate planning begins with lifetime gifts to family members. In other words, gifts that reduce the donor's assets subject to future estate tax. Such gifts are often made at year-end, during the holiday season, in ways that qualify for exemption from federal gift tax.

Gifts to a donee are exempt from the gift tax for amounts up to $14,000 a year per donee.

Caution: An unused annual exemption doesn't carry over to later years. To make use of the exemption for 2015, you must make your gift by December 31.

Husband-wife joint gifts to any third person are exempt from gift tax for amounts up to $28,000 ($14,000 each). Though what's given may come from either you or your spouse or both of you, both of you must consent to such "split gifts."

Gifts of "future interests", assets that the donee can only enjoy at some future time such as certain gifts in trust, generally don't qualify for exemption; however, gifts for the benefit of a minor child can be made to qualify.

Tip: If you're considering adopting a plan of lifetime giving to reduce future estate tax, don't hesitate to call the office for assistance.

Cash or publicly traded securities raise the fewest problems. You may choose to give property you expect to increase substantially in value later. Shifting future appreciation to your heirs keeps that value out of your estate. But this can trigger IRS questions about the gift's true value when given.

You may choose to give property that has already appreciated. The idea here is that the donee, not you, will realize and pay income tax on future earnings and built-in gain on sale.

Gift tax returns for 2015 are due the same date as your income tax return. Returns are required for gifts over $14,000 (including husband-wife split gifts totaling more than $14,000) and gifts of future interests. Though you are not required to file if your gifts do not exceed $14,000, you might consider filing anyway as a tactical move to block a future IRS challenge about gifts not "adequately disclosed."

Tip: Call if you're considering making a gift of property whose value isn't unquestionably less than $14,000.

Income earned on investments you give to children or other family members are generally taxed to them, not to you. In the case of dividends paid on stock given to your children, they may qualify for the reduced child tax rate, generally 10 percent, where the first $1,050 in investment income is exempt from tax and the next $1,050 is subject to a child's tax rate of 10 percent (0 percent tax rate on long-term capital gains and qualified dividends).

Caution: In 2015, investment income for a child (under age 18 at the end of the tax year or a full-time student under age 24) that is in excess of $2,100 is taxed at the parent's tax rate.

Other Year-End Moves

Retirement Plan Contributions. Maximize your retirement plan contributions. If you own an incorporated or unincorporated business, consider setting up a retirement plan if you don't already have one. It doesn't actually need to be funded until you pay your taxes, but allowable contributions will be deductible on this year's return.

If you are an employee and your employer has a 401(k), contribute the maximum amount ($18,000 for 2015), plus an additional catch-up contribution of $6,000 if age 50 or over, assuming the plan allows this and income restrictions don't apply.

If you are employed or self-employed with no retirement plan, you can make a deductible contribution of up to $5,500 a year to a traditional IRA (deduction is sometimes allowed even if you have a plan). Further, there is also an additional catch-up contribution of $1,000 if age 50 or over.

Health Savings Accounts. Consider setting up a health savings account (HSA). You can deduct contributions to the account, investment earnings are tax-deferred until withdrawn, and amounts you withdraw are tax-free when used to pay medical bills.

In effect, medical expenses paid from the account are deductible from the first dollar (unlike the usual rule limiting such deductions to the excess over 10 percent of AGI). For amounts withdrawn at age 65 or later, and not used for medical bills, the HSA functions much like an IRA.

To be eligible, you must have a high-deductible health plan (HDHP), and only such insurance, subject to numerous exceptions, and must not be enrolled in Medicare. For 2015, to qualify for the HSA, your minimum deductible in your HDHP must be at least $1,250 for single coverage or $2,500 for a family.

Call Arthur Lander, CPA, PC with any questions

These are just a few of the steps you might take. Please contact us for assistance with implementing these and other year-end planning strategies that might be suitable to your particular situation.

Have a happy and safe holiday season!

Best regards,

Art Lander