2015 Year-End Tax Planning

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Up to this point, 2015 has been a quiet year for tax changes. There are several tax provisions that expired at the end of 2014, but House and Senate negotiators have begun working to extend these benefits.

Tax Extenders: While we are hopeful that Congress will extend these items, they have yet to pass legislation related to the following tax benefits:

- Qualified charitable distributions from an IRA
- Cancellation of indebtedness on principal residence
- Tuition and fees deduction
- Educator expense deduction
- Non-business energy credits
- Itemized deduction for state and local sales tax
- Itemized deduction for mortgage insurance premiums

While there are a handful of items waiting on legislative action, there are still many things you can do before year-end to reduce your tax liability. Typical year-end tax planning techniques focus on deferring income and accelerating tax deductions to limit your current-year Adjusted Gross Income (AGI) and Taxable Income. It is important to note, however, that this strategy of shifting income and expenses to reduce the current-year tax is not always the most efficient long-term tax solution.

If you expect to have significantly higher income in 2016, for example, it may be more valuable to take those tax deductions next year. Likewise, deferring income may result in a higher tax rate in the following year. For this reason, it is important to think of tax planning as a multi-year exercise rather than looking at each year on its own.

Over the past few years, tax planning has becoming increasingly more complex. In addition to the regular tax system and the Alternative Minimum Tax (AMT), taxpayers now are faced with navigating phased-out tax benefits and additional taxes related to the Affordable Care Act (ACA).

As result of tax law changes over the past few years, reducing your AGI may be necessary to avoid (or limit) the phase-out of many tax benefits, and it also may reduce your exposure to additional taxes under the ACA. For wage earners, the most common ways to reduce AGI include deferring wage or bonus income and taking advantage of pre-tax deductions for contributions to retirement plans or Flexible Spending Accounts for medical or dependent-care expenses. Self-employed taxpayers tend

In This Letter

to have a bit more flexibility related to the timing of their income and deductions and also have the ability to make contributions to a variety of self-employed retirement plans as a way to reduce AGI.

Additional HI (Medicare) Tax: *For taxpayers with wages or self-employment income over a threshold amount ($250,000 for Married Filing Jointly and $200,000 for Single filers), there is an additional tax of 0.9% imposed on their earned income. Employers should withhold this additional tax on behalf of their employees, but they may not always be aware you are over the threshold. For example, if each spouse has wages of $150,000 their employer may not be taking out the additional HI withholding as they are not aware the combined income is over the limit.*

Once you have reduced your AGI, itemized deductions and other credits offer additional ways to lower your tax liability. Taxpayers should consider making a mortgage or tuition payment due in January 2016 by year-end as a way to accelerate those deductions. Paying for medical expenses by year-end also may be helpful, but the benefit may be limited or phased out based on your AGI. Charitable contributions are a great way to reduce your taxable income, especially gifts of appreciated securities held more than one year.

Portfolio Income: While most income is taxed at ordinary tax rates, some portfolio income is taxed at preferential rates. Taxpayers in the two lowest ordinary income tax brackets (10% and 15%) may pay a rate of 0% on Long-Term Capital Gains and Qualified Dividends. Taxpayers in the highest ordinary income tax bracket (39.6%) will pay a rate of 20%, and all other taxpayers will pay a rate of 15%.

Despite the lower tax rate on some portfolio income, investors may still face higher taxes as a result of the Net Investment Income Tax. Enacted as part of the Affordable Care Act, this 3.8% surtax on Net Investment Income applies to Single filers with AGI over $200,000 ($250,000 for Married Filing Jointly).

Taxpayers should review their investment portfolios and look to offset capital gains with capital losses as a way to reduce their taxable income before year-end. This is also a good time to consider giving appreciated securities to family members or charities. Transferring appreciated securities to family members in lower tax brackets may result in a tax savings upon disposition; however the Kiddie Tax must be considered for transfers to children under age 24. Donating appreciated securities held long-term will allow you to avoid tax on the appreciation while recognizing a charitable deduction for the full value of the stock.

Planning Point: *Year-end planning is a good time to review investments from a tax perspective. For example, you may find that municipal bonds are a better option than US Treasury bonds if you are in a higher ordinary tax bracket and possibly subject to the Net Investment Income Tax.*

Retirement Planning: Most retirement plan contribution limits remain the same for 2016. The limit for 401(k), 403(b), and 457 plans remains at $18,000, with an additional $6,000 contribution available for those over the age of 50. SIMPLE plans remain at $12,500 or $15,500 for those age 50 or over. Traditional and ROTH IRA limits stay at $5,500, with an additional $1,000 contribution available to those over the age of 50.

For self-employed taxpayers, the limits on SEP IRAs and solo 401(k) plans remain at $53,000. For those over the age of 50, an additional contribution of $6,000 can be made to a solo 401(k) to get the maximum contribution up to $59,000. Please note that a solo 401(k) plan must be in place by December 31st, unlike certain self-employed retirement plans which can be funded up to the date of a tax filing.

Year-End Gifting: In addition to income-tax planning, year-end is a good time to consider estate and gift tax strategies as well. You should consider making annual exclusion gifts of up to $14,000 per person ($28,000 for a married couple) as a way to reduce your taxable estate. For donations to a Section 529 Education Plan, you may be able make gifts of up to $70,000 per person ($140,000 for a married couple) at one time. Additionally, taxpayers generally can pay medical expenses or tuition directly on behalf of a donee without any limitations.

This is a sampling of the most common year-end tax planning strategies, but it is important to note that each taxpayer has a unique tax situation. You should contact your financial counselor to discuss your situation in more detail to develop the appropriate plan.

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Source: 2015 CCH