TAX TIPS FOR 2014 PLANNING

Planning opportunities to consider for 2014

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Although the new year is well under way, it is not too late to pause and consider planning opportunities for 2014. When planning, it is important to do so within the context of the current tax landscape, remembering that each individual's situation is unique.

Income tax rates are expected to remain at their current higher levels for the foreseeable future. In 2014 the top marginal income tax rate is 39.6%, the highest rate for long-term capital gains and qualified dividends is 20% and the 3.8% Medicare related tax on net investment income remains in effect. Depending on one's stage of life, both personal and financial, different opportunities may exist. It is important to work with knowledgeable advisors to determine the impact of planning decisions, including determining if deferring income and accelerating deductions lowers overall tax costs.

Consider Gifting Sooner

Year-end is typically associated with gifting, particularly for charitable giving. But for non-charitable gifts, the beginning of the year is often an opportune time to make a gift. Gifting to a family member or trust early in the year will remove appreciation and income from the donor's tax base sooner rather than later. And, doing so early in the year allows for the gift to benefit from potential growth throughout the remainder of 2014.

For 2014, the annual gift tax exclusion is $14,000 per donee, $28,000 for a married couple. Therefore, together parents may make a gift to a child of $28,000 without incurring gift tax. Also, the gift and estate tax applicable exclusion amount increased from $5,250,000 in 2013 to $5,340,000 in 2014—a $90,000 increase, $180,000 for a married couple. The increased applicable exclusion amount presents an opportunity to make additional tax-free gifts.

The highest marginal income and Medicare tax rate and gift/estate tax rates are converging at 43.4% and 40%, respectively. When considering the financial benefits of gifting, it is important to weigh the tax cost of gifting during life as opposed to at death due to the fact that giving during life transfers the donor's basis to the donee, whereas transferring assets at death entails a basis adjustment for the beneficiary to the value at the decedent's death. Therefore, it is important to weigh options and calculate the most tax efficient gifting strategy, taking income tax consequences into account.

Compensation and Bonus Planning

For some, the first quarter marks the time when 2013 performance based compensation and bonuses are paid. For individuals who have deferral options and expect future tax brackets to be lower, or for future income to be below the threshold for the additional Medicare related taxes, deferring performance, incentive or bonus payments may be an attractive planning option.

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In the case of a stock bonus plan, consideration may be given to whether a transfer to a child is an option. While the threshold at which the parents' income tax rate takes effect for a child is very low, transferred stock and any appreciation may be removed from the parent's estate.

Reevaluate Education Funding

Now is a good time to reassess education funding, particularly 529 plans. When setting or reevaluating expected contributions to 529 plans, it is important to consider funding levels—whether or not the plan is being over or under funded—and consider the plan's investments.

In light of the ever increasing cost of education and the tendency of students to take longer to earn their degrees, current education funding levels may be too low. Alternately, with the recent upswing in the markets, the funding of 529 plans may in fact have reached or exceeded desired levels. Remember, distributions from 529 plans are to be used for "qualified" education expenses (tuition, room and board). Generally, distributions not used to pay for qualified education expenses will be taxed. If a 529 plan is overfunded, individuals may consider adding or changing beneficiaries.

For some, it may be time to review the state tax benefits associated with a 529 plan. Many states allow contributions to a qualified plan to be deducted for state income tax purposes, providing additional tax savings.

Managing Inherited IRAs

For individuals who have experienced the loss of their parents, it is not uncommon for even a modest inheritance to include an IRA. There are a few important planning issues to keep in mind with an inherited IRA. Even though this might seem like found money, it is tax deferred and drawing down a traditional IRA will have an immediate income tax consequence.

If keeping an IRA intact, the non-spouse inheritor typically will be required to withdraw minimum distributions each year. Once the required minimum distribution is calculated, marking the calendar to take the required distribution late in the year will allow for the maximum tax free build up during the year.

In addition, individuals with recently inherited IRAs should reevaluate the investments in the IRA. The deceased IRA owner may have had a more conservative investment approach given their income requirements than the younger inheritor. As a result, realigning the investments away from income generating assets and focusing more on growth may be preferable.

Major Life Events

Individuals who experienced a major life event in 2013 should pause to reconsider tax, estate and financial planning circumstances. Consider scheduling a "year in review" conversation with advisors to determine how health issues, births, deaths, changes in relationship status or career changes may have impacted financial plans.

While 2014 is still new, realigning goals to take advantage of planning opportunities will help individuals make the most of 2014. Despite the higher tax rates, individuals should work with advisors to take advantage of opportunities in 2014, while avoiding unintended consequences.

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