Drucker & Scaccetti

Tax As A Business Strategy®

Tax & Financial Planning 2014-2015

A Year-Round, Year-End Guide

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2014 Income Tax Rates

This guide aims to provide accurate and authoritative information. The guide is distributed with the caveat that neither the publisher nor the distributor is herein rendering legal, accounting, or other professional services, and they assume no liability whatsoever in connection with its use. Because the information in this guide may not apply to your personal situation, always discuss tax, financial, and legal questions with competent professional counsel.
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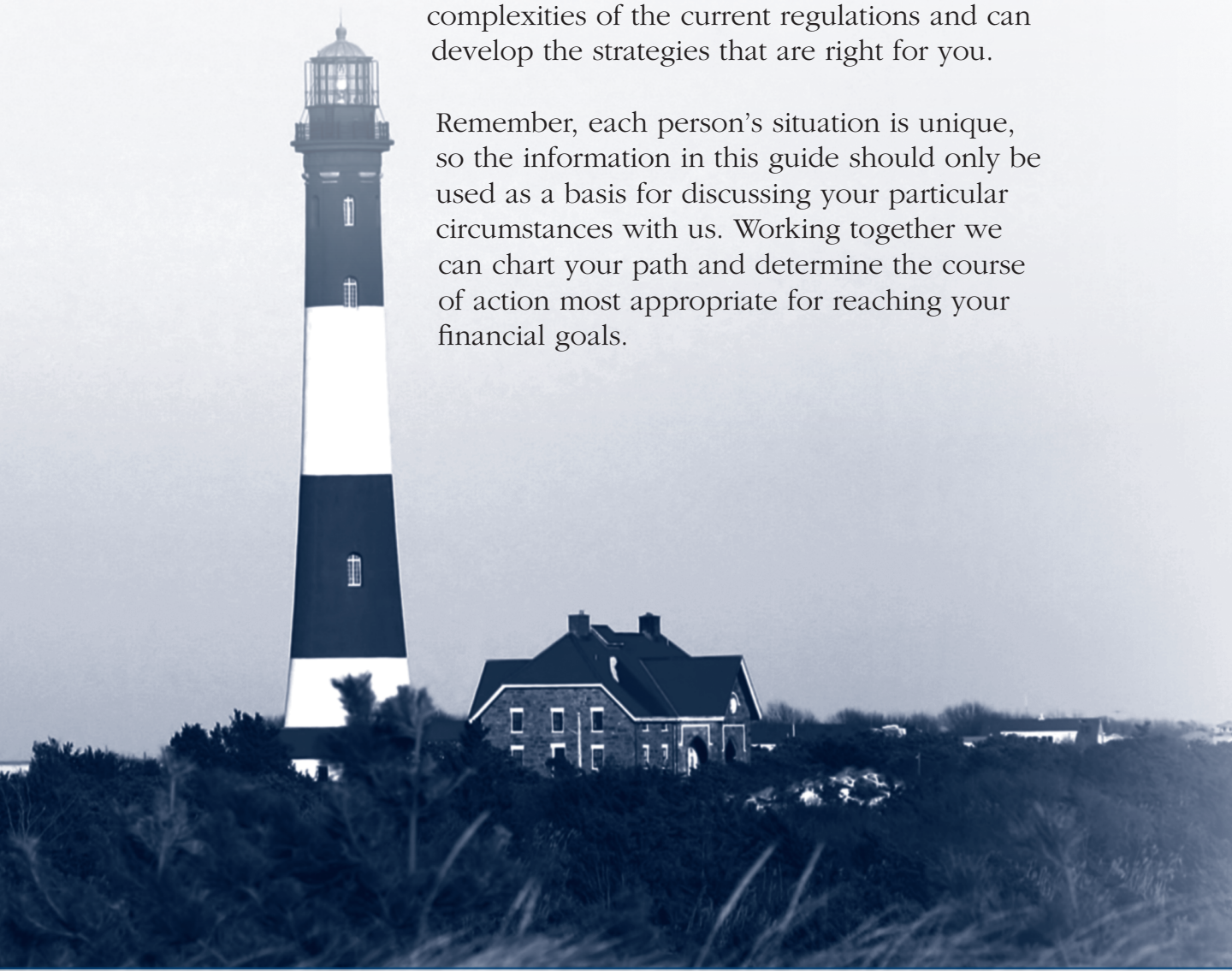
Finding Your Way

For hundreds of years lighthouses have illuminated the path to safe passage and warned of hidden dangers. Taking advantage of the benefits and avoiding the pitfalls created by the tax code changes of the past several years require the guidance of knowledgeable professionals who can do the same for you.

Making the best decisions regarding tax planning, investment options, retirement savings, or estate planning strategies can help protect your income and grow your wealth. We understand the complexities of the current regulations and can develop the strategies that are right for you.

Remember, each person's situation is unique, so the information in this guide should only be used as a basis for discussing your particular circumstances with us. Working together we can chart your path and determine the course of action most appropriate for reaching your financial goals.



Fire Island • Long Island, New York

The first lighthouse on this location was a 89 foot stone tower erected in 1827. In order to provide more powerful light, the old tower was torn down. Its replacement, this 167 foot brick tower, was operational from 1858 to 1974.

Quick Reference

"Above-the-line" Deductions (even if you don't itemize)

- portion of self-employment tax
- health insurance for self-employeds and 2% or greater owners of S Corps (limits apply)
- performers' expenses
- certain job-based moving costs
- surrendered jury pay
- up to $2,500 of student loan interest
- contributions by self-employeds to Keogh, SEP and SIMPLE plans, Medical Savings Accounts (MSAs) and Health Savings Accounts (HSAs)
- eligible IRA contributions
- alimony paid
- eligible HSA contributions
- up to $4,000 for eligible college expenses (based on AGI)*
- teachers' supplies up to $250*

*lapsed, may be reinstated before year-end

Fully Deductible (not subject to the 2%-of-AGI limit)

- estate tax on income heirs inherit, including estate taxes on IRAs, Keoghs, 401(k)s and savings bonds
- impairment-related job expenses of the handicapped
- amortizable bond premiums
- gambling losses to the extent of winnings

Included in Income

Wages; salaries; fees; tips; commissions; gain on sale of some real estate, securities, and other property; alimony received and separate-maintenance payments; annuities (to the extent the return exceeds investment) and pensions; gambling winnings (gambling losses to extent of winnings are deductible); business profits; net rental income; interest received; dividends; royalties; prizes and awards; some fringe benefits; income from an interest in an estate or trust; up to 85% of Social Security benefits—see pg. 20; net hobby income; barter income; strike benefits; unemployment compensation; sick pay.

Not Included in Income (generally)

Gifts and inheritances; interest from certain state and municipal bonds (or received by mutual funds that hold them); gain up to $500,000 on sale of primary residence (under certain conditions); employer-paid health coverage for immediate family; accident- and health-insurance proceeds; scholarships and fellowships to a degree candidate if used for certain purposes; returns of capital; federal income tax refunds; interest on eligible Education Savings Bonds; employer reimbursements for business expenses (that you don't deduct); some or all of Social Security benefits—see pg. 20; workers' compensation for sickness or injury; child support; veteran benefits; welfare; life-insurance proceeds (estate tax may apply); child's investment income up to $1,000.

Terms and Acronyms

Filing Status Acronyms – MFJ (married/filing jointly); **HH** (head of household); **MFS** (married/filing separately).
Deduction – reduces the amount of your income on which your tax liability is determined.
"Above-the-line" Deduction – directly reduces your gross income. Eligible deductions (listed above) are taken on the first page of your tax return *above the bold solid line.* You can take above-the-line deductions regardless of whether you take the Standard Deduction or itemize your deductions.
Credit – lowers your tax liability by the amount of the credit.
Refundable Tax Credit – a credit paid to you even if the credit amount is more than the tax you owe.
Adjusted Gross Income (AGI) – the difference between your gross income and your adjustments to income (eligible above-the-line deductions). It's a benchmark to determine if you can take certain deductions—e.g., IRA contributions, medical expenses (7.5%- or 10%-of-AGI), and miscellaneous expenses (2%-of-AGI).
Modified Adjusted Gross Income (MAGI) – determined by adding back certain deducted or excluded items, such as IRA contributions, student loan interest, foreign income, and savings bond interest, to your AGI.
Required Minimum Distribution (RMD) – the amount the IRS requires the owner of a traditional IRA (not a Roth IRA) to withdraw each year upon reaching age 70½. SEPs, SIMPLEs, and other employer-sponsored retirement plans are also subject to RMDs.

At A Glance—2014

Personal exemption	$3,950
Phaseout of personal exemptions and itemized deductions starts (AGI)	
• MFJ	$305,050
• HH	$279,650
• Single	$254,200
• MFS	$152,525
Standard mileage rate	
• business use	56¢
• medical & moving	23.5¢
• charitable	14¢
Taxable wage base	
• Social Security tax	$117,000
• Medicare	no limit
Social Security earnings limit	
• Age 62 to 66	$15,480
• Turn age 66 in 2014	$41,400
• Age 66 and older	no limit
2014 contribution limits	
• 401(k)s	$17,500
additional catch-up amount	$5,500
• IRAs	$5,500
additional catch-up amount	$1,000
• SIMPLEs	$12,000
additional catch-up amount	$2,500
Automatic exemption from federal estate tax	$5,340,000

Understanding the Medicare Surtaxes

There are two Medicare surtaxes that affect some higher-income individuals. The first is a 3.8% surtax applied to certain unearned income and assessed on the lesser of net investment income or the excess of MAGI over: $250,000 (MFJ); $200,000 (Single and HH); $125,000 (MFS). Investment income includes: interest, dividends, capital gains, annuities, royalties, and passive rental income (generally). It does not include tax free interest, distributions from retirement plans, pension plans, or deferred-pay plans. Investment expenses can be deducted from investment income thereby reducing the amount subject to the surtax. Trusts and estates with AGI above $12,150 and undistributed net investment income could also be subject to the surtax.

Example: Mike is a Single taxpayer. He has a 2014 salary of $230,000 and $50,000 of net investment income (NII) bringing his MAGI to $280,000. The surtax is applied to the ***lesser*** of NII or MAGI over the threshold for a Single taxpayer ($200,000).

Step 1: $230,000 salary
+ 50,000 NII
$280,000 MAGI

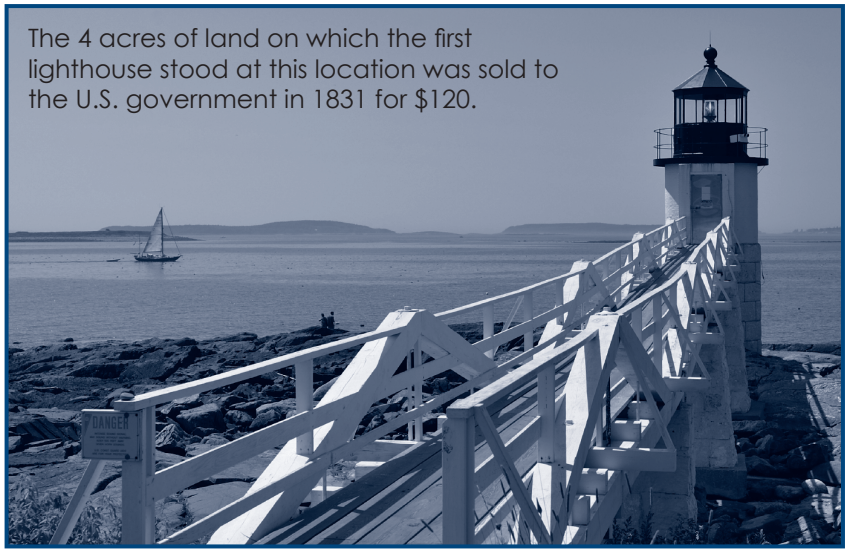
Step 2: $280,000 MAGI
- 200,000 threshold
$ 80,000 MAGI excess

Step 3: compare MAGI excess ($80,000) to NII ($50,000)—which is less?

Step 4: 3.8% Medicare surtax applied to $50,000 = $1,900 tax owed

The second surtax is a 0.9% tax applied to earned income (wages and self-employment income) above: $250,000 (MFJ); $200,000 (Single and HH); $125,000 (MFS). Employers are required to withhold the surtax once the employee's wages exceed $200,000. Taxpayers will calculate the actual tax due on their income tax returns. Couples take note: if each spouse makes less than $200,000 but your combined wages will exceed $250,000, you may face underwithholding of your taxes. Consider revising your W-4 to have more tax withheld.

Marshall Point • Port Clyde, Maine



You and Your Family

What's New for 2014

- Refer to the back inside cover for the 2014 Income Tax Rates, the Standard Deductions, personal exemptions information, and itemized deductions limitations.
- Lapsed for 2014 but may be re-instated before year-end: tax deductions for state and local sales taxes vs. income taxes; $250 of teachers' supplies; above-the-line deductions for college tuition; tax-free IRA distributions to charity.
- The $1,000 child tax credit has been extended through 2017.
- There are higher AMT exemption amounts this year: $82,100 (MFJ); $52,800 (Single and HH); and $41,050 (MFS). Annual increases based on inflation now occur automatically.
- Estimated tax: to avoid underpayment penalties in 2014 you must prepay in a timely manner 100% of your 2013 taxes or 110% of them if your 2013 AGI was more than $150,000.
- The exclusion for qualifying taxpayers working abroad rises to $99,200. The IRS is tightening its scrutiny for false claims. The maximum housing exclusion is $13,888 but high-cost foreign areas may have higher limits.
- The adoption tax credit is non-refundable and applicable to expenses up to $13,190 (also the exclusion for company-paid adoption aid). Adoptions of special needs children merit the full credit even if the expenses were less. The phaseout range for the credit is AGI $197,880–$237,880.
- Bonuses in excess of $1 million are subject to a 39.6% withholding rate.

Education

- The phaseout range regarding income from EE Bonds used for higher education expenses is MAGI $113,950–$143,950 (MFJ), $76,000–$91,100 (Single and HH).

Medical

- Individuals are now required to obtain qualifying health insurance coverage for themselves and their dependents. Anyone who does not could be subject to a penalty. Subsidies are available for some low- to middle-incomers.
- Long-term-care premiums can be deducted within limits: $370 for age 40 and younger; $700 for those age 41–50; $1,400 for age 51–60; $3,720 for age 61–70; and those age 71 and older can claim up to $4,660 per person. The limit on tax-free payouts rises to $330 per day.
- Medical Savings Accounts (MSAs) have higher limits. A high-deductible health plan for self-only coverage must have a deductible of at least $2,200 and not more than $3,250. Out-of-pocket expenses for covered benefits cannot exceed $4,350. For family coverage the respective limits are: $4,350, $6,550, and $8,000.

Green Energy Credits

- The 30%-of-cost credit continues through 2016 for alternative energy systems (such as solar water heaters, geothermal heat pumps, and wind turbines). Principal residences and second homes qualify whether new construction or existing homes.
- Federal tax credits for energy efficient home improvements have expired

Alternative Minimum Tax (AMT)

The 2014 AMT exemption amounts have been adjusted to $82,100 for MFJ and surviving spouses, $52,800 for Single and HH, and $41,050 for MFS. The AMT has only two rates (26% and 28%) and allows fewer deductions. Many ordinary tax write-offs are not allowed: personal exemptions, the Standard Deduction, state and local income taxes, sales and real estate taxes, and some medical expenses. If your tax is higher under the AMT rules than under the regular tax, you must pay the AMT.

AMT Risk Factors

- large unreimbursed employee business expenses
- exercising incentive stock option (ISOs) gains
- living in states with high state and/or real estate taxes
- large miscellaneous deductions
- large number of personal exemptions (big families)
- high medical expenses
- taking large capital gains

Children and Dependents

To claim a child as a dependent you may not need to pay over half of the child's support, so long as the child doesn't either (complex rules apply). There are rules on age, living in the same house, and close relationship. If you claim a person as a dependent, no one else, not even that person, can claim the exemption, but you get no exemption for anyone with 2014 income (excluding Social Security and tax-exempt income) over $3,950 except your spouse or a child under age 19 (under 24 if a student).

There is a uniform definition of "qualifying child" for HH filing status, the child care credit, and the earned income credit (EIC). The definition of a "qualifying child" includes the provision that the child must be younger than you in order to claim a dependency exemption. You may be able to claim an unrelated child as a dependent under certain conditions. If you have a "qualifying relative," you may be able to take a dependency exemption but you can't claim head-of-household status, the child tax credit, the EIC, or the dependent care credit (unless the person is disabled).

It's possible that the assets of a "special needs" child who requires care may disqualify him or her for government aid. Consider setting up a special needs trust charged with supplementing, rather than replacing, government aid. If you establish a larger trust, such as a 2503(c) trust, include a "special needs" clause that kicks in if a child becomes disabled. (Laws on special needs trusts vary from state to state.)

A CLOSER LOOK

If you claim someone as a dependent on your taxes, no one else can claim the exemption, not even that person.

Whether or not a dependent child needs to file a tax return depends on several factors—how much income and what type of income (earned, unearned or a combination) the child has. A return must be filed if: 1) the child's earned income from a job exceeds the year's Standard Deduction—$6,200 in 2014; 2) the child's unearned income (interest, dividends, investment income) exceeds $1,000; or 3) the child's gross income (the combined earned and unearned income) exceeds the larger of $1,000 or the child's earned income (up to $5,850) plus $350. You can report and pay a child's tax on your return if you and the child meet certain requirements.

Child-Related Credits

These child-related credits reduce income tax liability dollar for dollar for those who qualify.

- Adoption Credit. This non-refundable credit can be taken on up to $13,190 of expenses in 2014. The full credit is available for adoptions of children with special needs even if the adoption cost less than $13,190 (which is also the exclusion for company paid adoption aid). The phaseout range for the credit is AGI $197,880–$237,880. Claims for this credit must be substantiated and married couples must file jointly to claim the credit.
- Earned Income Tax Credit (EITC). This refundable credit is for low- to moderate-income working taxpayers. The 2014 maximum credit is $3,305 for a filer with one qualifying child, $5,460 for two, $6,143 for three or more, and $496 for a filer with no children.
- Child and Dependent Care Credit. You might claim a tax credit for costs of caring for a child up to age 13 or disabled dependent. The credit is 35% to 20% for qualifying expenses up to $3,000 (one child) or $6,000 (more than one). The reduction in the rate begins at AGI of $15,000. Employer provided dependent-care assistance reduces the qualifying expenses dollar-for-dollar. For a married couple, the claimed expenses can't exceed the earnings of the lower-earning spouse. The caregiver can even be a relative, such as a grandparent, but not a dependent. If you use a Flexible Spending Account (FSA) to pay dependent care costs, you can still claim the dependent care credit if your expenses exceed what can be paid through the FSA. The first $5,000 could be run through the FSA, and up to $1,000 could be eligible for the dependent care credit for those with 2 or more qualifying children.
- Child Tax Credit. If you have one or more qualifying dependent children younger than age 17 as of year-end, you may qualify for

a credit of up to $1,000 per child. Phaseout of the credit starts at modified AGI: $110,000 (MFJ), $75,000 (Single and HH), $55,000 (MFS).

Children and Investments

The kiddie tax was introduced years ago as a disincentive to avoid taxes by shifting investments to one's children. A child is subject to the kiddie tax if the child is 1) under age 18, 2) age 18 whose earned income does not exceed one-half his/her support or 3) age 19–23 and a full-time student whose earned income does not exceed one-half his/her support. The child's income can be reported on the parent's return if the child's gross income is only from interest, dividends, and capital gain distributions, and is more than $1,000 but less than $10,000. The first $1,000 of a child's investment income (interest, dividends, etc.) is tax-free, and the next $1,000 is taxed at the child's tax rate. If a child subject to the kiddie tax has investment income greater than $2,000, the excess is taxed at the parent's marginal rate and could reduce the parent's credits and deductions tied to his or her AGI.

Transferring investment assets to younger children may still be a good idea if they are in a low income tax bracket. You can transfer $14,000 (or $28,000 with your spouse) to each child this year without gift tax implications. The child owns the assets, however, which could be a barrier to financial aid if the child goes to college. If you shift assets to your children, they are treated as having held the assets since you acquired them.

Children age 19 and older may pay no capital gains tax on long-term gains up to the difference between their other taxable income and $36,900 this year. Up to $36,900 of this other income is taxed at a maximum income tax rate of 15% (or 10% if under $9,075), so consider shifting income-producing S Corp stock or appreciating stocks to them.

If you are a business owner, consider paying a child or grandchild reasonable summer job wages for a few years (bona fide services must be performed). If the child is under age 18, Social Security or Medicare taxes may not be due. Deduct the salary and put the wages into a Roth IRA in the child's name. The child can't deduct the contributions, but his or her tax bracket is probably low. If you give the child the money for the contribution, it counts toward the $14,000 annual gift tax exclusion, but even a single payment can constitute a nice retirement nest egg down the road.

Education Credits

The credits shown below are available to help with the cost of higher education. Marrieds who wish to take either of these credits must file jointly and claim the student as a dependent. Students can claim these credits if their parents don't take personal exemptions for them, and even if the parents paid the college tuition. Students subject to the kiddie tax must have some income tax liability to offset.

Tax Credit	Maximum Benefit	Qualified Expenses	2014 Income Phaseouts	Notes
American Opportunity Tax Credit	$2,500 tax credit per student per year 100% of first $2,000 25% of second $2,000 (Credit is 40% refundable; not subject to AMT)	Tuition, fees, and course materials (conditions apply)	Single and HH $80,000–$90,000 MFJ $160,000–$180,000	Usable for first 4 years of college
Lifetime Learning Tax Credit	$2,000 tax credit 20% of first $10,000	Tuition and fees	Single and HH $54,000–$64,000 MFJ $108,000–$128,000	Usable for undergrad and graduate education and courses to gain/improve skills

Eligible tuition expenses do not include any covered by grants, scholarships, and employer-assistance programs, and must be incurred on behalf of the taxpayer, spouse, or dependent. The student must be at least a half-time student for at least one academic period in the year. You can take either credit in a year you take tax-free distributions from a Coverdell Education Savings Account but not for the same expenses. Tuition paid in December for a course that begins next year counts toward this year's credit.

Other Education-Related Tax Benefits

Additional options that may be available to you:

Tax Benefit	Maximum Benefit	Qualified Expenses	2014 Income Phaseouts	Notes
Tuition and Fees Deduction (Lapsed for 2014; may be reinstated before year-end)	$4,000 above-the-line deduction Reduced to $2,000 in income phaseout band	Tuition and fees	Single and HH $65,000–$80,000 MFJ $130,000–$160,000 (These limits may change if credit is reinstated.)	• Undergrad + graduate • Can't claim deduction & educ credit in same year • MFS cannot claim • Taxpayer who can be claimed as dependent by another is not eligible for deduction
Student Loan Interest Deduction	$2,500 above-the-line deduction	Student loan interest	Single and HH $65,000–$80,000 MFJ $130,000–$160,000	Person obligated to make loan payment must be/ have been at least half-time student in degree program
Employer Tuition Assistance	$5,250 exclusion from income per student	Tuition, fees, books, supplies, equipment	None	
Scholarships	Excluded from income	Tuition, fees, books, supplies, equipment	None	Student must be degree candidate

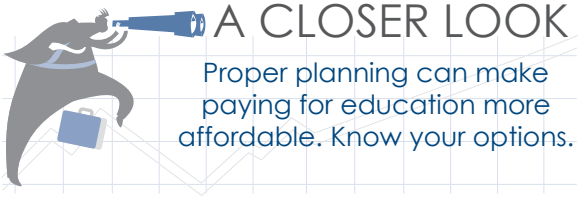
Those who have student loans forgiven may not have to pay tax on the waived debt if they work in public service jobs or teach in schools in low-income areas for 120 months, and make regular loan payments during that time. This rule applies to loans first made by the government or by private lenders that are later consolidated into federal loans. Information on federal loan forgiveness programs can be found at www.federalstudentaid.ed.gov.

Paying for Education

With some planning and foresight, you can prepare for the potentially high cost of education. Here are some vehicles to consider.

Education Plan	Tax Benefit	Qualified Expenses	2014 Income Phaseouts	Notes
529 College Savings Plans	Qualified distributions are excluded from income. Earnings portion of a non-qualified distribution is taxed at the beneficiary's rate and may be subject to a 10% tax penalty.	Tuition, fees, books, supplies and equipment, expenses for special needs services. Room and board if enrolled at least half-time.	None	• Undergrad + grad • Beneficiary can be changed but monies must be used for college expenses
Coverdell ESA	$2,000 non-deductible contribution limit per year but earnings are tax-free	Books, supplies, equipment. Higher educ: room & board if enrolled at least half-time. Payments to a Qualified Tuition Plan	Single and HH $95,000–$110,000 MFJ $190,000–$220,000	• K–12 at private and parochial schools • Undergrad & grad • Available for use until child reaches age 30 • Can take distribution in same year as educ credit, but not to cover same expenses
Education Bonds	Tax-free interest on Series EE bonds issued after Dec. 31, 1989, and all Series I bonds.	Tuition and fees Rollover into a 529 plan or Coverdell ESA	Single and HH $76,000–$91,100 MFJ $113,950–$143,950	• Income limits apply when bonds are cashed • Bonds must be in parent's name; child must be beneficiary, not co-owner • Purchaser must be age 24 or older

- Contributions to 529s are generally excluded from a donor's estate, making these a great way to reduce an estate and the potential for taxes on it. You can deduct from your estate in the first year the first five years' worth of gifts to a child's prepaid tuition account in a 529 plan so $70,000 can exit the estate (or up to $140,000 for a couple) in the first year for each child. Each state puts limits and conditions on its plans, but your advisor can help you find the best one for you.
- Parents and others (perhaps a relative) can establish Coverdell accounts for children under age 18. The non-deductible funds can grow and be used tax-free to pay tuition and other costs up to the time the child reaches age 30.



A CLOSER LOOK

Proper planning can make paying for education more affordable. Know your options.

Financial Aid

Most colleges use federal guidelines to determine the need-based aid for which your child may be eligible. (Criteria for colleges that use their own formulas may vary from what is discussed here.) Several factors determine the amount of the aid: the "cost of attendance" for the college in question; the money provided from outside sources (such as scholarships or tuition paid directly by a relative); and the "expected family contribution" (EFC). The information you provide each year on the Free Application for Federal Student Aid (FAFSA) is used to calculate your EFC. The college then uses that figure to calculate the amount of federal student aid you are eligible to receive through loans, grants, and/or work-study programs.

The EFC formula considers several financial pools: 2.5%–5.6% of the parents' assets; 22%–47% of the parents' income; 20% of the student's assets; 50% of the student's income. If you have multiple children in college at the same time, this is taken into consideration. Some assets, such as retirement accounts and home equity, are not included in the financial pool. If you have a child going to college next year, your assessment for aid will be based on this year's tax return. Consider minimizing your earned income, fully funding your retirement accounts, accelerating investment losses, and adjusting investments to hold down interest and dividend income.

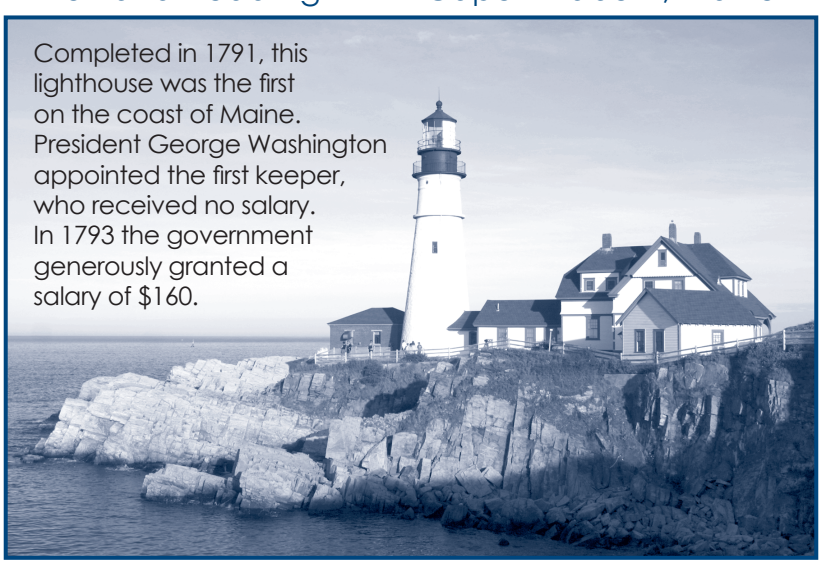
Job Hunting

If you are unemployed keep a record of your job-hunting expenses. If you're looking for a job in the same line of work you can deduct job-hunting costs to the extent all your miscellaneous itemized deductions exceed 2% of your AGI. If you're looking for your first job, you can't deduct the expenses, but if you're moving to get to your first job, and the job is at least 50 miles away from your previous home, some moving costs may be deductible "above the line." You can deduct certain costs of getting yourself, your family, and goods to the new area, and this includes parking fees, tolls, and 23.5¢ per mile.

Domestic Help

If you hire domestic help (such as maids, housekeepers, day-care workers, and babysitters), a "Nanny Tax" is due when their wages reach the $1,900 threshold for Social Security tax. The "Nanny Tax" is due on each person's wages. Babysitters and yard workers under age 18 and in school are exempt (including wages earned during the calendar year of the 18th birthday), but someone you hire to care for your child

Portland Head Light • Cape Elizabeth, Maine



in your home may be included. You also owe federal unemployment tax (FUTA) if you pay more than a total of $1,000 to all your domestic workers for any quarter. Employers can increase their own withholding or estimated tax to cover the Social Security taxes on a domestic.

Divorce

Because of the potentially complicated and financially significant implications of divorce, always consult with your tax, financial, and legal advisors for comprehensive advice.

Before a child reaches the age of majority (18 years), the custodial parent must waive the right to exemptions before a non-custodial parent can claim them. Any conditions in the divorce agreement cancel the non-custodial parent's claim to the dependency exemption if the custodial parent hasn't signed Form 8332 to waive his or her right to it. After a child reaches 18 years or a custody arrangement ends, the parent who supplies more than 50% of support gets the child's exemption.

Liquid assets are good to take from a divorce, but with up to $500,000 in gain on a primary home sale potentially tax exempt, a house can be more attractive, even though it generates maintenance and property tax bills and no income. An ex-spouse no longer residing in a house who helps to pay the mortgage cannot deduct the interest. Always have your tax advisor check out tax issues.

"Innocent spouses" are protected after a divorce against collection of tax for mistakes made on a joint return. Many spouses are eligible, and executors can assert claims for deceased spouses, or pursue claims filed before death. To qualify you must be at least legally separated from the other and not have lived together for the past 12 months. Recent IRS guidelines may enable more innocent spouses to qualify for relief.

Transferring assets in a divorce must normally occur within six years but more time may be allowed. The transfer triggers no gain or loss for the recipient until the asset is sold. Alimony is deductible by the payer and taxable to the payee. Child support is neither. Post-divorce payments on a marital home are alimony.

Medical Expenses

The threshold for deducting medical expenses is 10%-of-AGI for singles under age 65 and for MFJ in which both filers are under 65. If one of the filers is age 65 or older, the threshold drops to 7.5%-of-AGI. In general, medical expenses are deductible to the extent they exceed the 10% or 7.5% thresholds, and large medical insurance premiums put many over the threshold. Premiums deducted from Social Security benefits, or paid from certain benefit plans, count for purposes of exceeding the 10% or 7.5% threshold. Other deductions: capital improvements to your home needed for medical reasons (get a statement from your doctor); medical expenses paid for relatives and directly to the provider if you also pay more than half of the person's living costs; cosmetic surgery that improves the body's functioning.

Prescription drugs are fully deductible. Flexible Spending Accounts (FSAs), Health Saving Accounts (HSAs), and Health Reimbursement Arrangements (HRAs) cannot reimburse workers for unprescribed over-the-counter drugs. Only prescriptions and insulin are reimbursable. Medicare Part B and D payments are deductible as medical expense deductions. Costs of physician-prescribed weight loss plans and prescriptions to treat obesity, or prescribed in connection with another malady, are deductible under the percentage-of-AGI rule. The cost of diagnosing (e.g., pregnancy test kits, electronic body scans, or annual physicals), preventing, or

treating a specific disease may be deductible. Refundable entry fees to continuing care facilities are not deductible, but a deduction is okay for the medical related portion of non-refundable monthly fees. The medical mileage rate for 2014 is 23.5¢.

You may be able to deduct medical expenses you pay for a parent for whom you pay more than half the support, even if the parent lives separately. Long-term-care insurance may be especially valuable in protecting the parent's house and other assets. You might buy the insurance for the parent and possibly deduct all or some of the cost.

Health Insurance

Self-employeds can buy medical insurance in

their own names (rather than that of the business) but cannot aggregate profits from more than one business when calculating the deduction. 100% of the premiums are deductible.

Individuals must now have minimum essential health insurance for themselves and their dependents or risk paying a penalty. Qualifying coverage can be provided through employers, private plans, or purchased through an insurance exchange. Federal coverage such as Medicare or Medicaid also qualifies. There are some exceptions to paying the penalty under certain circumstances. A refundable tax credit to help cover the premiums (based on a sliding scale) may be available contingent upon one's household income and the number of people in the household.

Flexible Spending Accounts (FSAs)

There are several types of FSAs but the medical expense FSA and the dependent care FSA are the most common types. Medical FSAs allow employees to pay some health care expenses with pre-tax dollars. The tax savings can be substantial. Deductibles, co-pays, and coinsurance are reimbursable expenses as well as doctor-prescribed drugs and insulin. Some over-the-counter items may also be eligible. Employers can set a maximum contribution limit to their plans, although contributions are capped at $2,500 per year per participant on medical FSAs. Plans can now allow employees to carry over up to $500 to the next year without forfeiture but must first be amended to incorporate the change.

Dependent care FSAs can be used to pay certain expenses for dependents who live with the employee. Often this means child care for children under age 13, but care for mentally or physically handicapped children of any age as well as elderly dependents is also eligible. Spouses can each have a dependent care FSA but the combined total of their accounts cannot exceed $5,000, the cap for a dependent care FSA.

Health Reimbursement Arrangements (HRAs)

If your employer offers HRAs, you can withdraw funds tax-free to pay medical expenses (only) for yourself, your spouse and dependents. Unused sick leave can go into the HRA when the employee retires, but tax is payable if the employee could have taken cash. If a beneficiary other than an employee's spouse or dependent receives an HRA's funds after an employee's death, all reimbursements under the plan become taxable.

Health Savings Accounts (HSAs)

HSAs help workers, their spouses, and dependents who have health insurance policies with high deductibles (HDHP). Coverage under a disability, dental, vision, or long-term-care plan is okay. Some states require policies to pay certain expenses in full or part. Refer to the chart below for information on limits.

High Deductible Health Plan	Self-Only Coverage		Family Coverage	
	2014	2015	2014	2015
Minimum Deductible	$1,250	$1,300	$2,500	$2,600
Contribution Limit*	$3,300	$3,350	$6,550	$6,650
Maximum Out-of-Pocket	$6,350	$6,450	$12,700	$12,900

**Those age 55 by year-end can add another $1,000.*

Neither income nor withdrawals used to pay medical costs are taxed, but other distributions are taxed—and penalized 20%, except after age 65 or for death or disability. If you set up an HSA by December 1, you can put in the maximum for the whole year.

You can carry over HSA balances from year to year, or roll over an old Medical Savings Account into an HSA if you do so within 60 days. You can roll IRA funds into an HSA—once, up to the maximum annual contribution. A one-time transfer from an IRA to an HSA can make tax sense if after-tax contributions were made to the IRA. Making a medical payment from an HSA after an IRA rollover saves you tax and a 10% penalty on early distributions from the IRA. HSAs can be tapped to pay Medicare Part D premiums if the owner is age 65 or older, but withdrawals to pay them for a spouse are taxed as income and hit with a penalty if the account owner is under age 65. HSAs can be used to pay premiums for COBRA coverage for a spouse or dependent (or medical premiums for them if they're unemployed). Employers can open HSAs and contribute to them if they include all eligible workers. The contributions are then tax-free to the employees and free from payroll and income taxes.

Charitable Gifts

The deduction for charitable contributions is

usually limited to 50% of your AGI. The limit falls to 30% for gifts to private charities and gifts of appreciated stock. First deduct gifts that qualify for the 50% limit, then other gifts. In general, there's a five-year carryover for gifts you can't deduct this year. The IRS website (www.irs.gov) now has a database, updated monthly, of charities eligible to receive deductible contributions.

You can deduct the full market value of capital assets you donate to charities without paying taxes on their appreciation (limited to 30% of AGI). Don't donate loss property. Sell it first (so you can take the loss on your taxes) and donate the proceeds (so you can take the charitable deduction). Tax-free direct transfers to an eligible charity by IRA holders age 70½ and older has lapsed for 2014 but could be reinstated before year-end.

All monetary donations, regardless of amount, must be substantiated through bank records or written communications from the charity. Gifts under $250 get no deduction without a canceled check, a bank record, or a receipt with the charity's name and the amount of the gift. The only exception is for a contribution of less than $250 to a charitable remainder trust. For gifts of $250 or more, the charity's receipt must contain additional information: 1) a statement that no goods or services were provided in return for the contribution or 2) a description and estimate of the value of any goods or services that were provided. Incomplete information from the charity can invalidate the tax deduction. For donations made via payroll deductions, a pay stub or W-2 with donated amounts, and a pledge card with the charity's name may do. It may be a good idea to make all donations via checks.

Donations made to charities via check can be deducted in the current year, regardless of when the check clears. Donations made with credit cards have specific rules. If using a retail store credit card, the deduction can be taken only in the year you pay the bill. Donations via a bank credit card, however, can be deducted in the year that the charge was made even if the bill is paid in the following year. This is important for year-end contributions.

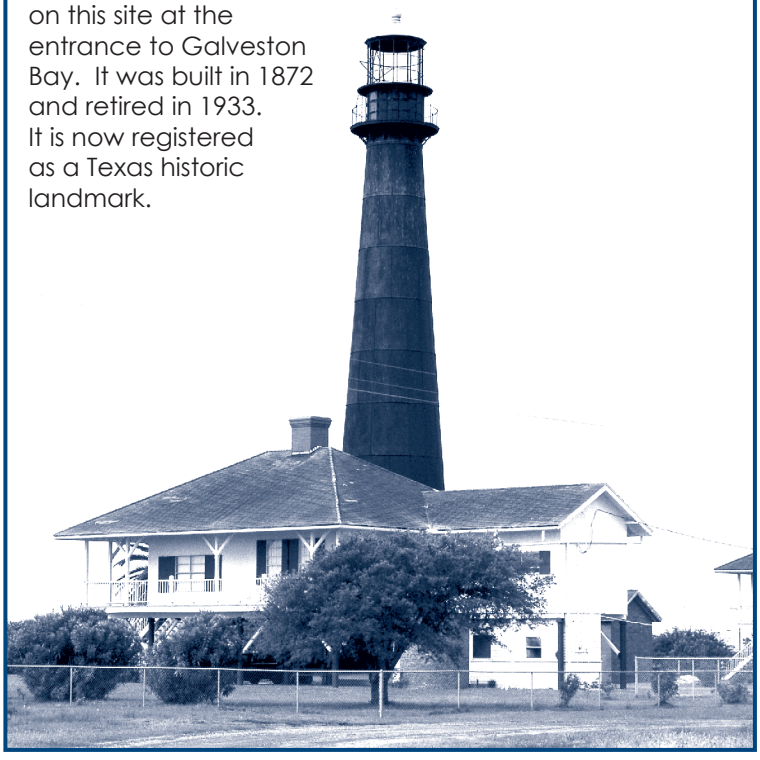
Clothing and household goods that are not in good used condition need an appraisal if you claim a deduction of more than $500. For items in good used condition or better, you need an appraisal if the item is valued at more than $5,000. Items of low value (e.g., socks) can't be deducted. Credit card rebates you donate to charity are deductible, but if the gift is $250 or more you need a receipt from the charity documenting the date and amount. You can deduct out-of-pocket costs you incur while doing work for a charity and 14¢ per mile you drive for charity. Note: if you donate more than $500 in non-cash contributions, you must attach Form 8283 to your tax return. The IRS is flagging returns that do not comply.

The rules on donations to charities of autos, boats, and planes are strict. If the donor claims the value of an item exceeds $500, there must be a written acknowledgment. If the charity sells the gift without rehabbing or using it, the donor's deduction cannot exceed the selling price (with a few exceptions). A charity need not sell a vehicle in 2014 for the donor to take a deduction for the year; the vehicle only needs to be transferred this year.

There are several additional tools, such as charitable remainder trusts and charitable lead trusts, which may be useful for your charitable

Bolivar Point • Galveston Bay, Texas

This is the second lighthouse erected on this site at the entrance to Galveston Bay. It was built in 1872 and retired in 1933. It is now registered as a Texas historic landmark.



giving objectives. Consult with your estate planning and tax advisors to determine their applicability to your situation.

Casualty Losses

Casualty losses on personal assets are claimed as an itemized deduction. The floor for casualty losses in regions not declared disaster areas remains $100 per loss event. The balance is deductible to the extent it exceeds 10% of AGI. (If you have more than one loss event for the year, the balances above $100 for each are totaled and the excess above 10% of AGI is deductible.) Repair costs due to corrosive drywall are eligible as a casualty loss in the year of payment, but slow damage, as from rust or insects, is not. Gain on insurance proceeds for personal property lost in a declared disaster is not taxed. You can take a 2014 declared-disaster loss on your 2014 or (amended) 2013 return; choose the year of lower AGI.

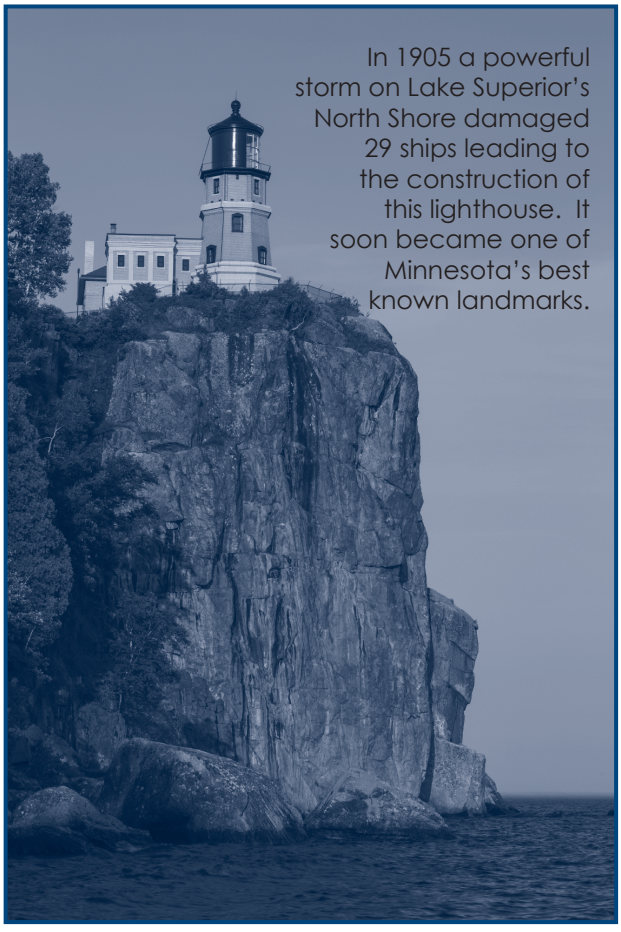
Insurance reimbursements for living expenses are taxable to the extent they exceed actual expenses in the year the owner receives the funds or moves back into the house, whichever is later. Insurance payments also taxed: for a destroyed house and not spent to replace the house within two years (four years in disaster areas); and for items listed in separate schedules of the policy and not reinvested in the house or similar items.

Compensation

You can convert compensation to a tax-advantaged form, such as no-extra-cost-to-the-employer services (e.g., free standby flights for airline employees), working-condition fringe benefits, employee discounts, or *de minimis* fringe benefits. Some types of noncash compensation are taxable—e.g., employer-provided automobile for personal use or employer aid for education not directly job-related or job-required. Also, stock options: the difference between the stock's fair market value and the option price is "income" when the option is exercised, but a special rule delays the tax on incentive stock options (ISOs) until the stock is sold or exchanged. Even ordinary stock options let you speculate on the stock, while ISOs benefit from the low rate on capital gain. Certain conditions must be met to receive favorable tax treatment on ISOs. If you receive restricted stock or options from your employer or exercise ISOs, consider making a Section 83(b) election within 30 days. With respect to stock, the election lets you use long-term capital gains rates on the difference between the sales price and your basis when you sell the stock; with respect to ISOs, it lets you pay lower AMT. Firms must report to the IRS ISOs exercised in 2014 as well as employee stock purchase plans.

Severance pay is fully taxable and severance paid to employees laid off as part of a reduction in workforce is subject to payroll taxes. An ex-employer's continued payment of health and accident benefits is not taxable. An ex-employee who pays his or her own COBRA health premiums can deduct them to the extent they and other medical expenses exceed 10% (or 7.5%) of AGI. Outplacement services are a tax-free benefit if not paid in cash, but state unemployment benefits are taxable.

Split Rock • Two Harbors, Minnesota



In 1905 a powerful storm on Lake Superior's North Shore damaged 29 ships leading to the construction of this lighthouse. It soon became one of Minnesota's best known landmarks.

Investments

The capital gains tax rate you pay on your investment gains depends on the type of asset, the holding period of the asset before selling, and your income tax bracket. Assets held short-term—12 months or less—are taxed at ordinary income tax rates as short-term gains. Assets held longer than a year, however, are long-term gains and taxed at reduced rates. See chart.

Capital Gains Tax

Income Tax Bracket	Capital Gains Rate
- 10% and 15%	0%
- 25% through 35%	15%
- 39.6%	20%
Exceptions	
- Section 1250 real property	up to 25%
- Qualified small business stock	28%
- Collectibles	28%

Dividends are either ordinary dividends or qualified dividends. Ordinary dividends are taxed at ordinary income tax rates. Qualified dividends are taxed at the long-term capital gains rates. At year-end the dividend payer will provide information regarding which dividends are "qualified." Dividends received from a regulated investment company (RIC) or real estate investment trust (REIT) also qualify for the reduced capital gains rates.

If possible, get your taxable income low enough to qualify for the 0% long-term capital gains rate if you plan to sell long held assets this year. (The 2014 threshold for MFJ is $73,800.) For example, maximize your deductible contributions to retirement plans to lower your AGI. For those below the threshold with appreciated long-term assets, the 0% rate creates tax planning opportunities.

Capital losses you incur this year offset your gains and up to $3,000 of other income. Net losses greater than $3,000 carry over to defray capital gains or other income in later years. To limit the tax on your capital gains, plan and correctly "net" (i.e., offset) your long- and short-term gains and losses. First net your short-term losses and gains then apply any excess loss against your net long-term capital gain. If you have a net long-term capital loss, you can apply it (and losses carried forward from earlier years) against any net short-term capital gain. Try to plan your sales to take full advantage of these offsets, without letting tax considerations dominate your investment moves.

You can increase your deduction for margin interest (up to the amount of your net investment income) by taking short-term gains. Long-term gains aren't investment income for this purpose unless you forego taking the capital gains rate on them (so also for qualified dividends). Low-bracket taxpayers and older investors who may lose the investment-interest carryover at death might elect to have capital gains taxed as ordinary income. Investment interest is deductible up to the total of investment income, and you can carry forward the excess undeducted interest to later years.

Collectibles held longer than one year are taxed at 28%, and gains on real property, to the extent depreciation was claimed on it, may be taxed as high as 25%. If you inherit property from a decedent, generally you'll be able to classify its sale as a long-term transaction. Like-kind exchanges of business or investment property also may delay tax on any gain until you dispose of the property you receive.

Many expenses connected with investments qualify as miscellaneous itemized deductions (subject to the 2%-of-AGI floor): office rent; legal fees; accounting and secretarial fees; certain travel expenses (not to conventions or meetings); investment-related newsletters, books,

Rules of Thumb

- If you have realized capital losses larger than your realized capital gains plus $3,000, sell more capital gain property.
- If your realized gains exceed your losses, sell more loss property to reduce tax on the gains.
- If your deductions for this year exceed your income, don't realize any more losses – they'll be unusable this year (and if they're non-capital they may not be eligible for carryover to later years.)

etc.; long-distance phone calls; postage; travel to your broker's office; custodial IRA fees paid out of separate funds; fees to financial planners or managers; and rental fees for safe-deposit boxes. Brokers' and mutual fund commissions are deducted by adding them to the basis to reduce capital gain upon sale.

- Keep in mind that net investment income could be subject to the 3.8% Medicare surtax for some higher-income individuals. Refer to the discussion of the surtax on page 3.
- An individual whose return fails to flag a "reportable transaction" (tax shelter) is subject to a minimum $5,000 penalty.
- Profits up to $500,000 for couples or $250,000 for singles upon the sale of a principal residence are exempt from tax under certain conditions. (See Real Estate chapter.)

The Kiddie Tax: A child is subject to the kiddie tax if the child is 1) under age 18, 2) age 18 whose earned income does not exceed one-half his/her support or 3) age 19–23 and a full-time student whose earned income does not exceed one-half his/her support. Unearned income over $2,000 for these children is taxed at the parent's marginal rate, and many such kids will get no advantage from the 0% capital gains rate. Shifting capital-gain property, however, especially if slated for sale before 2015, to other family members in the lower income tax brackets might save tax. Grandparents who wish to help grandchildren pay for college, take note, especially if the grandchildren are age 19 and over and escape the kiddie tax. Tax savings could be significant if the child sells the stock at a 0% capital gains rate.

Other Ideas

- The "wash sale" rule disallows losses on stocks and bonds if you re-buy substantially identical securities (or funds) within 30 days of the sale. Caution: if you sell a mutual fund within 30 days of a reinvested dividend, you could inadvertently violate the rule.
- Selling stocks to pay a tax bill is usually a bad idea. If they have appreciated, you are generating more taxable income.
- Keep your "buy and hold" stocks in your taxable account and stocks you may hold for shorter periods (as well as high-yield fixed income securities and CDs) in your tax-deferred account.
- Bond interest is taxable at regular rates that can reach 39.6% and, when interest rates rise, bond and bond mutual fund values generally fall. Municipal bonds may be good investments for high-incomers, especially in high-tax states.
- Use the correct "basis" for stocks or assets you inherit.
- The penalties for tax-shelter investments the IRS deems lack economic substance are stiff—up to 40%.
- Owners of worthless securities (but not of worthless partnerships) have seven years to file retrospective claims for tax refunds.

Mutual Funds

Capital gain distributions from mutual funds increase your net capital gain for the year. Long-term gains of mutual funds qualify for the capital gains tax rates. Non-qualified dividends of interest and short-term gains do not; they are taxed at ordinary income tax rates. If you see such gains coming, try to offset them by selling securities with values currently below your basis in them. You might even sell an extra $3,000 of loss securities, so as to deduct the losses and reduce your taxes, and use the proceeds from the sales to update and reposition your portfolio.

If you sell a mutual fund this year, remember to add to your original cost basis all subsequent reinvested interest, dividends, capital gains

St. Augustine Lighthouse • Florida

In 1824 St. Augustine became Florida's first lighthouse when a lens was installed in the old watchtower on Anatasia Island.

distributions and sales charges. This could greatly reduce your reported gain or increase your reported loss.

Long-term investors in mutual funds who reinvest dividends and capital gains should remember to include these in the cost basis of shares. An alternative is to take the dividends in cash, and thus keep your original cost basis, while reducing paperwork. Funds usually tell you your average basis for all your shares,

A CLOSER LOOK

If you sell a mutual fund, remember to add reinvested interest, dividends, capital gains distributions, and sales charges to your original cost basis.

including those bought by reinvesting dividends. Mutual funds must report the cost basis of shares purchased after 2011.

There are several ways to figure the cost basis of shares, and they all become complex when investors reinvest dividends and capital gains and sometimes sell shares. The average-cost method is most popular and most fund groups use it to provide cost figures to clients. Although the most flexible method to minimize taxes is to designate specific shares, it requires careful record keeping. Another option is first-in, first-out. Once you select a method, you must stick with it.

You may have paid foreign taxes if you invested in international mutual funds. If so, a dollar-for-dollar foreign tax credit may be available to you. Your fund should be able to tell you how much foreign tax was paid on each share.

- If you buy a mutual fund that is about to pay a dividend, including capital gains dividends, you'll pay tax on the payout without enjoying any increase in your wealth (share prices drop by amounts paid out). Wait to buy until after the record date for payment. If a fund's value has fallen, selling before the payout record date will provide a loss that can offset gains elsewhere, and you avoid taxes on the payouts.
- A mutual fund is "tax efficient" if its returns show up as appreciation in the share price, not as taxable distributions. Such funds often use a buy-and-hold strategy, although buying and selling actively provides more chances to offset gains with losses. A fund with large unrealized losses may be a buy, because, when realized, the losses will offset gains. A fund can lose value and still allocate gains taxable to you.
- You can swap one fund for another to lock in a loss while keeping exposure to the same asset class. Don't wait until year-end to capture losses; you can sell at any time.
- Mutual fund shareholders whose only gains are from fund payouts can avoid Schedule D. Form 1099-Div will tell you which portion of gain qualifies for what treatment.

Passive Activities

Some investment activities are defined as "passive" to prevent their use as tax shelters for other types of income. Passive activities are of two types: 1) the owner (often limited partnerships or S Corporations) does not "materially participate" and 2) any rental activity (irrespective of the level of participation) for which payment is mainly for the use of tangible property. (There are a few exceptions.) Passive activity investments do not include stocks and bonds. The Real Estate chapter describes an exception to the passive-loss restrictions for those who actively participate in renting real estate.

Calendar year filers must report changes on how passive activities are grouped or any new groupings. The reporting rules are intended to keep filers from playing games to deduct losses. The grouping rules are important because if two or more activities are grouped as one, the disposition of an activity will not trigger any suspended passive losses until all the others are disposed of.

Passive losses you can't deduct this year can be carried forward and deducted when you dispose of the entire activity or have passive income to offset them. Any interest owners receive on loans to passive activities is treated as portfolio income, and can't be used to offset passive losses—except that interest earned on loans owners make to partnerships or S Corps with passive activities (such as rental realty) is passive income to the owners. The owners need not have a 10% share in the S Corp or partnership to use this break.

To reduce your passive-activity interest expense, reduce your debt in a rental activity or convert the debt to home-equity debt, the interest on which may be deductible. (Use the proceeds from a home-equity loan to repay passive-activity loans.)

Retirement

What's New for 2014

- A new retirement plan, the myRA, is scheduled to be introduced in late 2014.
- The definition of a highly compensated employee remains $115,000. The definition of a key employee in a top-heavy plan rises to $170,000.
- Employer contributions to qualified plans can be based on $260,000 of salary this year. The contribution limit to a defined contribution plan increases to $52,000.
- Expired but may be reinstated before year-end: direct tax-free payouts of up to $100,000 to eligible charities from IRAs by taxpayers age 70½ or older.

The trend continues to shift toward providing for one's own retirement so retirement saving should be an essential part of your financial plan. There are numerous retirement saving vehicles, many of which are discussed in this chapter. The chart on page 18 provides a snapshot of the plans.

Contributions to retirement plans confer two large tax benefits: 1) they reduce your AGI and current income tax, and 2) they can grow faster than your other assets because they're sheltered from tax until withdrawn. Yet you may not lose current or early use of the money, since many plans let you borrow from them or withdraw funds early for certain reasons. Take advantage of your employer's plan especially if it features an employer match or you can make catch-up contributions.

If you have stock from your company in your retirement plan, find out its "cost basis" now; this number will help determine your later taxes and affect how you should take distributions. Employee contributions to pension plans can be rolled over into another plan via a trustee-to-trustee transfer. Non-spouse as well as spouse beneficiaries can roll over a decedent's interest in a qualified plan under strict rules. Consult with your advisor.

If you retire before the age of 55, you may incur a 10% penalty on early plan distributions. The penalty is avoided if you are 55 in the year you retire. The separation date, not the distribution date, is the key factor. This exception does not pertain to early distributions (before age 59½) from IRAs.

There is a "saver's credit" on the first $2,000 contributed to retirement plans by low- and moderate-income taxpayers. The maximum AGI limits in order to qualify are: $60,000 (MFJ); $45,000 (HH); and $30,000 (Single and MFS). The credit amount (10% to 50%) is tied to AGI. Maximum credit: $2,000 for MFJ, $1,000 for Single and all others. Taxpayers who are younger than 18 years, full-time students, or claimed as a dependent on another's return cannot take the credit. The credit is trimmed if the taxpayer took a distribution from a plan or IRA the same year or the two previous years.

Individual Retirement Accounts (IRAs)

If neither you nor your spouse is covered by a qualified employer-sponsored plan, you can each contribute to an IRA and jointly exclude from current tax up to $11,000 (or $13,000 if both are age 50 or older) of current income, even if one spouse does not work. (Spouses cannot contribute more than their combined earned incomes.) If either spouse participates in a qualified employer-sponsored plan, contribution deductibility is subject to MAGI

RMD Schedule For IRAs

AGE	YEARS*	AGE	YEARS*
70	27.4	85	14.8
71	26.5	86	14.1
72	25.6	87	13.4
73	24.7	88	12.7
74	23.8	89	12.0
75	22.9	90	11.4
76	22.0	91	10.8
77	21.2	92	10.2
78	20.3	93	9.6
79	19.5	94	9.1
80	18.7	95	8.6
81	17.9	96	8.1
82	17.1	97	7.6
83	16.3	98	7.1
84	15.5	99	6.7

**Distribution span in years*

To get a year's RMD, divide the sum of the prior year's Dec. 31 balances in your plan(s) by the distribution span for your age.

limits (see chart).

If ineligible for a deductible IRA contribution (or over the AGI limit for a Roth IRA), you can make non-deductible contributions up to your earned income or $5,500, whichever is less. Non-deductible IRAs are a good place for after-tax dollars if you trade in and out of stocks and mutual funds: you can buy and sell without paying taxes.

Be sure to amend your IRA forms if your beneficiary dies. If the IRA passes to the estate, unintended taxation and flexibility issues may result. Heirs may be able to claim an itemized deduction, not reduced by 2% of AGI, for the part of an estate tax bill due to the IRA.

You can temporarily withdraw funds from an IRA for 60 days without penalty, but if you exceed that limit you pay tax and penalty on the funds as of the day of withdrawal. You can make only one such temporary withdrawal per plan per year. Note: beginning in 2015 this rule will apply on an aggregate basis to all of your IRAs, not each IRA individually.

A 10% penalty plus regular income tax applies to premature withdrawals (before age 59½) from IRAs unless you are disabled, but you can avoid the penalty by withdrawing the funds in equal periodic payments (conditions apply). The penalty is also waived if the early withdrawal is used for: medical expenses in excess of 7.5%- or 10%-of-AGI; health insurance premiums (conditions apply); certain education-related expenses; or up to $10,000 for the purchase of a first house. Unemployed persons who receive unemployment benefits for 12 consecutive weeks can tap their IRAs (in the year the benefits are paid or the following year) penalty free to pay for health insurance. All early distributions are subject to income tax.

Required minimum distributions (RMDs) are required once the owner of a traditional IRA reaches age 70½. The first RMD can be delayed until April 1 of the year after turning 70½. For each year thereafter, the deadline is December 31. The RMD amount is determined by 1) the previous-year year-end IRA balances, and 2) a life-expectancy schedule provided by the IRS (see chart on page 16).

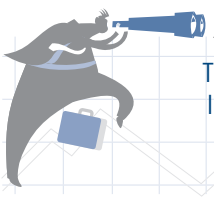
Is My IRA Contribution Deductible?

Plan at Work	Filing Status	2014 Modified AGI	IRA Deduction up to Contribution Limit
You're covered by retirement plan at work	Single and HH	$60,000 or less	Full
		$60,000–$70,000	Partial
		$70,000 or more	None
	MFJ	$96,000 or less	Full
		$96,000–$116,000	Partial
		$116,000 or more	None
Neither you nor your spouse is covered by retirement plan at work	Single and HH	No limits	Full
	MFJ	No limits	Full
You're not covered by retirement plan at work but your spouse is	MFJ	$181,000 or less	Full
		$181,000–$191,000	Partial
		$191,000 or more	None
	MFS	Special rules apply	

Roth IRAs

Contributions to Roth IRAs are made with after-tax money and, therefore, are not deductible. Eligibility to contribute to Roths is subject to modified AGI limits as shown in the chart on page 18. The greatest benefits of Roth IRAs may be in transferring wealth to heirs. A Roth IRA is not subject to minimum withdrawals (or a ban on contributions) at age 70½ and may provide far more to a beneficiary than other plans. Assets in the account for five years can pass to heirs without current income tax. Non-spousal heirs who inherit a Roth IRA may have to take minimum distributions but can stretch them out over a lifetime, during which the Roth is enjoying tax-free growth. Other heirs can compound the Roth assets for decades with only minimum annual withdrawals. A Roth can grow into a large sum for a child. A 16-year-old with $5,500 in a Roth that earns 7% each year will have $151,000 at age 65 and $212,000 at age 70, and much more if the child makes annual contributions for a few years.

Although contributions to a Roth IRA are non-deductible, you can withdraw the contributions without tax or penalty. So keep track of your Roth contributions. After five years you may be able to withdraw earnings early (before age 59½) without penalty for your first purchase of a house ($10,000 limit), for education, or because of disability. After five years and age 59½, you



A CLOSER LOOK

The largest benefits of Roth IRAs may be in their use to transfer wealth to heirs

can withdraw all of the Roth for any reason. The five year period starts with the tax year of the first conversion or contribution.

Conversions to Roth IRAs: Traditional IRAs can be converted to Roth IRAs and the latter back to traditional IRAs. If you convert a traditional IRA to a Roth, watch out for a 10% penalty on withdrawals in the first five years, even if you take out funds you converted tax free. Usually the penalty is on taxable withdrawals, but the whole withdrawal is subject to the penalty unless you've turned 59½, are disabled, or have elected to take a series of equal distributions from the Roth. A conversion can make sense if your personal tax rate will be higher or the same in the future.

If you convert a traditional IRA to a Roth IRA and want to put the funds into different types of investments, consider using a different Roth for each type. If any of the investments declines in value later in the year you can unconvert that portion until as late as the filing date plus extensions without paying income tax on it. Having enough cash on hand to pay the tax is important; you don't want to cripple the IRA's ability to grow.

Switching to a Roth from a traditional IRA can make more of seniors' Social Security benefits taxable in that year, and the increase in income could cause loss of some tax breaks. Try to schedule the conversion in a year your income dips or you have investment losses. Upper-incomers may have to pay a surcharge on their Medicare Part B premiums, and Roth conversion income counts toward the AGI trigger point. Even lower-income seniors who convert might see more of their Social Security benefits taxed, but at least they won't have to take minimum distributions from the Roth and any withdrawals will be tax free.

A conversion must meet certain conditions and it's usually not smart to use part of the distribution in a conversion to pay the taxes due. Consult your advisor to refine your strategy.

MyRAs

A new type of retirement savings account, the

Plan		Contribution Limits 2014	2015	Pros	Cons	Use
IRA	individual age 50+ add'l	$5,500 $1,000	Indexed to inflation $1,000	Tax-deferred savings	Withdrawals not tax-free; participation in employer plan affects contribution deductibility	For individuals
Roth IRA	individual age 50+ add'l	$5,500 $1,000	Indexed to inflation $1,000	Earnings and withdrawals tax-free; flexible distribution	No up-front deduction; contribution eligibility phases out at MAGI Single and HH $114,000–$129,000 MFJ $181,000–$191,000	For individuals
SIMPLE IRA	individual age 50+ add'l	$12,000 $2,500	Indexed to inflation in $500 increments	High contribution limit; employer must match	Withdrawals not tax-free	For small businesses-less than 100 employees
SEP		Employer can pay in lesser of $52,000 or 25% of compensation		High contribution limits	Withdrawals not tax-free	For self-employeds and their employees
401(k)	individual age 50+ add'l	$17,500 $5,500	Indexed to inflation in $500 increments	Tax-deferred contributions and growth; employer match not taxed to owner	Employee withdrawals only allowed under limited conditions	Employer sponsored
Roth 401(k)	individual age 50+ add'l	$17,500 $5,500	Indexed to inflation in $500 increments	Earnings and withdrawals tax-free; employer can match	No up-front tax deferral	Employer sponsored

myRA, will be introduced in late 2014 with a nationwide rollout slated for 2015. It will be available through participating employers who do not offer other retirement savings plans. Accounts can be opened with as little as $25 and payroll deductions of $5 or more made with each paycheck. Contributions will be made with after-tax dollars. The rules for the myRA will be similar to those of Roth IRAs.

401(k) and Roth 401(k) Plans

401(k) plans are excellent tax-saving vehicles, especially if your employer matches your contributions because the matches are not income to you; however, no unrealized losses, even on after-tax contributions, are deductible. Know the rules of your 401(k). If an employee cashes out of a 401(k) and doesn't roll over within 60 days, federal, state and local taxes are due on the entire amount withdrawn, and possibly a 10% early-withdrawal penalty. Consider borrowing from your 401(k) rather than cashing out. If a departing employee has a balance below $5,000 in a company 401(k) or pension plan, the company can opt to evict the employee from the plan.

The usual "distribution" or withdrawal choices from a company plan are a lump-sum or an annuity. Many who leave their jobs take a cash distribution from their 401(k)s rather than rolling the funds over into their IRA or a new employer's plan. This can be a serious mistake. If you roll over a lump-sum distribution to an IRA within 60 days, tax is deferred, but you cannot roll over only the nondeductible portions. There may be an exception to the 60-day rule in cases of hardship.

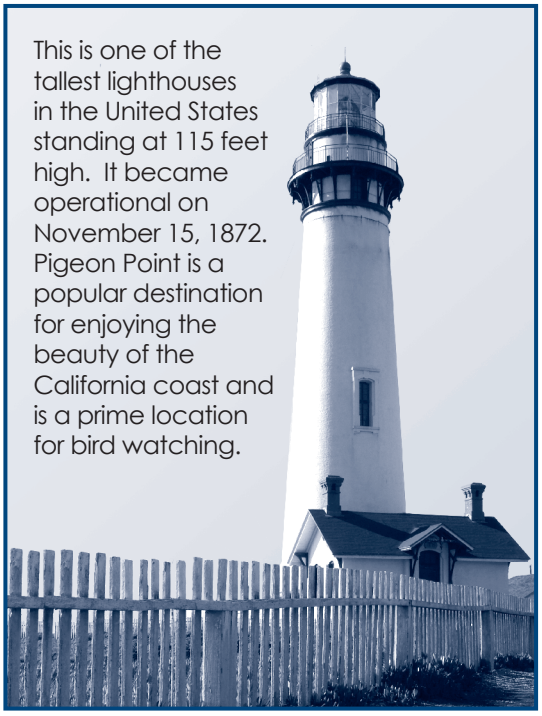
The Roth 401(k) combines the features of traditional 401(k)s and Roth IRAs. There's no up-front deduction for the contributions. The limits are the same as for regular 401(k)s and include catch-ups, but withdrawals are tax-free after age 59½. If the earnings are large or tax rates at the withdrawal date are high, the tax benefit will be invaluable. There are no income limits for eligibility for Roth 401(k)s, which is great for highly-paid employees. The contribution limits apply to all your 401(k)s, so you can't put $17,500 (or $23,000 with catch-up) into both a regular and a Roth 401(k), but you can divide your contribution between the two types in any year. Which type is better? When you contribute to a regular 401(k), you get a current deduction and delay paying taxes on those assets until retirement. For young people, if their retirement tax rate is higher than now, the Roth 401(k) may be better for them. If the reverse is true, the deductible 401(k) may be better. The main variables for deciding between regular and Roth 401(k)s are your tax brackets today and those estimated at the time you'll withdraw.

The value of unpaid leave can possibly be transferred to an employee's 401(k) or profit sharing plan annually. This can help employees with vacation that can't be carried over. If the plan allows, the value of unused leave can be contributed when the employee leaves the company.

Non-spousal heirs can take payouts over their lifetimes if they properly roll the 401(k) into their own IRAs. There are strict rules so see your advisor. They still face a deadline, however: to beat the five-year rule, and get lifetime payouts, the heir must transfer the 401(k) to an IRA within a year after the 401(k) owner dies.

A 401(k) can be converted directly to a Roth IRA or a Roth 401(k). In a conversion to a Roth 401(k) the after-tax contributions may be free of tax. A conversion the other way, from a Roth 401(k) to a Roth IRA, might eliminate the minimum distribution requirement because the Roth IRA has none. Conversion of an employee's 401(k) to a Roth 401(k) is okay if contributions were in the plan for two years or the employee was a member for five or more years, and a worker must be at least age 59½ to convert

Pigeon Point • California



This is one of the tallest lighthouses in the United States standing at 115 feet high. It became operational on November 15, 1872. Pigeon Point is a popular destination for enjoying the beauty of the California coast and is a prime location for bird watching.

contributions made by salary reduction. After-tax contributions and rollover amounts can be converted regardless of the owner's age. An in-plan conversion from a regular 401(k) to a Roth 401(k) can't be reversed later.

Keogh Plans

Self-employment income can be sheltered from tax with a Keogh plan but any full-time employee must be covered. The contribution limit to defined contribution plans (Keogh, profit-sharing, etc.) rises to $52,000 ($57,500 for those age 50 or older) and can be based on up to $260,000 in salary. The maximum annual payout for defined benefit plans increases to $210,000. Plans set up this year might qualify for a credit for some start-up costs. Keoghs must be set up by December 31 to get a 2014 deduction. "Defined-benefit"- type plans that provide a fixed amount per year have dwindled because of their complexity.

Simplified Employee Pension Plans (SEPs) and Simples

SEPs let employers make deductible contributions to the IRAs of employees and avoid much paperwork. All eligible employees must be covered but there's no waiting period for vesting. Businesses with no more than 100 employees can have a SIMPLE plan, to which an employee can contribute this year up to $12,000 of pre-tax wages (plus another $2,500 if age 50 or older). Employer matches must be made by the due date of the return plus extensions. Contributions to a SIMPLE have an earlier deadline than for an IRA: one month after year-end. SEPs are easily converted to Roths, but there are restrictions on conversions of SIMPLEs.

Social Security Benefits

Generally Social Security benefits are not taxed if they are the only income source for the year. If you have earned income or large investment income, up to 85% of benefits may be taxable depending on the amount of income and your filing status. Tax-exempt income also figures into the calculation of the taxability of benefits.

The 2014 earnings test (not applicable for individuals at full retirement age) for Social Security benefits is: a charge of $1 for every $2 that earnings exceed $15,480 if below full retirement age; a charge of $1 for every $3 that earnings exceed $41,400 if full retirement age is reached in 2014 (for earnings made in the months prior to the month you reach full retirement age). Full retirement age depends on the year you were born (see chart). The test applies to each person, not to couples. Beneficiaries who work continue to pay Social Security and Medicare payroll taxes, even if they work only part-time and the pay is not enough to raise their benefits. Social Security beneficiaries may withdraw an application for retirement benefits but only once per lifetime and only within 12 months of their first Social Security payment. Any benefits received prior to the withdrawal must be repaid.

Social Security Retirement Age Schedule

YEAR OF BIRTH	FULL RETIREMENT AGE
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

Other Retirement Considerations

Federal taxation is uniform across the country but not so for state taxation. If you're deciding where to live in retirement, consider the tax implications of a move. Take into account the state income tax rate, state taxation of retirement benefits and Social Security, state and local property taxes, state estate taxes, and state sales tax. These can vary widely from state to state and could have a measurable impact on retirees' finances.

Real Estate

What's New for 2014

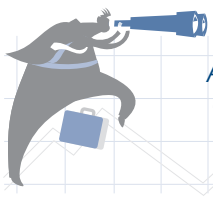
- Recapture of the $7,500 first-time homebuyer's credit continues for those who bought a house between April 9 and Dec. 31, 2008, and took the credit: $500 must be added to this year's taxes. The IRS is aggressively pursuing the recaptures. You can track your recaptures on the IRS website (www.irs.gov). Enter First-Time-Homebuyer-Credit-Account-Look-Up in the search engine.
- Expired but could be reinstated by year-end: the deduction for Private Mortgage Insurance (PMI) premiums on a qualified residence; the exclusion of up to $2 million of debt forgiveness on a primary home.

Home Sales

The familiar rules for home sales continue this year. Gain of up to $500,000 on the sale of a principal residence by a couple remains potentially exempt from tax; singles, $250,000. Unmarried co-owners of a house each can exclude $250,000 if they meet the other requirements. Surviving spouses have two years following a spouse's death to sell a primary home and claim the $500,000 exclusion. A taxpayer who owned and used the property as a principal residence for a cumulative two years during the five years preceding the sale can claim this exclusion once in any two-year period, for any number of periods. To qualify for a full exclusion, either spouse can meet the ownership requirement but both must meet the use requirement

Home sales due to job changes, bad health, or unforeseen circumstances may get partial relief even if the two-year use and residency tests aren't met. You can apply these rules retroactively to sales in which you didn't claim eligible relief.

Make certain you keep accurate records of what you paid for your home, as well as the costs of eligible improvements to it. Upon the sale of your home, such "basis" amounts will be compared to the sales proceeds to determine any potential taxable gain. If the gain is above the exemption amount ($500,000/$250,000), the excess could be subject to capital gains tax, and, for some high-incomers, the Medicare surtax.



A CLOSER LOOK

An exclusion for the sale of a principal residence can be claimed once in any two-year period.

Home Loans

Mortgage points paid on the purchase of a main residence are fully deductible whether paid in cash or financed over the life of the loan, so long as the cash down payment at least equals the cost of the points. You can deduct points on a refinanced loan evenly over the term of the loan. Refinancing the loan for a second time triggers the deduction of the remaining balance of points from the prior refinancing. If you sell a residence while amortizing the points, any points not yet deducted are written off in full. State and local transfer taxes on a house purchase are not deductible but can be added to the tax basis and reduce the realized gain when you sell the house.

Pulling out cash in a home refinancing can create AMT problems, because if the mortgage balance increases when you're refinancing a primary residence or a second home, interest on the excess portion is added back to income under the AMT. (Exception: when the extra proceeds are used to improve a first or second home.)

Interest on the first $1,000,000 of home acquisition debt (to buy, build, or substantially improve a main or second residence) is deductible. (For mortgages dated before Oct. 13, 1987, all interest is deductible.) Interest on a Home Equity loan up to $100,000 secured by a residence is deductible, with deductibility of amounts above that dependent on the use of the proceeds. If you borrow more than $1,000,000

to buy your primary home, the next $100,000 is deductible as home equity debt.

Keep in Mind

- You can tap a traditional IRA (penalty-free but not tax-free) for up to $10,000 to buy a first home. A Roth IRA can be tapped (tax-free and penalty-free) for up to $10,000 for a first home purchase if it has been open for five years. You can tap a 401(k) only by borrowing from it.
- If you tapped IRAs for a failed first-home purchase, you have 120 days to roll the money back to an IRA without tax or penalty—twice the time allowed for a standard IRA distribution. It's treated as a rollover and only one is allowed for each IRA per year.
- The time limits associated with tax-free exchanges of real estate are strictly enforced.
- The property tax on your home depends on the tax assessor's valuation. Make sure your house valuation is in sync with current market values.

Moving Expenses

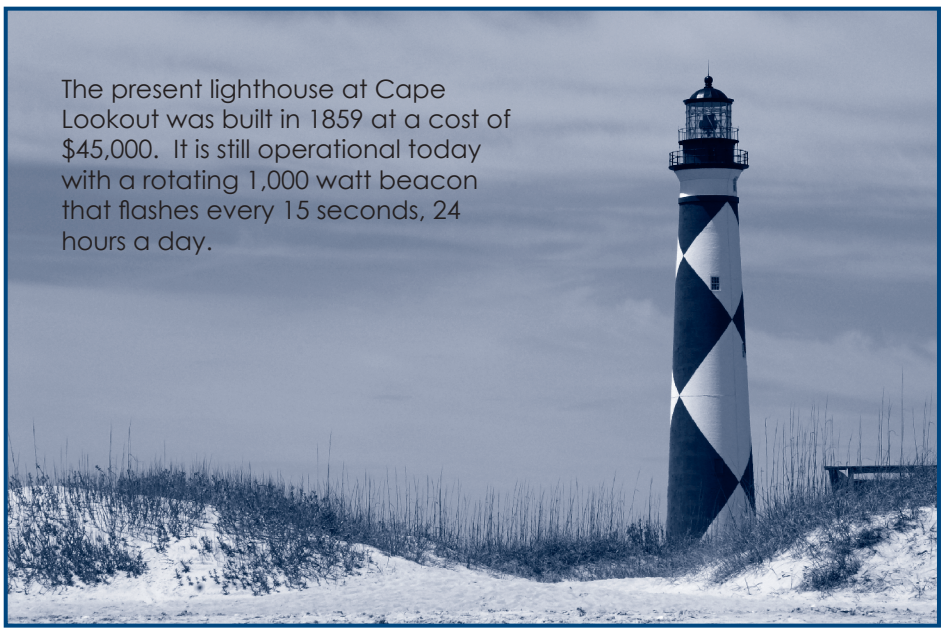
Certain costs of moving household goods are an "above-the-line" deduction from gross income: you get this benefit even if you don't itemize. The only deductible moving costs are those for a professional mover, rented moving van, moving a mobile home, and travel and lodging en route, and these only if the new job is 50 miles farther than the old job from the old house. (If the mover had no full-time pre-move job, the new job must be at least 50 miles from the old house.) There are also requirements for periods of work after the move. The nondeductible expenses of moving can be large, so bargain with your employer for reimbursement of as many of these as possible. Reimbursements to cover moving expenses that are not "qualified" are reportable as income, so try to get the taxes reimbursed as well. The standard mileage rate for moving is 23.5¢. If you move to a new state, you will likely owe income tax in both states. Consult with your tax advisor for proper allocation of your income.

Rental Investments

A rental activity in which the payment is for use of tangible property is "passive." Losses from this type of activity can offset only gains from such activities, including profits from sales of the properties. Losses unusable this year can be carried forward to years when you have passive-activity income. The only other way to use suspended losses is to dispose of the entire activity. The depreciation period for nonresidential real property is 39 years for most property placed in service after May 12, 1993. That for residential rental property is 27½ years.

Exception: If you "actively" participate in renting real estate (i.e., you are at least a 10%-owner and are deeply involved in its operation), you can deduct up to $25,000 from your nonpassive income in rental real estate losses. The deduction is reduced by $1 for every $2 AGI exceeds $100,000 (MFJ). Losses from fire, storm, theft, or such calamities don't count toward the $25,000 limit, nor is gain from the insurance proceeds passive income. MFS filers can't take this loss deduction unless the couple lived apart for the entire tax year; otherwise, the landlord must spend over half his or her time materially participating in realty

Cape Lookout • North Carolina



and put in more than 750 hours per year to deduct losses.

Note: income from a passive activity may be subject to the 3.8% Medicare surtax if you do not materially participate in the operation and you meet the AGI thresholds. (See the discussion on page 3 regarding the surtax.)

If your vacation home qualifies as a rental property, you can deduct up to $25,000 of rental expenses in excess of rental income. If you're close to the limit, consider reducing your time at the home to take a full deduction. If you expect to qualify for the full deduction next year, postpone repair and maintenance expenses.

Repairs to a rental property can be deducted for the year when made, but improvements must be depreciated over many years. The rules distinguishing one from the other can be complicated. To keep these types of work separate, do them at different times and get them billed separately, if possible by different contractors. If you convert to rental use a house that has lost value since you bought it, only the drop in value after the conversion will be deductible when you sell.

Vacation Homes

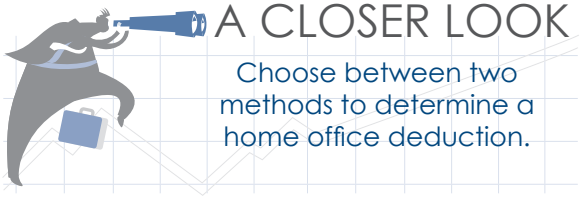
The tax details of owning a vacation home can be complex so guidance from your tax advisor can help you take advantage of the benefits available to you. In simple terms, if you rent your vacation home for less than 15 days a year, the rental income is tax-free and you can deduct interest and property tax payments (and casualty losses) on the house, but not rental expenses, for the entire year. If you rent your vacation home out for 15 days or more during the year, and personal use does not exceed the larger of 14 days or 10% of the rental days, you must include the rent in income. Days spent maintaining and repairing the home don't count as personal use. There is no deduction for depreciation, utilities, or repairs unless interest and taxes allocated to rental are less than rental income. If you occupy the house for more time, this is use of a personal residence and not part of a passive activity. Use by you, your family or relatives (even if they pay fair rent—except when the house is their main home) is "personal."

There's a restriction on converting a vacation home to a primary residence and later sold: a portion of any profit will be subject to tax, based on the time (after 2008) when the house was a second home or a rental to the total time you owned it. The tightening doesn't apply if you make a primary home a vacation home.

Although the gains on a sale of a primary home may enjoy an exemption from tax as discussed on page 21, gains on sales of second homes do not. Consequently, any gain could be subject to the 3.8% Medicare surtax if your income exceeds the MAGI thresholds for the surtax: $250,000 (MFJ); $200,000 (Single and HH); $125,000 (MFS). See the discussion of the surtax on page 3.

Home Offices

Home office expenses are potentially deductible if you have no other fixed location where you perform administrative or managerial activities. A home office must be your principal place of business for important business functions, where you meet with customers, or located in a separate structure on your property. It must be used regularly and exclusively for business. You cannot deduct more than the net income from the business but any excess can be carried over to next year.



There are now two methods for taking this deduction. A simplified method reduces paperwork and recordkeeping and may be used as an alternative to calculating, allocating, and substantiating actual expenses. Under the simplified method the deduction is capped at $1,500 ($5 per square foot up to 300 square feet). Depreciation cannot be claimed and allowable mortgage interest and real estate taxes are claimed as itemized deductions. Business expenses unrelated to the home office (e.g., supplies and advertising) remain deductible.

When using the regular method, you must first deduct from the income the business portion of your mortgage interest and real estate taxes and business expenses unrelated to the home office. Only then do you deduct home-office expenses and depreciation on the business portion of your house. In a sale of your home, gain on the office part may be taxable and depreciation may have to be recaptured.

Estate Planning

What's New for 2014

- The Estate Tax exclusion amount is now $5.34 million. (The permanent Estate Tax exemption base is $5 million, indexed annually for inflation.)
- The lifetime gift tax exemption also rises to $5.34 million. Up to $145,000 in gifts to an alien spouse are excludable.
- The Generation Skipping Tax (GST) has an exemption amount of $5.34 million with a top rate of 40%.
- The five-year deferral, for installment payments of estate tax when a closely-held business makes up over 35% of an estate, continues. For estates of decedents dying in 2014, the 2% interest rate applies on up to $580,000 in deferrals.
- The special use valuation of qualifying real property limit rises to $1,090,000. The "two percent portion" for calculating interest is $1,450,000.
- Trusts and estates could be subject to the 3.8% Medicare surtax. The surtax applies to the lesser of undistributed net investment income or the excess of AGI over $12,150.

Comprehensive estate planning often involves the application of large insurance policies within complex legal trusts. Carefully consider your circumstances and always discuss your situation with your financial, tax, and legal advisors.

Couples are entitled to two exemptions ($5.34 million each in 2014), and any of a deceased spouse's exemption that is unused can pass to the other (for those who die in 2014). This is known as exemption portability which means in effect the exemption amount for a couple is now $10.68 million adding another option to traditional estate planning strategies. The executor who handles the first deceased's estate must explicitly transfer the unused exemption to the survivor by filing a timely federal estate tax return. Portability does not apply to the generation-skipping tax.

One spouse can pass (outright or in trust) an unlimited amount to the other without tax. The assets are taxed when the surviving spouse passes them on to heirs. If one spouse passes everything to the other, they get only one exemption. To secure two exemptions, they can set up two asset pools: one pool, valued at the exemption amount, passes to children or others; the remaining assets are passed under the marital deduction to the surviving spouse, who can later use another exemption amount. Yet in other cases trusts such as an "AB" or "by-pass trust" may be desired. Note that the assets in a surviving spouse's estate will get a step-up in basis when he or she dies, whereas the value of assets in a by-pass trust are fixed when the trust starts.

It's easy to misjudge the size of your federally taxable estate. It includes home equity, retirement accounts, foreign assets, and proceeds from life insurance. Many of your assets could pass outside your will through IRAs, qualified plans, and insurance proceeds, so a precise designation of beneficiaries is a crucial planning issue.

To reduce your estate, transfer assets early through planned gifts and other devices. A personal residence trust may be worth considering. You can live in the house during the trust period but the estate tax value of the home is fixed as of the trust's starting date. Even if you outlive the trust, the home's value is out of your estate. Estates can get a six month filing extension but only once. There is no extension, however, for any taxes due.

As baby boomers transfer assets to children, the children must decide how to receive them. One method is an "inheritor's trust" to receive even small inheritances. Trust income, however, may be taxed as high as 39.6% for income above $12,150. Get help from your advisor.

Consider these other ways to save more of the assets if you are in line to inherit part or all of an estate:

- You can value an estate's assets either as of the date of death or six months later. (The estate tax return is due nine months after the death.) Check the value on both dates and try to use the date that produces the least estate tax.

- If the estate's executor is a beneficiary, he/she should collect executor's fees and deduct them from the estate. The executor's income tax rate may be far lower than the tax rate on the estate.
- The basis of property you inherit is stepped up to its market value on the date of death. If you later sell the property at a loss, you can deduct the loss on your return.
- If the inheritance will put your own estate over the exemption amount, you can renounce your share through a disclaimer and pass it on directly to later generations.

An executor must file an income tax return for the decedent on April 15 following the year of death even if no federal estate tax is due. Executors are liable for any unpaid estate tax and income tax, and often wait to distribute until the IRS agrees on its tax status. One of an executor's main roles is to determine the market value of all the estate's assets on the date of the death, so that the heirs can calculate the stepped-up basis when they later sell the assets. A joint return will cover part of a year for the deceased but a whole year for a surviving spouse, who can make tax-saving moves in the meantime. Examples:

- Realize losses or gains to offset those of the deceased.
- Deduct the decedent's medical expenses, if an appropriate election is made on the return.

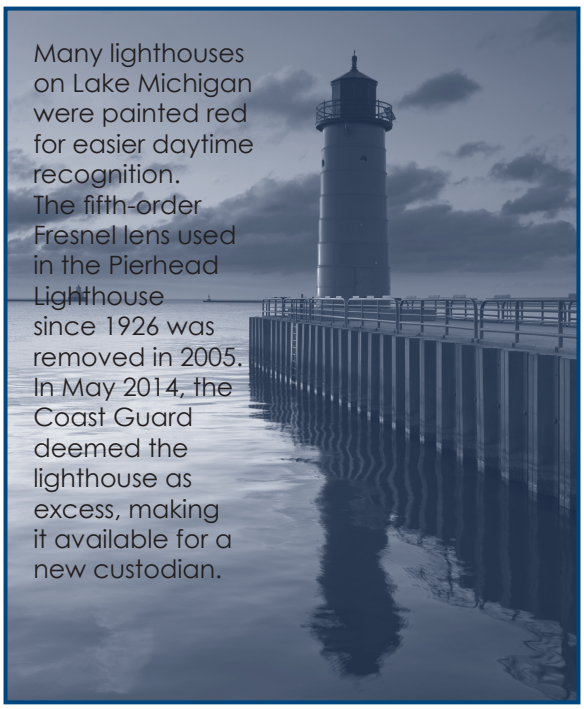
Other Planning Considerations

- When a document conveying power of attorney is silent about making gifts, huge problems can result if the person holding the power tries to make gifts. The power to make gifts must be explicitly authorized by the document.
- Be careful about holding joint bank, brokerage, or mutual fund accounts. Upon your death the joint owner will inherit the account no matter what your will says.
- A non-citizen spouse is not eligible for the marital deduction, but if the estate is less than the exemption amount it won't matter. Professional counsel could help find possible solutions.
- Roth IRAs and 529 plans can be useful in estate planning, and 401(k) Roths may be even better. Don't neglect 529 college savings plans. Withdrawals are tax-free if used for authorized purposes. Contributions may not be subject to gift tax, are usually excluded from the donor's estate, and may be deductible on the state return. You might be able to shelter as much as $70,000 (or $140,000 with your spouse) from gift tax.
- If you inherit an IRA, ask the estate executor for any Form 8606s that were attached which track non-deductible contributions. The IRS exacts a penalty for failure to file them.

Gifts and Gift Tax

The lifetime gift tax exemption amount rises to $5.34 million. The aging of baby boomers and their parents makes gift-giving important for tax saving. Each person can give $14,000 free of gift tax this year to each of an unlimited number of people, or a couple can give away $28,000 if both spouses agree. This exclusion is in addition to the unified credit. Up to $145,000 of gifts to an alien spouse are excludable. Gifts from foreign persons have to be reported if they exceed certain thresholds. Penalties for failing to report can be high. Gifts made by check must be deposited by the donee (the person receiving the gift) before year-end to qualify as a 2014 gift. A certified check will count toward this year's limit regardless of when deposited. Gifts of securities must be endorsed and delivered by year-end. Gifts paid to schools for tuition or to health-care providers for medical expenses or for medical insurance on behalf of a donee are not subject to the $14,000/$28,000 limit. Prepayments of tuition paid directly to a school get an unlimited

Milwaukee Pierhead • Wisconsin



Many lighthouses on Lake Michigan were painted red for easier daytime recognition. The fifth-order Fresnel lens used in the Pierhead Lighthouse since 1926 was removed in 2005. In May 2014, the Coast Guard deemed the lighthouse as excess, making it available for a new custodian.

exclusion, and reduce the donor's estate because they are not taxable gifts.

Recipients of gifts who are in lower tax brackets will pay lower income tax on the earnings of some assets, and any gain in donated property stays out of your estate. The best gifts are those with the highest chance of appreciation. If the assets are still in your estate when you die, their tax basis is stepped up but they could be subject to estate tax far higher than the capital gains rate. There can be good reasons to make gifts even above the tax-free limits; for example, if they would reduce your heirs' estate tax. If you exceed the $14,000/$28,000 limit, you must report the excess to the IRS (on Form 709) including transfers of real estate for little or no payment—usually to family—if they exceed the limit. You

pay no gift tax, however, if you haven't used up your lifetime exemption, and many never will. Neglecting to attach past gift tax returns (709s) to an estate tax return is an audit trigger, which the IRS is vigorously pursuing. Taxable gifts are added back to the estate, and use of the lifetime gift tax exemption reduces the estate tax exemption by that amount.

If you transfer realty to a relative for little or no consideration, make certain you report the gift. The IRS is searching property records to uncover unreported gifts.

Beneficiary Designations

Important—your provisions in a will do not generally supersede or trump the beneficiary designations you make in trust agreements, insurance policies, bonds, bank accounts, and retirement and profit-sharing plans, which can represent most of an estate. These designations usually trump a will, so keep them up to date. Better, make sure your will and such designations agree. Don't name your child as beneficiary if your spouse will need the money. These are crucial issues.

Trusts

You might consider putting assets in trust, with a trustee (possibly you) to administer and manage the trust's assets. Trusts have many features and variations: e.g., they can be established before or after you die. If you set up a trust now and make it irrevocable, the assets you donate to it are out of your estate. (There are gift tax implications, however.) Assets transferred into a trust after you die may be subject to probate. Some trusts used in estate planning include:

- "Wealth-replacement trusts" consist of a charitable remainder trust and an irrevocable trust holding a life insurance policy. The charitable trust can sell low-dividend stock you donate to it without paying tax on the appreciation as you would if you sold it. The trust can reinvest the proceeds and generate a larger income stream for the beneficiary. When you die, the assets in the trust go to charity while the insurance proceeds go to your heirs free of tax.
- By-pass trusts ensure that both spouses use their exemptions if the estate is worth more than $5.34 million. This kind of trust became less useful when exemptions became portable.
- Living trusts let assets in the trust avoid probate and go directly to the heirs. Living trusts bypass probate but don't affect estate tax liability.
- QTIPS (Qualified Terminable Interest Property) allow the income from the assets to go to the surviving spouse until his/her death, then the assets can pass to the children. A QTIP must give the surviving spouse a non-transferable income interest for life in all its assets, which will be included in the survivor's estate but could be distributed to others as the original donor directs. A QTIP is a way to provide income to a new spouse while making sure your assets eventually go to your kids from an earlier marriage.

Instead of setting up a life-insurance trust, you could have one of your children buy a policy on your life, or you could transfer an existing policy to one of them—so long as you don't die in the next three years. As a gift, the transfer will use up some of your $5.34 million lifetime gift tax exemption and reduce how much you can leave at death tax-free. You can give your child enough money each year to pay the premiums (which could possibly not exceed the tax-free gift limit).

Business

What's New for 2014

- Note: these tax breaks have expired for 2014 but could be reinstated retroactively before year-end: 50% bonus depreciation; the R & D credit; the work opportunity tax credit (WOTC); 15 year recovery period for certain assets; energy credits for improvements on commercial buildings; the conservation easement incentive for qualified farmers and ranchers.
- The Section 179 deduction limit has dropped to $25,000 available until $200,000 in qualifying new and used assets are placed in service. Computer software and qualified real property are not eligible. Congressional action before year-end could raise these limits.
- The 30% credit for businesses installing qualified solar energy property remains through 2016.
- Materials and supplies costing $200 or less can be expensed rather than depreciated.
- The per-diems for high-cost areas rise to $251 per day; elsewhere, $170. Meals and incidental expenses remain: high-cost areas, $65 per day; elsewhere, $52. Self-employeds on travel can use these rates for meals and incidentals only and must substantiate their lodging expenses separately.
- Taxpayers may immediately deduct up to $5,000 in qualified business start-up expenses in 2014 but the deduction is reduced by the amount of total start-up costs that exceeds $50,000.
- Caution: employers who reimburse employees tax free for health insurance premiums may be subject to an excise tax. Strict rules apply.
- The alternative simplified R & D credit can be elected on amended returns. If the regular credit was already claimed for the year, this option is not available.

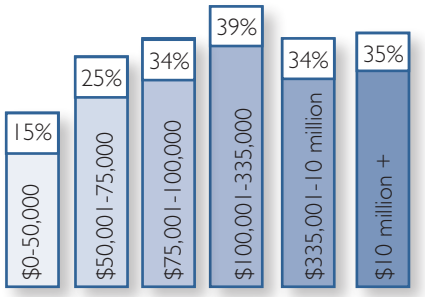
Business Structures and Taxes

Businesses can be structured in several ways. Choosing the right structure at the onset is important because changing the business structure later could have tax consequences. Although C Corporations pay only 15% on taxable income of less than $50,000, individual tax rates can be more favorable in many cases so operating as a sole proprietorship, partnership, or S Corporation may make sense. Consult with your

	Definition	Taxes	Liability
Sole Proprietorship	Someone who owns an unincorporated business by himself/herself	Profits/losses included on owner's individual tax return	Owner generally not protected
Partnership	Relationship between two or more persons who join to operate business or trade	Profits/losses pass through to each partner's individual tax return	General partners: unlimited Limited partners: to the extent of the investment
Limited Liability Company (LLC)	Structure allowed by state statute; not a classification for federal tax purposes	LLC must file corporation, partnership or sole proprietorship federal tax return	Limited
S Corporation	Corporation that passes income, losses, deductions, and credits through to shareholders	Because of pass through to shareholders' tax returns, double taxation on corporate income avoided	Limited for shareholders
C Corporation	Entity that conducts business, realizes net income or loss, pays taxes and distributes dividends	Taxed on earnings; shareholders taxed on dividends received	Limited for shareholders

advisor about which structure is the best for your business.

C Corporation Tax Rates



The first $50,000 of taxable income is taxed at 15%, the next $25,000 at 25%, etc. An extra 3% surtax applies to income between $15 million and $18 1/3 million. A Personal Service Corp. pays 35% tax on all income.

Business Credits and Deductions

There are numerous credits and deductions available to businesses which can result in substantial tax savings. Each year new credits are introduced while others may disappear. Your advisor can help pinpoint which credits apply to your business. Refer to the "What's New for 2014" section above for some of the new or revised credits for 2014.

Business expenses must be "ordinary" (common) and "necessary" (helpful and appropriate) in your type of business to quality as deductions. You can increase your deductions by paying attention to what you do near year-end. For example, buy supplies before year-end and accelerate repairs into this year; reduce or defer year-end income; delay shipping until next year; make sales on consignment or approval. For cash basis businesses, defer billing for services until the next month or quarter and advance into 2014 payments you expect to make in 2015 for expenses such as maintenance, office supplies, and advertising.

Keep in mind that the deduction for business meals and entertainment is 50% of eligible expenses, with receipts required for expenditures above $75. Be certain to document each expense, including the place, people in attendance, and the business focus of the discussion. You need an itemized bill for lodging; a credit card receipt is not enough.

Suggestion— hold a company party during the holidays. Limits on deductions for meals and entertainment don't apply if the party isn't limited to highly-compensated employees. Another idea: instead of buying your client a meal (only 50% deductible), give a gift certificate (100% deductible) to his or her favorite restaurant.

Vehicles

The standard mileage rate for business driving in 2014 is 56¢ per mile. It can be used for hired vehicles such as taxis as well as leased cars and for valuing an employee's use of a company car. It cannot be used for more than two cars used alternately for business or more than four vehicles used simultaneously (such as a fleet). If you use the mileage rate, parking and tolls are deductible expenses but not fuel, insurance, repairs, and other out-of-pocket costs. The allowance can't be used if you claimed depreciation or expensing on the vehicle. Employees have income for personal use of company cars. The 2014 maximum fair market value (FMV) for employer-provided vehicles using the cents-per-mile valuation rule: $16,000 passenger auto (unchanged from 2013); $17,300 truck or van.

Depreciation Schedule Luxury Vehicles Placed in Service 2014

	Cars	Light Trucks/Vans
First Year	$3,160*	$3,360*
Second Year	$5,100	$5,400
Third Year	$3,050	$3,250
Fourth Year +	$1,875	$1,975

*bonus depreciation has expired but could be reinstated before year-end.

When you depreciate a business vehicle, you must indicate what percentage of the annual use was for business. Claiming 100% business usage can be an audit flag. Make sure your records for business use of a car are written and contemporaneous or the deduction could be disallowed.

Employer-Provided Benefits

Health Care – The employer mandate to offer health insurance to employees goes into effect in 2015 for firms with 100 or more "full-time

equivalent" (FTE) employees. In 2016, coverage must be available for dependents as well. The mandate kicks in for firms with 50–99 FTE employees in 2016.

Small employers who pay at least half of the premiums for employee health-care coverage may be eligible for a refundable tax credit. An employer qualifies for some credit if it has no more than 25 FTE employees, and pays them annual wages averaging no more than $50,800. A 50% credit is good only for employers with 10 or fewer FTEs paid annual average wages of $25,400 or less. Tax-exempts that qualify get a credit of 35%. Household employers get the credit for coverage to a nanny. For tax years begining in 2014, the credit is available for two consecutive taxable years. Premium expenses in excess of the credit can be deducted. Refer to The Small Business Health Care Tax Credit page at www.irs.gov to determine if you qualify for the credit.

Health-insurance policies for self-employeds and 2% or more owners of S Corporations can be in the owner's or the company's name. If the policy is in the owner's name, the company must reimburse the shareholder in order for the premiums to be deductible. A sole proprietor whose spouse works for the company can provide coverage for employees, spouses, and dependents. The owner's coverage then is included with the spouse's: a business deduction and tax-free to the employees and spouses.

Transportation Benefits –

The allowance for mass transit drops to $130; the allowance for parking increases to $250. The benefit for bicycle commuters remains $20 per month when a bike is used for a substantial part of the commute.

Flex Plans –

Employers with flex plans: caution. The full amount an employee elects to have taken out of pay for the year must be available at the start of the year. The employer is liable for any amount needed that has not yet been paid in, and the employee need not pay it back. The IRS says FSAs are equivalent to insurance.

Qualified Retirement Plans

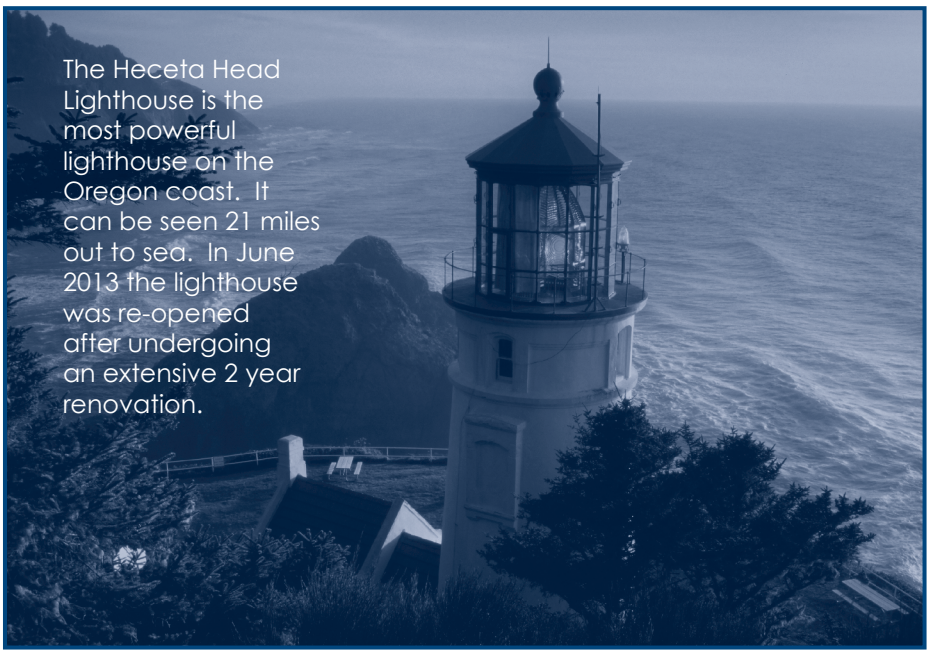
The IRS has a guide to retirement plans for small businesses. Called the Retirement Plans Navigator, it compares contribution limits, filing rules, and operational requirements for the various types.

A new type of retirement plan, the myRA, will be introduced late in 2014 with a national rollout in 2015. Employers who do not offer other retirement savings plans will be eligible to participate. Contributions will be made with after-tax dollars through payroll deductions with direct deposits to the employee's myRA. Employers will not administer employee accounts, contribute to them, or match.

Firms with fewer than 500 employees can offer a combined 401(k) and defined benefit pension plan, called the DB(k), which must pay a benefit equal to 1% of final average pay for each year of service, for up to 20 years. Enrollment must be automatic and participants must defer 4% of their pay unless they opt out, while the firm must match at least 2% of pay. The DB(k) may eventually become available to larger companies.

Firms can offer Roth 401(k)s but must amend earlier 401(k)s to add this feature. The IRS has a model amendment firms can use. Contributions

Heceta Head • Florence, Oregon



are from after-tax dollars, but after five years and age 59½ all withdrawals are tax free. Contribution limits are much higher for Roth 401(k)s than for Roth IRAs. Disadvantages of Roth 401(k)s: non-discrimination and minimum-distribution (after age 70½) rules apply, and employer matches may not be tax favored. So contributions to regular and Roth 401(k)s should be segregated. Employers must permit non-spousal IRA rollovers.

Small employers may be eligible for a credit for the start-up costs for a pension plan. First consider a Simplified Employee Pension plan (SEP) or a SIMPLE. With a SEP you contribute directly to employees' IRAs and avoid much paperwork and reports to the IRS. You must cover all eligible employees. An employer's contribution can't exceed the lesser of 1) 25% of the employee's compensation or 2) $52,000.

A SIMPLE must include employees who earn $5,000 or more. Employers must make contributions of either 2% of pay or match employee contributions up to 3% of salary, and all eligible employees must be covered. If you have low amounts of self-employment income (for instance, $25,000 or less), a SIMPLE may be just right for you; otherwise, consider a 401(k) or SEP.

Employers must put small ($5,000 or less) payouts from retirement plans into an IRA if a departing employee fails to specify a payout option. If this is done prudently, the employer is not liable for subsequent losses.

Compensation

C Corporations – If you own a small C Corporation in a lower tax bracket, you might save on taxes by taking out more as low-taxed dividends and less as salary. (Not in Personal Service Corporations—they pay a flat 35% rate.) If the IRS thinks your C Corp salary is too high, it may reclassify some of it as a dividend. Profitable C Corps should pay at least some dividends each year. Make clear that bonuses are tied to performance.

S Corporations – Owners: make sure you pay yourself a reasonable salary. If the IRS thinks you take too little in salary from an S Corp, it may reclassify some profits as compensation, on which you'll have to pay payroll taxes.

Deferred compensation plans can deduct payments of benefits to charities, whether or not the benefits are taxable to the payees. (Charities are often contingent beneficiaries if a primary beneficiary dies or disclaims his or her share.)

Employees with leave or vacation pay they are about to forfeit can use the vacation days by year-end or have the cash equivalent placed in their 401(k) accounts. Because they are not allowed to receive cash for it, the IRS says the contributions are free of income and FICA taxes. Make sure highly-paid employees don't have a disproportionate percentage of extra contributions. When employers contribute the dollar value of unused sick leave for retiring employees and buy additional medical coverage for them, the benefits are tax free so long as the workers cannot elect to take cash instead.

Miscellaneous

If your C Corporation is close to break even for the year, try to achieve a small profit. Why? If the company reports a loss for 2014, it must pay 100% of its year 2015 tax bill through estimated payments to avoid an underpayment penalty. If it owes $1 in tax for 2014, it need pay only $1 in estimated taxes for 2015.

Kilauea • Kauai, Hawaii

Kilauea Point is part of a 203 acre wildlife refuge on the island of Kauai. It is one of the most visited sites on the island with 500,000 visitors per year.

If you buy more than 40% of your 2014 asset purchases (excluding buildings) in the last quarter, regular depreciation on all 2014 purchases is figured on the mid-quarter basis, so assets bought near year-end get less current year depreciation. This is a complex area; seek professional advice.

Pay current tax liabilities before overdue taxes if your business owes the IRS back payroll taxes. You'll pay a new penalty if you miss current payments as well, and the IRS usually will let a business paying its current liabilities stay open.

In many cases owners of Limited Liability Companies will owe SECA (self-employment) taxes if they are personally liable for the LLC's debts, can sign contracts for the firm, work for an LLC that provides professional services, or work more than 500 hours a year. Talk to your advisor about your situation.

Be certain that assets are ready for business use before year-end or they may not qualify for this year's expensing.

Farmers

Farmers and ranchers in many drought stricken states have an extended period of time to replace livestock and defer tax on any gains from forced sales. Normally tax is deferred on the extra gains from such sales and the livestock must generally be replaced within four years. If the drought continues, additional extensions may be authorized by the IRS. Eligible counties as designated by the National Drought Mitigation Center can be found on the IRS website.

"Conservation reserve" payments (to keep tillable land idle) are subject to SECA tax as self-employment income (and might cause the farmer to lose Social Security benefits even if the farmer is retired or not engaged in farming). Cost-sharing payments to farmers who adopt conservationist practices are free of income and SECA taxes.

Tips for Small Business

A married couple who jointly owns an unincorporated business may be able to elect not to be treated as a partnership, and instead file tax returns as two sole proprietors. Conditions apply.

Many small businesses are legally obliged to make their premises accessible to the disabled. Many renovation charges qualify for the disabled access credit, which reduces the business's tax bill dollar for dollar. The first $250 of renovation expenses is excluded; then there's a 50% credit for the first $10,000 of qualified expenses, for a maximum credit of $5,000.

Sole proprietors, partnerships and S Corps can expense new equipment under Section 179 only to the extent they have taxable income, not to show a loss. Unused Section 179 expense can be carried over to future years.

Be sure to give 1099 forms to workers you claim are contractors. The IRS continues to focus on misclassifications of workers as contractors (and violations of fringe benefit and executive pay rules). Firms that voluntarily correct misclassifications may be allowed to pay lower penalties. Not so if already under audit.

Even small businesses may qualify for the "manufacturing deduction" for gross receipts from the sale, lease or rental of tangible personal property made in the U.S. The deduction remains 9% of qualifying income, but is limited to 50% of the W-2 wages (no independent contractors) for qualified production activities during the year.

Adding Spouse to Payroll 2014

Without spouse on payroll	Eligible owner's income	$180,000
	Spouse	-0-
	Family Income	$180,000
	401(k) deferral (1)	$17,500
	Age 50 catch-up (1)	$5,500
	Total 401(k) deferrals	$23,000
With spouse on payroll	Eligible owner's income	$155,000
	Spouse	$25,000
	Family Income	$180,000
	401(k) deferral (2)	$35,000
	Age 50 catch-up (2)	$11,000
	Total 401(k) deferrals	$46,000

Business owners who want to set aside as much as they can for retirement may want to consider adding their spouse to the payroll before year-end. The extra FICA tax paid on the income shifted to the spouse is more than offset by the additional 401(k) contributions.

Extra FICA tax paid on $25,000 income to spouse: (15.3% Co & employee) $3,825

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2014 Income Tax Rates

	Taxable Income		Tax Rate	Total Tax			Phaseout Range of Personal Exemptions
	Over	But not over		Tax is	Plus	Of the amount over	
Married/Filing Jointly (MFJ)	$0	$18,150	10%	$0	10%	$0	
	$18,150	$73,800	15%	$1,815.00	15%	$18,150	
	$73,800	$148,850	25%	$10,162.50	25%	$73,800	
	$148,850	$226,850	28%	$28,925.00	28%	$148,850	$305,050–$427,550
	$226,850	$405,100	33%	$50,765.00	33%	$226,850	
	$405,100	$457,600	35%	$109,587.50	35%	$405,100	
	$457,600		39.6%	$127,962.50	39.6%	$457,600	
Head of Household (HH)	$0	$12,950	10%	$0	10%	$0	
	$12,950	$49,400	15%	$1,295.00	15%	$12,950	
	$49,400	$127,550	25%	$6,762.50	25%	$49,400	
	$127,550	$206,600	28%	$26,300.00	28%	$127,550	$279,650–$402,150
	$206,600	$405,100	33%	$48,434.00	33%	$206,600	
	$405,100	$432,200	35%	$113,939.00	35%	$405,100	
	$432,200		39.6%	$123,424.00	39.6%	$432,200	
Single	$0	$9,075	10%	$0	10%	$0	
	$9,075	$36,900	15%	$907.50	15%	$9,075	
	$36,900	$89,350	25%	$5,081.25	25%	$36,900	
	$89,350	$186,350	28%	$18,193.75	28%	$89,350	$254,200–$376,700
	$186,350	$405,100	33%	$45,353.75	33%	$186,350	
	$405,100	$406,750	35%	$117,541.25	35%	$405,100	
	$406,750		39.6%	$118,118.75	39.6%	$406,750	
Married/Filing Separately (MFS)	$0	$9,075	10%	$0	10%	$0	
	$9,075	$36,900	15%	$907.50	15%	$9,075	
	$36,900	$74,425	25%	$5,081.25	25%	$36,900	
	$74,425	$113,425	28%	$14,462.50	28%	$74,425	$152,525–$213,775
	$113,425	$202,550	33%	$25,382.50	33%	$113,425	
	$202,550	$228,800	35%	$54,793.75	35%	$202,550	
	$228,800		39.6%	$63,981.25	39.6%	$228,800	
Estates & Trusts	$0	$2,500	15%	$0	15%	$0	
	$2,500	$5,800	25%	$375.00	25%	$2,500	
	$5,800	$8,900	28%	$1,200.00	28%	$5,800	
	$8,900	$12,150	33%	$2,068.00	33%	$8,900	
	$12,150		39.6%	$3,140.50	39.6%	$12,150	

Personal Exemption $3,950

2014 Standard Deduction

	Under Age 65	Age 65 and older	
Married/Filing Jointly	$12,400	$13,600 $14,800	(one spouse) (both spouses)
Head of Household	$9,100	$10,650	
Single	$6,200	$7,750	
Married/Filing Separately	$6,200	$7,400	

Blind taxpayers get an extra $1,200 if married; $1,550 if single or head of household.

Itemized Deductions

Reduced for high-incomers but cannot lose more than 80% of your deductions. Phaseout starts at AGI:

MFJ $305,050 HH $279,650 Single $254,200 MFS $152,525

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