Dear Clients,

It's that time of year where we should think about preparing an estimate of your current year tax liability and see if we can reduce that liability.

There are several things to consider when doing year-end tax planning: taking advantage of expiring tax provisions, deferring income into next year, or accelerating income into the current year (and doing the opposite with expenses). The proper strategy depends on whether or not you anticipate a significant change in income or expenses next year.

With respect to expiring provisions, many taxpayer-favorable provisions were recently extended retroactively for the 2014 tax year by the Tax Increase Prevention Act of 2014 (TIPA), but will expire at again at year-end. TIPA was signed into law by the President on December 19. The law retroactively extends numerous tax breaks for the 2014 tax year.

TIPA includes the following items which may impact your total tax for 2014:

(1) *Deduction for expenses of elementary and secondary school teachers* - This provision allows teachers and other school professionals a $250 above-the-line tax deduction in 2014 for expenses paid or incurred for books, supplies (other than non-athletic supplies for courses of instruction in health or physical education), computer equipment (including related software and service), other equipment, and supplementary materials used by the educator in the classroom.

(2) *Mortgage debt forgiveness* - Under this provision, up to $2 million of forgiven mortgage debt is eligible to be excluded from income ($1 million if married filing separately) for 2014.

(3) *Increased exclusion from income for employer-provided mass transit and parking benefits* - This provision increases for 2014 the monthly exclusion from income for employer-provided transit and vanpool benefits from $130 to $250, so that it would be the same as the exclusion for employer-provided parking benefits.

(4) *Deduction for mortgage interest premiums* - Under this provision, for 2014 taxpayers can deduct the cost of mortgage insurance on a qualified personal residence. The deduction is phased-out ratably by 10 percent for each $1,000 by which adjusted gross income (AGI) exceeds $100,000. Thus, the deduction is unavailable for a taxpayer with an AGI in excess of $110,000.

(5) *Deduction for state and local general sales taxes* - This provision would extend for 2014 the election to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction permitted for state and local income taxes.

(6) *Special rules for contributions of capital gain real property made for conservation purposes* - This provision extends for 2014 the increased contribution limits and carry-forward period for contributions of appreciated real property (including partial interests in real property) for conservation purposes.

(7) *Above-the-line deduction for higher education expenses* - This provision would extend an above-the-line tax deduction for qualified higher education expenses. The maximum deduction for 2014 is $4,000 for taxpayers with AGI of $65,000 or less ($130,000 for joint returns) or $2,000 for taxpayers with AGI of $80,000 or less ($160,000 for joint returns). This deduction is not available for individuals with income higher than these thresholds.

(8) *Tax-free distributions from individual retirement plan for charitable purposes* - This provision allows an individual retirement arrangement (IRA) owner who is age 70-1/2 or older generally to exclude from gross income for 2014 up to $100,000 in distributions made directly from the IRA to certain public charities.

Income Subject to Top Tax Rate

For 2014, the amount of income subject to the top tax rate of 39.6 percent increased from the 2013 amounts to $457,600 (married filing jointly), $406,750 (single individuals), $432,200 (head of household) and $228,800 (married filing separately).

Net Investment Income Tax

The net investment income tax is a 3.8 percent tax on net investment income that took effect in 2013. Besides applying to investment income, the tax also applies to income from trades or businesses of the taxpayer that are passive activities. An activity is not generally considered passive if the taxpayer materially participates. If you are engaged in an activity which may be considered passive and thus has the potential to trigger the net investment income tax, we should evaluate the seven factors that determine material participation to see if your business can escape the net investment income tax.

Affordable Care Act ('Obamacare')

Beginning in the 2014 tax year, most individual taxpayers will be required to obtain health insurance, either through their employer or independently on a health insurance exchange marketplace, or risk facing a tax penalty. In 2014 the penalty is either $95 per adult ($47.50 per child) or 1% of income, whichever is higher. In some situations, the amounts of these penalties will increase in 2015. If you or your family members do not have health insurance, it may make sense for us to evaluate your options by comparing the amount of the potential penalties with the cost of obtaining coverage.

Alternative Minimum Tax

If you are subject to the alternative minimum tax (AMT), your deductions may be limited. Thus, if we anticipate that you will be subject to the AMT, we need to consider the timing of deductible expenses that may be limited under the AMT.

IRA Considerations

In 2014, the waiting-period rule on IRA rollovers changed, and not to your benefit. While the rule used to be that the one-year waiting period between rollovers applied on an IRA-by-IRA basis, the courts and IRS determined that it applies on an aggregate basis instead. This means that you cannot make a tax-free IRA-to-IRA rollover if you've made such a rollover involving any of your IRAs in the preceding one-year period. This new rule applies beginning in 2015. However, the rule does not affect your ability to transfer funds from one IRA trustee directly to another, because such a "trustee-to-trustee transfer" is not a rollover and, therefore, is not subject to the one-waiting period.

Self-directed IRAs have become increasingly popular in recent years because they allow an IRA owner to have more control over the type of investments that will be held in the IRA. This higher degree of flexibility in choosing IRA investments allows the IRA owner to invest in assets with greater wealth-building potential. However, the large amount of money held in self-directed IRAs makes them attractive targets for fraud promoters. Thus, self-directed IRA can be costly if not properly managed. In addition, because of the types of investments taxpayers with self-directed IRAs are able to make, taxpayers have a greater risk of running afoul of the prohibited transaction rules. The prohibited transaction rules impose an excise tax on certain transactions - such as sales of property, the lending of money or extension of credit, or the furnishing of goods, services, or facilities - between an IRA and a disqualified person. If you have a self-directed IRA, we need to review the specifics of your arrangement.

Self-Employed Consideration

If you are self-employed and your business has shown losses for the past several years, there is a danger that the IRS will consider your business a hobby and disallow deductions in excess of revenue. If you are in this situation, there are certain steps we can take to mitigate this potential. For example, we can ensure there is appropriate documentation as to the business-like manner in which the business is carried on, including the adoption of new techniques or the abandonment of unprofitable methods.

The IRS has issued new rules on the capitalization and expensing of tangible property used in a trade or business. If tangible property is a part of your business, these rules will most likely impact your current year taxes and may require certain actions by year end. For example, if you acquired numerous small dollar items, a de minimis safe harbor rule may apply to allow you to deduct all items below a certain threshold. Or, if you incurred significant repair and maintenance costs for heavy machinery, a routine maintenance safe harbor may be used to increase current deductions.

S Corporation Shareholders

In 2014, the IRS loosened the rules relating to S corporation shareholder debt. Under the new rules, it is easier for such debt to give the shareholder basis against which to deduct losses from the S corporation. The rules eliminated the "actual economic outlay" doctrine and made the changes retroactive. Thus, if you previously could not deduct S corporation losses because loans to the S corporation did not meet the actual economic outlay doctrine, amended returns may be in order.

Estate/Gift Tax Considerations

Annual Exclusion

There is still time to reduce your estate by gifting amounts to relatives or friends, free of the gift tax that normally applies. For 2014, you can gift up to $14,000 to each donee.

Charitable Remainder Trusts

If you are in the top tax bracket, have appreciated assets that would be subject to capital gains tax if sold, and would like to make a significant gift to a favorite charity while reducing estate or gift taxes, you may want to think about utilizing a charitable remainder trust (CRT). A CRT, which has an income interest part and a remainder interest part, can allow you to sell appreciated assets tax free, while providing you with a current income tax deduction that can offset all forms of income in addition to providing a charity with a substantial donation. Please let me know if you would like more information on this option.

Other Steps to Consider Before the End of the Year

The following are some of the additional actions we should review before year end to see if they make sense in your situation. The focus should not be entirely on tax savings. These strategies should be adopted only if they make sense in the context of your total financial picture.

Accelerating Income into 2014

Depending on your projected income for 2015, it may make sense to accelerate income into 2014 if you expect 2015 income to be significantly higher. Options for accelerating income include:

(1) harvesting gains from your investment portfolio;

(2) if you own a traditional IRA or a SEP IRA, converting it into a Roth IRA and recognizing the conversion income this year;

(3) taking IRA distributions this year rather than next year;

(4) selling stocks or other assets with taxable gains this year;

(5) if you are self employed with receivables on hand, trying to get clients or customers to pay before year end; and

(6) settling lawsuits or insurance claims that will generate income this year.

Deferring Income into 2015

There are also scenarios (for example, if you think that your income will decrease substantially next year) in which it might make sense to defer income into the 2015 tax year or later years. Some options for deferring income include:

(1) if you are due a year-end bonus, asking your employer to pay the bonus in January 2015;

(2) if you are considering selling assets that will generate a gain, postponing the sale until 2015;

(3) delaying the exercise of any stock options you may have;

(4) if you are selling property, considering an installment sale;

(5) consider parking investments in deferred annuities;

(6) establishing an IRA, if you are within certain income requirements; and

(7) if your employer has a 401(k) plan, consider putting the maximum salary allowed into it before year end.

Deferring Deductions into 2015

If you anticipate a substantial increase in taxable income, we may want to explore deferring deductions into 2015 by looking at the following:

(1) postponing year-end charitable contributions, property tax payments, and medical and dental expense payments, to the extent you might get a deduction for such payments, until next year; and

(2) postponing the sale of any loss-generating property.

Accelerating Deductions into 2014

If you expect your income to decrease next year, accelerating deductions into the current year can offset the higher income this year. Some options include:

(1) consider prepaying your property taxes in December;

(2) consider making your January mortgage payment in December;

(3) if you owe state income taxes, consider making up any shortfall in December rather than waiting until your return is due;

(4) since medical expenses are deductible only to the extent they exceed 10 percent (7.5 percent if you or your spouse are 65 before the end of the year) of your adjusted gross income (AGI), if you have large medical bills not covered by insurance, bunching them into one year may help overcome this threshold;

(5) making any large charitable contributions in 2014, rather than 2015;

(6) selling some or all of your loss stocks; and

(7) if you qualify for a health savings account, consider setting one up and making the maximum contribution allowable.

Life Events

Certain life events can also affect your tax situation. If you've gotten married or divorced, had a birth or death in the family, lost or changed jobs, retired during the year, we need to discuss the tax implications of these events.

Miscellaneous Items

Finally, these are some additional miscellaneous items to consider:

(1) If you have a health flexible spending account with a balance, remember to spend it before year end (unless your employer allows you to go until March 15, 2015, in which case you'll have until then).

(2) If you own a vacation home that you rented out, we need to look at the number of days it was used for business versus pleasure to see if there is anything we can do to maximize tax savings with respect to that property. For example, if you spent less than 14 days at the home, it may make sense to spend a few more days and have the house qualify as a second residence, with the interest being deductible. For a rental home, rental expenses, including interest, are limited to rental income.

(3) We should also consider if there is any income that could be shifted to a child so that the income is paid at the child's rate.

(4) If you have any foreign assets, there are reporting and filing requirements with respect to those assets. Noncompliance carries stiff penalties.

Please call me at your convenience so we can set up an appointment and estimate your tax liability for the year and discuss any questions you may have.

Sincerely,

Heather Jenkins, CPA

Jenkins CPA, LLC

www.JenkinsCPA.com

417-725-3924