INDIVIDUAL TAX STRATEGIES

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TOPICS TO BE COVERED TODAY

- WHAT IS TAX PLANNING
- NEW CHANGES FOR 2014 & OUTSTANDING TAX CHANGES TO COME
- PLANNING OPPORTUNITIES & REPORTING UNDER THE AFFORDABLE CARE ACT
- NEW POSSIBILITIES IN NON TAX DEDUCTIBLE RETIREMENT FUNDING
- LIVING WITH THE NORTH CAROLINA TAX LAW CHANGES
- BIG 5 PLANNING OPPORTUNITIES

- **What is Tax Planning?**

What is Tax Planning?

- Our planning approach is to utilize tax laws to reduce your taxes as much as possible while recognizing that sound financial decisions should be the driving force.
- We must consider your 2014 activity and possible 2015 activity in order to:
  - Weigh the tax situation of both years to determine when to recognize income and when to incur expenses
  - Look at your marginal tax rate for both years to make a sound decision

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- **New Changes for 2014 & Outstanding Tax Changes to Come**

New Changes & Developments

- There are no major changes for 2014 however there are several items still up for possible renewal. The following items lapsed after 2013 and are up for renewal:
  - State Sales Tax Deduction
  - Research & Development Credit
  - Charitable Donations from IRA's up to $100,000 for those 70 ½ & older
  - Teacher's $250 Deduction
  - $500 Qualified Energy Home Improvement Credit
  - Qualified Home Mortgage Insurance Premium Deduction

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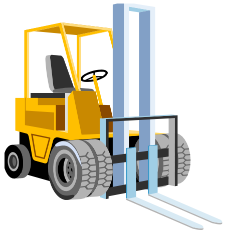
But What About Depreciation?

- Currently, Congress has not addressed the issue surrounding depreciation
  - If Congress does nothing → No Bonus Depreciation & 179 expense remains at $25,000 with a $200,000 asset addition limit
  - Expecting some sort of bill but details are iffy
    - Possibility → 50% bonus depreciation with a 179 expense of $250,000
    - Could be passed after year end



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Individual Tax Strategies

Changes for 2015:

- No change in tax rate from 2014 to 2015
- Social Security Wage Base will be $118,500
- Estate Tax Exclusion is $5.34 million
  - Remember, if one spouse passes away, the unused portion can be carried over to the surviving spouse as long as an Estate Return is filed on Form 706
- Gift Tax Exclusion is $14,000 per individual. Since each spouse is considered separate, a combined gift of $28,000 may be given to one person

Individual Tax Strategies

Affordable Care Act (ACA):

The Affordable Care Act made many changes to 2013 that personal taxpayers are still living with:

- New top tax rates – 39.6% is back
- Phase out of Itemized Deduction and Personal Exemption when Adjusted Gross Income (AGI) exceeds $254,200 for Single filer and $305,050 for MFJ filer
- New high end capital gain rate of 20% when taxable income is over $406,751 for Single filer and $457,601 for MFJ
- Medicare Surtax
- Net Investment Income Tax (NIIT)

ACA (cont):

Medicare Surtax:

- Medicare Surtax - .9% on wages and self-employment income over the following amounts:

  $250,000 for Married Filing Joint (MFJ)
  $200,000 for Head of Household
  $200,000 for Single
  $125,000 for Married Filing Separate (MFS)

.9%

Only applies to earned income. This includes W-2 wages, Self-Employment earnings from Schedule C as well as from pass through entities.

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ACA (cont):

Net Investment Income Tax (NIIT):

- Net Investment Income Tax - Calculated by applying a 3.8% tax to the LESSER of the Net Investment Income or the amount by which Modified Adjusted Gross Income (MAGI) exceeds the following amounts:

$250,000 for MFJ
$200,000 for Head of Household
$200,000 for Single
$125,000 for MFS

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Individual Tax Strategies

<u>ACA – NIIT (cont):</u>

- <u>Net Investment Income</u> applies to your passive income and includes the following:
  - Interest & Dividends (but not self charged interest from an entity in which the taxpayer materially participates)
  - Annuities
  - Rental Income as long as it is <u>not</u> a trade or business
  - Royalties
  - "Passive" income (pass through income from S corporations and Partnerships)
  - Long Term & Short Term Capital Gains
  - Gains from the Sale of interest in S corporations and Partnerships if the taxpayer is considered "Passive"

  - A key item <u>not</u> included is income from Retirement accounts. Will need to monitor if paying out of these accounts instead of Annuities

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Individual Tax Strategies

ACA – NIIT (cont):

- Opportunities to reduce Net Investment Income Tax:
  - Try to increase your above the line deductions since NIIT only applies to the extent your AGI is above $250,000 (MFJ) or $200,000 (Single)
  - Allocate a portion of your investment expenses for managing income to reduce the passive income
  - Allocate a portion of state income tax expense to reduce the passive income
  - If you own a property that has suspended passive losses, consider selling in a year where there is a potential for a large NIIT. The suspended passive losses that get released in the year of sale will reduce your Net Investment Income subject to the tax.
  - Allocate a portion of your tax preparer fees to reduce passive income

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ACA – NIIT (cont):

Potential Issues with the Net Investment Income Tax:

- A trust or estate starts paying NIIT when taxable income is $12,150
  - Will want to make sure all income is distributed to beneficiaries to keep taxable income within the Trust or Estate below $12,150
- IRS could start auditing your classification of pass through entities
  - NIIT only applies to passive income so nonpassive income is not taxed. In order to be considered nonpassive the taxpayer must materially participate in the pass through entity
    - Material participation requires that the taxpayer spend at least 500 hours in the activity
    - Also nonpassive is considered to be significantly participating to the extent that the taxpayer must spend at least 100 hours in the activity and more than anyone else

ACA (cont):

The Affordable Care Act, besides creating additional taxes, also requires everyone to be insured. 2014 is the first year that a taxpayer must be insured or incur a penalty.

- Penalty is called a "Shared Responsibility Tax" (SRT)
  - It is reported on your personal tax return
- Tax is calculated on a month by month basis. If uninsured for four months, tax must be paid on the four months not covered.
- If a person qualifies as your dependent then you must cover them under your insurance plan. If not, then you are responsible for the SRT

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ACA (cont):

Calculation of the Shared Responsibility Tax:

The tax is based on the greater of the following:

- $95 per uncovered adult member and $47.50 per uncovered child (under 18) not to exceed $285
- 1% of household income that is in excess of the income required to obtain insurance ($10,000 for Single/ $20,000 for MFJ)

The tax is reported on your tax return

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Individual Tax Strategies

ACA (cont):

The following are exemptions from having to obtain insurance and being subject to the tax:

- If you are not covered for 3 months or less
- Person is below the required level to file a tax return ($10,000 single/$20,000 MFJ)
- Person whose available insurance would be more than 8% of their household income
- Person qualifies under one of the hardship exemptions. In order to qualify under a hardship exemption the person must obtain a certificate from the exchange.

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<u>ACA (cont):</u>

Good News! – You could possibly get a credit to help pay for insurance

- If someone has to go to the Exchange to buy insurance, the ACA provides for a potential credit against the purchase price of the insurance
  - Household Income must be below 100% of poverty level to get a full credit
  - Credit starts to phase out after 100% of poverty level up to 400%
    - A family of four with income below $94,200 could qualify for a partial credit
- The credit is claimed on your tax return and is "refundable" which means that you get the money refunded on your tax return even if your taxable income comes to zero
- May also receive an Advanced Payment from the government for the credit. You must report what you received on your tax return. If you received too much, then you must pay a portion back.

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ACA (cont):

One last tidbit on the ACA from a personal taxpayer standpoint:

- The Flexible Spending Account rules have always required that claims be submitted for every amount set aside during a year or lose what is not used
- The rules have been changed to allow carry over of $500 in unused reimbursements to the next year
    - There is a catch
        - First, this can only be done if the company plan documents have been updated to allow it
        - Second, all claims must now be submitted by December 31st, where it used to be allowed up to 2 ½ months after year end

- **New Possibilities in Non Tax Deductible Retirement Funding**

Planning for Retirement with Non-Tax Deductible Contributions:

- A Roth has been a primary means to plan for retirement with funds that are not currently tax deductible but grow tax free and are tax free when withdrawn
  - Two types of Roths
    - Roth IRA – limited contribution based on current year income
    - Roth 401k – provided by employer and has same contribution rules as a regular 401k
- In the past, we have evaluated the benefit of doing a Roth conversion or making a contribution to a Roth based on your current tax rates
  - A new perspective in talking with people who are using their Roth's in retirement ---- according to many clients, they recommend a Roth contribution no matter what tax bracket you are in
    - Main reason – ease of living and not worrying about taxes in retirement

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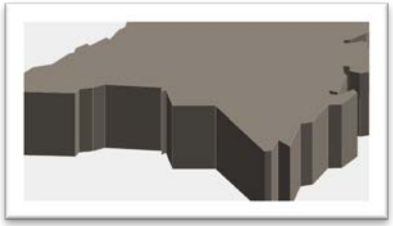
<u>Planning for Retirement with Non-tax Deductible Contributions (cont)</u>:

<u>A new way to get money into a Roth</u>:

- If you have a 401k plan, then you are only allowed to make tax deductible contributions of $17,500 ($23,000 if 50 and over)
  - However, you can put up to $52,000 back for retirement
  - All contributions in excess of the tax deductible portion would be considered non deductible
  - You would then convert the non deductible portion of the 401k to a Roth IRA upon termination and avoid picking up taxable income except to the extent these contributions have earned income
    - Better than an IRA conversion to a Roth because an IRA conversion could possibly tax a portion of your deductible contributions

➢ Living with North Carolina Income Tax Law Changes



Individual Tax Strategies

North Carolina made a major overhaul to the income tax and sales tax rules during 2013 that will take effect in 2014.

The goal was to spread the tax among everyone and at the same time keep the state attractive to business owners.

Individual Tax Strategies

NC Tax Law Changes (cont):

- Tax rate – 5.8% in 2014 and 5.75% starting 2015
- Taxable Income will start with Federal AGI and will now have the following deductions allowed:
  - 1/5 of Bonus Depreciation or 179 Expense added back in prior years
  - Social Security Income
  - Bailey Retirement – other retirement is not
  - U.S. Obligation Interest
  - State Income Tax Refunds

Individual Tax Strategies

NC Tax Law Changes - Taxable Income (cont):

- The greater of Standard Deduction or Modified Itemized Deductions from Schedule A
  - Standard Deduction is the following:
    - $15,000 for MFJ
    - $12,000 for Head of Household
    - $ 7,500 for Single
    - $ 7,500 for MFS
  - Modified Itemized Deductions include the following without taking into account any federal limitation on the phase-out of these amounts:
    - Charitable Contributions
    - Up to $20,000 of the combined qualified residence loan interest and real property taxes. The $20,000 limitation applies in total to married couples as well as to all other filing statuses.

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Individual Tax Strategies

NC Tax Law Changes (cont):

- Tax credits are still allowed for the following:
  - Credit for taxes paid to other states or governments
  - Credit for children if allowed by the IRS
  - Credit for adoption but only 30% of amount allowed by IRS
  - Earned Income credit but only 4.5% of amount allowed by IRS
  - Energy credit – goes away after 2015

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Individual Tax Strategies

NC Tax Law Changes (cont):

- Notable items no longer deductible or allowed:
  - Personal Exemption
  - Medical Expenses
  - Investment Interest Expense
  - 529 Contribution for Education
  - Deduction for Severance Wages
  - Small Business $50,000 Exclusion

NC Tax Law Changes (cont):

So - How do the new North Carolina law changes affect us?

Four different scenarios follow:

Taxpayer #1 is a single, elderly person living in a retirement home and her income and expenses consists of the following:

- $25,000 of social security income
- $70,000 of other income
- Medical expenses of $70,000
- No expenses for contributions or mortgage interest

In 2013, her total tax was $0 for North Carolina. In 2014 without the deduction for medical expenses, her total tax would be $3,625.

Individual Tax Strategies

<u>NC Tax Law Changes (cont)</u>:

<u>Taxpayer #2</u> is a retired couple and their income consists of the following:

- $10,000 from a NC vested retirement plan before 1989
- $25,000 of social security income
- $2,500 from each person's IRA
- $10,000 from another government retirement plan not vested as of 1989
- Other income of $20,000

Their expenses include the following:

- Mortgage interest of $7,000
- Property taxes of $2,500
- Contributions of $5,000

In 2013, their tax for North Carolina was $498. In 2014, without the deductions for the IRA income and other government retirement income, their tax in North Carolina would be $1,160.

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NC Tax Law Changes (cont):

Taxpayer #3 is a couple with 2 children. Their income and expenses consist of the following:

- $150,000 of wages and other income
- Mortgage interest of $10,000
- Property taxes of $3,500
- Contributions of $3,000
- NC 529 Plan contribution of $5,000

In 2013, their tax for North Carolina was $8,346. In 2014, without the deduction for the NC 529 plan contribution, their tax in North Carolina would be $7,743.

Individual Tax Strategies

NC Tax Law Changes (cont):

Taxpayer #4 is a couple with 2 children and has a closely held business that is an S corporation. Their income and expenses consist of the following:

- $250,000 of wages and interest and dividends.
- S corporation pass through income of $50,000
- Mortgage interest of $17,000
- Property taxes of $6,000
- Contributions of $7,000
- NC 529 Plan contribution of $5,000

In 2013, their tax for North Carolina was $15,050. In 2014, they would not get a deduction for the small business exemption, the NC 529 plan contribution and their mortgage and property tax deduction would be limited to $20,000. After these adjustments their tax in North Carolina would be $15,834

Individual Tax Strategies

NC Tax Law Changes (cont):

- Outside a select group of individuals, most everyone's total tax liability should decrease in 2014 compared to 2013. However, will your refund actually increase?
    - Most likely no.
      The new NC withholding tables issued by the NCDOR were adjusted for the tax changes as well. The tables now withhold less tax from your paycheck which could create a possible tax due on your return. Please contact us to make sure you have your exemptions listed correctly. Most people should have a "0" as their number of exemptions.

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- **Big 5 Planning Opportunities**

5

For Estates & Trusts, the 39.6% rate starts at $12,150 taxable income.

Be sure to structure beneficiary distributions so the income passed out to them will not cause the estate or trust to be subject to the 3.8% Medicare tax or 20% capital gain tax.

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4

Time your capital gains if you are in the lowest or highest tax brackets:

- If you are in the 15% marginal tax bracket, take advantage of the 0% capital gain rate
    - Taxable income must be less than $73,800 for MFJ or $36,900 for Single.
- If you are in the highest tax bracket with a 20% capital gain rate, then time your capital gains to occur in a year you fall out of that bracket.
    - Taxable income is over $457,600 for MFJ or $406,750 for Single.

3

Based upon your marginal rate, bunch these expenses into the most beneficial year:

- Contributions
- Medical costs – bunch into year that they will cumulatively exceed 10% of AGI
- Mortgage interest payment
- Property tax payment
- State estimated tax payments
- Miscellaneous itemized deductions for investment fees, unreimbursed employee costs, planning costs to CPA/Attorney

2

If your gross income is above $200k (single) or $250k (MFJ) reduce your NIIT by:

- Recognizing capital losses
- Timing the recognition of end of year capital gains to following year if income will be lower the following year
- Taking distributions from IRA's & Pension Plans before Annuities
- Increasing your above the line deductions:
  - SEP, Simple or IRA contributions
  - HSA Contributions
  - Self Employed Health Insurance Premiums
  - Moving Expenses
  - Alimony
  - Business Expenses for those that are Self-Employed

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1

Contribute to your retirement account – Pay yourself first!!

- 401k plan
- SEP IRA
- Traditional IRA
- Simple IRA

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Any final questions or comments?

THANK YOU FOR ATTENDING

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