Wealth Management

KANE COMPANY

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Certified Public Accountants and Financial Advisors

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14 Top Year-End Tax Moves For Individuals In 2014

'Tis the season for year-end tax planning. By making tax moves, particularly those that relate to your investments, as the year winds down, you can pile up tax savings. Here are 14 strategies that may result in holiday cheer:

1. Harvest capital gains. Despite recent tax rate increases, you still can benefit from favorable tax rates if you sell securities at year-end. For instance, the maximum tax rate for long-term capital gains remains 15% for most investors in 2014. It's 20% for those in the top ordinary income tax bracket—still pretty good.

2. Harvest capital losses. If you've already realized gains this year—especially short-term gains taxed at ordinary income rates—you could unload something now at a loss. Your losses can offset the capital gains, plus up to $3,000 of ordinary income in 2014.

3. Maximize the 0% rate. If you expect this year to be a low-income year (for example, if you have a large business loss), a portion of your long-term capital gains may qualify for the 0% tax rate that applies to income in the two lowest ordinary income tax brackets. Try to make sure that you and other family members cash in on this benefit when you can.

4. Buy into dividend-paying stocks. Most stock dividends are taxed at the same preferential tax rates as long-term capital gains under the same basic tax rate structure. To qualify for this tax break, you must hold the stocks paying the dividends for at least 61 days.

5. Minimize NII tax. A 3.8% tax applies to the lesser of your net investment income (NII), which includes capital gains and dividends, or your modified adjusted gross income (MAGI) above $200,000 for single filers and $250,000 for joint filers. (If your income falls below those thresholds, you won't owe NII tax.) You can reduce exposure to this tax by lowering your NII and MAGI for 2014 (for example, by investing in tax-free municipal bonds).

6. Sidestep the wash sale rule. If you buy "substantially identical" shares within 30 days of selling securities at a loss, you can't deduct the loss on your tax return. Avoid this "wash sale" rule by waiting at least 31 days to buy back the same shares or buy the new stock first and then wait at least 31 days to sell the original shares.

7. Arrange an installment sale. Generally, you can defer tax on the sale of real estate or other property if you receive payments over two years or longer. Not only do you stretch out your tax payments over time, you might pay a lower tax rate for capital gains than if selling the property pushed you

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2014 Year-End Reminders & ACA Tax Implications

Much of our continuing education has focused on the tax implications of the Affordable Care Act (ACA). One significant requirement: everyone must maintain minimum essential coverage, demonstrate a coverage exemption, OR make a shared responsibility payment.

2014 tax returns for those with minimum essential coverage the entire year (i.e. employer or private plans, Medicare/Medicaid), will be virtually unaffected. If your coverage was through HealthCare.Gov, you will receive a Form 1095-A for filing with your tax return to report coverage and reconcile any premium tax credits.

Coverage exemptions are available, but some require receiving a certificate prior to filing your tax return. A list and how to apply can be found at Healthcare.Gov. Those who don't qualify for an exemption and didn't enroll in coverage must make a shared responsibility payment (SRP). The 2014 SRP is 1% of your household income or $95 per person for the year, whichever is higher, and payable with your tax return.

For those affected by the ACA, year-end tax planning may be especially crucial. Contact us to discuss any strategies. Also, December 31 is the deadline for Roth IRA conversions and College Savings Iowa contributions. We can assist in pension and IRA rollovers, or any required minimum distributions (RMDs) you may need to complete.

Our office hours will be extended January through April 15th: Monday through Friday 8am-5pm & Saturdays 8am-12pm. Thank you very much for your continued patronage and referrals. We wish all of you a happy and healthy holiday season, as well as a prosperous New Year!

Steven L. Kane, CPA/PFS, CFP®

Unused Estate Tax Election

"DSUEA" sounds like a top-secret agency inside the government. But that's not even close. It's actually the acronym for "deceased spouse unused exclusion amount," a key component of the portability provision in the federal estate tax law.

It's important to understand how the DSUEA is calculated and how portability can save a family hundreds of thousands—or possibly even millions—of estate tax dollars.

Consider the basic federal estate tax framework. For starters, there's an unlimited marital deduction between spouses. Any amount that's transferred from one spouse to another, whether through a bequest or a lifetime gift, is automatically exempt from estate and gift taxes. In addition, each person's estate can benefit from an exemption for transfers to heirs other than a spouse.

Under the latest tax law changes, the estate tax exemption is permanently fixed at an inflation-adjusted amount based on $5 million. The "basic exclusion amount" (BEA) for 2014 is $5.34 million and increases to $5.43 million in 2015. That allows a married couple to transfer up to $10.77 million to other heirs in 2015, and that amount will be even higher in future years.

The basic premise behind portability is quite simple. When one spouse dies, any unused BEA amount is available to the estate of his or her surviving spouse. Normally a surviving spouse will be able to add the deceased spouse's unused exclusion amount to his or her maximum exempt amount.

Hypothetical example: Susan and Jim, husband and wife, own $3 million individually and $4 million jointly with rights of survivorship. (For simplicity, we will avoid any gains or losses in the value of the assets.) That adds up to a combined estate of $10 million. Their wills specify that their individually owned assets will go to their children when each parent dies.

Now suppose that Susan died in 2014 when the BEA was $5.34 million. Under the tax law formula (see chart), the DSUEA is limited to the lesser of (a) the BEA and (b) the excess of (i) the BEA of the last deceased spouse over (ii) the taxable estate of the last deceased spouse. In the example involving Susan and Jim, the DSUEA is $2.34 million. Therefore, when Jim dies, his estate will be able to utilize the $2.34 million DSUEA—plus the BEA available to Jim in the year of his death.

How much tax will that save? With a 40% top estate tax rate, the savings on the $2.24 million DSUEA is $936,000 ($2.34 million x 40%)!

To take advantage of the portability provision your heirs must make an election on an estate tax return. Coordinate this estate tax break with other aspects of your overall estate plan. ●

Portability Basics

DSUE is limited to the lessor of:

A. The basic exclusion amount (BEA):	B. The excess of:
$5.34 M in 2014	(i) the BEA of the last deceased spouse of the surviving spouse over (ii) The taxable estate of the last deceased spouse **Example:** • BEA = $5.34 M • Deceased's estate = $3.00 M • $5.34 M – 3.00 M = $2.34 M

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What's The Step-Up In Basis Worth?

When you're developing an estate plan for your family, several elements factor into the equation, including a lot of tax ramifications—which may include both estate taxes *and* income taxes. They're not mutually exclusive and, in fact, they're often intertwined.

A case in point is the so-called "step-up in basis" on inherited assets. That can be a reason to keep some assets in your estate rather than trying to reduce the estate's value.

Slimming down an estate, particularly by making gifts to family members during your lifetime, is often a good idea. However, there's a marital deduction that normally allows you to leave unlimited assets to your spouse free of estate tax, while transfers to other heirs are sheltered by a generous individual estate tax exemption that's inflation-indexed. Each person can shield $5.43 million from estate and gift taxes in 2015, up from $5.34 million in 2014.

Meanwhile, if you sell real estate or other assets before you die, you'll owe capital gains tax on your profits. The maximum tax rate on a long-term gain (on assets you've held longer than a year) is 15%, or 20% for investors in the top ordinary income tax bracket. In addition, you may be liable for a 3.8% surtax on net investment income (NII), including capital gains, that exceeds an annual threshold. That adds up to a possible effective tax rate of 23.8% on capital gains at the federal level.

But if you bequeath appreciated assets to your heirs, they can largely avoid capital gains taxes. Those taxes are calculated according to how much the price has gone up from your "basis" in the asset—basically what you paid for it, subject to adjustment. When you die, the basis of the assets your heirs receive is "stepped up"—increased to their value on the date of your death. That eliminates tax liability on the appreciation of the assets during

When To Harvest Gains, When To Harvest Losses

It's harvest time again! The end of the year often presents golden opportunities for investors to "harvest" capital losses by selling stocks that can offset capital gains they realized earlier. But sometimes the reverse is called for—harvesting capital gains to make good use of earlier losses. Handling this the right way could have a major impact on your 2014 tax liability.

Start with the basic premise that capital gains and losses from securities transactions are treated as short-term gains or losses if you've held the assets a year or less and long-term if you've owned them longer. Gains and losses are "netted"—losses are subtracted from gains—when you file your tax return. But you'll want to act months earlier, deciding to realize gains or losses, either short-term or long-term, depending on what works best in your particular situation.

If you still show a capital loss for the year after using your losses to offset your capital gains, one option is to use the excess loss to offset up to $3,000 of ordinary income, now taxed at rates as high as 39.6%. If that still doesn't use up all of your losses, you get to carry over the remainder to the following year and the one after that. This means that a capital loss you realize in 2014 might be used to offset capital gains in 2015, 2016, and even beyond.

The tax rules for capital gains are a little trickier. Short-term gains are taxed at ordinary income tax rates. But long-term gains are taxed at a maximum tax rate of 15% for most filers and 20% for investors in the top 39.6% bracket for ordinary income. Investors in the two lowest ordinary income tax brackets of 10% and 15% may benefit from a 0% tax rate on long-term capital gains.

To complicate matters further, a 3.8% surtax applies to the lesser of your "net investment income" (NII) or the amount by which modified adjusted gross income (MAGI) exceeds a threshold of $200,000 for single filers and $250,000 for joint filers. (If your income falls below those amounts, this surtax won't affect you.) The definition of NII includes capital gains from securities sales. As a result, if you realize a short-term gain in 2014, you could be stuck with a combined federal income tax rate of 43.4% (39.6% + 3.8%) if you're in the top tax bracket, not to mention any state income taxes you might have to pay.

Against this backdrop, these general principles could help guide your harvesting decisions:

- If you're showing a net loss, it's preferable to offset it with a short-term gain. Hold onto long-term gains until you can take advantage of a favorable tax rate.
- If you're showing a short-term gain, it may be best to offset it with a long-term loss, rather than using such a loss to offset a long-term gain.
- Harvesting capital gains may be a good idea when your time horizon is short, limiting the benefit of tax deferral.
- When your time horizon is longer, tax deferral becomes more valuable, and harvesting capital gains normally isn't a good idea.

To see how all of this may play out, consider the following examples of year-end tax planning in 2014. (For simplicity's sake, these don't involve the NII surtax or other complications.)

Example 1: You have a long-term loss of $10,000 and can realize a short-term capital gain of $8,000. If you harvest the gain, the entire amount is absorbed by your loss and you still can offset $2,000 of ordinary income.

Example 2: You have a long-term gain of $10,000 and can realize a long-term loss of $10,000. Although you might harvest the loss to offset the gain completely, consider the implications if the gain will be taxed at 15% or 20% or, even better, at the 0% rate. It may be better to preserve the loss for 2015.

Example 3: You have a short-term gain of $5,000 and can realize a long-term loss of $8,000. If you harvest the loss, it will offset a gain that could be taxed at a rate as high as 39.6%, plus you can offset an additional $3,000 of ordinary income.

Example 4: You have a short-term loss of $7,000 and can realize a long-term gain of $10,000. If you harvest the gain, $7,000 will be absorbed by the loss. The remaining $3,000 of gain will be taxed at a rate no higher than 20%.

As these examples suggest, year-end harvest planning for taxes can hinge on many factors. We can help you consider all of the financial ramifications in light of your overall investment plan. ●

the time you owned them. Of course, those assets have to be in your estate to qualify for that benefit, but the generous exemptions for estates will help your heirs avoid estate taxes, too.

Consider this example. Tom, a resident of Florida, bought an apartment building for $900,000 that is currently worth $2.2 million. If Tom sells the building now, he must pay an effective tax rate of 23.8% on a $1.3 million capital gain, or $309,400 (23.8% of $1.3 million). But what if he keeps the property and leaves it to his heirs? The basis of the property is stepped up to the full $2.2 million, and they'll owe capital gains taxes only if it appreciates further before they sell it. What's more, the estate tax exemption means they won't owe estate taxes on their inheritance.

Note that Florida doesn't have a state income tax. If Tom resided in a high tax state, such as California or New York, the savings would be even more pronounced. ●

What is the Value of a Step-up?

Example:

- Tom, a Florida Resident, purchased an apartment building for $900,000. Later, the fair market value of the property increases to $2,200,000. If he were to sell the property at $2,200,000, he incurs income tax.

Basis	900,000
Fair Market Value	2,200,000
Gain	1,300,000
Tax Rate	23.8%
Tax	309,400

- Alternatively, if Tom dies before the apartment is sold, the original basis would "step-up" to reflect the current fair market value. Tom is therefore able to pass more property to his heirs.

Basis	2,200,000
Fair Market Value	2,200,000
Gain	0
Tax Rate	23.8%
Tax	0

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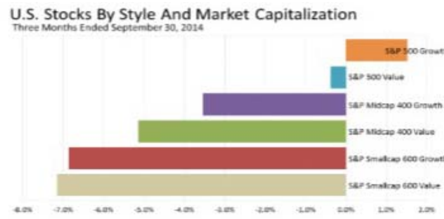
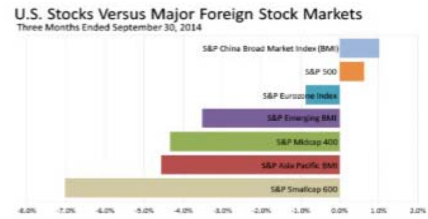
Market Data Bank: 3rd Quarter 2014 Ψ





THE BIG PICTURE

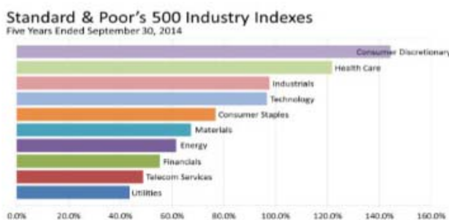
Since 1900, only three of 23 bull markets have lasted six years or longer. Chances of a bear market — a correction of at least 20% — increase as the bull market grows older. But economic conditions that accompanied bear markets in the past were not present as the end of 2014 neared.

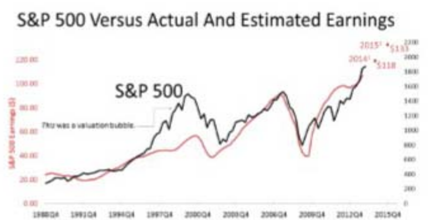
U.S. STOCKS

Europe's slower than expected growth cast new doubt on the strength of the global economy caused periodic jitters over the Federal Reserve's "taper" — the winding down of longstanding monetary policy liquefying economy. But the stream of improving economic data continued.

FOREIGN VS. U.S. STOCKS

"American exceptionalism," the theory that the U.S. is different from all other nations because of ita unique traits — like freedom, entrepreneurship and an abundance of natural resources — was bolstered again last quarter as US stocks outran foreign again.





LARGE-CAP U.S. STOCKS BY INDUSTRY

Over the past five years, cumulative returns on consumer discretionary stocks led the 10 S&P 500 industry sector indices, followed by health care and technology stocks, as growth investors were rewarded. Utilities trailed as income oriented investments remained weak. No industry was hit for a loss over the period.

ASSET CLASSES±

Looking at the cumulative return on broad group of 12 asset classes for the five years ended September 30, 2014 shows master limited partnerships at the top of the heap. But second best was the return on U.S. stocks. Stocks tied to commodities prices and foreiogn equity markets trailed.

S&P 500 INDEX VS. EARNINGS¥

Red squares show expected earnings on the S&P 500 index of blue-chip companies, based on a 10/2/2014 forecast of Wall Street analysts, for $118 per share in 2014 and $133 in 2015. Unless there's a crisis or sudden and surprising bad news, the trajectory of earnings growth could continue to propel stocks higher.

Past performance does not indicate future results. ±Indices and ETFs representing asset classes are unmanaged and not recommendations for any specific investment. Foreign investing involves special risks, including political or economic instability and currency fluctuation. Bonds offer a fixed rate of return while stocks fluctuate. ¥Estimated bottom-up S&P 500 earnings per share as of October 2, 2014 was $118.28 for 2014 and $132.91 for 2015. Sources: Yardeni Research, Inc. and Thomson Reuters I/B/E/S survey of consensus estimates. Standard and Poor's for index price data through October 7, 2014; and actual earnings data through June 2014.

Top Year-End Tax Moves

(Continued from page 1)

into the top tax rate.

8. Boost 401(k) contributions. Try to increase your tax-deferred contributions to a 401(k) plan at work. For 2014, you can elect to defer up to $17,500 to your account ($23,000 if age 50 or over). Besides trimming your current tax bill, it helps build savings for the future.

9. Convert to a Roth. If you have funds in a traditional IRA, you may move some or all of those funds to a Roth IRA, paying income tax now on the converted amount so that most future Roth distributions will be tax-free. If you spread the taxable conversions over several years, you'll reduce the tax bite.

10. Rent out a vacation home. You can write off specified rental activity costs, plus depreciation, but be careful. If your use exceeds the greater of 14 days, or 10% of the days the home is rented out, deductions can't exceed the amount of rental income you receive. Keep an eye on personal use as the year draws to a close.

11. Dust off charitable donations. Instead of tossing out old furniture and clothing, give items in good condition to charity. Generally, you can deduct the fair market value of property donated to a qualified charitable organization, within certain limits.

12. Take RMDs in time. You normally must take required minimum distributions (RMDs) from qualified retirement plans and IRAs each year after age 70½. If you don't, you'll pay a penalty equal to 50% of the required payout. To avoid problems, arrange for RMDs well before January 1.

13. Find a PIG. Under the passive activity rules, you can deduct losses from passive activities, including most investing, only against income from other passive activities. (Special rules apply to real estate.) Investing in a passive income generator (PIG), a special investment that produces passive income, could help increase this year's deductions.

14. Be generous to your family. Finally, under the annual gift tax exclusion, you can give up to $14,000 to anyone you choose in 2014 without paying gift tax. This reduces your taxable estate and generally results in overall income tax savings for the family. Happy holidays! ●

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