Individual Year End Letter

Dear Client,

Just as the daylight hours are getting shorter, so is the time for fine tuning any last-minute strategies to lower your 2015 tax bill. While year-end legislation extending certain expired tax benefits may still come to pass and be of benefit to you, there are other options we should explore for potentially lowering your taxes. Often, the correct steps to take will depend on whether you see your income going up or down next year.

For 2015, the top tax rate of 39.6% will apply to incomes over $413,201 (single), $464,851 (married filing jointly and surviving spouse), $232,426 (married filing separately), and $439,000 (heads of households). However, high-income taxpayers are also subject to the 3.8 percent net investment income tax and/or the .9 percent Medicare surtax. If you are subject to one or both of these additional taxes, there are certain actions we should discuss that can mitigate the damage of these additional taxes.

Finally, there is the alternative minimum tax which can creep up on taxpayers with a multitude of deductions; but there are also strategies available to deal with this if they make sense in the context of your situation.

Thus, it's important that we meet before the end of the year to nail down any actions that may be appropriate with respect to your 2015 tax return. The following are some ideas that you may want to consider before our meeting.

Retirement Plans Considerations

Fully funding your company 401(k) with pre-tax dollars will reduce current year taxes, as well as increase your retirement nest egg. For 2015, the maximum 401(k) contribution you can make with pre-tax earnings is $18,000. For taxpayers 50 or older, that amount increases to $24,000.

If you have a SIMPLE 401(k), the maximum pre-tax contribution for 2015 is $12,500. That amount increases to $15,500 for taxpayers age 50 or older.

If certain requirements are met, contributions to an individual retirement account (IRA) may be deductible. For taxpayers under 50, the maximum contribution amount for 2015 is $5,500. For taxpayers 50 or older but less than age 70 1/2, the maximum contribution amount is $6,500. Contributions exceeding the maximum amount are subject to a 6 percent excise tax. Even if you are not eligible to deduct contributions, contributing after-tax money to an IRA may be advantageous because it will allow you to later convert that traditional IRA to a Roth IRA. Qualified withdrawals from a Roth IRA, including earnings, are free of tax, while earnings on a traditional IRA are taxable when withdrawn.

If you already have a traditional IRA, we should evaluate whether it is appropriate to convert it to a Roth IRA this year. You'll have to pay tax on the amount converted as ordinary income, but subsequent earnings will be free of tax. And if you have a traditional 401(k), 403(b), or 457 plan that includes after-tax contributions, a new rule allows you to generally rollover these after-tax amounts to a Roth IRA with no tax consequences. A rollover of a SIMPLE 401(k) into a Roth IRA may also be available. As with all tax rules, there are qualifications that apply to these rollovers that we should discuss before you take any actions.

Additionally, the Treasury Department has introduced a starter retirement account known as "myRA," into which you may deposit tax refunds. The program allows you to establish a Roth IRA with a Treasury Department designated custodian. You can continue to participate in the program until your account balance reaches $15,000 or until you have participated in the program for 30 years, whichever occurs first. At any time, you can transfer your balance to a commercial financial services provider to take advantage of a broader array of retirement products available in the marketplace.

Finally, self-directed IRAs allow an IRA owner to have more control over the type of investments that will be held in the IRA. 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.

Net Investment Income Tax Considerations

A 3.8 percent tax applies to certain net investment income of individuals with income above a threshold amount. The threshold amounts are $250,000 (married filing jointly and qualifying widow(er) with dependent child), $200,000 (single and head of household), and $125,000 (married filing separately). In general, investment income includes, but is not limited to: interest, dividends, capital gains, rental and royalty income, non-qualified annuities, and income from businesses involved in trading of financial instruments or commodities. Thus, while the top tax rate for qualified dividend income is generally 20%, the top rate on such income increases to 23.8% for a taxpayer subject to the net investment income tax.

One way around the increased tax rate on dividend income is to invest instead in tax-exempt state and municipal bonds. The bonds generate tax-exempt income which isn't subject to the net investment income tax and is not included in determining if you meet the threshold amount for being subject to the net investment income tax. Note, however, that such income may be subject to state taxes and the alternative minimum tax. Additionally, if you are selling an appreciated asset and the gain on the sale will throw you over the threshold amount for being subject to the net investment income tax, you might consider selling the asset on an installment basis.

The net investment income tax also applies to income from trades or businesses that are passive activities. An activity is not generally considered passive if the taxpayer materially participates in the activity. 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 factors for determining material participation to see if they can help you escape this tax.

Finally, since net capital losses can be used against capital gains, you may want to consider getting rid of some of your losing stocks.

Additional Medicare Taxes

An additional Medicare tax of 0.9 percent is imposed on wages and self-employment income in excess of a threshold amount. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case. Employers are required to withhold the extra .9 percent once an individual's wages pass $200,000. No deduction is allowed for the additional tax. However, you may be due a credit if, for example, your status is married filing jointly, one of you had wages over $200,000, but joint wages are less than $250,000. On the flip side, you may owe the additional .9 percent if you and your spouse file jointly and each made under $200,000 of wages but together made over $250,000 in wages.

AMT Considerations

Because many deductions taken for regular tax purposes are not allowed for alternative minimum tax (AMT) purposes, you may be subject to the AMT if you have excessive deductions. Deductions which typically throw taxpayers into an AMT situation include high state and local taxes, interest on home equity loans, a high number of dependent deductions, and a large amount of miscellaneous itemized deductions. For 2015, the AMT rate is 26% on alternative minimum taxable income (AMTI) up to $185,400 ($92,700 for married filing separately) and 28% on AMTI over that amount. However, you are allowed an AMT exemption depending on your filing status; but the exemption is phased out for taxpayer's above a certain income level.

If it looks like you may be subject to the AMT this year, we should discuss what actions can be taken to reduce your exposure. Since the calculation of the AMT begins with adjusted gross income, lowering your adjusted gross income by maximizing contributions to a tax-deferred retirement plan (e.g., 401(k)) or tax-deferred health savings account may be appropriate. Additionally, if you use your home for business, related expenses (e.g., a portion of your property taxes, mortgage interest, etc.) allocable to Schedule C will also reduce your adjusted gross income.

American Opportunity Credit

If you, your spouse, or a dependent incurred qualified education expenses to attend an accredited postsecondary institution (e.g., a college or university), you may be eligible for the American Opportunity Credit. The maximum annual credit is $2,500 per eligible student. Expenses which qualify for the credit include tuition and fees required for the enrollment or attendance at an eligible educational institution. For taxpayers with modified adjusted gross income in excess of

$80,000 ($160,000 for joint filers), the amount of the credit is phased out. The credit is not available for married taxpayers filing separately.

Obamacare Considerations

Under Obamacare, there is a penalty, known as the "shared responsibility payment," for not having health insurance coverage. You may be liable for this penalty if you didn't have health insurance for two or more months in 2015. However, depending on your income, you may be eligible for an exemption from the penalty. The penalty is 2 percent of your 2015 income or $325 per adult, whichever is higher, and $162.50 per uninsured dependent under 18, up to $975 total per family.

Extension of the Health Coverage Tax Credit

Taxpayers who receive benefits under certain trade adjustment assistance (TAA) programs or benefits from the Pension Benefit Guaranty Corporation (PBGC) generally are allowed a credit for a percent of amounts paid for qualified health insurance coverage. This Health Coverage Tax Credit (HCTC) was set to expire at the end of 2013 but was extended and modified by the Trade Preferences Extension Act of 2015. The HCTC can now be claimed for coverage through 2019.

If you received the type of benefits mentioned in either 2014 or 2015 (or both), we should determine if you were eligible for the credit and make sure that you receive the tax benefit.

Child Tax Credit

The Trade Preferences Extension Act also added a provision which limits the refundable portion of the child tax credit if you elect to exclude foreign earned income from tax. If you have foreign earned income you wish to exclude, we should discuss the impact it may have on any child tax credits you planned to claim.

Tax Extenders Legislation

Additional tax benefits may be available if Congress passes Tax Extender legislation introduced in the Senate in August. That legislation would retroactively extend many tax breaks that expired in 2014. If it passes, the bill will extend the following tax breaks through 2016:

(1) the deduction by elementary and secondary school teachers of up to $250 of qualified expenses they paid during the year ($500 on a joint return if both spouses were eligible educators) and expand the deduction to include expenses in connection with the professional development activities of an educator;

(2) the exclusion from income of imputed income from the discharge of acquisition indebtedness for a principal residence;

(3) the equalization of the tax exclusion for employer-paid mass transit and parking benefits and expands such exclusion to include bike sharing programs;

(4) the tax deduction for mortgage insurance premiums;

(5) the tax deduction for state and local general sales taxes in lieu of state and local income taxes;

(6) the tax deduction for contributions of property made for conservation purposes;

(7) the deduction from gross income for qualified tuition and related expenses; and the tax-free distributions from IRAs for charitable purposes.

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 2015

Depending on your projected income for 2016, it may make sense to accelerate income into 2015 if you expect 2016 income to be significantly higher. Options for accelerating income include:

(1) harvesting gains from your investment portfolio, but keeping in mind the 3.8 investment income tax;

(2) as previously mentioned, converting a retirement account into a Roth IRA and recognizing the conversion income this year;

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

(4) 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 2016

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 2016 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 2016;

(2) if you are considering selling assets that will generate a gain, postponing the sale until 2016;

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

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

(5) parking investments in deferred annuities.

Deferring Deductions into 2016

If you anticipate a substantial increase in taxable income, we may want to explore pushing deductions into 2016 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 2015

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) prepaying your property taxes in December;

(2) making your January mortgage payment in December;

(3) if you owe state income taxes, 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), bunching large medical bills not covered by insurance into one year to help overcome this threshold;

(5) making any large charitable contributions in 2015, rather than 2016;

(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, 2016, in which case you'll have until then). You may want to check with your employer to see if they give the optional grace period to March 15.

(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 can 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 determine whether any estimated tax payments may be due before year end.

Sincerely,

Heather Jenkins, CPA

Jenkins CPA, LLC