The
FINANCIAL UPDATE

DAY & ENNIS, LLC
FEE-ONLY FINANCIAL PLANNING

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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

(Continued on page 4)

Do You Have Enough?

"To Know You Have Enough Is To Be Rich."
--from the Tao Te Ching.

Everyone's definition of "enough" is different. From the perspective of an investment plan, however, your personal definition becomes paramount. It determines the level of risk you'll consider to achieve your financial goals. Once you have sufficient wealth to meet all your needs, you'll require a different strategy to maintain your comfort level. While you've taken calculated risks to reach your goal of having "enough", you'll now need to minimize risk to avoid losses. You'll also take care to avoid jeopardizing your principal through excessive spending.

At this point, taking on incremental risk to achieve a higher net worth no longer makes sense. The potential damage of an unexpected negative outcome exceeds the potential benefit gained from incremental wealth.

At Day & Ennis, we take the time to help you evaluate your particular situation, realizing that each client is unique. Then we monitor the markets and talk with you about changes in your situation, adapting your financial plan as needed.

As always, we remain available to talk with clients and those interested in improving their financial plans.

Sincerely,
Day & Ennis, LLC

Social Security: Taxes In And Out

It seems like the IRS has you coming and going on Social Security. While you are working for a living, you must pay taxes into the system to provide benefits for current retirees. Then, when you finally retire, you're entitled to receive retirement benefits but they might be subject to tax as well.

Don't confuse the two taxes. The Social Security tax you pay as an employee is a payroll tax that applies to wages, commissions, and other compensation as part of the FICA tax. An employee's combined FICA rate for Social Security and Medicare in 2014 is 7.65% on the first $117,000 of compensation and 1.45% (Medicare only) above that. But the tax that may apply to Social Security benefits you get in retirement is a federal income tax that is reported along with other items on Form 1040. It's more complicated than the payroll tax.

Here's how it works: You're liable for tax on Social Security benefits if your provisional income (PI) exceeds certain thresholds in the tax law. For this purpose, PI is the total of (1) your adjusted gross income (AGI), (2) your tax-exempt interest income (for example, from municipal bonds), and (3) one-half of the Social Security benefits you received. For example, if the combined AGI of you and your spouse is $100,000 and you collect $5,000 in municipal bond income and $20,000 in Social Security benefits, your PI is $125,000 ($100,000 + $5,000 + $20,000).

There are actually two thresholds for computing the tax on Social Security benefits.

Threshold 1: For a PI between $32,000 and $44,000 ($25,000 and $34,000 for single filers), you're taxed on the lesser of one-half of your benefits or 50% of the amount by which PI exceeds $32,000 ($25,000 for single filers).

Threshold 2. For a PI greater than $44,000 ($34,000 for single filers), you're taxed on 85% of the amount by which PI exceeds $44,000 ($34,000 for single filers) plus the lesser of the amount determined under the first tier or $6,000 ($4,500 for single filers). Silver lining: You'll never owe tax on more than 85% of your total benefits.

These two thresholds aren't indexed annually for inflation. If your PI exceeds a relatively low level of $32,000 ($25,000 for single filers), you'll owe the tax year in and year out. And you'll get hit with the higher tax rate every year that your PI exceeds just $44,000 ($34,000 for single filers).

What can you do about it? You might lower your PI by harvesting capital losses to offset capital gains or deferring taxable income to the following year. But remember that the income from tax-free municipal bonds counts against you in the calculation of PI. Consider all the relevant factors, including the potential tax implications for Social Security benefits, in your investment decisions. ●

Fly Below The Tax Radar At Year-End

The IRS often zooms in on upper-income taxpayers, especially those who buy and sell a lot of investments, and with good reason: These taxpayers have the most to gain or lose because the stakes are high. However, you can reduce the chances for an unhappy tax landing by flying below the "tax radar."

There are three key tax thresholds to think about in 2014. If you stay below those lines, you're more likely to end up with a reduced tax bill. Let's examine each one:

1. Ordinary income tax rates. Under the graduated tax structure, there are seven tax rates that range from a low of 10% to a high of 39.6%. Even if you're in the top tax bracket, you benefit from the lower brackets, but once your income rises into the top bracket—in 2014, when it exceeds $457,600 as a joint filer or $406,750 as a single filer—any additional taxable income will be subject to the 39.6% rate. Deferring some income to 2015 could help, especially if you expect to be in a lower tax bracket next year.

2. The Pease and PEP rules. Under the Pease rule, named for the congressman who introduced this provision, most itemized deductions are reduced by 3% of the amount that your adjusted gross income (AGI) exceeds a dollar threshold, though the total reduction can't be more than 80%. Personal exemptions are reduced by the PEP (personal exemption phaseout) rule by 2% for each $2,500 (or a portion of that amount) that your AGI goes over the same threshold—$305,050 of AGI for joint filers and $254,200 for single filers.

3. The NII tax. There's now a 3.8% surtax that applies to the lesser of your "net investment income" (NII) or modified adjusted gross income (MAGI) that exceeds an annual threshold. Although NII includes most income items, distributions from IRAs and employer retirement plans are

Why Give Securities To Charity Instead Of Cash?

Want to make a sizable donation to your favorite charity? Of course, you could write out a big, fat check to the organization and claim a current tax deduction for your generosity. But you might fare even better, when taking taxes into account, by donating securities that have appreciated in value. As a bonus, you won't have to sell anything or dip into your cash to pay for the gift.

There's a simple tax incentive for donating stock rather than cash. If you write a check, you generally can write off the exact amount on your federal income tax return, subject to an overall charitable limit of 50% of your adjusted gross income (AGI) for the year. However, if you donate securities, you can deduct the fair market value (FMV) of the investments on the date of the contribution and avoid being taxed on the profit you would have made if you'd sold that holding.

In other words, you (and your charity) would benefit from the stock's appreciation without being taxed on it. It's as if your gains never occurred—except for the tax break you would get to enjoy.

But this works only if you've held an investment for more than a year. That's the definition of "long term" for calculating taxes on capital gains. With donations of stock that would have produced a short-term gain if you had sold it, your deduction is limited to your basis in the stock, which is usually what you paid for your shares. So there's no tax reward for giving away stock you've acquired within the year, no matter how much its price may have increased.

Let's take a look at two hypothetical examples to see the tax difference.

Example 1: Suppose you acquired ABC Co. stock nine months ago for $10,000. The stock is now worth $15,000. If you donate the ABC stock to a charity, your deduction is limited to your basis, or $10,000. There's no tax benefit from the $5,000 of appreciation in value. In fact, you would be giving that away for nothing.

Example 2: Suppose you acquired XYZ Co. stock two years ago for $5,000 that is now worth $15,000. In this case, if you donate your XYZ shares to charity, your deduction is based on its FMV, or $15,000. You would get to deduct the entire $15,000 even though you only paid $5,000 for the stock.

These rules lead to guidelines that can help you decide which investments to donate. For tax purposes, it's generally best to give the long-term holdings that have gained the most in value. But it makes little tax sense to donate stock that has moved up only a small amount, especially if you've owned it for a year or less. These differences may be especially important to donors in high tax brackets.

If you donate stock that has lost value, your deduction will be based on the stock's FMV. In this case, it usually makes sense tax-wise to sell the stock first and then donate the proceeds to charity. This way, you can claim a capital loss that you could use to offset capital gains from other securities sales.

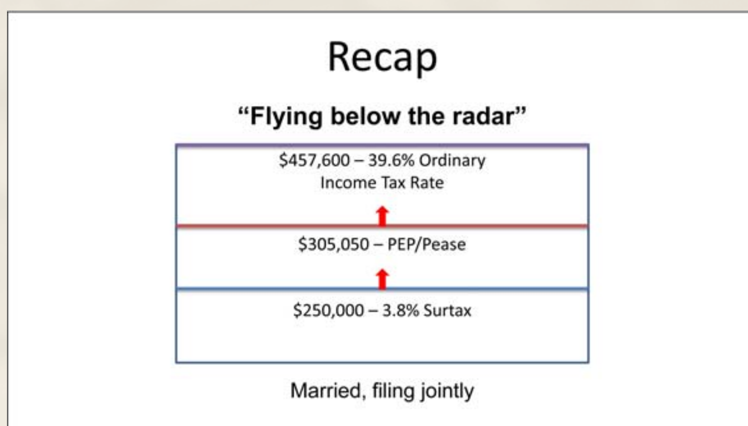
There are a few other tax wrinkles to consider when you're thinking about giving securities to charity. That 50%-of-AGI limit applies to all gifts during the year, whereas charitable gifts of property are limited to 30% of your AGI for the year—though you can carry over any excess to subsequent tax years. In addition, some itemized deductions for high-income tax-payers, including those for charitable contributions, may be reduced by the "Pease rule." Generally, this reduction is equal to 3% of income exceeding an annual threshold amount (indexed for inflation), but the reduction is capped at 80% of your total deduction. For 2014, the threshold for the Pease rule is $254,200 of AGI for single filers and $305,050 for those who file jointly.

Finally, there's more at stake here than just taxes. Investment factors, too, come into play, and it's usually better to choose stocks that you feel may have reached peak value than those that may continue to rise. You also may want to keep stocks that pay solid dividends. And there could be consequences relating to your estate plan and assets you might want to leave to your heirs instead of donating to charity.

The best approach is to consider all the significant factors before giving securities to a charity. We can help you coordinate your decisions with other aspects of your investment and estate plans. ●

exempt. Nevertheless, the money you take from such plans still increases your MAGI for this calculation. The MAGI limit is $250,000 for joint filers and $200,000 for single filers. And while many tax law provisions rise when inflation does, this one doesn't.

Develop a year-end plan that is geared toward staying below these thresholds or at least as close to them as you can manage. In some cases, such as with the Pease and PEP rules or the NII tax, you may be able to avoid the tax complication altogether. Happy flying! ●



Unused Estate Tax Election

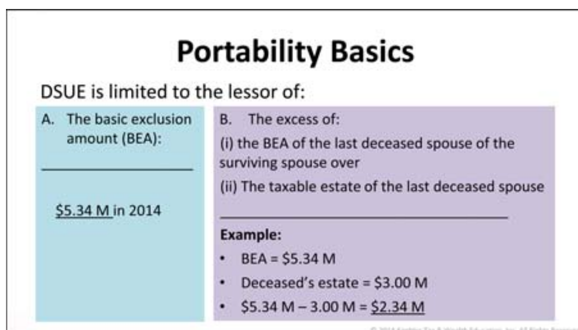
"DSUEA" sounds like a top-secret agency inside the government. But that's not even close. It's actually the acronym for "deceased spouse unused exclusion amount," a key component of the portability provision in the federal estate tax law.

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.



Portability Basics

DSUE is limited to the lessor of:

A. The basic exclusion amount (BEA):

$5.34 M in 2014

B. The excess of:

(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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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. ●

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! ●

John R. Day CPA/PFS Bill Ennis CPA/PFS Stephanie Davidson CPA CFP 125 Plantation Centre Dr., Bldg. 400 Macon, GA 31210
(478) 474-7480 www.dayandennis.com

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