

C

P

A I H

ABRAHAM I. HORWITZ, CPA

Tax Hints

Volume 2014, Issue 1

December 1, 2014

2014 Tax Planning

The ordinary federal income tax rates for 2014 will be the same as last year: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. For 2014, the top 39.6% rate affects taxpayers with taxable income above \$406,750 for singles, \$457,600 for married joint-filing couples, \$432,200 for heads of households, and \$228,800 for married individuals who file separate returns. Higher-income individuals can also be hit by the 0.9% Medicare tax and the 3.8% Net Investment Income Tax (NIIT), which can result in a higher-than-advertised federal tax rate for 2014.

Despite recent tax increases, the current federal income tax envi-

ronment remains relatively favorable by historical standards. This letter presents some tax planning ideas to consider when you have time to think. Some of the ideas may apply to you, some to family members, and others to your business.

Year-end planning will be more challenging than normal this year. Unless Congress acts, a number of popular deductions and credits expired at the end of 2013 and won't be available for 2014. Deductions not available this year include, for example, the election to deduct state and local sales taxes instead of state and local income taxes and the above-the-

line deductions for tuition and educator expenses, generous bonus depreciation and expensing allowances for business property, and qualified charitable distributions that allow taxpayers over age 70^{1/2} to make tax-free transfers from their IRAs directly to charities.

Of course, Congress could revive some or all the favorable tax rules that have expired as they have done in the past. However, which actions Congress will take remains to be seen and may well depend on the outcome of the elections.

2014 Tax Planning Issue
Inside this issue:

Bunching Deductions /
Deferring Income 1

Investments 2

The 2% Club 3

Adjust Withholding 3

Before the End of 2014 3

Possible Delay of Tax
Season and Tax Refunds 3

Individual Retirement
Accounts 4

A Few More Tips 4



Bunching Deductions / Deferring Income

Leverage Standard Deduction by Bunching Deductible Expenditures

Are your 2014 itemized deductions likely to be just under or just over the standard deduction amount? If so, consider the strategy of bunching together expenditures for itemized deduction items every other year, while claiming the standard deduction in the intervening years. The 2014 standard deduction is \$12,400 for married joint filers, \$6,200 for single filers, and \$9,100 for heads of households.

For example, say you're a joint filer whose only itemized deductions are about \$4,000 of annual property taxes and about \$8,000 of home mortgage interest. If you prepay your 2014 property taxes by December 31 of this year, you could claim \$16,000 of itemized

deductions on your 2014 return (\$4,000 of 2014 property taxes, plus another \$4,000 for the 2015 property tax bill, plus the \$8,000 of mortgage interest). Next year, you would only have the \$8,000 of interest, but you could claim the standard deduction (it will probably be around \$12,600 for 2015). Following this strategy will cut your taxable income by a meaningful amount over the two-year period (this year and next). You can repeat the drill all over again in future years. Examples of other deductible items that can be bunched together every other year to lower your taxes include charitable donations and state income tax payments.

Consider Deferring Income

It may be beneficial to defer some taxable income from this year into

next year, especially if you expect to be in a lower tax bracket in 2015 or affected by unfavorable phase-out rules that reduce or eliminate various tax breaks (child tax credit, education tax credits, and so forth) in 2014. By deferring income every other year, you may be able to take more advantage of these breaks every other year. For example, if you're in business for yourself and a cash-method taxpayer, you can postpone taxable income by waiting until late in the year to send out some client invoices. That way, you won't receive payment for them until early 2015. You can also postpone taxable income by accelerating some deductible business expenditures into this year. Both moves will defer taxable income from this year until next year.

Investments

Take Advantage of 0% Rate on Investment Income

For 2014, the federal income tax rate on long-term capital gains and qualified dividends is 0% when those gains and dividends fall within the 10% or 15% federal income tax rate brackets. This will be the case to the extent your taxable income (including long-term capital gains and qualified dividends) does not exceed \$73,800 for married joint-filing couples (\$36,900 for singles). While your income may be too high, you may have children, grandchildren, or other loved ones who will be in the bottom two brackets. If so, consider giving them some appreciated stock or mutual fund shares that they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term as long as your ownership period plus the gift recipient's ownership period (before he or she sells) equals at least a year and a day.

“For most taxpayers, the federal income tax rate on long-term capital gains is still much lower than the rate on short-term gains.”

Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 10% or 15% rate bracket, they will be federal-income-tax-free.

Time Investment Gains and Losses

For many other individuals, the 2014 federal tax rates on long-term capital gains will be 15%



There is still time to cut taxes

However, the maximum rate for higher-income individuals is 20%.

This 20% rate affects taxpayers with taxable income above \$406,750 for singles, \$457,600 for married joint-filing couples, \$432,200 for heads of households, and \$228,800 for married individuals who file separate returns. Higher-income individuals can also be hit by the new 3.8% NIIT on net investment income, which can result in a maximum 23.8% federal income tax rate on long-term capital gains.

As you evaluate investments held in your taxable brokerage firm accounts, consider the tax impact of selling appreciated securities (currently worth more than you paid for them). For most taxpayers, the federal income tax rate on long-term capital gains is still much lower than the rate on short-term gains. Therefore, it often makes sense to hold appreciated securities for at least a year and a day before selling in order to qualify for the lower long-term gain tax rate.

Biting the bullet and selling some loser securities (currently worth less than you paid for them) before year-end may be a good idea as well. The resulting capital losses will offset capital gains from other sales this year, including short-term gains from securities owned for one year or less. For 2014, the maximum rate on short-term gains

is 39.6%, and the 3.8% NIIT may apply too, which can result in an effective rate of up to 43.4%. However, you don't have to worry about paying a high rate on short-term gains that can be sheltered with capital losses (you will pay 0% on gains that can be sheltered).

If capital losses for this year exceed capital gains, you will have a net capital loss for 2014. You can use that net capital loss to shelter up to \$3,000 of this year's high-taxed ordinary income from salaries, bonuses, self-employment, and so forth (\$1,500 if you're married and file separately). Any excess net capital loss is carried forward to next year.

Selling enough loser securities to create a bigger net capital loss that exceeds what you can use this year might make sense. You can carry forward the excess net capital loss to 2015 and beyond and use it to shelter both short-term gains and long-term gains recognized in those years.

If you own any securities that are all but worthless with little hope of recovery, you might consider selling them before the end of the year so you can capitalize on the loss this year.

Invest in Tax-free Securities

The most obvious source of tax-free income is tax-exempt securities, either owned outright or through a mutual fund. Whether these provide a better return than the after-tax return on taxable investments depends on your tax bracket and the market interest rates for tax-exempt investments. With the additional layer of net investment income taxes on higher income taxpayers, this year might

be a good time to compare the return on taxable and tax-exempt investments. In some cases, it may be as simple as transferring assets from a taxable to a tax-exempt fund.



Make Sure You Qualify to Exclude Principal Residence Gain

Gains up to \$500,000 on the sale of a principal residence are completely tax-free for married couples who file joint returns. A still-generous \$250,000 is the limit for singles and married individuals filing a separate return. To qualify for this break, you normally must have owned and used the house as your principal residence for a total of at least two years in the five-year period prior to the sale. You'll definitely want to take these rules into consideration if you're planning on selling your home.



The 2% Club

If you are in what the press has called the 2% club, be aware that the rest of America will soon be joining you! When the surtaxes on this group of Americans were passed, Congress purposefully did not adjust the thresholds for infla-

tion, and in 6 years, over 50% of all Americans will pay these surtaxes based on estimated inflation rates. Begin planning now whether you are a 2% club member or not by -in order- maximizing 401-k contributions; utilizing employer-sponsored

cafeteria plans to their fullest limit; investigating and using employer sponsored fringe benefits such as child care and education; turn in job expenses for reimbursement; and consider your marital status as your income increases because of the incredible marital penalty built in to the surtaxes.

“Congress purposefully did not adjust the thresholds for inflation, and in 6 years 50% of all Americans will pay these surtaxes.”

Adjust Withholding

If it looks like you are going to owe income taxes for 2014, consider bumping up the federal income taxes withheld from your paychecks now through the end of the year.

Withholding is considered as paid equally throughout the year, so having extra withholding now could reduce potential penalties for underestimating your taxes earlier in the year.

Additionally, consider the tip under Individual Retirement Accounts on page 4.

Before the end of 2014

Here are two money-saving ideas that you may want to put in action before the end of 2014:

1—If you or a family member own traditional IRAs and reached age $70\frac{1}{2}$ this year, consider whether it's better to take the first required minimum distribution in 2014 or by April 1 of next year.

2—If your employer offers a flexible spending account arrangement for your out-of-pocket medical or child care expenses, make sure you're maximizing the tax benefits during the upcoming enrollment period for 2015.



Possible Delay of Tax Season and Tax Refunds

In an interview published in late October, IRS Commissioner John Koskinen said that the coming tax-filing season could be the most complicated one ever for the Internal Revenue Service. He has also written a letter to the leaders of Congress's tax committees asking that they decide soon what to do about extending dozens of expired tax provision. If that doesn't happen, tax season and the processing of tax refunds could be delayed.

In his letter he stated "Making this decision in a timely manner will allow the IRS to implement Congress's decision without unnecessary disruptions and delays to the

upcoming 2015 tax filing season, and it will provide certainty for millions of taxpayers who are affected by the expired provisions."

"This uncertainty, if it persists into December or later, could force the IRS to postpone the opening of the 2015 filing season and delay the processing of tax refunds for millions of taxpayers. Moreover, if Congress enacts any policy changes to the existing extenders or adds new provisions, the IRS would have to reprogram systems and make processing changes, which would result in longer delays. If Congress waits until 2015 and then enacts retroactive tax law changes

affecting 2014, the operational and compliance challenges would be even more severe—likely resulting in service disruptions, millions of taxpayers needing to file amended returns, and substantially delayed refunds."

Once again things are stalled in Washington. The House has voted to extend several of the expired provisions, but the Senate is looking for a more comprehensive fix to the tax system and accordingly has not acted on extending expired provisions.

Leaders in Congress have already warned that action is unlikely until after the midterm elections, possibly during a "lame-duck" session of

Congress.

For those who haven't been able to block out the memory, we have been here before. In 2013, the IRS had to delay tax season as a result of the last-minute extension of the Bush tax cuts at the beginning of the year. We could be looking at a repeat.

It actually could be worse than 2013. In his interview, Commissioner Koskinen reminded us that this is different than the past as they also have to implement both the Affordable Care Act (Obamacare) and FACTA (Foreign Account Tax Compliance Act). We could be looking at a very difficult and very delayed tax season.

130 Wes 67th Street - Ste. 4M
New York, NY 10023
Phone: 212-819-1040
Fax: 212-504-2626
E-mail: ah@cpabe.com



ABRAHAM I. HORWITZ, CPA

Individual Retirement Accounts

Take an eligible rollover distribution from a qualified retirement plan before the end of 2014 if you are facing a penalty for underpayment of estimated tax and having your employer increase your withholding isn't viable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2014. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2014, but the withheld tax will be applied pro rata over the full 2014 tax year to reduce previous underpayments of estimated tax.

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. 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 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, if doing so proves advantageous.

A Few More Tips

Charitable Giving: You might want to consider this strategy that can help boost your 2014 charitable contribution deduction. Donations charged to a credit card are deductible in the year charged, not when payment is made on the card. Charging donations to your credit card before year-end enables you to increase your 2014 charitable donations deduction even if you are temporarily short of cash.

Maximize Contributions to 401(k) Plans. If you have a 401(k) plan at work, it's just about time to tell your company how much you want to set aside on a tax-free basis for next year. Contribute as

much as you can stand, especially if your employer makes matching contributions. You give up "free money" when you fail to participate up to the maximum for the matching.

Take Advantage of Flexible Spending Accounts (FSAs). If your company has a healthcare and/or dependent care FSA, before year-end you must specify how much of your 2015 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying dependent care

costs. Watch out, though, FSAs are "use-it-or-lose-it" accounts—you don't want to set aside more than what you'll likely have in qualifying expenses for the year.

If you currently have a healthcare FSA, make sure you drain it by incurring eligible expenses before the deadline for this year. Otherwise, you'll lose the remaining balance. It's not that hard to drum some things up: new glasses or contacts, dental work you've been putting off, or prescriptions that can be filled early.