November 2015

AN ALERT FROM SMITH LEONARD PLLC:

Smith Leonard 2015 Planning Letter

Subject:

2015 YEAR-END INDIVIDUAL INCOME TAX PLANNING

CONTACT:

Kevin Benson – Tax Partner
336.821.1402
kbenson@smithleonardcpas.com

Addison Maille – Tax Partner
336.821.1304
amaille@smithleonardcpas.com

Mark Bulmer – Tax Partner
336.821.1411
mbulmer@smithleonardcpas.com

Aimee McWhorter – Tax Partner
336.243.2772
amcwhorter@smithleonardcpas.com

Jon Glazman – Tax Partner
336.821.1407
jglazman@smithleonardcpas.com

Tom Smith – Tax Partner
336.243.2772
tsmith@smithleonardcpas.com

TABLE OF CONTENTS

2015 YEAR-END INDIVIDUAL INCOME TAX PLANNING

INTRODUCTION

With the end of the year approaching, it's time to once again review year-end tax planning strategies that could reduce your 2015 taxes. Year-end planning is particularly challenging this year because a host of popular ***individual tax breaks expired at the end of 2014.*** In previous years, Congress has retroactively extended the vast majority of these temporary tax breaks after they expired. However, ***as we complete this letter,*** Congress has not yet extended these tax provisions.

Planning Alert: It is worth noting that these tax breaks previously expired at the end of 2013, however last year's legislation that retroactively extended the provisions through the end of 2014 ***was not signed into law until December 19, 2014.*** So, don't be surprised if it is mid-December before Congress gets around to voting on legislation to extend these tax provisions. We closely monitor Congressional tax legislation, so ***please call our firm*** if you need a ***status report.***

Tax Tip: Due to the uncertainty of the status of these expired tax provisions, we believe the best approach for year-end planning is to be ***prepared to act quickly near the end of 2015*** in case Congress retroactively restores these expired tax breaks. Consequently, the first segment of this letter highlights the expired individual tax breaks that could be retroactively extended.

Although the prospect of Congress extending these expired tax breaks beyond 2014 is not totally certain, there are many *traditional* year-end tax planning strategies that can help lower your 2015 taxable income, and postpone the payment of your taxes to later years. Therefore, we are sending you this letter to remind you of these time-tested, year-end planning strategies. This letter also highlights *new* tax planning opportunities available to individuals because of recent law changes.

Tax Tip: Many tax provisions impacting your 2015 income tax liability are affected by your adjusted gross income, modified adjusted gross income, or taxable income. We ***highlight prominently*** in this newsletter the various ***income thresholds that may affect your tax liability.***

Caution: Tax planning strategies suggested in this letter may subject you to the alternative minimum tax (AMT). For example, many deductions are not allowed for AMT purposes, such as: personal exemptions, the standard deduction, state and local income taxes, and real estate taxes. Also, the AMT can be triggered by taking large capital gains, having high levels of dividend income, or exercising incentive stock options. Therefore, ***we suggest that you call our firm before implementing any tax planning technique discussed in this letter.*** You cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the AMT and any state income tax) with and without that strategy.

Please Note: This letter contains ideas for Federal income tax planning only. ***State income tax issues are not addressed.***

MONITOR THE STATUS OF IMPORTANT INDIVIDUAL TAX BREAKS THAT EXPIRED AFTER 2014:

Summary Of Selected Individual Tax Breaks That Expired After 2014

There is an ever-expanding list of temporary tax breaks that expire every few years. However, even though Congress often waits until the last minute, it has *historically* extended most of the more popular provisions. Unfortunately, Congress has yet to extend a host of tax breaks that ***expired at the end of 2014,*** including: School Teachers' Deduction (Up to $250) For Certain School Supplies; Deduction For State And Local Sales Taxes; Deduction (Up to $4,000) For Qualified Higher Education Expenses; Qualifying Tax-Free Transfers Directly From IRAs To Charities For Those Who Are Age 70½ Or Older; Increased Charitable Deduction Limits For Qualifying Conservation Easements; $500 Credit For Qualified Energy-Efficient Home Improvements; Deduction For Qualified Home Mortgage Insurance Premiums; Income Exclusion For Principal Residence Mortgage Cancellations; and Temporary 100% Exclusion Of Gain From Sale Of "Qualified Small Business Stock."

Caution: Although Congress is currently considering "extenders" legislation that would extend most, if not all, of these provisions at least through 2015, as we complete this letter, Congress has not yet extended these tax breaks. Don't be surprised if Congress doesn't get around to passing an extenders bill until this December. Consequently, you should be ***prepared to act quickly near the end of 2015*** in case Congress passes an "extender's bill" late in the year.

Planning Alert: Several of the above-listed tax breaks warrant special attention, including: Qualifying Tax-Free ***Transfers Directly From IRAs To Charities*** For Those Who Are Age 70½ Or Older; Income Exclusion For ***Principal Residence Mortgage Cancellations;*** and the optional ***Deduction For State And Local Sales Taxes.*** Most observers believe that Congress will eventually extend these provisions at least through 2015. This prediction is based, in part, on proposed legislation currently being considered by the House and the Senate. Later in this letter, we discuss year-end planning strategies using these three breaks that could save you taxes – assuming they are ultimately extended through 2015. ***Please note*** that we monitor proposed legislation closely, so ***please call our firm*** if you need a ***status report.***

KEEPING UP WITH RECENT TAX LEGISLATION

Over the last twelve months, President Obama has signed into law four separate bills – each containing a number of important tax provisions (*Recent Tax Legislation*). Collectively, this *Recent Tax Legislation* contained a variety of tax changes that impact individual taxpayers. This segment provides an overview of these provisions, which may have an impact on you or your family.

Caution: Some of these changes ***will first apply to the 2015 tax years,*** while others ***are not effective until 2016.*** Therefore, please pay special attention to the highlighted ***"effective date"*** of each new tax provision discussed below:

New Tax-Favored ABLE Accounts For Disabled Individuals

For tax years beginning after 2014, *Recent Tax Legislation* authorizes a new tax-advantaged savings account ("ABLE Account") for certain qualified disabled individuals. The tax rules for *ABLE Accounts* are generally patterned after the tax rules for the popular Section 529 plans which are currently used to accumulate funds for qualified college expenses. The stated purpose of this new savings account is to "*provide secure funding for disability-related expenses on behalf of designated beneficiaries with disabilities that will supplement, but not supplant, benefits otherwise available to those individuals, whether through private sources, employment, public programs, or otherwise*" (e.g., private insurance, Medicaid, SSI). The key features of the *ABLE Account* include: **1)** Subject to certain exceptions, an ABLE Account is generally disregarded in determining the individual's eligibility for Federal means-tested programs; **2)** ABLE Accounts generally may only be established by (or on behalf of) an individual who is entitled to benefits based on ***blindness*** or ***disability under the Social Security disability insurance program*** or the ***Supplemental Security Income*** for the Aged, Blind, and Disabled (SSI) program, ***and*** that blindness or disability occurred ***before the date on which the individual reached age 26*** (or the beneficiary obtains and files a ***"disability certification"*** with the IRS that certifies that the individual has specifically-defined physical or mental impairments or is blind and the blindness or disability occurred before the individual attained age 26); **3)** Like a Section 529 college-savings account, contributions to ABLE Accounts are not deductible, but assets in the account grow tax-free, while withdrawals are tax-free if the money is used for qualified disability-related expenses; and **4)** A qualified disabled person cannot have more than one ABLE Account, and total annual contributions by all individuals to an ABLE Account cannot exceed the inflation-adjusted annual gift tax exclusion amount (i.e., $14,000 for 2015).

Planning Alert: Generally, a qualified disabled individual is allowed to establish an ABLE Account only under a state ABLE program sponsored by the state in which the disabled individual resides. Disabled individuals or their representatives interested in an ABLE Account should check with the resident state to determine whether a state-sponsored ABLE program has been adopted and, if so, whether the program is available for applications.

Penalty-Free Retirement Plan Distributions Allowed For An Expanded Group Of Public-Safety Employees

Under current law, ***state or local*** police, firefighters or emergency medical services personnel who have separated from service may take distributions from their government "defined benefit plan" without a 10% penalty – once they reach age 50 (instead of age 55 or 59½ that generally apply to other taxpayers). *Recent Tax Legislation* expands this "age 50" exception to the 10% penalty to ***Federal*** law enforcement officers, ***Federal*** customs and border protection officers, ***Federal*** firefighters, and air traffic controllers. In addition, the new law allows the exception to apply to all government retirement plans, not just government *"defined benefit"* (pension) plans.

Planning Alert: This expanded relief from the 10% penalty is effective ***for distributions made after December 31, 2015.*** Therefore, if you are a member of this broadened group of qualifying *"Federal"* workers and wish to take advantage of this expanded exception to the 10% penalty, it will not be available to you ***unless you take the distribution after December 31, 2015.***

Claiming The Foreign Earned Income Exclusion Will Nix The Refundable Portion Of The Child Credit

Generally, an individual is allowed a child credit of up to $1,000 for each qualifying child who has not attained age 17 by the close of the calendar year. The child tax credit claimed for a tax year is reduced $50 for each $1,000 of modified AGI over $110,000 (if married filing jointly), over $75,000 (for unmarried individuals), and over $55,000 (for married individuals filing separate returns). Moreover, this child credit is generally "refundable" to the extent of 15% of an individual's earned income in excess of $3,000 for 2009 through 2017. This generally means that, to the extent the credit exceeds the taxes on your individual income tax return without the credit, the IRS will actually send you a check for the excess. For example, the full $1,000 child credit would be refundable (to the extent the credit exceeded 2015 income taxes) for a married couple with one child under age 17 who file jointly, if their AGI for 2015 were at least $9,667 but not more than $110,000. If the couple's AGI were between $3,000 and $9,667, only a portion of the child tax credit would be refundable.

Effective for tax years beginning after 2014, *Recent Tax Legislation* now provides that taxpayers who "elect" to exclude "any amount" of foreign earned income under §911 will not be allowed to treat any portion of the child credit as a "refundable" credit. Under §911, a U.S. citizen or resident who lives abroad and satisfies certain requirements may "elect" to exclude from taxable income up to $100,800 (for 2015) of "foreign earned income." Thus, under the new law, if a taxpayer "elects" to take any foreign earned income exclusion, the individual will only benefit from the otherwise qualifying child credit to the extent the taxpayer has sufficient tax liability to absorb the credit. This means that, starting with the 2015 tax year, if you qualify for both the foreign earned income exclusion and the child credit, we should consider a "with" and "without" calculation to see if electing the foreign earned income exclusion will save you overall taxes.

Taxpayers Will Be Required To Have Form 1098-T In Order To Claim Education Credits Or Tuition Deduction

Generally, educational institutions are required to provide Form 1098-T to students who attend their institution and file a copy of Form 1098-T with the IRS. This form contains information regarding the student's qualifying tuition and related fees that are used to determine various education tax credits and education deductions. ***Effective for tax years beginning after June 29, 2015,*** *Recent Tax Legislation* provides that the following education tax breaks will not be allowed unless the taxpayer possesses a valid Form 1098-T from the educational institution: the ***American Opportunity Tax Credit*** (of up to $2,500 – generally used for the first four years of post-high school education), the ***Lifetime Learning Credit*** (of up to $2,000 – generally used for graduate school), and the college ***Tuition and Fees Deduction*** (of up to $4,000).

Tax Tip: This new requirement will not apply to the filing of your 2015 tax return, but will be applicable to your 2016 tax return. So, this new requirement effectively means that you will have to wait to file your tax return for the 2016 tax year until you receive Form 1098-T, if you are claiming any of these education tax benefits.

Planning Alert: The ***Tuition and Fees Deduction*** (of up to $4,000) ***expired at the end of 2014.*** Although Congress is currently considering "extenders" legislation that would extend this provision at least through 2015, as we complete this letter, Congress has not yet extended this tax break. Please contact our firm if you need a status report on this legislation.

New Initial Due Date And Allowable Extensions For FinCEN Form 114 (FBAR)

If you own (or have signatory authority over) foreign financial accounts exceeding an aggregate value of $10,000 at any time during the year, you are generally required to file FinCEN Form 114, "*Report of Foreign Bank and Financial Accounts*" (FBAR), by June 30 of the year immediately following the reporting year. Traditionally, no extensions have been available for this June 30th due date. ***For tax years beginning after 2015,*** *Recent Tax Legislation* provides that the ***initial due date*** for ***FinCen Form 114*** will be ***April 15th*** of the following year (i.e., the same initial due date for your Form 1040), and provides for a maximum ***extended due date*** until the following

October 15th (i.e., the same extended due date for your Form 1040). In addition, the IRS will be authorized to waive the penalty for failure to timely request an extension for filing the form for any taxpayer required to file FinCEN Form 114 for the first time.

Planning Alert: These new reporting deadlines do not apply until 2016. Therefore, the due date for filing FinCEN Form 114 ***for the 2015 calendar year will still be June 30, 2016,*** with ***no extensions of time to file.***

New Income Tax Basis And Reporting Rules For Certain Inherited Property

Generally, an individual who inherits property from a decedent, receives an "income tax basis" in the property equal to the property's *fair market value* on the date of the decedent's death. In addition, if the *"fair market value"* of all the property included in a decedent's taxable estate exceeds $5,430,000 (for deaths in 2015), the estate must file an *"estate tax return,"* and may be required to pay an estate tax based on the fair market value of the property included in the estate. ***Effective for property with respect to which an estate tax return is filed after July 31, 2015,*** *Recent Tax Legislation* generally provides that the *"income tax basis"* in the hands of the recipient of the inherited property ***may not exceed*** the value of the property as reported in the estate tax return, if the property increases the estate tax liability. Also, executors of larger estates (i.e., large enough to require the filing of Federal estate tax return) ***that are filed after July 31, 2015,*** will be required to file certain information reports with the IRS and furnish them to the beneficiary containing information identifying the value of the property received by the beneficiary as reported on the estate tax return.

Planning Alert: Although this information report is generally required to be filed within 30 days following the filing of the estate tax return, the IRS has announced that it has ***delayed the initial filing of this report until February 29, 2016.*** The IRS has also stated that it plans to release a "draft" copy of the new reporting form in mid-January, 2016. ***Please call our firm*** if you need additional details.

Veterans With VA Medical Coverage For Service-Connected Disabilities Will Be Allowed To Contribute To Health Savings Accounts (HSAs)

Individuals may generally make deductible ("pre tax") contributions to a health savings account (HSA) if they are covered under a qualified ***"high deductible health plan"*** (HDHP). However, individuals are generally not eligible to contribute to an HSA if they are also covered under any other type health care coverage that is not an HDHP (except for certain "permitted" insurance). In certain situations, this restriction has caused some veterans who were covered by an HDHP to be ineligible for an HSA if they were also receiving VA medical coverage for service-connected disabilities. ***Effective for months beginning after 2015,*** *Recent Tax Legislation* provides that an otherwise qualifying individual covered by an HDHP ***will not be disqualified*** from contributing to an HSA solely because the individual ***receives hospital care or medical services*** under any law ***administered by the VA*** for a ***service-connected disability.***

Tax Tip: Starting ***in 2016,*** veterans receiving VA health care services ***for a service-related injury*** will have the opportunity to have a tax-favored HSA provided the veteran is otherwise covered by a qualified HDHP.

Lenders Will Be Required To Provide Additional Information On Form 1098 That Reports Interest Paid

Under current law, if you make payments on a mortgage, the mortgage service provider is generally required to report to you and the IRS certain information on Form 1098 regarding the interest you paid to the lender. Most individuals use this information to determine how much interest they may deduct with regard to their current year home mortgage payments. The IRS has previously expressed concern that the information currently reported on the Form 1098 was not sufficient for the IRS to determine whether the interest reported qualified for the home mortgage interest deduction. In response to that concern, *Recent Tax Legislation* provides that, for forms ***required to be furnished to borrowers after 2016,*** the following additional information must be included in ***Form 1098*****: 1)** The ***amount of the outstanding mortgage principal*** as of the beginning of the calendar year, **2)** The ***mortgage origination date*****,** and **3)** The ***address of the property*** (or description of property without an address) which secures the mortgage.

DON'T OVERLOOK "AFFORDABLE CARE ACT" TAX CONSIDERATIONS

The "Shared Responsibility Tax" Rate For Those Who Fail To Carry Qualified Health Care Coverage Doubled In 2015

The ***"Shared Responsibility Tax"*** (***SR Tax***) rate increased from 1% of household income (in excess of the income filing threshold) for 2014, to 2% for 2015 – for those individuals who fail to carry qualified health care coverage for all of 2015, and don't qualify for an exemption. More specifically, for those without health care coverage for all of 2015, the ***SR Tax*** is generally the ***greater of:*** **1)** 2% of household income (in excess of the filing threshold), or **2)** $325 per adult ($162.50 per child) limited to a household maximum of $975. Also, the *SR Tax* may not exceed the cost of the national average for a bronze level health plan available through the government health insurance exchanges. The SR Tax is prorated on a monthly basis for individuals without coverage for only part of 2015. **For example,** assume a single individual (under age 65): **1)** Was uninsured for the ***entire 2015 year*** and does not qualify for an "exemption," and **2)** Earned ***$70,300*** (which is also the person's "*household income*"). The ***SR Tax*** for ***2015*** would be ***$1,200*** (for ***2014*** the SR Tax would have been only ***$600***).

Planning Alert: Spouses filing a joint return are jointly liable for any *SR Tax* on the return, including any *SR Tax* due for qualifying dependents. The amount of the excise tax increases again in ***2016*** to ***2½%*** of household income (in excess of the filing threshold).

Planning Alert: Individuals generally must pay an ***SR Tax*** if the individual or the individual's dependents are not covered by a ***"Qualified Health Plan"*** (i.e, a health plan or insurance policy providing "minimum essential coverage") for any month during 2015. To avoid the *SR Tax*, an individual (and anyone the individual ***may claim*** as a dependent) generally must either: **1)** Be covered under a ***"qualified health plan,"*** or **2)** Qualify for a specific ***"exemption"*** from the tax.

- **Planning Alert:** The IRS says that an individual cannot avoid the *SR Tax* for someone who he or she may claim as a dependent, simply by failing to claim that person as a dependent on the individual's tax return.

- **Tax Tip:** If you or your dependent do not have qualifying health care coverage, you may qualify for an exemption, such as: You lived abroad and met certain conditions; You failed to have "qualified health plan coverage" for less than 3 months during 2015; Your income is below the threshold for filing an income tax return; or, You qualify for a ***"hardship exemption."***

- **Planning Alert:** If you think you or your dependent may need a "hardship" exemption in 2015, you will generally need to apply for an "exemption certificate." This certificate is obtained by submitting a form entitled ***"Application for Exemption from the Shared Responsibility Payment for Individuals who Experience Hardships"*** to: Health Insurance Marketplace – Exemption Processing, 465 Industrial Blvd., London, KY 40741. This application form may be obtained on-line at www.HealthCare.gov.

- **Tax Tip:** If you think you or anyone in your household may qualify for a hardship exemption, we suggest you begin the application process as soon as possible. If your application is approved, be sure to provide our firm with your exemption certificate. Please call us if you need additional information.

IRS Provides Relief For Individuals Who Purchased Health Insurance On The New Health Insurance Exchanges During 2014

Eligible individuals who purchased health insurance on the new government-sponsored (state or Federal) health insurance exchanges (Exchanges) may be entitled to a refundable premium tax credit (PTC). This generally means that, to the extent the credit exceeds the taxes that you would otherwise owe with your individual income tax return without the PTC, the IRS will actually send you a check for the excess. However, these individuals have the option to have the PTC paid in advance to their insurance company to lower what they would otherwise pay for their monthly premiums. Those who choose this *"advance payment"* option are also required to reconcile (on Form 8962) the amount paid in advance (as reported in new Form 1095-A) with the actual PTC computed when they file their income tax return. If the amount of *the "advance payment"* PTC made to a health care provider is more than the actual PTC as computed on your income tax return, you are generally required to pay the excess back as an *"additional income tax"* with your income tax return. ***For 2014 tax returns,*** taxpayers who ended up owing this *additional income tax* could also face the possibility of having penalties for late payments or underpayment of estimated taxes*.*

- **IRS Provides Relief For Qualifying Taxpayers:** Recognizing that 2014 was the first tax year individuals were required to comply with these rules, the IRS announced that it will provide relief from *certain potential penalties* and possibly from the *additional income tax* itself – in certain situations. For example, the IRS says that it will: **1)** Waive any penalties for individuals who timely filed their 2014 return and who received a delayed or incorrect Form 1095-A from the Exchange, **2)** Waive underpayment of tax penalties caused by a qualifying taxpayer's requirement to pay back all or a portion of the PTC *advance payment*, and **3)** Not require a taxpayer to amend a previously-filed return if it is later learned that the information on the Form 1095-A (provided by the Exchange) was incorrect, even if the corrected Form 1095-A would have required the taxpayer to pay additional taxes. Please contact our firm if you believe you may benefit from any of these relief provisions, and you need additional details.

- **Who Qualifies For The "Premium Tax Credit" (PTC)?:** An individual *generally* qualifies for the *PTC* ***for 2015*** if the individual's ***"household income"*** for ***2015*** is ***at least 100%*** and ***not more than 400%*** of the ***"2014"*** Federal Poverty Line (FPL) for the individual's family size. ***For example,*** a family of four could qualify for at least some *PTC* ***with "2015" household income of up to $95,400.***

TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

Postponing Taxable Income Frequently Saves Overall Taxes

Deferring income into 2016 is a good idea if you believe that your marginal tax rate for 2016 will be equal to or less than your 2015 marginal tax rate. In addition, deferring income into 2016 could increase various credits and deductions for 2015 that would otherwise be phased out as your adjusted gross income increases.

Tax Tip: This tax planning strategy may generate unexpected tax benefits if, as many expect, Congress retroactively extends the income-sensitive tax breaks that expired at the end of 2014 (e.g., $4,000 qualified higher education expense deduction, deduction for home mortgage "insurance premiums").

Deferring Income Could Help You Stay In Lower Tax Brackets

Deferring taxable income from 2015 to 2016 may reduce your exposure to higher tax brackets if, for example: **1)** The deferral of income causes your 2015 taxable income to fall below the thresholds for the highest 39.6% tax bracket (i.e., $464,850 for joint returns; $413,200 if single), or **2)** As discussed in more detail below, you have income subject to the 3.8% Net Investment Income Tax (3.8% NIIT) and the income deferral causes your 2015 modified adjusted gross income (MAGI) to fall below the thresholds for the 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single). If, after considering these factors, you believe that deferring taxable income into 2016 will save you taxes, consider the following strategies:

- **Self-Employment Income:** If you are self-employed and use the cash method of accounting, consider delaying year-end billings to defer income until 2016.

  Planning Alert: If you have already received the check in 2015, deferring the deposit does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

- **Installment Sales:** If you plan to sell certain appreciated property in 2015, you might be able to defer the gain until later years by taking back a promissory note instead of cash. If you qualify for installment treatment, the gain will generally be prorated over the term of the note and is taxed to you as you collect the principal payments. This is called reporting your gain on the "installment method."

  Planning Alert: Although the sale of real estate and closely-held stock generally qualify for this deferral treatment, some sales do not. For example, even if you are a cash method taxpayer, you cannot use this gain deferral technique if you sell publicly-traded stock or securities. Also, you may not want to take back a promissory note in lieu of cash if you believe this reduces your chances of getting paid.

  Tax Tip: Since the "installment method" essentially allows you to spread a single gain over several years, this could cause the seller's income in the year of sale (and possibly subsequent years) to fall below the income thresholds that kick in the top 39.6% rate, or the top 20% capital gains rate. In addition, this could also prevent the seller's income from exceeding the thresholds for the 3.8% NIIT (discussed in more detail below).

- **Cancellation Of Debt Income:** If you negotiate or arrange a reduction or cancellation of a debt you owe to others, unless you meet certain exceptions, you will generally have to report “cancellation of debt” (COD) income. For example, COD income could occur where: Your creditor agrees to accept as full payment an amount which is less than the balance due on an obligation; You own real estate subject to a mortgage and the lender forecloses on the property (or, you enter into a short sale of the mortgaged property); you own an interest in a partnership (or LLC) or “S” corporation that is anticipating a transaction that could trigger COD income that will “pass through” to your individual return.

<u>Planning Alert:</u> If you are in the process of negotiating an agreement with your creditors that involves a debt reduction that would trigger COD income, consider postponing the action until after 2015 to defer any debt cancellation income into 2016.

<u>Caution:</u> A “temporary” tax break allowing you to exclude income from the discharge of all or a portion of a mortgage (not exceeding $2 million) that you incurred to purchase, construct, or substantially improve your principal residence, ***expired after 2014.*** This tax break can be beneficial for taxpayers who are negotiating home mortgage work-outs with the bank (which may include a “short-sale” of the residence) and may be extended by Congress. If you are in this situation, please call us before finalizing your negotiations with the lender and we will update you on the availability of this exclusion. If the exclusion is extended to 2015 by Congress, it may be preferable to have the debt cancelled in 2015 so you can use the exclusion.

- **<u>“Required Minimum Distributions” From Retirement Plans And IRAs”:</u>** If you want to postpone the distribution (and therefore the taxation) of amounts in your traditional IRA or a qualified retirement plan as long as possible, there are several things to consider. First and foremost, it is critical that you name the appropriate beneficiaries, such as an individual or a “qualified trust.” If your estate is the beneficiary of your IRA or qualified plan account, your heirs will generally miss out on substantial tax deferral opportunities after your death. In addition to naming an individual or individuals as your beneficiary, you should also name a “contingent beneficiary” in case your primary beneficiary dies before you. If you do not name a qualified beneficiary or if your estate is your beneficiary and you die before reaching age 70½, your entire retirement account generally must be distributed and taxed within ***five years*** after the year of your death. This could cause your beneficiaries to lose valuable tax deferral options.

  <u>Planning Alert:</u> The rules for maximizing the tax deferral possibilities for IRAs and qualified plan accounts are complicated. We will gladly review your beneficiary designations and offer planning suggestions. However, here are some actions, relating to retirement plans and IRAs, that should ***be considered before the end of 2015.***

- **<u>Tax-Free IRA Payments To Charities If You Are Age 70½ Or Older:</u>** For the past several years, we have had a popular rule that allows taxpayers, who ***have reached age 70½,*** to have their IRA trustee contribute ***up to $100,000*** from ***their IRAs directly to a qualified charity***, and ***exclude the IRA distribution from income.*** The IRA transfer to the charity also counts toward the IRA owner’s “required minimum distributions” (RMDs) for the year. For those with charitable desires, this tax break effectively allows a qualifying taxpayer to exclude all or a portion of their otherwise taxable RMDs from taxable income. This, in turn, could cause your 2015 modified adjusted gross income (MAGI) to stay below the thresholds for the 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single), that might otherwise be imposed on your investment income (e.g., dividends, interest, capital gains). Moreover, this exclusion could also increase various credits and deductions for 2015 that would otherwise be phased out as your adjusted gross income increases.

Tax Tip: To qualify, the check from your IRA must be made out "directly" to your designated charity. In addition, if the contribution is $250 or more, you must get a timely, qualifying receipt from the charity for the charitable contribution.

Planning Alert: This provision ***expired at the end of 2014:*** However, this tax break is included in the current proposed "extenders" legislation currently before Congress. Please call our firm for a status report on this provision.

- **Post Mortem Planning For Retirement Plan And IRA Distributions:** If you are the beneficiary of an IRA or qualified plan account of someone that has died in 2015, there are certain planning techniques you should consider as soon as possible.

  Tax Tip: If the decedent named multiple beneficiaries or included an estate or charity as a beneficiary, we should review the situation as soon as possible to see if there is anything we can do to avoid certain tax traps. The rules for rearranging IRA beneficiaries for maximum tax deferral are complicated and are subject to rigid deadlines. Acting before certain deadlines pass is critical. If the owner died in 2015, the best tax results can generally be achieved by making any necessary changes ***no later than December 31, 2015.*** If you need assistance, please call our office as soon as possible so we can advise you.

- **IRA Owners Who Attain Age 70½ During 2015:** If you reached age 70½ at any time during 2015, you must begin distributions from a traditional IRA account ***no later than April 1st of 2016.*** A 50% penalty applies to the excess of the required minimum distribution over the amount actually distributed. In addition, if you wait until 2016 to take your first payment, you will still be required to take your second required minimum distribution no later than December 31, 2016, which will cause you to take two payments in 2016. This "bunching" of the first two annual payments into one tax year (2016) could cause your income to be taxed in a higher tax bracket and, therefore, result in more overall tax than if you received the first required payment in 2015.

  Tax Tip: If you reached age 70½ in 2015, and you own an IRA or other qualified retirement account, we will gladly help you navigate these rules to your best advantage.

- **Rollovers By Surviving Spouses:** If an individual ***over age 70½*** died during 2015 and the beneficiary of the decedent's IRA or qualified plan is the surviving spouse, and the *surviving spouse* is ***over 59½,*** the surviving spouse should consider rolling the decedent's qualified plan or IRA amount into his or her name ***on or before December 31, 2015.*** If the decedent's retirement account is rolled into an IRA in the surviving spouse's name ***before 2016*****,** then: **1)** Provided the surviving spouse has not reached age 70½, no distributions are required in 2016, or **2)** If the surviving spouse is at least 70½, the required minimum distribution in 2016 will be determined using the Uniform Lifetime Distribution Table that results in a smaller annual required payout. Therefore, ***converting the account into the surviving spouse's name*** on or ***before December 31, 2015,*** could substantially reduce the amount of the required minimum distribution for 2016 where the decedent was at least 70½.

  Planning Alert: If the surviving spouse is not yet 59½, leaving the IRA or qualified plan account in the name of the decedent may be the best option if the surviving spouse needs to withdraw amounts from the retirement account before age 59½. If the account is transferred into the spouse's name, and the spouse receives a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty unless made as a series of payments based on the surviving spouse's life expectancy.

TAKING ADVANTAGE OF DEDUCTIONS

"Above-The-Line" Deductions Become Even More Important In Light Of Recent Tax Increases

So-called ***"above-the-line"*** deductions reduce both your "adjusted gross income" (AGI) and your "modified adjusted gross income" (MAGI), while ***"itemized"*** deductions (i.e., below-the-line deductions) do ***not*** reduce either AGI or MAGI. Deductions that reduce your AGI (or MAGI) are particularly favorable because they not only reduce your taxable income, they also may free up other deductions (and tax credits) that phase out as your AGI (or MAGI) increases (e.g., itemized deductions, personal exemptions, certain IRA contributions, certain education expense deductions and credits, adoption credit, etc.). In addition, "above-the-line" deductions could serve to reduce your MAGI below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8 % NIIT only applies if MAGI exceeds $250,000 if married filing jointly; $200,000 if single).

- **"Above-The-Line" Deductions:** ***"Above-the-line"*** deductions include deductions for IRA or Health Savings Account (HSA) contributions, health insurance premiums for self-employed individuals, qualified student loan interest, qualified moving expenses, alimony, and business expenses for a self-employed individual. **Tax Tip.** Unreimbursed employee business expenses are classified as *"miscellaneous itemized deductions"* and trigger two potential limitations: **1)** Aggregate "miscellaneous itemized deductions" are allowed only to the extent they exceed 2% of your AGI, and **2)** Any excess is included in "itemized deductions" which are reduced once your AGI exceeds certain thresholds (e.g., for 2015 – $309,900 for joint returns; $258,250 if single). However, if you arrange for your employer to reimburse you for your "qualified" employee business expenses under an ***"accountable reimbursement plan,"*** the reimbursement is excluded from your income (which is generally the equivalent of an "above-the-line deduction). **Note:** We can help you establish a qualifying *accountable reimbursement plan* with your employer.

  - **Accelerating "Above-The-Line" Deductions:** As a cash method taxpayer, you can generally accelerate a 2016 deduction into 2015 by "paying" it in 2015. "Payment" typically occurs in 2015 if a check is delivered to the post office, if your electronic payment is debited to your account, or if an item is charged on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express) in 2015.

    Caution: If you post-date the check to 2016 or if your check is rejected, no payment has been made in 2015.

    Planning Alert: The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payment are not deductible in 2015.

  - **Take Advantage Of Health Savings Accounts (HSAs):** Qualifying contributions to health savings accounts (HSAs) are "above-the-line" deductions (i.e., fully deductible whether or not you itemize deductions), and distributions from the HSA for qualifying medical expenses are tax free. To qualify for an HSA, you must be covered by a qualifying "high deductible health plan" (HDHP). ***For 2015,*** if you have "family" coverage, your HDHP must have a minimum annual deductible of $2,600 ($1,300 for self only coverage). For 2015, your maximum contribution to an HSA is $3,350 ($4,350 if 55 or older) for self-only coverage, and $6,650 ($7,650 if 55 or older) for family coverage.

Tax Tip: As long as you are covered by a qualifying high deductible health plan by ***December 1, 2015,*** you will be able to contribute up to the maximum 2015 contribution limitation (e.g., $6,650 for family coverage in 2015), subject to potential recapture rules.

- **Deductions For Business Expenses Paid By Partners:** Generally, the IRS allows a partner in a partnership (or owner of an LLC) to take an "above-the-line" deduction for business expenses the owner ***paid on behalf*** of the partnership (or LLC) ***only if*** there is an agreement (preferably in writing) between the partner and the partnership providing that those expenses are to be paid by the partner, and that the expenses will not be reimbursed by the partnership.

  Tax Tip: If you are a partner or LLC owner paying unreimbursed expenses on behalf of your partnership or LLC, to be safe, you should have a written agreement with the entity providing that those expenses are to be paid by you, and that the expenses will not be reimbursed by the partnership or LLC.

Accelerating "Itemized" Deductions Into 2015

As mentioned above, although ***"itemized"*** deductions (i.e., *below-the-line* deductions) do ***not*** reduce your AGI or MAGI, they still may provide valuable tax savings. ***Itemized deductions*** generally include charitable contributions, state and local income taxes, property taxes, medical expenses, unreimbursed employee travel expenses, home mortgage interest, and gambling losses (to the extent of gambling income). However, if your itemized deductions fail to exceed your standard deduction in most years, you are not receiving maximum benefit for your itemized deductions. You could possibly reduce your taxes over the long term by bunching the payment of your itemized deductions in alternate tax years. This may produce tax savings by allowing you to itemize deductions in the years when your expenses are bunched, and use the standard deduction in other years.

Tax Tip: The easiest deductions to shift from 2016 to 2015 are *charitable contributions*, *state and local taxes*, and your January, 2016 home *mortgage interest payment*. For 2015, the standard deduction is $12,600 on a joint return and $6,300 for single individuals. If you are blind or age 65, you get an additional standard deduction of $1,250 if you're married ($1,550 if single).

Watch Out For AMT: Certain itemized deductions are not allowed in computing your alternative minimum tax (AMT), such as state and local taxes (including state income taxes) and unreimbursed employee business expenses. Before you accelerate 2016 itemized deductions into 2015, to be safe, we should calculate your taxes "with and without" accelerating the deduction so we can determine the AMT impact of this strategy.

"Bunching" Medical Expenses

Prior to 2013, you were allowed an *itemized deduction* for un-reimbursed medical expenses (including un-reimbursed health insurance premiums) only to the extent your aggregate medical expenses exceeded ***7.5%*** of adjusted gross income (10% for alternative minimum tax purposes). ***Starting in 2013,*** the *Affordable Care Act* generally increased this threshold from 7.5% of adjusted gross income (AGI) ***to 10% of AGI.***

Exception For Seniors: If either you or your spouse is at least age 65 before the close of the year, the 7.5% of AGI threshold will continue to apply ***through 2016*** (whether you file a joint return or separate returns).

Tax Tip: Consider accelerating as many elective medical expenses (i.e., braces, new eye glasses, etc.) into 2015 as possible if paying the expenses in 2015 will cause your deductible medical expenses to be above the 2015 AGI threshold and your medical expenses will not be in excess of the AGI threshold for 2016.

- **Qualified Long-Term Care Services:** Generally, deductible medical expenses include the cost of maintenance or personal care services prescribed by a "licensed health care practitioner" for a "chronically ill" individual. However, you must meet certain requirements before you may deduct these types of expenses as medical deductions.

- **IRS Medical Mileage Rate:** The standard IRS medical deduction mileage rate for use of your vehicle for essential medical care purposes is ***23 cents per mile for 2015.***

- **Qualified Long-Term Care Insurance Premiums:** Generally, qualified long-term care insurance premiums qualify as deductible medical expenses – subject to dollar caps based on your age (which are adjusted annually for inflation). ***For 2015,*** the ***maximum amount*** you can deduct for these premiums is: if you are age 40 or less - $380; age 41 to 50 - $710; age 51 to 60 - $1,430; age 61 to 70 - $3,800; and over age 70 - $4,750.

  Tax Tip: These dollar caps are per individual, not per return. So, for example, if you and your spouse are both age 65 and you each have a qualified long-term care policy, you could each deduct up to $3,800 of your respective premiums for 2015. Also, if you are a self-employed taxpayer, you are generally allowed an *"above-the-line"* deduction (discussed above) for the premiums up to the dollar caps.

Don't Miss Use-It-Or-Lose-It Deadline For Flex Plans

If you participate in a cafeteria or flexible savings account plan (flex plans), you can generally elect to make a pre-tax salary reduction contribution to the plan. You can then access that account to reimburse yourself tax-free for qualified expenditures (e.g., medical expenses, dependent care assistance, adoption assistance). For most *calendar-year* plans, you must clean out your 2015 account by March 15, 2016, or forfeit any funds that aren't used for qualifying expenses.

Qualified Home Office Can Generate Valuable Tax Benefits

Qualifying for home office deductions (e.g., depreciation, insurance, utilities, repairs and maintenance) often takes careful planning. To qualify, your home office must be used ***"regularly and exclusively"*** as your ***"principal place of business."*** For example, your home office will generally be deemed your ***principal place of business*** if you use the office to perform ***management or administrative duties*** for your business ***and*** there is ***no other fixed location*** where you perform substantial management or administrative duties for that business. If you are an "employee" (as opposed to being self-employed), in addition to meeting these requirements, you must also establish that your home office is ***"for the convenience of your employer"*** (this generally means you're not provided an office at work).

Tax Tip: The IRS says that if you have a qualifying home office, you can deduct the costs of traveling from your home office to another work location as a business expense. So, by having a qualified home office, you will generally have more deductible business travel expenses.

Note: The ***"business standard mileage"*** rate for 2015 is ***57.5 cents*** per mile. Furthermore, if you're an employee who qualifies for home office deductions, you should ask your employer to reimburse your home office expenses. This reimbursement is ***excluded from your income*** if reimbursed under an ***"accountable reimbursement plan."***

Planning Alert: If you have a qualifying home office, you may elect to compute certain home office expenses using the following formula: $5.00 times the home office's actual square footage (not to exceed 300 square feet). Thus, the maximum deduction under this formula is $1,500 (300 square feet x $5.00). If you elect to use this safe harbor, you must generally forgo the "actual" expenses otherwise allocable to your home office (e.g., depreciation, maintenance, home insurance, utilities). However, you may deduct your entire qualified mortgage interest and property taxes as an itemized deduction. Also, you generally may not make this election if your home office expenses are reimbursed by your employer.

Planning Opportunities For Charitable Contributions

The following are charitable-giving planning techniques that could reduce your 2015 tax bill:

- **"Pay" Your Charitable Contribution In 2015:** A charitable contribution deduction is allowed for 2015 if the check is *mailed* ***on or before December 31, 2015,*** or the contribution is made by a credit card charge in 2015. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay the note or pledge.

- **Contributions Of Appreciated Property:** If you are considering a significant 2015 contribution to a qualified charity (e.g., church, synagogue, or college), it will generally save you taxes if you contribute *appreciated* long-term capital gain property, rather than selling the property and contributing the cash proceeds to the charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation.

  Caution: Your current year deduction for appreciated capital gain property is generally limited to 30% of your AGI, with a 5-year carryover of the excess.

  Tax Tip: If you want to continue to hold an investment position in stock that you contribute to charity, consider purchasing stock that is the same or similar to the appreciated stock you contributed. That way, you will have a higher "tax" basis in the replacement stock, without having to recognize the gain on the stock contributed to charity.

  Caution: If you plan to contribute appreciated realty or stock for 2015, make sure that you begin the paperwork for the transfer early enough so that all documentation is completed by ***December 31, 2015.***

  Planning Alert: If you intend to use "loss" stocks to fund a charitable contribution, you should sell the stock first and then contribute the cash proceeds. This will allow you to deduct the capital loss from the sale, while preserving your charitable contribution deduction. If you contribute the loss stock directly to the charity, although you will get a charitable deduction equal to the value of the contributed stock, you will ***lose the capital loss*** deduction.

  Caution: Be sure to satisfy the rigid documentation requirements discussed in the next segment. For example, contributions of property other than publically traded securities, generally require a "qualified appraisal" if the property is valued at more than $5,000.

Be Careful – IRS And The Courts Are Rigidly Enforcing The Documentation Requirements For Charitable Contributions

The IRS regulations provide that you may not take a deduction for a charitable contribution unless you strictly comply with the rigid documentation requirements imposed by the Internal Revenue Code. Over the last several years, there have been a series of Court cases disallowing an entire charitable contribution deduction because the taxpayer failed to satisfy one or more of the following documentation requirements:

- **Contributions Made In Cash:** In order to deduct a "cash" contribution to a charity, you must have a receipt, letter, or other written communication from the charity (showing the name of the charity, the date and the amount of the contribution).

  Planning Alert: If your cash contribution is $250 or more, you ***must also satisfy*** the ***"Mandatory Documentation Requirements For Contributions Of $250 Or More,"*** discussed below.

- **Contributions Made By Check, Debit Card, Or Charge Card:** If you make a contribution by check, you are required to have either a receipt described above for ***"Contributions Made In Cash,"*** a copy of the cancelled check, or some other bank record (e.g., a bank statement). If your contribution is by debit card or by charge card, you are required to have either a receipt as described above for ***"Contributions Made In Cash,"*** or a bank record (e.g., a bank statement, credit card statement, etc.).

  Planning Alert: If your contribution is $250 or more, you ***must also satisfy*** the ***"Mandatory Documentation Requirements For Contributions Of $250 Or More,"*** discussed below.

- **Mandatory Documentation Requirements For Contributions Of $250 Or More:** If you contribute ***$250 or more*** (whether by cash, check, charge card, or property) to a charity, you are allowed a deduction ***only if*** you receive a ***"qualifying written receipt"*** from the charity by the time you file your return (a cancelled check is not enough) **and** the return is timely filed. The ***qualifying written receipt*** must contain the following information: **1)** The amount of cash and a description (but not value) of any property other than cash you contributed to the charity, **2)** A statement as to whether the charity provided you with any goods or services in return for your contribution, and **3)** A description and good faith estimate of the value of any goods or services, if any, the charity provided to you (or, if applicable, a statement that the goods and services consisted solely of intangible religious benefits). ***In addition,*** for all noncash contributions, the receipt must contain the date of the charitable contribution, the location of the contribution, and a description of the property contributed.

  Planning Alert: As mentioned above, both the IRS and the Courts require you to strictly comply with each and every rigid documentation requirement in order for you to deduct a charitable contribution. ***For example,*** last April the Tax Court denied a charitable deduction of over $37,000 for aggregate donations of household items allegedly made in separate batches of less than $250. The taxpayer unsuccessfully argued that the donations did not require a ***qualifying written receipt*** because they were made in batches below the $250 threshold. The Court found it implausible that, without direct supporting evidence, that the taxpayer had limited each batch of his contributions to a value below $250.

- **Property Contributions Of More Than $500:** If you contribute non-cash property of a similar type ***valued over $500***, you must not only ***satisfy*** the ***"Mandatory Documentation Requirements For Contributions Of $250 Or More,"*** discussed above, but you must also maintain and report with your return certain additional information including the date you acquired the property, your basis in the property, your valuation method, etc.

Planning Alert: If you are claiming a deduction of ***more than $500*** for a ***vehicle, a boat, or an airplane*** that you contributed to charity, the law also requires that you obtain a *Form 1098-C* in order to deduct your contribution.

- **Property Contributions Of More Than $5,000:** You must obtain a ***qualified appraisal*** for contributions of property ***valued in excess of $5,000,*** unless the property is: **1)** Securities for which market quotations are readily available, or **2)** Non-publicly traded stock valued at $10,000 or less. Furthermore, you must also ***satisfy*** the ***"Mandatory Documentation Requirements For Contributions Of $250 Or More,"*** discussed above.

- **Contributions Of Clothing And Household Items:** Even if you meet the previously-discussed documentation requirements, you are not allowed a deduction for charitable contributions of ***clothing or household items*** unless the items are in ***"good used condition or better."***

  Tax Tip: You should consider contributing your clothing and household items to charities that have a policy of accepting only items that are in good condition.

Maximizing Your Home Mortgage Interest Deduction

If you are looking to maximize your 2015 itemized deductions, you can increase your home mortgage interest deduction by paying your January, 2016 payment ***on or before December 31, 2015.*** Typically, the January mortgage payment includes interest that was accrued in December and, therefore, is deductible if paid in December.

Planning Alert: Make sure that you send in your January, 2016 mortgage payment early enough in December for your lender to actually receive it before year-end. That way, your lender should reflect that last payment on your 2015 Form 1098, and we can avoid a matching problem on your 2015 return.

Here are some other planning strategies for the interest deduction you should consider:

- **Look For Deductible "Points":** Points paid in connection with the purchase or improvement of your ***principal residence*** are immediately deductible. Points are deductible even if the bank labels them as something else. For example, points include "loan-processing fees," "loan premium charges," or "loan origination fees" so long as they don't represent fees for services, etc. (e.g., appraisal, title, inspection, attorneys' fees, credit checks, property taxes, or mortgage insurance premiums).

- **Remember To Deduct Seller-Paid Points:** If you bought a house this year and negotiated for the seller to pay your points at closing, the IRS says you can deduct those seller-paid points as though you paid them yourself.

- **Pay Off Personal Loans First:** If you have both home mortgage loans and other personal debt, pay off the personal debt first because interest on personal debt is generally not deductible but home mortgage interest is generally deductible. This will maximize your interest deduction.

Pay Careful Attention To The Payment Of Your State And Local Income Taxes

If you anticipate deducting your state and local income taxes, consider paying them (fourth quarter estimate and balance due for 2015) and any property taxes for 2015 ***prior to January 1, 2016*** if your tax rate for 2015 is higher than or the same as your projected 2016 tax rate. This will provide a deduction for 2015 (a year early) and possibly against income taxed at a higher rate.

Caution: If you expect your 2015 AGI to be above the threshold for phasing out "itemized deductions" (e.g., above $309,900 for joint returns; $258,250 if single), but expect your 2016 AGI to be below those thresholds, accelerating your tax payment into 2015 may not be advisable.

Planning Alert: State and local income and property taxes are not deductible for AMT purposes. Consequently, you should not employ this tactic without carefully calculating the alternative minimum tax impact. Also, "overpayment" of your 2015 state and local income taxes is generally not advisable if a refund in 2016 from a 2015 overpayment will be taxed at a higher rate than the rate that applied to the 2015 deduction. ***Please consult us before you overpay state or local income taxes:***

- **Option To Deduct Sales Tax Expired After 2014:** For the past several years, taxpayers could "elect" to deduct "either" state and local ***income*** taxes or state and local ***sales*** taxes, as itemized deductions. This election has been particularly popular among residents who live in states with little or no state income taxes, or states where the state income taxes paid are generally less than the sales taxes paid.

  Planning Alert: This provision is included in the list of tax breaks that ***expired after 2014***. However, if and when "extenders" legislation is passed by Congress, this provision will likely be included.

TAX PLANNING FOR INVESTMENT INCOME (INCLUDING CAPITAL GAINS AND THE 3.8% NIIT)

Planning With The 3.8% Net Investment Income Tax (3.8% NIIT)

The ***Affordable Care Act*** (*ACA*) contains a ***3.8% Net Investment Income Tax (3.8% NIIT)*** on *net investment income* of higher-income individuals. This tax started in 2013, and applies to individuals with modified adjusted gross income (MAGI) exceeding the following ***"thresholds"*** (which are ***not indexed*** for future inflation): ***$250,000*** for ***married filing jointly; $200,000*** if ***single;*** and ***$125,000*** if ***married filing separately.*** The 3.8% NIIT is imposed upon ***the lesser of*** an individual's: **1)** Modified adjusted gross income (MAGI) in excess of the ***threshold,*** or **2)** Net investment income. ***Trusts and estates*** are also subject to the ***3.8% NIIT*** on the ***lesser of*: 1)** The adjusted gross income of the trust or estate in excess of $12,300 (for 2015), or **2)** The undistributed net investment income of the trust or estate.

The 3.8% NIIT not only applies to traditional types of investment income (i.e., interest, dividends, annuities, royalties, and capital gains), but it also applies to "business" income that is taxed to a "passive" owner (as discussed in more detail below) unless the "passive" income is subject to S/E taxes. If you believe that the 3.8% NIIT may apply to you, consider the following planning techniques:

- **Shifting To Investments That Generate Tax-Exempt Income:** Fortunately, the following types of income are ***not subject*** to the *3.8% NIIT*: ***tax-exempt bond interest;*** gain on the sale of a principal residence *otherwise excluded* from income under the ***home-sale exclusion*** rules (i.e., up to $250,000 on a single return, up to $500,000 on a joint return); and ***distributions from qualified retirement plans*** (e.g., 401(k) plans, IRAs, §403(b) annuities, etc.).

  Tax Tip: Investments that generate tax-exempt income (e.g., tax exempt municipal bonds) potentially provide higher-income individuals with a double benefit: **1)** The interest will not be included in the individual's MAGI, thus reducing the chance that the individual will exceed the income thresholds for the 3.8% NIIT, and **2)** The tax-exempt interest itself is exempt from the 3.8% NIIT as well as from Federal income taxes.

  Planning Alert: Although taxable distributions from qualified retirement plans (e.g., IRAs, 401(k) plans, etc.) are exempt from the 3.8% NIIT, the taxable distributions will increase your "modified adjusted gross income" (MAGI). Therefore, to the extent the taxable distributions cause your MAGI to exceed the MAGI thresholds for the 3.8% NIIT (e.g., $250,000 for joint returns; $200,000 for singles), the distributions could cause your other "net investment income" (e.g., dividends, interest, capital gains, rents, passive income) to be hit with the 3.8% NIIT.

- **Roth IRAs (Including Roth IRA Conversions):** Tax-free distributions from a Roth IRA are exempt from the 3.8% NIIT, and do not increase your MAGI (and, thus will not increase your exposure to the 3.8% tax). Therefore, these tax-favored features should be factored into any analysis of whether you should contribute to a Roth IRA. However, if you are considering converting a traditional IRA into a Roth, the income triggered in the year of conversion would increase your MAGI and, therefore, may increase your exposure to the 3.8% NIIT on your *net investment income* (e.g., dividends, interest, capital gains).

  Planning Alert: If you want a Roth conversion to be ***effective for 2015,*** you must transfer the amount from the regular IRA to the Roth IRA ***no later than December 31, 2015*** (you do not have until the due date of your 2015 tax return).

  Caution: Whether you should convert your traditional IRA to a Roth IRA can be an exceedingly complicated issue, and this new 3.8% NIIT is just one of many factors that you should consider. ***Please call our firm*** if you need help in deciding whether to convert to a Roth IRA.

- **"Tax-Deferred" Investments:** The 3.8% NIIT does not apply to earnings generated by a ***tax-deferred annuity*** (TDA) contract ***until the income is distributed.*** Thus, after first considering the economics, investing in a TDA in your higher-income years may allow you to defer the annuity income until later years when your MAGI is below the 3.8% NIIT thresholds.

- **"Passive" Income:** *"Net Investment Income"* for purposes of the 3.8% NIIT generally includes net income from a business activity if you are a "passive" owner (unless the income constitutes *self-employment* income that is subject to the 2.9% Medicare tax). You will generally be deemed a "passive" owner if you do not "materially participate" in the business as determined under the traditional "passive activity loss" rules. For example, under the *passive activity loss* rules, you may be a *"passive"* owner unless you spend more than 500 hours working in the business during the year or meet one of the other "material participation" tests. Furthermore, *rental income* is generally deemed to be "passive" income under the *passive activity loss* rules, regardless of how many hours you work in the rental activity.

Tax Tip: In certain situations, real estate rentals may not be treated as "passive" income and could also be exempt from the 3.8% NIIT. For example, if you are a "qualified real estate professional," or you lease property to a business and you "materially participate" in the business operations of your lessee, the rental income may be exempt from the 3.8% NIIT. If you believe you may qualify for one of these rental exemptions, or you otherwise believe you may have "passive" income from non-rental business activities, please contact our firm. We will gladly evaluate your situation to determine whether there are steps you could take before the end of 2015 to avoid "passive" income classification, and thus, reduce your exposure to the 3.8% NIIT.

Traditional Year-End Planning With Capital Gains And Losses

Generally, net capital gains (both short-term and long-term) are potentially subject to the 3.8% NIIT. This could result in an individual who is otherwise taxed in the 39.6% ordinary income tax bracket paying tax on his or her ***net long-term capital gains*** at a ***23.8%*** rate (i.e., the maximum capital gains tax rate of 20% plus the 3.8% NIIT). This individual's ***net short-term capital gains*** could be taxed as high as ***43.4%*** (i.e., 39.6% plus 3.8%). Consequently, traditional planning strategies involving the timing of your year-end sales of stocks, bonds, or other securities are more important than ever. The following are time-tested, year-end tax planning ideas for sales of capital assets.

Planning Alert: Always consider the ***economics of a sale or exchange first:***

- **Planning With Zero Percent Tax Rate For Capital Gains And Dividends:** Long-term capital gains and qualified dividends that would be taxed (if ordinary income) in the 15% or lower ordinary income tax bracket, are taxed at a zero percent rate. For 2015, taxable income up to $74,900 for joint returns ($37,450 if single) is taxed at the 15% rate, or below.

  Tax Tip: Taxpayers who have historically been in higher tax brackets but now find themselves between jobs, recently retired, or expecting to report higher-than-normal business deductions in 2015, may temporarily have income low enough to take advantage of the zero percent rate for 2015. If you are experiencing any of these situations, please call our firm and we will help you take advantage of this zero percent tax rate for long-term capital gains and qualified dividends.

- **Lower-Income Retirees:** The zero percent rate for long-term capital gains and qualified dividends is particularly important to lower-income retirees who rely largely on investment portfolios that generate dividends and long-term capital gains. Furthermore, gifts of appreciated securities to lower-income donees who then sell the securities could reduce the tax on all or part of the gain from as high as 23.8% to as low as zero percent.

  Caution: If the donee is subject to the so-called *kiddie tax*, this planning technique will generally not work.

- **Timing Your Capital Gains And Losses:** If the value of some of your investments is less than your cost, it may be a good time to harvest some capital losses. For example, if you have already recognized capital gains in 2015, you should consider selling securities ***prior to January 1, 2016*** that would trigger a capital loss. These losses will be deductible on your 2015 return to the extent of your recognized capital gains, plus $3,000.

Tax Tip: These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as the: $2,500 American Opportunity Tuition Tax Credit, $1,000 Child Credit, $13,400 Adoption Credit, etc.

Planning Alert: If, within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the "wash sale" rules (although the disallowed loss will increase the basis of the acquired stock).

Tax Tip: If you are afraid of missing an upswing in the market during this 60-day period, consider buying shares of a different company in the same sector. Also, there is *no* wash sale rule for *gains*. Thus, if you decide to sell stock at a gain in order to take advantage of a zero capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

- **Planning With Capital Loss Carryforwards:** If you have substantial capital loss carry forwards coming into 2015, and your stock sales to date have created a *net* capital loss exceeding $3,000, consider selling enough appreciated securities ***before the end of 2015*** to decrease your net capital loss to $3,000. Stocks that you think have reached their peak would be good candidates. All else being equal, you should sell the short-term gain (held 12 months or less) securities first. This will allow your *net* capital loss (in excess of $3,000) to offset your short-term capital gain, while preserving favorable long-term capital gain treatment for later years.

  Planning Alert: Your *net* short-term capital gains can be used to free up a deduction for any "investment interest" you have incurred (e.g., interest you have paid on your margin account). If you eliminate your short-term capital gains by recognizing your short-term capital losses, you may be restricting your ability to deduct your investment interest.

  Tax Tip: If you are considering selling "loss" investments held 12 months or less, and you also have short-term capital gains and investment interest expense, please call our office. We will help you determine a strategy that will maximize your tax savings.

PLANNING WITH RETIREMENT PLANS

Consider Contributing The Maximum Amount To Your Retirement Plan

As your income rises and your marginal tax rate increases, deductible retirement plan contributions generally become more valuable. Also, making your deductible contribution to the plan as early as possible generally increases your retirement benefits. As you evaluate how much you should contribute, consider the following:

- **IRA Contributions:** If you are married, even if your spouse has no earnings, you can generally deduct in the aggregate up to $11,000 ($13,000 if you are both at least age 50 by the end of the year) for contributions to your and your spouse's traditional IRAs. You and your spouse must have *combined earned income* at least equal to the total contributions. However, no more than $5,500 ($6,500 if at least age 50) may be contributed to either your IRA account or your spouse's IRA account for 2015. If you are an active participant in your employer's retirement plan during 2015, your IRA deduction is reduced ratably as your adjusted gross income increases from **$98,000 to $118,000** on a joint return (**$61,000 to $71,000** on a single return). However, if you file a joint return with your spouse and your spouse is an active participant in his or her employer's plan and you are not an active participant in a plan, your IRA deduction is reduced as the adjusted gross income on your joint return goes from **$183,000 to $193,000.**

Planning Alert: Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. For 2015, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **$183,000 to $193,000** on a joint return or from **$116,000 to $131,000** if you are single.

Planning Alert: Unlike the rule for traditional IRA contributions, the amount you may contribute to a Roth IRA is reduced if your adjusted gross income falls within these phase-out ranges regardless of whether you or your spouse is a participant in another retirement plan. In addition, contributions to a Roth IRA are not deductible.

- **Workers At Least Age 70½:** If you are age 70½ or older, you ***cannot*** make a contribution to a traditional IRA for yourself.

  Tax Tip: If you are working, age 70½ or older, have a spouse under age 70½, and otherwise qualify, you can make a deductible IRA contribution to a separate traditional IRA for your spouse (not to exceed your compensation) even where the spouse has no earned income. Also, if you otherwise qualify, you can contribute to a nondeductible Roth IRA even after you reach age 70½ as long as you have sufficient earned income.

- **Consider Contributing To Your Company's 401(k) Plan:** If you are covered by your company's 401(k) plan, consider putting as much of your compensation into the plan as allowable. The maximum amount of compensation you can defer into the 401(k) plan for 2015 is $18,000 ($24,000 if you're at least age 50 by the end of 2015). Deferring the maximum compensation amount into the plan is particularly appealing if your employer offers to match your contributions.

- **Seek Advice Before Taking Money From Your IRA Prematurely:** If you are experiencing financial distress and are considering withdrawing funds from your IRA to fill the financial void, ***be extremely careful:*** There can be a 10% penalty for withdrawing funds from your IRA on top of any income tax on the distribution. However, there are specific exceptions to the 10% distribution penalty (although you generally must still include the amount distributed in your taxable income). For example, you can generally withdraw funds from your IRA without penalty if: **1)** You have reached age 59½, **2)** You have been medically determined to be disabled, **3)** You are using the funds for qualified education expenses, **4)** You are receiving unemployment benefits and you use the funds for medical insurance premiums, or **5)** You take substantially equal payments over your life expectancy.

  Planning Alert: These rules are exceedingly technical and if not properly followed, can result in a 10% penalty in addition to any income tax due on the distribution. Please call our firm if you need to access your IRA funds and we will help you determine if you qualify for one of these exceptions to the penalty.

  Note: The rules for Roth IRA distributions are different.

MISCELLANEOUS YEAR-END TAX PLANNING OPPORTUNITIES

Before wrapping up your *traditional* year-end planning review, here are several more strategies you might consider:

Exercising Incentive Stock Options (ISOs) Could Trigger AMT

Exercising an incentive stock option (ISO) in 2015 can generate a 2015 alternative minimum tax (AMT) if the difference between the stock's value and the exercise price is substantial.

Tax Tip: If you exercised an ISO ***in 2015*** and the stock you acquired has declined in value since the date of exercise, it may be possible to eliminate or reduce your 2015 AMT tax liability if you sell the stock ***on or before December 31, 2015.*** Please check with us if you have exercised incentive stock options during 2015 and the price of the stock has fallen since the date of exercise.

Consider Increasing Withholding If Facing An Estimated Tax Underpayment Penalty

If you have failed to pay sufficient estimated taxes during 2015 potentially causing an estimated tax underpayment penalty, ***increasing your withholdings before the end of 2015*** may solve the problem. Any income tax withholding (including withholdings at the end of 2015 from a year-end bonus or an IRA distribution) is generally deemed paid 1/4 on April 15, 2015; June 15, 2015; September 15, 2015; and January 15, 2016. Therefore, amounts ***withheld on or before December 31, 2015*** may reduce or eliminate your penalty for underpaying estimated taxes.

Tax Tip: If you are a higher-income individual with ***investment income*** that will trigger the ***3.8% NIIT*** for 2015, the additional NIIT could subject you to the underpayment penalty if you haven't adjusted your estimated tax payments or withholdings to cover the 3.8% NIIT and do not otherwise meet one of the exceptions to the penalty (i.e., paying in 110% of last year's tax). Increasing your withholdings on or before December 31, 2015 could eliminate the penalty.

Planning Alert: If you take an IRA distribution and have taxes withheld from the distribution to avoid an underestimate penalty, you must roll the distribution (unreduced by the withheld taxes) into an IRA within 60 days of the distribution to avoid paying taxes (and possibly a 10% penalty) on the IRA distribution. You are allowed to take a distribution from an IRA and roll it over into a new IRA, ***only one time per year*** (beginning with the date you received the distribution).

Caution: If you used this withholding technique last year by having taxes withheld from an IRA distribution in 2014, ***be very careful*** that you do not violate the ***one-rollover-per-year*** rule if you plan to use this technique again this year. Please call our firm before you initiate an IRA distribution in order to increase your tax withholdings.

Consider Utilizing The $14,000 Annual Gift Tax Exclusion

You can reduce your estate without using any of your $5.43 million exclusion amount (for 2015) and without triggering any gift tax – by making annual gifts up to the annual gift tax exclusion amount of $14,000 per donee. Your spouse can do the same, bringing the total gifts that can be made free of gift tax and without using any of the unified exclusion amount to $28,000 per donee.

Planning Alert: If you make your 2015 gift by check, the IRS says that the donee must actually "deposit" the check ***by December 31, 2015*** in order to utilize the $14,000 annual gift tax exclusion amount for 2015. Therefore, if gifts are made near the end of the year, you should consider making the gifts using a cashier's check which should constitute a gift when the check is delivered.

Make Sure You Comply With The Filing Requirements For Same-Sex Marriages

Two years ago, the U.S. Supreme Court essentially held that the Federal government had to recognize same-sex marriages performed in jurisdictions that allow them. In response to this Supreme Court decision, in the summer of 2013, the IRS adopted a general rule recognizing for Federal tax purposes any marriage entered into in a state whose laws permitted same-sex marriages, even if the couple resided in a state that did not recognize them as a legally married couple. Therefore, since 2013, legally married same-sex couples have been largely treated the same as legally married opposite sex couples for Federal income tax purposes. However, after the 2013 Supreme Court ruling, approximately 14 states did not permit same-sex married couples to file as married individuals for "state" income tax purposes. However, on June 26, 2015 the Supreme Court in Obergefell v. Hodges, generally held that a state must license a marriage between two people of the same sex, as well as recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed out-of-state.

Planning Alert: This latest Supreme Court decision should not affect a couple's income tax filing status for Federal income tax purposes, since individuals who were married in a state recognizing same-sex marriage have been treated as "married" for Federal income tax purposes since the 2013 Supreme Court decision. However, the *Obergefell* decision now seems to require that all legally married same-sex couples file "state" income tax returns as married individuals. Several states that did not previously recognize same-sex marriages have announced that subsequent returns filed by legally married same-sex couples should be filed as married individuals. These states also should allow legally married same-sex couples the option of filing amended returns for prior years for which the statute of limitations is open to file as married individuals.

Tax Tip: Same-sex couples residing in states that previously did not allow same-sex couples to file as married individuals, should consider filing amended state income tax returns for prior years for which the statute of limitations is open, if they would benefit by filing as "married" for state income tax purposes. Before filing amended returns, check with the state's Department of Revenue for their procedures.

Credit For Energy-Efficient Improvements To Your Residence

The temporary 10% credit (with a life-time cap of $500) for qualified energy-efficient improvements to your "principal residence" ***expired after 2014.*** However, the current 30% credit for installing a ***qualifying solar water heater, solar electric generating property, geothermal heat pump,*** or ***small wind energy property*** is not ***currently scheduled to expire until after 2016.*** This 30% credit applies if you install the qualifying energy-efficient property in or on property located in the U.S. that you use as a residence. The residence does ***not*** have to be your ***"principal residence."*** So, installations for a second residence or vacation home may qualify. The 30% credit also applies to the on-site installation costs.

Tax Tip: If you are the initial purchaser of your newly-constructed residence that contains qualifying energy-efficient components (e.g., solar water heater, solar electric generating property, geothermal heat pump), you should ask the builder to provide you with a reasonable allocation of the cost of the home attributable to the qualified energy property (including labor costs for on-site preparation, assembly, and installation of the property).

Caution: To ***take the 30% credit for 2015,*** the property must ***actually be installed*** no later than ***December 31, 2015.***

Planning Alert: The credit ***is not allowed*** with respect to ***"investment"*** property such as a "rental property." However, you may possibly receive a business energy credit for qualifying energy-efficient improvements to rental property or other business property, where the property is not a "passive activity" and the credit is not limited under the passive activity rules. Also, expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) ***do not qualify.***

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information.

Note: The information contained in this letter represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of the provisions discussed may apply to a specific situation.

Disclaimer: Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of promoting, marketing, or recommending to another party any transaction or matter addressed herein. The preceding information is intended as a general discussion of the subject addressed and is not intended as a formal tax opinion. The recipient should not rely on any information contained herein without performing his or her own research verifying the conclusions reached. The conclusions reached should not be relied upon without an independent, professional analysis of the facts and law applicable to the situation.