2014-2015 TAX PLANNING GUIDE

Year-round strategies to make the tax laws work for you

Dear Clients and Friends,

The more tax laws change, the more one thing remains the same: Thorough, thoughtful and nimble tax planning — followed by timely implementation of appropriate strategies — is essential to maximizing savings and achieving your financial goals.

Another essential is the need to work with an advisor who can guide you through the bewildering maze of the federal tax code without missing a step or overlooking a way to reduce your tax liability. Our deep knowledge of tax law, derived from years of experience in helping clients like you minimize taxes, gives us the expertise to map out a plan that takes full advantage of all strategies available to you.

To give you an idea of the many ways we can help you save tax, we're pleased to present this tax planning guide. It highlights recent tax law changes, shows how different strategies apply to different situations, and presents charts, tax rate schedules and case studies designed to help you understand the specifics of tax planning.

We invite you to look through the guide and note sections that apply to you. Then let us know if you have any questions about the strategies presented or about other aspects of tax planning and compliance.

But don't wait until filing time! Most tax reduction strategies must be implemented by Dec. 31. In fact, to save the most, you may need to act *now*. So please contact us at your earliest convenience to discuss how we can help you minimize your taxes for 2014 and beyond.

Best regards,

Scott C. Schoenstadt, CPA
Director — Tax Services Group

Tax planning is as essential as ever

At the beginning of 2013, many tax rates and breaks were made permanent. The increased certainty brought by these tax law changes has in some ways made tax planning in 2014 a little easier.

But the changes also brought tax hikes to many higher-income taxpayers. In addition, some new and expanded taxes under the Affordable Care Act (ACA) now affect higher-income taxpayers. The ACA also has a tax impact on many businesses, and last year's tax law changes only temporarily extended (generally through 2013) many valuable tax breaks for businesses.

It's also important to remember that, even though many tax law provisions are now "permanent," this simply means that they don't have expiration dates. With tax reform still on its agenda, Congress may make some major changes in the future. So in your 2014 planning, don't count on the tax regime remaining the same indefinitely.

What does this all mean? Tax planning in 2014 is as essential as ever. This guide provides an overview of some key tax provisions that you need to be aware of and offers a wide variety of strategies for minimizing your taxes. But there isn't space to touch on all of the available tax-savings opportunities. So please contact your tax advisor to learn exactly which strategies can benefit you the most.

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To save or defer tax, think about timing

Maximizing deductible expenses for a given year typically allows you to minimize your income tax — but not always. If you're subject to the alternative minimum tax (AMT) this year, you may be better off deferring certain expenses if you can. In some circumstances, accelerating or deferring income where possible might save, or at least defer, tax. No matter what your situation, plan carefully to find the best timing strategies for you.

The AMT

When timing income and deductions, first consider the AMT — a separate tax system that limits some deductions and disallows others, such as:

- State and local income tax deductions,
- Property tax deductions, and
- Miscellaneous itemized deductions subject to the 2% of adjusted gross income (AGI) floor, such as professional fees, investment expenses and unreimbursed employee business expenses.

You must pay the AMT if your AMT liability exceeds your regular tax liability. You may be able to time income and deductions to avoid the AMT, reduce its impact or even take advantage of its lower maximum rate. (See Chart 6 on page 16.)

Planning is a little easier now that the AMT brackets and exemptions are annually adjusted for inflation. Before 2013, Congress had to legislate any adjustments, which they often were slow to do. This left uncertainty about what the AMT situation would be the next year, inhibiting the ability to effectively implement timing strategies.

Home-related breaks

Consider both deductions and exclusions:

Property tax deduction. Before paying your bill early to accelerate the itemized deduction into 2014, review your AMT situation. If you're subject to the AMT this year, you'll lose the benefit of the deduction for the prepayment.

Mortgage interest deduction. You generally can deduct interest on up to a combined total of $1 million of mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your *principal* residence also may be deductible.

Home equity debt interest deduction. Interest on home equity debt used for any purpose (debt limit of $100,000) may be deductible. So consider using a home equity loan or line of credit to pay off credit cards or auto loans, for which interest isn't deductible and rates may be higher. ***Warning:*** If the home equity debt isn't used for home improvements, the interest isn't deductible for AMT purposes.

Home office deduction. If your use of a home office is for your employer's benefit and it's the only use of the space, you generally can deduct a portion of your mortgage interest, property taxes, insurance, utilities and certain other expenses, and the depreciation allocable to the space. Or you may be able to take the simpler "safe harbor" deduction. (Contact your tax advisor for details.) For employees, home office expenses are a miscellaneous itemized deduction, and you'll enjoy a tax benefit only if these expenses plus your other miscellaneous itemized expenses exceed 2% of your AGI. (If you're self-employed, see page 11.)

Rental income exclusion. If you rent out all or a portion of your principal residence or second home for less than 15 days, you don't have to report the income. But expenses directly associated with the rental, such as advertising and cleaning, won't be deductible.

Home sale gain exclusion. When you sell your principal residence, you can exclude up to $250,000 ($500,000 for married couples filing jointly) of gain if you meet certain tests. ***Warning:*** Gain that's allocable to a period of "nonqualified" use generally isn't excludable.

Home sale loss deduction. Losses on the sale of a principal residence aren't deductible. But if part of your home is rented out or used exclusively for your business, the loss attributable to that portion may be deductible.

Debt forgiveness exclusion. This break for homeowners who received debt forgiveness in a foreclosure, short sale or mortgage workout for a principal residence expired Dec. 31, 2013, but Congress might extend it. Check with your tax advisor for the latest information.

Health-care-related breaks

If your medical expenses exceed 10% of your AGI, you can deduct the excess amount. Eligible expenses may include:

- Health insurance premiums,
- Long-term care insurance premiums (limits apply),
- Medical and dental services,

- Prescription drugs, and
- Mileage (23.5 cents per mile driven for health care purposes).

Consider "bunching" nonurgent medical procedures (and any other services and purchases whose timing you can control without negatively affecting your or your family's health) into one year to exceed the 10% floor. Taxpayers age 65 and older enjoy a 7.5% floor through 2016 for regular tax purposes but are subject to the 10% floor now for AMT purposes.

Expenses that are reimbursable by insurance or paid through a tax-advantaged account such as the following aren't deductible:

HSA. If you're covered by qualified high-deductible health insurance, you can contribute pretax income to an employer-sponsored Health Savings Account — or make deductible contributions to an HSA you set up yourself — up to $3,300 for self-only coverage and $6,550 for family coverage (for 2014), plus an additional $1,000 if you're age 55 or older. HSAs can bear interest or be invested, growing tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year.

FSA. You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit — not to exceed $2,500 for plan years beginning in 2014. The plan pays or reimburses you for qualified medical expenses. What you don't use by the plan year's end, you generally lose — though your plan might allow you to roll over up to $500 to the next year. Or it might give you a 2½-month grace period to incur expenses to use up the previous year's contribution. If you have an HSA, your FSA is limited to funding certain "permitted" expenses.

Sales tax deduction

The break allowing you to take an itemized deduction for state and local *sales* taxes in lieu of state and local *income* taxes was available for 2013 but, as of this writing, hasn't been extended for 2014. (Check with your tax advisor for the latest information.)

Limit on itemized deductions

If your AGI exceeds the applicable threshold, certain deductions are reduced by 3% of the AGI amount that exceeds the threshold (not to exceed 80% of otherwise allowable deductions). For 2014, the thresholds are $254,200 (single), $279,650 (head of household), $305,050 (joint filer) and $152,525 (married filing separately).

If your AGI is close to the threshold, AGI-reduction strategies (such as making retirement plan and HSA contributions) may allow you to stay under it. If that's not possible, consider the reduced tax benefit of the affected deductions before implementing strategies to accelerate or defer deductible expenses. The limitation doesn't apply, however, to deductions for medical expenses, investment interest, or casualty, theft or wagering losses.

Additional 0.9% Medicare tax

If you're thinking about timing *income*, consider the additional 0.9% Medicare tax. Under the ACA, since 2013, taxpayers have had to pay this tax on FICA wages and self-employment income exceeding $200,000 per year ($250,000 for joint filers and $125,000 for separate filers). You may be able to implement income timing strategies to avoid or minimize the tax, such as deferring or accelerating a bonus or a stock option exercise.

Be aware that employers are obligated to withhold the additional tax beginning in the pay period when wages exceed $200,000 for the calendar year — without regard to an employee's filing status or income from other sources. So your employer might withhold the tax even if you aren't liable for it — or it might *not* withhold the tax even though you *are* liable for it.

If you *don't* owe the tax but your employer *is* withholding it, you can claim a credit on your 2014 income tax return. If you *do* owe the tax but your employer *isn't* withholding it, consider filing a W-4 form to request additional *income* tax withholding, which can be used to cover the shortfall and avoid interest and penalties.

CASE STUDY I — Making the most of charitable donations

Last year Leslie earned a promotion that came with a significant salary increase and an opportunity for a larger bonus. As a result, she decided to step up her charitable giving in 2014. She knew that donations to qualified charities were generally fully deductible for both regular tax and AMT purposes, so she asked her tax advisor how she could maximize both the benefit to charity and her tax savings. He explained that donations may be the easiest deductible expense for her to time to her tax advantage, because she has complete control over when and how much she gives.

For a large donation, Leslie's tax advisor suggested she carefully consider which assets to give and the best ways to give them. For example, publicly traded stock and other securities she'd held more than one year could make one of the best donations. Why? Because she could deduct the current fair market value and avoid the capital gains tax she'd pay if she sold the securities.

Leslie also mentioned that her father was charitably inclined but concerned about having enough income through the remainder of his retirement to support his desired lifestyle. Her tax advisor suggested a charitable remainder trust (CRT): For the rest of Leslie's father's life, the CRT would pay an amount to him annually (some of which would be taxable). At his death, the CRT's remaining assets would pass to one or more charities. When her father funded the CRT, he'd receive a partial income tax deduction. If he contributed appreciated assets, he also could minimize and defer capital gains tax.

Turn saving tax dollars into a family tradition

2014 may be another good year for families to save taxes. Most of the child- and education-related tax breaks on the table the last several years are available once again to parents — or in some cases to grandparents or to students themselves. Make sure that you and your family are taking advantage of the credits, deductions and other tax-saving opportunities that apply to you. Savvy, strategic tax-related decision-making can become a family tradition, if it's not already.

Child and adoption credits

Tax credits reduce your tax bill dollar-for-dollar, so make sure you're taking every credit you're entitled to. For each child under age 17 at the end of the year, you may be able to claim a $1,000 child credit.

If you adopt in 2014, you may qualify for an adoption credit — or for an income exclusion under an employer adoption assistance program. Both are $13,190 per eligible child.

Warning: These credits phase out for higher-income taxpayers. (See Chart 1.)

Child care expenses

A couple of tax breaks can help you offset these costs:

Tax credit. For children under age 13 or other qualifying dependents, you may be eligible for a credit for a portion of your dependent care expenses. Eligible expenses are limited to $3,000 for one dependent and $6,000 for two or more. Income-based limits reduce the credit but don't phase it out altogether. (See Chart 1.)

FSA. You can contribute up to $5,000 pretax to an employer-sponsored child and dependent care Flexible Spending Account. The plan pays or reimburses you for these expenses. You can't use those same expenses to claim a tax credit.

IRAs for teens

IRAs can be perfect for teenagers because they likely will have many years to let their accounts grow tax-deferred or tax-free. The 2014 contribution limit is the lesser of $5,500 or 100% of earned income. Traditional IRA contributions generally are deductible, but distributions will be taxed. On the other hand, Roth IRA contributions aren't deductible, but qualified distributions will be tax-free.

Choosing a Roth IRA is typically a no-brainer if a teen doesn't earn income that exceeds the standard deduction ($6,200 for 2014 for single taxpayers), because he or she will likely gain no benefit from the ability to deduct a traditional IRA contribution. See Case Study II for an illustration of just how powerful Roth IRAs for teens can be. (For more information on IRAs, see page 12.)

If your children or grandchildren don't want to invest their hard-earned money, consider *giving* them the amount they're eligible to contribute — but keep the gift tax in mind. (See page 14.) If they don't have earned income and you own a business, consider hiring them. As the business owner, you can deduct their pay, and other tax benefits may apply. ***Warning:*** The children must be paid in line with what you'd pay nonfamily employees for the same work.

CHART 1 2014 family and education tax breaks: Are you eligible?

Tax break	Modified adjusted gross income phaseout range	
	Single filer	**Joint filer**
Child credit[1]	$ 75,000 – $ 95,000	$110,000 – $130,000
Adoption credit	$197,880 – $237,880	$197,880 – $237,880
Child or dependent care credit[2]	$ 15,000 – $ 43,000	$ 15,000 – $ 43,000
ESA contribution	$ 95,000 – $110,000	$190,000 – $220,000
American Opportunity credit	$ 80,000 – $ 90,000	$160,000 – $180,000
Lifetime Learning credit	$ 54,000 – $ 64,000	$108,000 – $128,000
Student loan interest deduction	$ 65,000 – $ 80,000	$130,000 – $160,000

[1] *Assumes one child. The phaseout end is higher for families with more than one eligible child.*

[2] *The phaseout is based on AGI rather than MAGI. The credit doesn't phase out altogether, but the minimum credit percentage of 20% applies to AGIs above $43,000.*

The "kiddie tax"

The "kiddie tax" applies to children under age 19 as well as to full-time students under age 24 (unless the students provide more than half of their own support from earned income).

For children subject to the tax, any unearned income beyond $2,000 (for 2014) is taxed at their parents' marginal rate rather than their own, likely lower, rate. Keep this in mind before transferring income-generating assets to them.

529 plans

If you're saving for college, consider a Section 529 plan. You can choose a prepaid tuition program to secure current tuition rates or a tax-advantaged savings plan to fund college expenses:

- Although contributions aren't deductible for federal purposes, plan assets can grow tax-deferred. (Some states do offer tax incentives, in the form of either deductions or credits.)
- Distributions used to pay qualified expenses (such as tuition, mandatory fees, books, equipment, supplies and, generally, room and board) are income-tax-free for federal purposes and typically for state purposes as well.
- The plans usually offer high contribution limits, and there are no income limits for contributing.
- There's generally no beneficiary age limit for contributions or distributions.
- You remain in control of the account, even after the child is of legal age.
- You can make tax-free rollovers to another qualifying family member.
- The plans provide estate planning benefits: A special break for 529 plans allows you to front-load five years' worth of annual gift tax exclusions and make a $70,000 contribution (or $140,000 if you split the gift with your spouse).

The biggest downsides may be that your investment options — and when you can change them — are limited.

CASE STUDY II — Roth IRAs: A powerful savings tool for teens

Roth IRAs can be perfect for teenagers — just look at how much difference starting contributions early can make: Both Ethan and Hannah contribute $5,500 per year to their Roth IRAs through age 66. But Ethan starts contributing when he gets his first job at age 16, while Hannah waits until age 23, after she's graduated from college and started her career. Ethan's additional $38,500 of early contributions results in a nest egg at full retirement age of 67 that's nearly $600,000 larger!

Total contributions made

Ethan: $280,500

Hannah: $242,000

Balance at age 67

Ethan: $1,698,158

Hannah: $1,098,669

Note: *This example is for illustrative purposes only and isn't a guarantee of future results. The figures presume $5,500 is contributed at the end of each year over the ages shown and a 6% rate of return.* *See page 12 for more information on Roth IRA contribution rules.*

ESAs

Coverdell Education Savings Accounts (ESAs) are similar to 529 savings plans in that contributions aren't deductible for federal purposes, but plan assets can grow tax-deferred and distributions used to pay qualified education expenses are income-tax-free. One of the biggest ESA advantages is that tax-free distributions aren't limited to college expenses; they also can fund elementary and secondary school costs. ESAs are worth considering if you want to fund such expenses or would like to have direct control over how and where your contributions are invested.

But the $2,000 contribution limit is low, and it's phased out based on income. (See Chart 1.) Amounts left in an ESA when the beneficiary turns age 30 generally must be distributed within 30 days, and any earnings may be subject to tax and a 10% penalty.

Education credits and deductions

If you have children in college now, are currently in school yourself or are paying off student loans, you may be eligible for a credit or deduction:

American Opportunity credit. This tax break covers 100% of the first $2,000 of tuition and related expenses and 25% of the next $2,000 of expenses. The maximum credit, *per student,* is $2,500 per year for the first four years of postsecondary education. The credit is scheduled to be available through 2017.

Lifetime Learning credit. If you're paying postsecondary education expenses beyond the first four years, you may benefit from the Lifetime Learning credit (up to $2,000 *per tax return*).

Tuition and fees deduction. If you don't qualify for one of the credits because your income is too high, you might be eligible to *deduct* up to $4,000 of qualified higher education tuition and fees — but only if this break is extended for 2014. (Check with your tax advisor for the latest information.)

Student loan interest deduction. If you're paying off student loans, you may be able to deduct the interest. The limit is $2,500 *per tax return*.

Warning: Income-based phaseouts apply to these breaks (see Chart 1), and expenses paid with distributions from 529 plans or ESAs can't be used to claim them.

No easy task: Tax planning for investments involves many considerations

When it comes to tax planning and your investments, it can be difficult to know where to start. First, tax treatment of investments varies based on a number of factors. You need to understand the potential tax consequences of buying, holding and selling a particular investment. Higher-income taxpayers also need to know when higher capital gains tax rates and the ACA's net investment income tax (NIIT) kick in. Yet, it's unwise to make investment decisions based solely on tax consequences — you should consider your risk tolerance and desired return as well. Finally, your portfolio and your resulting tax picture can change quickly because of market volatility. Vigilance is necessary to achieve both your tax and investment goals.

Capital gains tax and timing

Although time, not timing, is generally the key to long-term investment success, timing can have a dramatic impact on the tax consequences of investment activities. Your long-term capital gains rate might be as much as 20 percentage points lower than your ordinary-income rate. The long-term gains rate applies to investments held for more than 12 months. The applicable rate depends on your income level and the type of asset. (See Chart 2.)

Holding on to an investment until you've owned it more than a year may help substantially cut tax on any gain. Here are some other tax-saving strategies related to timing:

Use unrealized losses to absorb gains. To determine capital gains tax liability, realized capital gains are netted against any realized capital losses. If you've cashed in some big gains during the year and want to reduce your 2014 tax liability, before year end look for unrealized losses in your portfolio and consider selling them to offset your gains.

Avoid wash sales. If you want to achieve a tax loss with minimal change in your portfolio's asset allocation, keep in mind the wash sale rule. It prevents you from taking a loss on a security if you buy a substantially identical security (or an option to buy such a security) within 30 days before or after you sell the security that created the loss. You can recognize the loss only when you sell the replacement security.

Fortunately, there are ways to avoid triggering the wash sale rule and still achieve your goals. For example, you can immediately buy securities of a different company in the same industry or shares in a mutual fund that holds securities much like the ones you sold. Or, you may wait 31 days to repurchase the same security. Alternatively, before selling the security, you can purchase additional shares of that security equal to the number you want to sell at a loss, and then wait 31 days to sell the original portion.

CASE STUDY III — Avoiding or reducing a 3.8% NIIT hit

When Edgar and Julia filed their 2013 joint tax return, they were surprised to be hit with a new tax on their investments: the NIIT. Under the ACA, starting in 2013, taxpayers with modified adjusted gross income (MAGI) over $200,000 per year ($250,000 for married filing jointly and $125,000 for married filing separately) are subject to this extra 3.8% tax on the lesser of their net investment income or the amount by which their MAGI exceeds the applicable threshold.

To learn how they might reduce their NIIT hit in 2014 (or perhaps even avoid the tax), Edgar and Julia decided to consult a tax advisor. The advisor explained that many of the strategies that can help save or defer income tax on investments can also help avoid or defer NIIT liability. For example, they could use unrealized losses to absorb gains or transfer highly appreciated or income-producing assets to a family member who isn't subject to the NIIT. And because the threshold for the NIIT is based on MAGI, strategies that reduce MAGI — such as making retirement plan contributions (see page 12) — could also help avoid or reduce NIIT liability.

Swap your bonds. With a bond swap, you sell a bond, take a loss and then immediately buy another bond of similar quality and duration from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical. Thus, you achieve a tax loss with virtually no change in economic position.

Mind your mutual funds. Mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you more tax dollars because of the lower long-term rates.

See if a loved one qualifies for the 0% rate. The 0% rate applies to long-term gain that would be taxed at 10% or 15% based on the taxpayer's ordinary-income rate. If you have adult children in one of these tax brackets, consider transferring appreciated assets to them so they can enjoy the 0% rate. This strategy can be even more powerful if you'd be subject to the 3.8% NIIT or the 20% long-term capital gains rate if you sold the assets.

Warning: If the child will be under age 24 on Dec. 31, first make sure he or she won't be subject to the "kiddie tax." (See page 5.) Also, consider any gift tax consequences. (See page 14.)

Loss carryovers

If net losses exceed net gains, you can deduct only $3,000 ($1,500 for married taxpayers filing separately) of the net losses per year against ordinary income (such as wages, self-employment and business income, and interest).

You can carry forward excess losses indefinitely. Loss carryovers can be a powerful tax-saving tool in future years if you have a large investment portfolio, real estate holdings or a closely held business that might generate substantial future capital gains.

Be aware, however, that loss carryovers die with the taxpayer. So older or seriously ill taxpayers may want to sell investments at a gain now to absorb these losses.

CHART 2 What's the maximum capital gains tax rate?

Assets held	2014[1]
12 months or less (*short term*)	Taxpayer's ordinary-income tax rate
More than 12 months (*long term*)	
• 39.6% ordinary-income tax bracket	20%
• 25%, 28%, 33% or 35% ordinary-income tax bracket	15%
• 10% or 15% ordinary-income tax bracket	0%
Some key exceptions	
Long-term gain on collectibles, such as artwork and antiques	28%
Long-term gain attributable to certain recapture of prior depreciation on real property	25%

[1] *In addition, the 3.8% NIIT applies to net investment income to the extent that modified adjusted gross income (MAGI) exceeds $200,000 (singles and heads of households), $250,000 (married filing jointly) or $125,000 (married filing separately.)*

They can immediately reinvest the proceeds in the same stocks if they wish to maintain their position. The wash sale rule isn't an issue because it applies only to losses, not to gains.

Alternatively, they can use the proceeds to purchase different stocks and diversify their portfolio at no tax cost.

Finally, remember that capital gains distributions from mutual funds can also absorb capital losses.

Beyond gains and losses

With some types of investments, you'll have more tax consequences to consider than just gains and losses:

Dividend-producing investments. Qualified dividends are taxed at the favorable long-term capital gains tax rate rather than at your higher, ordinary-income tax rate. ***Warning:*** Qualified dividends are included in investment income under the 3.8% NIIT.

Interest-producing investments. Interest income generally is taxed at ordinary-income rates. So, in terms of income investments, stocks that pay qualified dividends may be more attractive tax-wise than, for example, CDs or money market accounts. But nontax issues must be considered as well, such as investment risk and diversification.

Bonds. These also produce interest income, but the tax treatment varies:

- Interest on U.S. government bonds is taxable on federal returns but generally exempt on state and local returns.
- Interest on state and local government bonds is excludable on federal returns. If the bonds were issued in your home state, interest also may be excludable on your state return.
- Tax-exempt interest from certain private-activity municipal bonds can trigger or increase the alternative minimum tax (AMT — see page 2) in some situations.
- Corporate bond interest is fully taxable for federal and state purposes.
- Bonds (except U.S. savings bonds) with original issue discount (OID) build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay this interest annually — and you must pay tax on it.

Stock options. Before exercising (or postponing exercise of) options or selling stock purchased via an exercise, consult your tax advisor about the complicated rules that may trigger regular tax or AMT liability. He or she can help you plan accordingly.

Tackle 2014's tax planning challenges head on

Tax planning could be a challenge for businesses this year. As of this writing, several valuable tax breaks that expired Dec. 31, 2013, have not been revived by Congress. In addition, some significant tax-related changes under the ACA require attention. Finally, with the economic recovery continuing to move forward at a snail's pace in many sectors, you may not know which tax strategies will be appropriate this year. You can tackle these challenges head on by reviewing the information here and then discussing the relevant issues with your tax advisor.

Projecting income

Projecting your business's income for this year and next can allow you to time income and deductions to your advantage. It's generally — but not always — better to defer tax, so consider:

Deferring income to next year. If your business uses the cash method of accounting, you can defer billing for products or services. If you use the accrual method, you can delay shipping products or delivering services.

Accelerating deductible expenses into the current year. If you're a cash-basis taxpayer, you may make a state estimated tax payment by Dec. 31, so you can deduct it this year rather than next. But consider the alternative minimum tax (AMT) consequences first. Both cash- and accrual-basis taxpayers can charge expenses on a credit card and deduct them in the year charged, regardless of when the credit card bill is paid.

Warning: Don't let tax considerations get in the way of sound business decisions. For example, the negative impact of these strategies on your cash flow may not be worth the potential tax benefit.

Taking the opposite approach. If it's likely you'll be in a higher tax bracket next year, accelerating income and deferring deductible expenses may save you more tax.

WHAT'S NEW!

ACA's play-or-pay provision scheduled to take effect Jan. 1, 2015

Who's affected: "Large" employers, which for 2015 generally include those with at least 100 full-time employees or the equivalent, as defined by the ACA. However, the threshold is scheduled to drop to 50 beginning in 2016.

Key changes: The play-or-pay provision imposes a penalty on large employers if just one full-time employee receives a premium tax credit. Under the ACA, premium tax credits are available to employees who enroll in a qualified health plan through a government-run Health Insurance Marketplace and meet certain income requirements — but only if:

- They don't have access to "minimum essential coverage" from their employer, or
- The employer coverage offered is "unaffordable" or doesn't provide "minimum value."

The IRS has issued detailed guidance on what these terms mean and how employers can determine whether they're a "large" employer and, if so, whether they're offering sufficient coverage to avoid the risk of penalties. Final IRS regulations issued in February 2014 offer some transitional relief.

Planning tips: Although the play-or-pay provision isn't scheduled to take effect until Jan. 1, 2015, if your business could be subject to the penalties, start reviewing your workforce and coverage offerings now. There may be changes you could make to avoid or minimize penalties. Or it may be cheaper to pay the penalties. But remember that penalties aren't deductible, and not offering health care coverage could make it harder to attract and retain the best employees. Finally, keep in mind that the IRS may issue additional guidance or transitional relief, or Congress could make changes to the law. Check with your tax advisor for the latest information.

Depreciation

For assets with a useful life of more than one year, you generally must depreciate the cost over a period of years. In most cases, the Modified Accelerated Cost Recovery System (MACRS) will be preferable to the straight-line method because you'll get larger deductions in the early years of an asset's life.

But if you make more than 40% of the year's asset purchases in the last quarter, you could be subject to the typically less favorable midquarter convention. Careful planning can help you maximize depreciation deductions in the year of purchase.

Other depreciation-related breaks and strategies also may be available:

Section 179 expensing election. This allows you to deduct (rather than depreciate over a number of years) the cost of purchasing eligible new or used assets, such as equipment, furniture and off-the-shelf computer software. As of this writing, the expensing limit for 2014 is $25,000, and the break begins to phase out dollar-for-dollar when total asset acquisitions for the tax year exceed $200,000. You can claim the election only to offset net income, not to reduce it below zero to create an NOL. (See page 10.)

Warning: The expensing limit and phaseout threshold have dropped significantly from their 2013 levels. And the break allowing up to $250,000 of Sec. 179 expensing for qualified leasehold-improvement, restaurant and retail-improvement property also expired Dec. 31, 2013. Congress may revive the enhanced Sec. 179 breaks. So check with your tax advisor for the latest information.

50% bonus depreciation. This additional first-year depreciation allowance expired Dec. 31, 2013, with a few exceptions. But Congress may revive bonus depreciation. Check with your tax advisor for the latest information.

Accelerated depreciation. The break allowing a shortened recovery period of 15 years — rather than 39 years — for qualified leasehold-improvement, restaurant and retail-improvement property expired Dec. 31, 2013. However, it might be revived. Check with your tax advisor for the latest information.

Cost segregation study. If you've recently purchased or built a building or are remodeling existing space, consider a cost segregation study. It identifies property components that can be depreciated much faster, increasing your current deductions. Typical assets that qualify include decorative fixtures, security equipment, parking lots and landscaping.

Vehicle-related deductions

Business-related vehicle expenses can be deducted using the mileage-rate method (56 cents per mile driven in 2014) or the actual-cost method (total out-of-pocket expenses for fuel, insurance and repairs, plus depreciation).

Purchases of *new or used* vehicles may be eligible for Sec. 179 expensing. However, many rules and limits apply. For example, the normal Sec. 179 expensing limit generally applies to vehicles weighing more than 14,000 pounds. Even when the normal Sec. 179 expensing limit is higher, a $25,000 limit applies to SUVs weighing more than 6,000 pounds.

Vehicles weighing 6,000 pounds or less are subject to the passenger automobile limits. For autos placed in service in 2014, the first-year depreciation limit is $3,160. The amount that may be deducted under the combination of MACRS depreciation

WHAT'S NEW!

IRS has issued final regs for tangible property repairs vs. improvements

Who's affected: Businesses that have made repairs or improvements to tangible property, such as buildings, machinery, equipment and vehicles.

Key changes: Costs incurred to acquire, produce or improve tangible property must be depreciated. But costs incurred on incidental repairs and maintenance can be expensed and immediately deducted. The final IRS regulations make distinguishing between repairs and improvements simpler. Here are some key provisions:

- **Routine maintenance safe harbor.** Recurring activities dedicated to keeping property in efficient operating condition can be expensed. Routine activities are those that your business reasonably expects to perform more than once during the property's "class life," as defined by the IRS.
- **Small business safe harbor.** For buildings that initially cost $1 million or less, qualified small businesses may elect to deduct the lesser of $10,000 or 2% of the adjusted basis of the property for repairs, maintenance, improvements and similar activities each year. (A qualified small business is generally one with gross receipts of $10 million or less.)
- **Materials and supplies.** The final regs increase the dollar threshold for property that's exempt from depreciation to $200 (from $100). In addition:
  - Incidental materials and supplies (such as office and cleaning supplies) can be deducted when purchased.
  - Nonincidental materials and supplies (such as small engine parts, saw blades, and fuel and motor oil) can be deducted only after first used or consumed.

The final regs also address how to identify "units of property" when distinguishing repairs from improvements in relation to commercial buildings.

Planning tips: These are only some of the rules under the final regs, which apply to tax years beginning on or after Jan. 1, 2014. Contact your tax advisor to learn exactly how the final regs apply to you and ensure that you're taking all of the repair and maintenance deductions you're entitled to.

and Sec. 179 for the first year is limited under the luxury auto rules.

In addition, if a vehicle is used for business and personal purposes, the associated expenses, including depreciation, must be allocated between deductible business use and nondeductible personal use. The depreciation limit is reduced if the business use is less than 100%. If business use is 50% or less, you can't use Sec. 179 expensing or the accelerated regular MACRS; you must use the straight-line method.

Manufacturers' deduction

The manufacturers' deduction, also called the "Section 199" or "domestic production activities deduction," is 9% of the lesser of qualified production activities income or taxable income. The deduction is also limited to 50% of W-2 wages paid by the taxpayer that are allocable to domestic production gross receipts. The deduction is available to traditional manufacturers and to businesses engaged in activities such as construction, engineering, architecture, computer software production and agricultural processing. It isn't allowed in determining net self-employment earnings and generally can't reduce net income below zero. But it can be used against the AMT.

Employee benefits

Offering a variety of benefits not only can help you attract and retain the best employees, but also may save tax:

Qualified deferred compensation plans. These include pension, profit-sharing, SEP and 401(k) plans, as well as SIMPLEs. You take a tax deduction for your contributions to employees' accounts. (For information on the benefits to employees, see page 12.) Certain small employers may also be eligible for a credit when setting up a plan. (See page 11.)

HSAs and FSAs. If you provide employees with a qualified high-deductible health plan (HDHP), you can also offer them Health Savings Accounts. Regardless of the type of health insurance you provide, you can offer Flexible Spending Accounts for health care. (See page 3.) If you have employees who incur day care expenses, consider offering FSAs for child and dependent care. (See page 4.)

HRAs. A Health Reimbursement Account reimburses an employee for medical expenses up to a maximum dollar amount. Unlike an HSA, no HDHP is required. Unlike an FSA, any unused portion can be carried forward to the next year. But only the employer can contribute to an HRA.

Fringe benefits. Some fringe benefits — such as employee discounts, group term-life insurance (up to $50,000 annually per person), parking (up to $250 per month), mass transit / van pooling (up to only $130 per month, unless Congress revives transit benefit parity; check with your tax advisor for the latest information), and health insurance — aren't included in employee income. Yet the employer can still receive a deduction for the portion, if any, of the benefit it pays and typically avoid payroll tax as well.

NOLs

A net operating loss occurs when operating expenses and other deductions for the year exceed revenues. Generally, an NOL may be carried back two years to generate a refund. Any loss not absorbed is carried forward up to 20 years to offset income.

Carrying back an NOL may provide a needed influx of cash. But you can elect to forgo the carryback if carrying the entire loss forward may be more beneficial. This might be the case if you expect your income to increase substantially or tax rates to go up.

Tax credits

Tax credits reduce tax liability dollar-for-dollar, making them particularly valuable. Numerous credits are available, but two of the most valuable

WHAT'S NEW!

Small businesses might enjoy a larger health care coverage credit in 2014

Who's affected: Businesses with fewer than 25 full-time equivalent employees (FTEs as defined by the ACA for purposes of this credit) and average annual wages of less than $50,800 (for 2014).

Key changes: A few significant changes go into effect in 2014:

- **Maximum credit.** It has increased to 50% (from 35% in 2013) of group health coverage premiums paid by the employer, provided it contributes at least 50% of the total premium or of a benchmark premium. The qualification requirements for the full credit vs. a partial credit remain the same: The full credit is available for employers with 10 or fewer FTEs and average annual wages of $25,400 (for 2014) or less per employee. Partial credits are available on a sliding scale to businesses with fewer than 25 FTEs and average annual wages of less than $50,800 (for 2014).
- **Two-year limit.** The credit now can be taken for only two years, which must be *consecutive* years. But, even if you claimed it for tax years *before* 2014, you can still claim the credit for two years beginning in 2014 or later.
- **SHOP requirement.** Beginning in 2014, the ACA requires you to purchase Small Business Health Options Program (SHOP) coverage to qualify for the credit. However, the Treasury Department announced that employers without access to SHOP coverage will be eligible for the credit as long as they provide coverage that meets the guidelines of a SHOP plan.

Planning tips: If you're eligible for the credit this year but you think it could provide a greater benefit in a future year, you may want to refrain from taking it now.

expired Dec. 31, 2013, and, as of this writing, have yet to be revived:

1. Research credit. When available, this credit (also commonly referred to as the "research and development" or "research and experimentation" credit) generally is equal to a portion of qualified research expenses.

2. Work Opportunity credit. This credit was designed to encourage hiring from certain disadvantaged groups. Examples of groups that have qualified in the past include food stamp recipients, ex-felons and certain veterans.

Check with your tax advisor for the latest information on the status of these and other expired credits.

One credit that didn't expire is the retirement plan credit. Small employers (generally those with 100 or fewer employees) that create a retirement plan may be eligible for a $500 credit per year for three years. The credit is limited to 50% of qualified startup costs.

Business structure

Income taxation and owner liability are the main factors that differentiate one business structure from another. (See Chart 3 to compare the tax treatments.) Many businesses choose entities that combine flow-through taxation with limited liability, namely limited liability companies (LLCs) and S corporations.

The top individual rate is now higher (39.6%) than the top corporate rate (generally 35%), which might affect business structure decisions. For tax or other reasons, a structure change may be beneficial in certain situations, but there also may be unwelcome tax consequences.

Some tax differences between structures may provide tax planning opportunities, such as differences related to salary vs. distributions/dividends:

S corporations. Only income that shareholder-employees receive as salary is subject to employment taxes and, if applicable, the 0.9% Medicare tax. To reduce these taxes, you may want to keep your salary relatively (but not unreasonably) low and increase your distributions of company income — which generally isn't taxed at the corporate level or subject to the 0.9% Medicare tax (see page 3) or 3.8% NIIT (see page 6).

C corporations. Only income that shareholder-employees receive as salary (which is deductible at the corporate level) is subject to employment taxes and, if applicable, the 0.9% Medicare tax. Nevertheless, you may prefer to take more income as salary as opposed to dividends (which aren't deductible at the corporate level, but are taxed at the shareholder level and could be subject to the 3.8% NIIT) if the overall tax paid by both the corporation and you would be less.

Warning: The IRS is cracking down on misclassification of corporate payments to shareholder-employees, so tread carefully.

CHART 3 Income tax differences based on business structure

Flow-through entity or sole proprietorship	C corporation
One level of taxation: The business's income flows through to the owner(s).	Two levels of taxation: The business is taxed on income, and then shareholders are taxed on any dividends they receive.
Losses flow through to the owner(s).	Losses remain at the corporate level.
The top individual tax rate is 39.6%.	The top corporate tax rate is generally 35%[1], and the top rate on qualified dividends is 20%.

[1] *See Chart 7 on page 16 for exceptions.*

Sale or acquisition

Whether you're selling your business or acquiring another company, the tax consequences can have a major impact on the transaction's success or failure.

Consider installment sales, for example. A taxable sale might be structured as an installment sale if the buyer lacks sufficient cash or pays a contingent amount based on the business's performance. An installment sale also may make sense if the seller wishes to spread the gain over a number of years — which could be especially beneficial if it would allow the seller to stay under the thresholds for triggering the 3.8% NIIT or the 20% long-term capital gains rate. But an installment sale can backfire on the seller. For example:

- Depreciation recapture must be reported as gain in the year of sale, no matter how much cash the seller receives.
- If tax rates increase, the overall tax could wind up being more.

With a corporation, a key consideration is whether the deal should be structured as an asset sale or a stock sale. If a stock sale is chosen, another important question is whether it should be a tax-deferred transfer or a taxable sale.

Of course, tax consequences are only one of many important considerations when planning a sale or acquisition.

The self-employed

If you're self-employed, you can deduct 100% of health insurance costs for yourself, your spouse and your dependents. This above-the-line deduction is limited to your net self-employment income. You also can take an above-the-line deduction for contributions made to a retirement plan (see page 12) and, if you're eligible, an HSA (see page 3) for yourself.

You pay both the employee and employer portions of employment taxes on your self-employment income, and the employ*er* portion of the tax paid (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible above the line.

And you may be able to deduct home office expenses from your self-employment income. (See page 2.)

Making golden decisions about your golden years

Planning for your retirement means making a series of financial decisions that will have an impact on your golden years: Should you invest in a traditional tax-deferred plan, a Roth plan that offers tax-free distributions, or both? If you opt for a Roth plan, which of the several options available is right for you? Also, when should you start withdrawing from your retirement savings, and in what amounts? Whether you're just starting to think about retirement planning, are retired already or are somewhere in between, addressing the questions relevant to your current situation will help ensure your golden years are truly golden.

401(k)s and other employer plans

Contributing to a traditional employer-sponsored defined contribution plan is usually a good first step:

- Contributions are typically pretax, reducing your taxable income.
- Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions.
- Your employer may match some or all of your contributions pretax.

Chart 4 shows the 2014 employee contribution limits. Because of tax-deferred compounding, increasing your contributions sooner rather than later can have a significant impact on the size of your nest egg at retirement. If, however, you're age 50 or older and didn't contribute much when you were younger, you may be able to partially make up for lost time with "catch-up" contributions.

If your employer offers a match, at *minimum* contribute the amount necessary to get the maximum match so you don't miss out on that "free" money.

More tax-deferred options

In certain situations, other tax-deferred savings options may be available:

You're a business owner or self-employed. You may be able to set up a plan that allows you to make much larger contributions than you could make to an employer-sponsored plan as an employee. You might not have to make 2014 contributions, or even set up the plan, before year end.

Your employer doesn't offer a retirement plan. Consider a traditional IRA. You can likely deduct your contributions, though your deduction may be limited if your spouse participates in an employer-sponsored plan. You can make 2014 contributions as late as April 15, 2015. Your annual contribution limit (see Chart 4) is reduced by any Roth IRA contributions you make for the year.

4 Roth options

A potential downside of tax-deferred saving is that you'll have to pay taxes when you make withdrawals at retirement. Roth plans, however, allow tax-free distributions; the tradeoff is that contributions to these plans don't reduce your current-year taxable income:

1. Roth IRAs. An income-based phaseout may reduce or eliminate your ability to contribute. But estate planning advantages are an added benefit: Unlike other retirement plans, Roth IRAs don't require you to take distributions during your life, so you can let the entire balance grow tax-free over your lifetime for the benefit of your heirs.

2. Roth conversions. If you have a traditional IRA, consider whether you might benefit from converting some or all of it to a Roth IRA. A conversion can allow you to turn tax-*deferred* future growth into tax-*free* growth and take advantage of a Roth IRA's estate planning benefits. There's no income-based limit on who can convert to a Roth IRA. But the converted amount is taxable in the year of the conversion.

CHART 4 Retirement plan contribution limits for 2014

	Regular contribution	Catch-up contribution[1]
Traditional and Roth IRAs	$ 5,500	$ 1,000
401(k)s, 403(b)s, 457s and SARSEPs[2]	$ 17,500	$ 5,500
SIMPLEs	$ 12,000	$ 2,500

[1] *For taxpayers age 50 or older by the end of the tax year.*

[2] *Includes Roth versions where applicable.*

Note: *Other factors may further limit your maximum contribution.*

CASE STUDY IV Don't start taking distributions before age 70½ if you don't have to

Tom has a $250,000 traditional IRA and will be subject to required minimum distributions (RMDs) when he turns age 70½ in five years. He's trying to decide whether to wait to take distributions until he's subject to RMDs or to start taking distributions now. His tax advisor runs some numbers and provides the following example:

	Distributions begin at age 70½			Distributions begin at age 65½		
Age at year end	Total distributions	Year end IRA balance	Combined total	Total distributions	Year end IRA balance	Combined total
70½	$ 12,546	$337,902	$350,448	$ 57,675	$265,380	$323,055
80½	$146,412	$371,497	$517,909	$162,811	$291,765	$454,576
90½	$338,313	$334,741	$673,054	$313,525	$262,898	$576,423

By waiting until age 70½ Tom would not only maintain a much larger balance, but, if he lived long enough, he'd also receive more total distributions. Even if he lived only long enough to take his first RMD, he'd still have about $27,000 more in combined distributions received and IRA balance than if he'd started taking distributions at age 65½. So if he can afford to leave the funds in the plan until age 70½, he may want to do so — even if it means depleting other investment accounts.

This example is for illustrative purposes only and isn't a guarantee of future results. It assumes a 6% return on the IRA funds and annual distributions equal to the greater of Tom's RMD or 5% of the IRA balance.

Whether a conversion makes sense depends on factors such as:

- Your age,
- Whether the conversion would push you into a higher income tax bracket or trigger the NIIT (see page 6),
- Whether you can afford to pay the tax on the conversion,
- Your tax bracket now and expected tax bracket in retirement, and
- Whether you'll need the IRA funds in retirement.

Your tax advisor can run the numbers and help you decide if a conversion is right for you this year.

3. "Back door" Roth IRAs. If the income-based phaseout prevents you from making Roth IRA contributions and you *don't* have a traditional IRA, consider setting up a traditional account and making a nondeductible contribution to it. You can then convert the traditional account to a Roth account with minimal tax impact.

4. Roth 401(k), Roth 403(b), and Roth 457 plans. Employers may offer one of these in addition to the traditional, tax-deferred version. You may make some or all of your contributions to the Roth plan, but any employer match will be made to the traditional plan. No income-based phaseout applies, so even high-income taxpayers can contribute. Plans can now more broadly permit employees to convert some or all of their existing traditional plan to a Roth plan.

Early withdrawals

Early withdrawals from retirement plans should be a last resort. With a few exceptions, distributions before age 59½ are subject to a 10% penalty on top of any income tax that ordinarily would be due on a withdrawal. Additionally, you'll lose the potential tax-deferred future growth on the withdrawn amount.

If you must make an early withdrawal and you have a Roth account, consider withdrawing from that. You can withdraw up to your contribution amount free of tax and penalty. Another option, if your employer-sponsored plan allows it, is to take a plan loan. You'll have to pay it back with interest and make regular principal payments, but you won't be subject to current taxes or penalties.

Early distribution rules also become important if you change jobs or retire and receive a lump-sum retirement plan distribution. You should request a direct rollover from your old plan to your new plan or IRA. Otherwise, you'll need to make an indirect rollover within 60 days to avoid tax and potential penalties.

Warning: The check you receive from your old plan may be net of 20% federal income tax withholding. If you don't roll over the gross amount (making up for the withheld amount with other funds), you'll be subject to income tax — and potentially the 10% penalty — on the difference.

Required minimum distributions

After you reach age 70½, you must take annual required minimum distributions (RMDs) from your IRAs (except Roth IRAs) and, generally, from your defined contribution plans. The noncompliance penalty equals 50% of the amount you should have withdrawn but didn't. You can avoid the RMD rule for a non-IRA Roth plan by rolling the funds into a Roth IRA.

Waiting to take distributions until age 70½ generally is advantageous. (See Case Study IV.) But a distribution (or larger distribution) in a year your tax bracket is low may save tax. Be sure, however, to consider the lost future tax-deferred growth and, if applicable, whether the distribution could: 1) cause Social Security payments to become taxable, 2) increase income-based Medicare premiums and prescription drug charges, or 3) affect tax breaks with income-based limits.

If you've inherited a retirement plan, consult your tax advisor about the distribution rules that apply to you. ◗

Seize opportunities while they're available

Now that estate, gift and generation-skipping transfer (GST) tax exemptions and rates no longer are scheduled to expire, estate planning may be a little easier. Plus, because the exemptions are at record-high levels, far fewer taxpayers need to worry about being subject to these taxes. But Congress could still pass legislation at any time making estate tax law changes — and not necessarily for the better. So whether or not you'd be subject to estate taxes under the current exemptions, it's a good idea to consider whether you can seize opportunities to potentially lock in tax savings today. Those same opportunities might not be available in the future.

Estate tax

The estate tax rate is currently 40%, and it's scheduled to remain at that level. The estate tax exemption increased to $5.34 million for 2014 (see Chart 5), and it will continue to be adjusted annually for inflation.

To avoid unintended consequences, review your estate plan in light of the changing exemption. A review will allow you to make the most of available exemptions and ensure your assets will be distributed according to your wishes.

Gift tax

The gift tax continues to follow the estate tax exemption and rates. (See Chart 5.) Any gift tax exemption used during life reduces the estate tax exemption available at death.

You can exclude certain gifts of up to $14,000 per recipient each year ($28,000 per recipient if your spouse elects to split the gift with you or you're giving community property) without depleting any of your gift tax exemption. This is the same as the 2013 amount. (The exclusion is adjusted for inflation annually, but it increases only in $1,000 increments, so it typically goes up only every few years.)

Warning: You need to use your 2014 exclusion by Dec. 31. The exclusion doesn't carry over from year to year. For example, if you don't make an annual exclusion gift to your granddaughter this year, you can't add $14,000 to your 2015 exclusion to make a $28,000 tax-free gift to her next year. (Case Study V shows just how powerful the annual exclusion can be.)

GST tax

The GST tax generally applies to transfers (both during life and at death) made to people more than one generation below you, such as your grandchildren. This is in addition to any gift or estate tax due. The GST tax continues to follow the estate tax exemption and rate. (See Chart 5.)

The GST tax exemption can be a valuable tax-saving tool for taxpayers with large estates whose children also have — or may eventually have — large estates. With proper planning, they can use the exemption to make transfers to grandchildren and avoid any tax at their children's generation.

State taxes

A federal estate tax deduction is available for state estate taxes paid. Keep in mind that some states impose estate tax at a lower threshold than the federal government does.

To avoid unexpected tax liability or other unintended consequences, it's critical to consider state law. Consult a tax advisor with expertise on your particular state.

Exemption portability

If one spouse dies and part (or all) of his or her estate tax exemption is unused at his or her death, the estate can elect

CASE STUDY V — Why annual exclusion gifts can be a powerful tax-saver

In 2014, Steve and Carol combine their $14,000 annual exclusions so that their three children and their children's spouses, along with their six grandchildren, each receive $28,000. The result is that $336,000 is removed from the couple's estates free of taxes.

If the same amounts were transferred to the recipients upon Steve's or Carol's death instead — and no estate or GST tax exemption was available — the tax hit, at the current 40% rate, would be $134,400 in federal estate taxes and $67,200 in GST taxes. So the annual exclusion gifts could potentially save the family $201,600 in taxes. If they maximize their annual exclusion gifts each year, just think about how much tax they could save!

to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption. ***Warning:*** Portability is available only for the most recently deceased spouse. It doesn't apply to the GST tax exemption and isn't recognized by some states. And it must be elected on an estate tax return for the deceased spouse — even if no tax is due.

The portability election will provide flexibility if proper planning hasn't been done before the first spouse's death. But portability doesn't protect future growth on assets from estate tax like applying the exemption to a credit shelter trust does. Trusts offer other benefits as well, such as creditor protection, remarriage protection, GST tax planning and state estate tax benefits.

So married couples should still consider marital and credit shelter trusts — and transferring assets to each other to the extent necessary to fully fund them at the first death. Transfers to a spouse (during life or at death) are tax-free under the marital deduction, assuming he or she is a U.S. citizen.

Tax-smart giving

Giving away assets now will help reduce the size of your taxable estate. Here are some strategies for tax-smart giving:

Choose gifts wisely. Consider both estate and income tax consequences and the economic aspects of any gifts you'd like to make:

- To minimize *estate tax*, gift property with the greatest future appreciation potential.
- To minimize *your beneficiary's income tax*, gift property that hasn't already appreciated significantly since you've owned it.
- To minimize *your own income tax*, don't gift property that's declined in value. Instead, consider selling the property so you can take the tax loss and then gifting the sale proceeds.

Plan gifts to grandchildren carefully. Annual exclusion gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers. For gifts to a grandchild that don't qualify for the exclusion to be tax-free, you generally must apply both your GST tax exemption and your gift tax exemption.

CHART 5 Transfer tax exemptions and rates

Year	Estate tax exemption[1]	Gift tax exemption	GST tax exemption	Estate, gift and GST tax rate
2013	$5.25 million	$5.25 million	$5.25 million	40%
2014	$5.34 million	$5.34 million	$5.34 million	40%
Future years	Indexed for inflation	Indexed for inflation	Indexed for inflation	40%

[1] *Less any gift tax exemption already used during life.*

Gift interests in your business. If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts. So, for example, if the discounts total 30%, in 2014 you can gift an ownership interest equal to as much as $20,000 tax-free because the discounted value doesn't exceed the $14,000 annual exclusion. ***Warning:*** The IRS may challenge the calculation; a professional, independent valuation is recommended.

Gift FLP interests. Another way to potentially benefit from valuation discounts is to set up a family limited partnership. You fund the FLP and then gift limited partnership interests. ***Warning:*** The IRS scrutinizes FLPs, so be sure to properly set up and operate yours.

Pay tuition and medical expenses. You may pay these expenses without the payment being treated as a taxable gift to the student or patient, as long as the payment is made directly to the provider.

Make gifts to charity. Donations to qualified charities aren't subject to gift tax and may provide an income tax deduction. (See Case Study I on page 3.)

Trusts

Trusts can provide significant tax savings while preserving some control over what happens to the transferred assets. You may want to consider these:

- A *credit shelter (or bypass) trust* helps married couples minimize estate tax and provides additional benefits.
- A *qualified terminable interest property (QTIP) trust* can benefit first a surviving spouse and then children from a prior marriage.
- A *qualified personal residence trust* (QPRT) allows you to give your home to your children today — removing it from your taxable estate at a reduced tax cost (provided you survive the trust's term) — while you retain the right to live in it for a certain period.
- A *grantor-retained annuity trust* (GRAT) works similarly to a QPRT but allows you to transfer other assets; you receive payments from the trust for a certain period.

Finally, a GST — or "dynasty" — trust can help you leverage both your gift and GST tax exemptions, and it can be an excellent way to potentially lock in the currently high exemptions while removing future appreciation from your estate.

Insurance

Along with protecting your family's financial future, life insurance can be used to pay estate taxes, equalize assets passing to children who aren't involved in a family business, or pass leveraged funds to heirs free of estate tax. Proceeds are generally income-tax-free to the beneficiary. And with proper planning, you can ensure proceeds are excluded from your taxable estate.

CHART 6 2014 individual income tax rate schedules

Tax rate	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
Regular tax brackets				
10%	$ 0 – $ 9,075	$ 0 – $ 12,950	$ 0 – $ 18,150	$ 0 – $ 9,075
15%	$ 9,076 – $ 36,900	$ 12,951 – $ 49,400	$ 18,151 – $ 73,800	$ 9,076 – $ 36,900
25%	$ 36,901 – $ 89,350	$ 49,401 – $127,550	$ 73,801 – $148,850	$ 36,901 – $ 74,425
28%	$ 89,351 – $186,350	$127,551 – $206,600	$148,851 – $226,850	$ 74,426 – $113,425
33%	$186,351 – $405,100	$206,601 – $405,100	$226,851 – $405,100	$113,426 – $202,550
35%	$405,101 – $406,750	$405,101 – $432,200	$405,101 – $457,600	$202,551 – $228,800
39.6%	Over $406,750	Over $432,200	Over $457,600	Over $228,800

Tax rate	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
AMT brackets				
26%	$ 0 – $182,500	$ 0 – $182,500	$ 0 – $182,500	$ 0 – $ 91,250
28%	Over $182,500	Over $182,500	Over $182,500	Over $ 91,250

AMT exemptions	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
Amount	$ 52,800	$ 52,800	$ 82,100	$ 41,050
Phaseout[1]	$117,300 – $328,500	$117,300 – $328,500	$156,500 – $484,900	$ 78,250 – $242,450

[1] *The AMT income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.*

Note: *Consult your tax advisor for AMT rates and exemptions for children subject to the "kiddie tax."*

CHART 7 2014 corporate income tax rate schedule

Tax rate	Tax brackets
15%	$ 0 – $ 50,000
25%	$ 50,001 – $ 75,000
34%	$ 75,001 – $ 100,000
39%	$ 100,001 – $ 335,000
34%	$ 335,001 – $10,000,000
35%	$10,000,001 – $15,000,000
38%	$15,000,001 – $18,333,333
35%	Over $18,333,333

Note: *Personal service corporations are taxed at a flat 35% rate.*

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Are you doing everything you can to save tax?

Making sure you keep your tax liability to a minimum is key to your overall financial health. Fortunately, there are some tried and true ways to help you achieve that goal. Below are tax-reduction strategies for individuals and businesses. Check off those that may apply to your situation:

Personal strategies:

- ❏ Accelerating or deferring income
- ❏ Maximizing or bunching deductions
- ❏ Watching out for AMT triggers
- ❏ Contributing to a retirement plan
- ❏ Donating to charity
- ❏ Claiming all possible exemptions and credits
- ❏ Taking child-related breaks
- ❏ Timing capital gains and losses
- ❏ Planning for retirement distributions
- ❏ Participating in a flexible spending plan
- ❏ Taking advantage of education savings plans
- ❏ Making timely estimated tax payments
- ❏ Incorporating tax planning into your estate plan

Business strategies:

- ❏ Selecting a tax-advantaged business structure
- ❏ Claiming all credits for which you're eligible
- ❏ Deducting all eligible business expenses
- ❏ Accelerating or deferring income
- ❏ Using a tax-smart depreciation method
- ❏ Considering a cost segregation study
- ❏ Qualifying expenditures as repairs
- ❏ Taking advantage of the expensing provision
- ❏ Evaluating the merits of leasing
- ❏ Choosing an inventory method that saves tax
- ❏ Setting up a retirement plan
- ❏ Making timely estimated tax payments
- ❏ Incorporating tax planning into your exit plan

We would welcome the opportunity to help you pay as little tax as necessary. Please call us today to talk about ways to put these and other strategies to work for you.

Morison Cogen LLP
150 Monument Road
Suite 500
Bala Cynwyd, PA 19004 USA

p. 267-440-3000
f. 267-440-3001

www.morisoncogen.com