TAX PLANNING

2015 Year-End Tax-Planning Techniques

By Suzanne L. Shier, JD

Now that the American Taxpayer Relief Act of 2012 (ATRA) and higher income-tax rates have been in place for nearly two years, and low interest rates and volatile financial markets have become the norm, many individuals have adjusted their tax-planning strategies. When income-tax rates remain steady, the standard approach is to accelerate deductions into the current year and defer income until the next. This remains true for 2015. It is important that you stay actively involved in your tax planning even after the 2015 tax year ends so that you can maximize tax savings and stay on track to meet your long-term wealth planning and management goals. This article discusses several tax-planning techniques that you may want to consider before 2015 comes to an end. As a reminder, each individual's tax situation is unique and should be evaluated with the guidance of a trusted tax professional.

Year-End Income-Tax Planning

Be mindful of thresholds. Although 2015 and 2016 tax rates are to remain the same as 2014, the thresholds will change. If practicable, it generally is preferable to avoid spikes in income that will cause a taxpayer to cross a threshold that triggers a higher tax rate or lower deduction. Spreading the recognition of certain income between 2015 and 2016 may smooth income and reduce your tax bill. The question to be answered in this context is at what point one is considered "high income." Your 2014 tax return and your 2015 pay stubs and other income- and deduction-related materials are good starting points for estimating your adjusted gross income (AGI). As a reminder for individuals who expect to marry or divorce before year-end, marital status is determined for the entire year on December 31 and may affect your applicable income-tax rate and filing status.

Table 1: 2015 Threshold Tax Rates

	39.6% ordinary income and 20% long-term capital gain and qualified dividend tax rate	Phase-out personal exemptions and itemized deductions	3.8% Medicare contribution tax on net investment income
Married filing jointly and surviving spouses	$464,850 taxable income	$309,900 adjusted gross income	$250,000 modified adjusted gross income
Head of household	$439,000 taxable income	$284,050 adjusted gross income	$200,000 modified adjusted gross income
Single filer	$413,200 taxable income	$258,250 adjusted gross income	$200,000 modified adjusted gross income
Married filing separately	$232,425 taxable income	$154,950 adjusted gross income	$125,000 modified adjusted gross income

Timing of Income, Losses, and Deductions

With rate stability from 2015 to 2016, deferring income and accelerated losses and deductions can provide overall tax savings. Because a number of tax-reform proposals are taking aim at the deductions claimed by high-income taxpayers, take advantage of deductions and losses sooner and recognize income later. However, decisions with respect to timing should take into consideration the alternative minimum tax as well as the effect of future spikes in income as a result of deferral given the various thresholds described in table 1. Additionally, with the volatility in the financial markets over the course of 2015, it may be time to consider recognizing losses on investments that have fallen in value. However, note that the wash sale rule limits the ability to sell an investment to recognize a loss and then repurchase it or a substantially identical security within a short timeframe.

The following techniques for postponing income should be considered:

- Postpone profitable asset sales, but remember that market considerations may take precedence over tax considerations.
- Take advantage of installment-sale treatment for property sales, pushing all or a portion of the gain to a subsequent tax year.
- Contribute to a qualified retirement plan.
- Minimize retirement distributions, but be sure to withdraw your required minimum distribution, if any.
- Postpone receipt of salary to next year.
- Bill customers or clients at the beginning of the New Year.
- Structure transactions to qualify for like-kind exchange treatment.
- Determine whether to exercise stock options before year-end.
- Consider if a Roth individual retirement account (IRA) conversion is beneficial.

The following techniques may be considered to accelerate deductions:

- Double-up on charitable contributions, but be aware of thresholds and phase-outs.
- Realize losses on taxable investments.
- Claim bad-debt deductions.
- Accelerate business-equipment purchases.
- Prepay state and local income and property taxes.
- Fully fund Health Savings Accounts (HSAs) before year-end with a maximum contribution of $3,350 per individual or $6,650 per family.
- Watch for AGI limitations on deductions and credits.

- Watch for net investment interest restrictions.

Retirement planning. Retirement planning is a long-term commitment, not just an item on the year-end to-do list. However, year-end is a good time to evaluate retirement planning. If you are considering converting a traditional IRA to a Roth IRA in 2015, take into account how the conversion will impact your 2015 tax bracket, Medicare contribution tax on net investment income computations, and any phase-out of itemized deductions. Note that you can undo a Roth conversion completed in 2015 up until the final date, including extensions, for filing your 2015 tax return, which is typically on or about October 15. For 2015, you can contribute a maximum of $5,500 to an IRA plus an additional $1,000 catch-up contribution for those age 50 and older. For those who participate in an employer's elective deferral plan, such as a 401(k), the 2015 contribution limit is $18,000 plus an additional $6,000 catch-up contribution for those age 50 and older.

Accelerating charitable contributions. Charitably inclined individuals who seek the tax benefits of charitable contributions but are undecided about where to donate may wish to consider year-end contributions to a donor-advised fund. Distributions may be made from the fund to specific charities in the current and subsequent years. The donor receives a current-year income-tax deduction (subject to applicable limitations) for a 2015 contribution to a donor-advised fund in 2015 under the tax laws now in effect. If there are restrictions on charitable gifts under future tax laws, your current deduction will not be affected.

Year-End Wealth Transfer Planning

Tax implications are an important consideration in the development and execution of any estate plan. ATRA brought welcome changes for gift, estate, and generation-skipping transfer-tax planning and we continue to have the benefit of traditional gifting strategies.

Inflation-adjusted high-level applicable exclusion. The gift- and estate-tax rate remains 40 percent, but the applicable exclusion amount and generation-skipping transfer-tax exemption in effect in 2015 is $5.43 million. This reflects inflation adjustments to the basic $5 million exclusion, which was $5.34 million in 2014. If you utilized your full exclusion of $5.34 million in 2014, the incremental inflation adjustment ($90,000 from 2014 to 2015) provides an opportunity to make additional gifts tax-free. With portability and its related regulations permanent and finalized, surviving spouses may be able to transfer up to $10.86 million in 2015 with the benefit of a decedent spouse's unused exclusion amount if properly elected. However, with high income-tax rates for high-income taxpayers and the benefit of the higher level gift- and estate-tax exclusion, the decision to make additional lifetime gifts should take into account the basis of property. With lifetime gifts the recipient generally receives the donor's basis in the property. As a result, all appreciation in the property will be preserved and eventually subject to income tax on the built-in capital gain when the recipient disposes of the property. However, for transfers at death, the recipient's basis is adjusted to the value of the property at death (or the alternate valuation date). Thus, for appreciated assets, a basis step-up at death provides an income-tax advantage to the beneficiary.

Annual gifts. In 2015 you may make tax-free gifts of $14,000 to as many individuals as you choose. For a married couple, combined gifts can total $28,000. This remains a simple and efficient wealth-transfer strategy.

Gift trusts. If you have established irrevocable gift trusts designed to have you treated as the owner for income-tax purposes, you should take the tax liability flowing through to you from the trust(s) into account in your year-end tax planning. If your trust was structured to allow for the termination of the grantor-as-owner income-tax treatment during your lifetime, year-end is a good time to review your gift, estate, and income-tax circumstances with your advisor and determine whether any change in the tax status of the trust (from grantor with flow-through tax treatment to non-grantor with separate taxpayer treatment) is desired and permissible for the new year.

Planning in a low interest-rate environment. The tax law requires the use of certain interest rates to value various items in estate planning such as an income, an annuity, or remainder interests in a trust. These rates are at or near historic lows—2 percent for November 2015—presenting several planning opportunities. Low interest rates make grantor retained annuity trusts (GRATs) very tax-efficient wealth transfer vehicles. In a GRAT, you transfer property to a trust but retain a right to annuity payments for a term of years, with the remainder passing at the end of the term to the trust's remainder beneficiary, usually a child or other family member. The value of the gift of a remainder interest is discounted for gift-tax purposes. If you survive the trust term, the trust property is not includable in your gross estate for estate-tax purposes. Assuming the rate of appreciation of the transferred assets is greater than the required interest rate, the excess inures to the benefit of the remainder beneficiary without further gift or estate tax. As a general rule, the lower the required interest rate, the shorter term required to maximize the value of the gift to the beneficiary.

Tax reform. There has been much discussion of tax reform, and the 2016 presidential hopefuls are proposing significant and comprehensive reforms. The best that can be expected from Congress, however, is the extension of more than 50 tax provisions that expired at the end of 2014. For example, Congress typically has extended provisions allowing for individuals age 70½ and older to exclude up to $100,000 from gross income, and satisfy the year's required minimum distribution, for donations made directly to a charity from an IRA. However, as of January 1, 2015, those provisions have once again expired, and there has been movement in Congress to once again extend them. The Senate Finance Committee has passed a bill extending the expired provisions for two years, but there is no certainty as to when, or if, the extending legislation would move through Congress and reach the president's desk for signature.

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Filing deadline. A Washington, DC, holiday, Emancipation Day, will shift the filing and payment deadline for 2015 individual returns from Friday, April 15, 2016, to Monday, April 18, 2016.

Although rates have remained the same from 2014, the future tax landscape remains uncertain. What does not change, however, is the need to review circumstances and adjust course as appropriate in advance of turning the calendar to the New Year.

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