2014 Year-End Tax Planning For Individuals

The 2015 tax filing season may seem like a long time away but it is not. Individuals who want to explore minimizing their tax burden and maximizing their tax savings are eager to get started now on 2014 year-end planning. By taking certain steps now, before 2014 draws to a close, individuals may be able to reduce the size of their tax bill otherwise due when they file their returns next year. This communication explores some of traditional year-end planning techniques, how events in 2015 may impact year-end planning, and more, including the Affordable Care Act, which impacts almost everyone in one way or another. Please feel free to contact our office if you have any questions about 2014 year-end tax planning.

Applying some traditional techniques

One year ago, prospects for comprehensive tax reform were looking up in Congress. Two senior lawmakers, Sen. Max Baucus, D-Montana, and Rep. Dave Camp, R-Mich., had worked together to develop a tax reform package. In early 2014, Camp introduced a sweeping tax reform bill, the Tax Reform Act of 2014. If it had passed, Camp's bill would have had turned traditional year-end planning upside down. However, momentum for tax reform quickly faded. Baucus retired from Congress to become U.S. ambassador to China. Camp also announced his plans to retire after 2014. Several proposals in Camp's bill have moved separately in the House, but not yet in the Senate, but any action on the overall bill is extremely unlikely before year-end.

What does this mean for tax planning? It means that the current Tax Code, with all its complexities, will be around for 2015 and likely for 2016. The current individual income tax rate structure (10, 15, 25, 28, 33, 35, and 39.6 percent) will be in place for 2015. The same is true for the current tax treatment of capital gains and dividends. The limitation on itemized deductions and the personal exemption phaseout are also expected to remain unchanged for 2015. The alternative minimum tax (AMT) is "patched" thanks to the American Taxpayer Relief Act of 2012 (ATRA), providing enhanced exemption amounts and allowing the use of nonrefundable personal credits against regular tax and AMT liability. All these developments provide some certainty in tax planning for year-end 2014.

Individuals should take a look at traditional year-end tax planning techniques. One traditional technique is, if possible, to spread the recognition of income between 2014 and 2015. This may come into play for individuals who are able to postpone year-end bonuses, maximize deductible retirement contributions, and delay year-end billings. Individuals may want to consider the pre-payment of real estate taxes or mortgage interest. Timing the recognition of capital gains and losses at year-end may help to minimize an individual's net capital gains tax and maximize deductible capital losses. Life changes can also impact traditional year-end tax planning. Individuals who married or divorced, changed jobs, retired, or experienced other life events in 2014 need to review how these events may have revised their tax planning. A change in employment, for example, may bring about severance pay, sign-on bonuses, stock options, moving expenses, and COBRA health benefits, which all must be taken into account in year-end tax planning.

Retirement savings strategies also fall within traditional year-end planning techniques. Individuals also can contribute up to $5,000 to an IRA or Roth IRA for 2014. If they qualify, individuals can make additional so-called “catch-up contributions” of an additional $1,500. This treatment is targeted to individuals age 50 and older. Keep in mind that individuals have until April 15, 2015, to make an IRA contribution for 2014. Code Sec. 401(k) plans and similar arrangements, including new myRA accounts, should be explored to determine their maximum benefit.

Gift-making in general should be part of a year-end review. Individuals can make tax-free gifts of $14,000 per recipient (unlimited in number) for 2014. Married couples may combine their gift-tax exclusion amounts and make tax-free gifts per recipient of up to $28,000 for 2014. There is an important and often over-looked provision affecting gifts. An individual can make unlimited tax-free gifts used for qualified tuition or medical expenses of another person. The qualified tuition or medical expenses must be paid directly to a medical or educational institution.

Net investment income tax

For some individuals, the new net investment income tax has become part of their year-end tax planning. The Affordable Care Act created the net investment income to help fund health care reform. There are three categories of net investment income:

> Category 1: gross income from interest, dividends, annuities, royalties and rents, if the income is not derived in a trade or business;
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> Category 2: income from a "trade or business" that is a passive activity, as determined under Code Sec. 469, or is from a business as a financial trader; and
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> Category 3: net gains from the sale of property, unless the property is held in a nonpassive trade or business.

Under Code Sec. 469, individuals may group multiple activities into a single activity. Generally, an individual must meet the material participation standard of Code Sec. 469 for each activity. Grouping into a single activity can make it easier for a taxpayer to meet the standard by combining the taxpayer’s hours and participation. By grouping activities, a taxpayer may be able to avoid having income treated as net investment income.

The Affordable Care Act envisioned that the net investment income tax would impact higher income taxpayers. The Affordable Care Act set certain income thresholds for triggering the net investment income tax: $200,000 for single taxpayers; $250,000 for married couples filing a joint return; and $125,000 for married couples filing separately.

Tax extenders

Prospects for permanent extension of many of the so-called tax extenders also appear dim before year-end. However, there will likely be an extension of the extenders, probably for two years. That means extension will be retroactive to January 1, 2014 because many of the extenders expired after December 31, 2013. For planning purposes, individuals should consider their tax strategies under one scenario that includes extension of the extenders and another that does not. Keep in mind that some of the extenders impact other provisions of the Tax Code. For example, there is no “double dipping” with education tax incentives.

The list of expired extenders is long. Among the more popular are:

- State and local general sales tax deduction
- Higher education tuition
- Teachers’ classroom expense deduction
- Qualified charitable distributions from IRAs
- Charitable contributions of real property for conservation purposes
- Mortgage insurance premium deduction

Some extenders were made permanent by ATRA. They include the student loan interest deduction, special enhancements to the earned income tax credit, the child tax credit and the child and dependent care credit as well as special enhancements to the adoption credit and adoption assistance programs.

Any news about the fate of the extenders will likely not come until late in 2014 or even in early 2015. The House and Senate have taken very different approaches to the extenders. The House has passed several extenders in stand-alone bills. The Senate has taken the traditional approach of wrapping all the extenders in a comprehensive bill (called the EXPIRE Act). When lawmakers return to work after the November elections, the leaders of the House and Senate are expected to confer about how to move the extenders before year-end.

Affordable Care Act

As of January 1, 2014, the Affordable Care Act requires all individuals to carry health insurance or make a shared responsibility payment, unless exempt. For many, employer-provided health insurance will satisfy the individual mandate. Others will satisfy the individual mandate if they are covered by Medicare or Medicaid. Individuals who are not exempt will need to make a shared responsibility payment when they file their 2014 returns in 2015.

Generally, 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:

> 1 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.

The individual shared responsibility payment is capped at the cost of the national average premium for the bronze level health plan available through the Marketplace in 2014.

The lack of health insurance does not automatically mean an individual must make a shared responsibility payment. The types of exemptions are broad. For example, an individual may have no affordable coverage options because the minimum amount he or she must pay for the annual premiums is more than eight percent of household income. An individual also may have a hardship that prevents him or her from obtaining coverage.

Some seven million individuals have obtained health insurance through the Affordable Care Act Marketplace. Many qualified for a special tax break to help offset the cost of coverage (the Code Sec. 36B credit) and many took advance payments of the credit. In these cases, individuals must reconcile the amount paid in advance with the amount of the actual credit computed when they file their tax returns. Life changes in 2014 may impact the final credit amount.

For more details about the year-end planning ideas we have discussed, and to review other strategies, please contact our office. Together, we can create a customized 2014 year-end tax strategy tailored to you.