



Year End Tax Planning Considerations

As we begin to usher in fall, year-end tax planning will become a hot topic for many individuals. Whether it's the closely held business owner or a high net worth individual, income taxes represent a significant outflow for our clients. With top rates of 39.6% on ordinary income, 20% for long term capital gains plus a 3.8% Net Investment Income Tax (NIIT), our tax environment requires us to find favorable opportunities that generate tax savings for clients. If not already addressed on a regular basis, year-end planning is the last chance to evaluate opportunities before the year comes to a close. As conversations begin to shift towards year-end planning, below are a few strategies to consider.

What About Next Year Planning?

Year end planning requires the planner to gather information on the current and at least the next upcoming tax year. Savings can be generated for our clients by leveling out taxable income – accelerating income and deferring deductions from the lower anticipated income years or deferring income and accelerating deductions in high income tax years. Similarly, investment account activity needs to be reviewed to determine if capital gains can be offset by available unrecognized losses in the account.

Tax Payment Planning

Individuals with adjusted gross income in excess of \$150,000 have two methods available for managing estimated tax payment obligations: the safe-harbor method and the current year method. Under the safe-harbor method a taxpayer will avoid underpayment penalties if 110% of the prior year liability is remitted on a quarterly basis. The current year method requires quarterly payments based upon 90% of the current year tax. Taxpayers can use either method for any tax quarter. Educating clients on their payment options will strengthen the client relationship, and set an expectation for income tax obligations coming due. Clear reminders from the consulting professional regarding exposure to underpayment penalties allows clients to evaluate the cost of forgoing estimate planning.

Quarterly estimates for individuals are due on the 15th of April, June, September and January of the subsequent year. On April 15th taxpayer's are required to satisfy 100% of the liability due for the prior year, as well as Q1 of the current year. The combined total tax bill frequently surprises our clients. Often times a shortfall can be mitigated by implementing simple year-end planning techniques. For example, a W-2 employee can address a withholding shortfall by increasing Federal withholdings on the last few pay periods of the year or on a year-end bonus. Federal Form 2210 calculates the penalty for underpayment of estimated taxes for individuals. Annual withholding payments are deemed ratably paid throughout the year, whereas quarterly estimates are credited on the actual date paid. Therefore, increased year end withholding can reduce or eliminate a penalty from missed estimated payments or under withholdings earlier in the year.



Retirement Distribution Planning

Required Minimum Distributions (RMDs) represent the minimum amount an individual must withdraw each year from qualified retirement plans and IRAs, beginning in the year when the individual reaches 70 ½. (Amounts from qualified plans, but not IRAs, can be deferred until the year of retirement, if later, rather than age 70 1/2 for non-owners of the employer sponsor.) The amount required to be distributed is based on IRS generated distribution tables. The date an individual turns 70 ½ is 6 months after their 70th birthday. In the first minimum distribution year, taxpayers have an option to defer the payment on account of that tax year until the first quarter of the subsequent tax year. For example, if a taxpayer has a birthday on or before June 30, 2015, 2015 will be the first RMD year and the RMD on account of the 2015 tax year must be paid no later than April 1, 2016. If a taxpayer elects this one time deferral, 2015 taxable income will not include the minimum distribution amount and 2016 taxable income will include the required minimum distribution amounts for both 2015 and 2016. Depending on the individual's tax situation over the two years, this flexibility can result in lower overall taxes. Note that the IRS has strict guidelines with regard to RMD payments and if not followed, penalties apply. Generally administrators of the retirement plan calculate the RMD annually, however the taxpayer is ultimately responsible for compliance with IRS requirements. As professional advisors, we should confirm that required distributions have been received.

As many clients defer receipt of their RMDs until late in the year, this is also a good vehicle to use to adjust needed withholdings to reduce estimated tax payment requirements.

Retirement Plan Creation Planning

While retirement plan contributions can generally be made to a qualified plan up to the due date of the taxpayer's return, the qualified plan itself must have been adopted prior to the end of the tax year to permit contributions to be made for that year. Year end planning is the perfect time to review the types of plans available for your client and consider if any changes should be made to the structures currently in place.

Charitable Planning

In December 2014 the Tax Extenders Package gave individuals age 70 ½ and older the option of making tax-free distributions of up to \$100,000 from IRA's for charitable purposes. This is known as a Qualified Charitable Distribution (QCD). Generally the QCD is a nontaxable distribution made directly by the IRA trustee to a specific eligible charitable organization. For QCD purposes, eligible charitable organizations do not include private foundations and donor advised funds. The QCD will also satisfy the taxpayers Required Minimum Distribution in the amount transferred to charity. From an income tax perspective QCD's are excluded from gross income and are not deductible on Schedule A, so that there would appear to be little benefit to the QCD. However, certain deductions are limited based on a taxpayer's Adjusted Gross Income (AGI) and utilizing the QCD reduces AGI.

This provision has not yet been extended for the 2015 tax year, so advisors may want to advise clients to postpone their RMD from IRAs and some of their charitable gifting commitments until Congress determines whether to extend the QCD rules for 2015.



Annual Gifting

For Federal gift tax purposes each individual can transfer each year (either cash or property) up to an allowable exclusion amount to as many individuals as they choose without incurring gift tax or using any of his or her lifetime exclusion amount. For 2015 the annual gift exclusion is \$14,000 per person, or \$28,000 for married taxpayers. Most planners consider annual exclusion gifts the “low-hanging fruit” of estate planning. Since the annual exclusion expires each December 31 if not used, we should encourage our clients not to waste this tax free opportunity to reduce their taxable estates. Implementing an annual gifting program permits taxpayers with large estates to regularly transfer wealth gift tax free. Annual exclusion gifts can be part of sophisticated gifting programs reflected on gift tax returns each year and reducing the taxable gifts made in certain types of trusts. But in other cases the administration of an annual gifting program can be very minimal. The IRS does not require a gift tax return when total gifts made to individuals are under the annual exclusion amount. Therefore, gift tax returns will not be required in many situations.

Annual exclusion gifts can be useful in creating Section 529 Education accounts for children and/or grandchildren or to help working children establish tax favored Roth IRA accounts. Each year’s gifts are manageable and over time, a significant estate can be established for our clients’ family members.

Appreciated Stock

The sale of appreciated stock will often lead to increased personal income taxes. For high-income taxpayers the federal long-term capital gains rate tops out at 23.8% for 2015 (20% Income tax plus 3.8% Net Investment Income Tax). If appropriate year-end planning takes place, your client may find a more efficient use of long-term appreciated stock. For example, using the annual exclusion to gift appreciated stock to a family member may result in the capital gain being taxed at a lower rate and perhaps excluded from the Net Investment Income Tax altogether. Another option is to use appreciated stock rather than cash to satisfy a charitable gift. The taxpayer deducts the fair market value of the stock as a charitable donation, without triggering capital gains tax on the appreciation.

Trust Planning

From an income tax perspective trusts become subject to the highest rates very quickly, which certainly leads to opportunities for year-end tax planning. Trust taxable income, excluding long term capital gains, in excess of \$12,300 will be subject to tax at 39.6%. The tax on long term capital gains also rises from 15% to 20% when income exceeds \$12,300. Similarly, the additional NIIT at the rate of 3.8% applies to undistributed trust investment income in excess of \$12,300.

The key to complex trust distribution planning is identifying opportunities to carry out beneficial tax opportunities to beneficiaries. Trust distributions are governed by the terms of the trust document, but the benefits of distribution planning should be communicated to trustees if a favorable tax opportunity exists.



Trust Planning (continued)

The marginal rate brackets and NIIT thresholds are more favorable for individual taxpayers. Therefore in cases where a beneficiary is below the top bracket a tax savings may be generated by distributing income from a complex trust. However, this may thwart the non-tax purpose of the trust so the trustee will want to consider both the tax and non-tax considerations before making this decision. Distributions of capital gain is a more complex matter requiring review of the trust document and consultation with tax counsel in some cases.

Trustees are given an opportunity to make a distribution post year end and treat it as if made in the prior tax year. If paid within 65 days of year end and properly reflected on a timely filed fiduciary return, distributions made within the first 65 days of the year will be treated as made in the prior year. Because of the potential significant difference in taxes to be paid at the trust level versus the beneficiary level, it is important to take advantage of this rule and review the estimated taxable income of the trust during this period.

Finally, if a trust has made estimated tax payments that are not needed for the year by the trust, an election may be made by filing Form 1041-T within 65 days of year end to allocate the estimated payments to trust beneficiaries.