LOOKING AHEAD TO 2015

Planning considerations for personal and financial goals

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As we prepare to turn the page on 2014 and welcome 2015, it is time to look ahead and consider personal as well as financial goals to start the New Year positioned to move toward those objectives. There are plentiful strategies to incorporate in 2015 wealth and tax planning, being mindful that an individual's stage of wealth is important to consider when establishing strategies for success—as well as defining individual success. In any event, wealth and tax planning should involve knowledgeable advisors able to add perspective and guidance throughout the planning process.

The Current Tax Environment

Although much discussion has occurred over the course of the last few years regarding the possibility of tax reform, a comprehensive overhaul of the Tax Code is uncertain in the near-term. In 2014, there was much discussion of tax reform as both Max Baucus, former chairman of the Senate Finance Committee, and Dave Camp, Chairman of the House Ways and Means Committee, released proposals. However, 2014 also marked the changing of the guard as Max Baucus left the Senate and Ron Wyden took over leadership of the Senate Finance Committee.

In the wake of the midterm elections, leadership continues to change as Republicans will have a majority in the Senate and expanded control of the House. In the Senate, Mitch McConnell will become the majority leader and Orrin Hatch will become the new chair of the Finance Committee. In the House, John Boehner will continue as Speaker and Paul Ryan will succeed David Camp as Chairman of the Ways and Means Committee. Senator McConnell and Representative Ryan have both been strong proponents of comprehensive tax reform. However, there has been little sustained in-depth engagement with holistic tax reform from President Obama's administration.

In the near term, tax extender legislation to address the dozens of tax provisions that expired at the end of 2013 or will expire at the end of 2014 continues to be on the minds of many. Following the midterm elections, and in light of the lame duck session, the continuing conversation regarding possible tax extender legislation remains an important issue. With the recent and pending leadership changes in Congress, it remains to be seen if current extender legislation proposals will be passed in some iteration before year end, in January with retroactive effect, or if Congress will wait to act until more comprehensive reform is on the table at a later date. Proposals have ranged from one year extensions retroactive for 2014, to two year extensions for 2014 and 2015, to permanent extensions.

2015 Taxes

2015 continues to be a high-tax environment, with the highest marginal federal income tax bracket of 39.6% on taxable income over $413,200 for single filers and $464,850 for married filing jointly. When taking into account the 3.8% Medicare contribution tax on net investment income, as well as state income taxes, high-net-worth individuals may be subject to a combined tax rate of 50% or more.

In 2015, the inflation adjusted amount of the applicable exclusion for gift and estate tax purposes will increase from $5,340,000 to $5,430,000. The top gift and estate tax rate remains at 40% and the annual gift tax exclusion remains at $14,000 per donor per donee.

Area of Taxation	2014 Law	2015 Law
Ordinary Income Tax Rates of Individuals	10%, 15%, 25%, 28%, 33%, 35% and 39.6% on taxable income over $406,750 for single filers and $457,600 for married filing jointly	10%, 15%, 25%, 28%, 33%, 35% and 39.6% on taxable income over $413,200 for single filers and $464,850 for married filing jointly
Ordinary Income Tax Rates of Estates and Trusts	15%, 25%, 28%, 33% and 39.6% on taxable income in excess of $12,150	15%, 25%, 28%, 33% and 39.6% on taxable income in excess of $12,300
Qualified Dividends and Long-Term Capital Gains	• 0%, 15% and 20% • Other special purpose rates (e.g., collectibles 28%)	• 0%, 15% and 20% • Other special purpose rates (e.g., collectibles 28%)
Itemized Deductions and Personal Exemptions	• Phase-out personal exemption ($3,950) and up to 80% of itemized deductions for high-income taxpayers • Beginning of phase-out AGI $254,200 for single filers and $305,050 for married filing jointly	• Phase-out personal exemption ($4,000) and up to 80% of itemized deductions for high-income taxpayers • Beginning of phase-out AGI $258,250 for single filers and $309,900 for married filing jointly
Standard Deduction	$6,200 for single filers and $12,400 for married filing jointly	• $6,300 for single filers and $12,600 for married filing jointly
Alternative Minimum Tax Exemption Amount	• $82,100 married filing jointly and surviving spouse • $41,050 married filing separate • $52,800 single filers and heads of households • Subject to phase-outs	• $83,400 married filing jointly and surviving spouse • $41,700 married filing separate • $53,600 single filers and heads of households • Subject to phase-outs
Medicare Contribution/Net Investment Income Tax	• 3.8% Medicare contribution surtax on net investment income • Individual threshold amount MAGI $200,000 for single filers, $250,000 for married filing jointly • Estate and trust threshold amount AGI $12,150	• 3.8% Medicare contribution surtax on net investment income • Individual threshold amount MAGI $200,000 for single filers, $250,000 for married filing jointly • Estate and trust threshold amount AGI $12,300
Gift, Estate, Generation Skipping Transfer Highest Marginal Tax Rate	40%	40%
Gift Tax Annual Exclusion	$14,000	$14,000
Applicable Exclusion Amount/Exemption Gift, Estate, Generation Skipping Transfer Tax	$5,340,000 U.S. citizens or U.S. domiciled persons	$5,430,000 U.S. citizens or U.S. domiciled persons

Income Tax Planning

In the current high income tax rate environment it remains important to consider strategies which will allow for the deferral of income, acceleration of deductions, and harvesting of losses to offset gains and reduce overall taxable income, especially for those individuals who anticipate being in lower income tax brackets in the future. At the same time, "smoothing" income is important when navigating changes in tax brackets, thresholds for the phase-out of deductions and exemptions and for the Medicare contribution tax, as well as the Alternative Minimum Tax. One planning option is to make maximum contributions to retirement accounts in order to reduce taxable income. The elective deferral for employees who participate in 401(k) and similar plans is increased from $17,500 in 2014 to $18,000 in 2015. The catch-up contribution limit for employees aged 50 and over is increased from $5,500 in 2014 to $6,000 in 2015. The limit on annual contributions to an individual retirement account (IRA) remains unchanged at $5,500, with a catch up for individuals age 50 and older of $1,000.

The combination of relatively high income tax rates and the differences in the tax treatment of various types of income makes both asset allocation and asset location important planning considerations – being "tax efficient". Long-term capital gains and qualified dividends are both taxed at lower preferred rates (when compared to ordinary income) of either 15% or 20%, and tax-exempt interest is not subject to tax (or may only be subject to state but not federal income tax). Conversely, wages, non-qualified dividends and taxable interest are taxed at a marginal federal income tax rate of 39.6%. And investments held in a traditional qualified retirement account (e.g., 401(k) or IRA) are taxed as ordinary income when distributed. So whether income generating assets are held in taxable or tax deferred accounts and when income will be treated as received for income tax purposes continues to have a significant impact on what one has available for their personal use and to accomplish their financial goals. The transition to the New Year is an ideal time to reassess and reevaluate where assets are located for tax efficiency.

2015 Transfer Tax Considerations Income

Increased gift and estate tax exclusion amounts and persistent low interest rates present some familiar wealth transfer planning opportunities for 2015. But transfer tax planning opportunities are best assessed in the context of associated income tax consequences.

The $90,000 inflation-adjusted increase for 2015 in the gift and estate tax exclusion amount ($5,340,000 in 2014 to $5,430,000 in 2015) allows for additional lifetime gifts for those who have previously used their full exclusion. However, long-term tax and wealth transfer planning should continue to take into consideration the tradeoffs of lifetime transfers versus transfers at death. The early transfer of an asset expected to appreciate in the future can remove the gifted asset, including the associated appreciation, from a person's estate for eventual estate tax purposes. However, gifted assets have a "carryover" basis in the hands of the donee for income tax purposes. Conversely, assets transferred at death receive a new basis for income tax purposes based on their fair market value at death (or an alternate valuation date, if elected for estate tax purposes).

For those individuals who use their full indexed $5,430,000 gift and estate tax exclusion or simply wish to make current gifts in excess of annual exclusion gifts ($14,000 in 2015), consideration may be given to making direct medical or educational payments that are excluded from the gift tax. When thinking about how to benefit grandchildren in particular, without making taxable gifts, making direct payments to qualified educational institutions may be a way to lessen the value of an estate while bestowing a present benefit to support educational aspirations.

Low interest rates continue to make wealth transfer strategies such as grantor retained annuity trusts, sales to defective grantor trusts, and charitable lead trusts attractive. The December 2014 applicable federal Section 7520 rate, used to determine the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest for gift tax purposes is 2.0%, the same as the rate for December 2013, and the lowest the rate has been all year.

Charitable planning has the potential to create tax, as well as non-tax benefits. Annual giving to qualified charities may reduce taxable income in the current year, with a potential five year carryover. Additionally, taxpayers may wish to consider philanthropic strategies such as a charitable lead trust, mentioned above. Depending on the structure of the charitable lead trust, the benefits may be twofold, an income tax deduction as well as removal of future appreciation from one's estate for estate tax purposes.

Keeping Everything in Place

As projections are made and planning occurs, recordkeeping continues to be an important issue in order to substantiate transactions. Furthermore, we are in a heightened compliance and reporting environment, especially for those whose wealth operates on a global scale, making it ever important to confirm not only timely and accurate income and gift tax record-keeping and reporting, but also "information reporting", particularly with respect to foreign assets, accounts and trusts.

Whatever planning path is chosen for 2015, it remains important to keep pace with or seek expert help to protect and grow wealth in 2015 and beyond.

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