HERITAGE RETIREMENT ADVISORS

Retirement Transition Specialists

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2014 Year-end Tax Report

Year-End Tax Moves for 2014

One of our major goals is to help our clients identify opportunities that coordinate tax reduction with their investment portfolios. In order to achieve this goal, we stay current on ever-changing tax reduction strategies. This special report covers the details of many year-end tax strategies for 2014.

Remember—every situation is different and not all strategies will be appropriate for you. Please discuss all tax strategies with your tax preparer prior to making any final decisions.

Income Tax Rates for 2014

Tax brackets have changed slightly for 2014. For example, for the 2013 tax year, the top of the 15% federal income tax bracket for married couples filing jointly was $72,500. In 2014, that figure has been increased to $73,800. Below is a table of federal income tax rates for 2014.

Federal Tax Rates		Single		Head of Household		Married Filing Separately		Married Filing Jointly / Qualifying Widow or Widower	
Ordinary Income	*Long Term Capital Gains and Qualified Dividends*	*Taxable Income over*	*to*	*Taxable Income over*	*to*	*Taxable Income over*	*to*	*Taxable Income over*	*to*
10%	**0%**	$0	$9,075	$0	$12,950	$0	$9,075	$0	$18,150
15%	**0%**	9,075	36,900	12,950	49,400	9,075	36,900	18,150	73,800
25%	**15%**	36,900	89,350	49,400	127,550	36,900	74,425	73,800	148,850
28%	**15%**	89,350	186,350	127,550	206,600	74,425	113,425	148,850	226,850
33%	**15%**	186,350	405,100	206,600	405,100	113,425	202,550	226,850	405,100
35%	**15%**	405,100	406,750	405,100	432,200	202,550	228,800	405,100	457,600
39.6%	**20%**	406,750	--	432,200	--	228,800	--	457,600	--

Year End Tax Planning For 2014

As you read through this report you will find some key aspects of the current 2014 Tax laws and how they may apply to your situation. Late-breaking decisions in Washington, D.C., can make it difficult to plan ahead. This year is no different, with dozens of provisions waiting to be renewed.

One of the tax breaks that remains an open-ended question is a tax deduction for contributions to charitable organizations directly from an individual retirement account (IRA). Some retirees are holding off on taking their required minimum distributions until they know what happens with this law. Right now, some lawmakers say this, and other tax breaks, like the deductibility of sales tax in some states that do not have income taxes, might be renewed. However, nothing is a sure thing until a final bill is passed.

Despite this uncertainty, there are many year-end tax moves around income and expenses you can make to lessen your tax liability based on what you do know. To the extent that income or expenses can be moved between 2014 and 2015, for many investors, year-end tax planning often is about determining the best decision in which year to earn additional income or to incur more tax deductions. Now is the time to focus on how to optimize your situation between these two years.

The goal of this report is to share strategies that could be effective if discussed and implemented before year-end. Choosing the appropriate strategies will depend on your income, as well as a number of other personal circumstances. As with all tax strategies it is always in your best interest to discuss your personal situation with your tax preparer before making any moves or final decisions. **While everyone's situation is unique, we urge you to begin your final year end planning now!**

Nine Things To Review Before Year-end

9. **Review tax strategies with your tax preparer.**

Consider All of Your Retirement Savings Options for 2014

If you have earned income or are working, retirement savers should consider contributing to retirement plans. This is an ideal time to make sure you maximize your intended use of retirement plans for 2014 and start thinking about your strategy for 2015. In October, the Internal Revenue Service announced cost-of-living adjustments affecting dollar limitations for pension plans and other retirement-related items for tax year 2015. Many of the pension plan limitations will change for 2015 because the increase in the cost-of-living index met the statutory thresholds that trigger their adjustment. However, other limitations will remain unchanged because the increase in the index did not meet the statutory thresholds that trigger their adjustment. Highlights include the following:

- **Higher 401(k) contribution limits.** The elective deferral (contribution) limit for employees who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan is increased from $17,500 to $18,000. The catch-up contribution limit for employees aged 50 and over who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan is increased from $5,500 to $6,000.

- **IRA contribution limits unchanged.** The limit on annual contributions to an Individual Retirement Arrangement (IRA) remains unchanged at $5,500. The additional catch-up contribution limit for individuals aged 50 and over is not subject to an annual cost-of-living adjustment and remains $1,000.

- **Higher IRA income limits.** The deduction for taxpayers making contributions to a traditional IRA is phased out for singles and heads of household who are covered by a workplace retirement plan and have modified adjusted gross incomes (AGI) is $60,000 and $70,000 for 2014, and will increase to between $61,000 and $71,000, for 2015. For married couples filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phase-out range moves from $96,000 to $116,000 in 2014 to $98,000 to $118,000 for 2015. For an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered, the deduction is phased out in 2014 as the couple's income reaches $181,000 and completely at $191,000 for 2015 that range moves to $183,000 and $193,000. For a married individual filing a separate return who is covered by a workplace retirement plan, the phase-out range is not subject to an annual cost-of-living adjustment and will be $0 to $10,000 for 2014 and 2015.

- **Increased Roth IRA income cutoffs.** The AGI phase-out range for taxpayers making contributions to a Roth IRA is $181,000 to $191,000 for married couples filing jointly in 2014, and rises to $183,000 to $193,000 in 2015. For singles and heads of household, the income phase-out range is $114,000 to $129,000 for 2014, and rises to $116,000 to $131,000 in 2015. For a married individual filing a separate return, the phase-out range is not subject to an annual cost-of-living adjustment remains at $0 to $10,000 for 2014 and 2015.

- **Larger saver's credit threshold**. The AGI limit for the saver's credit (also known as the retirement savings contribution credit) for low- and moderate-income workers is $60,000 for married couples filing jointly in 2014, increasing to $61,000 in 2015; $45,000 for heads of household, increasing to $45,750; and $30,000 for married individuals filing separately and for singles, increasing to $30,500.

- **NEW IRA one rollover rule**. IRA investors were always limited to one rollover per year, per IRA. Now beginning on January 1, 2015, investors can make only one rollover from <u>all</u> of their IRAs to another in any 12-month period. A second IRA-to-IRA rollover in a single year could result in income tax becoming due on the rollover, a 10 percent early withdrawal penalty and a 6 percent per year excess contributions tax as long as that rollover remains in the IRA. Individuals can only make one IRA rollover during any one-year period, but there is no limit on trustee-to-trustee transfers. Multiple trustee-to-trustee transfers between IRAs and conversions from traditional IRAs to Roth IRAs will continue to be allowed in the same year. **If you have any questions on this, please call us.**

Roth IRA Conversions

Some IRA owners are considering converting part or all of their traditional IRAs to a Roth IRA. This is never a simple and easy decision. Roth IRA conversions can be helpful, but they can also create immediate tax consequences and can bring additional rules and potential penalties. It is best to run the numbers and calculate the most appropriate strategy for your situation. **Call us if you would like to review your options.**

Capital Gains and Losses

Looking at your investment portfolio can reveal a number of different tax saving opportunities. Start by reviewing the various sales you have realized so far this year on stocks, bonds, and other investments. Then review what's left and determine whether these investments have an unrealized gain or loss. (Unrealized means you still own the investment and haven't yet sold it, versus realized, which means you've actually sold the investment.)

Know your basis. In order to determine if you have unrealized gains or losses, you must know the tax basis of your investments, which is usually the cost of the investment when you bought it. However, it gets trickier with investments that allow you to reinvest your dividends and/or capital gain distributions. We will be glad to help you calculate your cost basis.

Consider loss harvesting. If your capital gains are larger than your losses, you might want to do some "loss harvesting." This means selling certain investments that will generate a loss. You can use an unlimited amount of capital losses to offset capital gains. However, you are limited to only $3,000 of net capital losses that can offset other income, such as wages, interest and dividends. Any remaining unused capital losses can be carried forward into future years indefinitely.

Be aware of the "wash sale" rule. If you sell an investment at a loss and then buy it right back, the IRS disallows the deduction. The "wash sale" rule says you have to wait at least 30 days before buying back the same security in order to be able to claim the original loss as a deduction. However, while you cannot immediately buy a substantially identical security to replace the one you sold, you can buy a similar security—perhaps a different stock in the same sector. This strategy allows you to maintain your general market position while utilizing a tax break.

Sell worthless investments. If you own an investment that you believe is worthless, ask your tax preparer if you can sell it to someone other than a related party for a minimal amount, say $1, to show that it is, in fact, worthless. The IRS often disallows a loss of 100% because they will usually argue that the investment has to have at least some value.

Always double check brokerage firm reports. If you sold a stock in 2014, the brokerage firm reports the basis on an IRS Form 1099-B in January 2015. Unfortunately, there have been a number of problems implementing the new reporting rules, so we suggest you double-check these numbers to make sure that the basis is calculated correctly and does not result in a higher amount of tax than you need to pay.

Zero Percent Tax on Long-term Capital Gains

You may qualify for a 0% capital gains tax rate for some or all of your long-term capital gains realized in 2014. The strategy is to figure out how much long-term capital gain you might be able to recognize to take advantage of this tax break.

The 0% long-term capital gains tax rate has been permanently extended for taxpayers who end up in the 10% or 15% ordinary income tax brackets, which is up to $36,900 for single filers and $73,800 for joint filers (See chart on page 1). If your taxable income goes above this threshold, then any excess long-term capital gains will be taxed at a 15% capital gains tax rate and/or 20% capital gains tax rate, depending on how high your taxable income is for the year. (**NOTE**: The 0%, 15% and 20% long-term capital gains tax rates only apply to "capital assets" (such as marketable securities) held longer than one year. Anything held one year or less is considered "short-term capital gains" and is taxed at ordinary income tax rates.)

If you are eligible for the 0% capital gains tax rate, it might be a good time to consider selling some appreciated investments to take advantage of it. Sell just enough so your gain pushes your income to the top of the 15% tax bracket, then buy new shares in the same company. You do not have to comply with the "wash sale" and wait 30 days. With "gains harvesting," you can actually sell the stock and buy it back in the same day. Of course, there will be transaction costs such as commissions and other brokerage fees. At the end of the day you will have the same number of shares, but with a higher cost basis. Please remember, you must also review your state income tax rules to determine whether or not these gains will be tax-free at the state level.

If you're ineligible for the 0% capital gains tax rate, but you have adult children in the 0% bracket, consider gifting appreciated stock to them. Your adult children will pay a lot less in capital gains tax than if you sold the stock yourself and gifted the cash to them.

Medicare Tax

In 2014, a 3.8% Medicare surtax on "net investment income" remains in place for wealthy taxpayers. The 3.8% Medicare surtax is on top of ordinary income and capital gains taxes, meaning long-term capital gains and qualified dividends may be subject to taxes as high as 23.8%, while short-term capital gains and other investment income (such as interest income) could be taxed as high as 43.4%!

The Medicare surtax is imposed only on "net investment income" and only to the extent that total "Modified Adjusted Gross Income" ("MAGI") exceeds $200,000 for single individuals and $250,000 for taxpayers filing joint returns. The chart attached shows which types of income are subject to this new Medicare tax.

For those of you who are subject to this new Medicare surtax, some of the strategies that we can consider will take time to implement. Now is a good time to review your situation. For example, you might:

- Consider investing in tax-advantaged vehicles such as: tax-exempt bonds, qualified retirement accounts, qualified annuities, or cash value life insurance policies (assuming that the cost of acquisition and maintenance does not exceed the tax savings).
- Convert passive real estate activities to active interests.
- Marry someone who has large capital loss carry-forwards, or currently has large net operating losses (just joking!).

For specific ideas, please call our office or bring this up at your next review.

Type of Income	Subject to 3.8% Medicare Contribution Tax?	
	YES	NO
Interest and Dividends	X	
Capital Gains	X	
Royalties and net rental income	X	
Installment sales proceeds	X	
Gain from the sale of personal residence in excess of the IRC 121 exclusion	X	
Passive income from S corporations	X	
Passive activity income	X	
Income from a trade or business that trades in financial instruments or commodities	X	
Non-passive income from S corporations		X
Wages		X
Income from qualified pension, profit-sharing plan and stock bonus plans		X
Social security income		X
Tax-exempt interest		X
Source: The Essential Planning Guide To The Income & Estate Tax Increases, pg. 61		

Taxation of Social Security Income

Social Security income may be taxable, depending on the amount and type of other income a taxpayer receives. If a taxpayer only receives Social Security income, this income is generally not taxable (and it is possible that the taxpayer might not even need to file a federal income tax return).

If a taxpayer receives other income in addition to Social Security income, then up to 85% of the Social Security income could be taxable. There is a "floor" ($32,000 married filing jointly; $0 married filing separately; $25,000 all other taxpayers) whereby a portion of Social Security benefits become taxable and that the 85% inclusion kicks in once provisional income goes above a "ceiling" ($44,000 married filing jointly; $0 married filing separately; $34,000 all other taxpayers). For married taxpayers filing a joint return and for married persons filing separately who do not live apart from their spouses for the whole year, the "provisional income" threshold is $0. A complicated formula is necessary to determine the amount of Social Security income that is subject to income tax. (We suggest using the worksheet in IRS Publication 915 to make this determination.)

Finally, it is important to note that Social Security income is included in the calculation of "Modified Adjusted Gross Income" ("MAGI") for purposes of calculating the 3.8% Medicare surtax on "net investment income" (as discussed earlier). Therefore, taxpayers having significant net investment income will have more reason to defer Social Security benefits.

Itemized Deductions & Exemptions

Taxpayers are entitled to take either a standard deduction or itemize their deductions on IRS Form 1040, Schedule A. Itemized deductions include, but are not limited to, mortgage interest, certain types of taxes, charitable contributions and medical expenses. Unfortunately, itemized deductions are subject to several limitations. For example, in 2014 medical expenses are now deductible only to the extent that they exceed 10% of AGI in any given year. However, if you or your spouse are over 65, the deduction limit will stay at 7.5% until December 31, 2016.

Consider "bunching" your deductions. Many taxpayers don't have enough itemized deductions to reduce their taxes more than if they take the standard deduction. If you find you often miss the threshold by only a small amount per year, it may be best to "bunch" your deductions every other year, taking a standard deduction in the alternate years. The standard deduction for 2014 is $6,200 for singles, $6,200 for married persons filing separate returns, and $12,400 for married couples filing jointly.

Charitable Giving

This is a great time of the year to clean out your garage and give your items to charity. Please remember that you can only write off these donations to a charitable organization if you itemize your deductions. Sometimes your donations can be difficult to value. You can find estimated values for your donated clothing at http://turbotax.intuit.com/personal-taxes/itsdeductible/.

Send cash donations to your favorite charity by December 31, 2014, and be sure to hold on to your cancelled check or credit card receipt as proof of your donation. If you contribute $250 or more, you also need a written acknowledgement from the charity.

If you plan to make a significant gift to charity this year, consider gifting appreciated stocks or other investments that you have owned for more than one year. Doing so boosts the savings on your tax returns. Your charitable contribution deduction is the fair market value of the securities on the date of the gift, not the amount you paid for the asset, and therefore you avoid having to pay taxes on the profit!

Do not donate investments that have lost value. It is best to sell the asset with the loss first and then donate the proceeds, allowing you to take both the charitable contribution deduction and the capital loss. Also remember, if you give appreciated property to charity, the unrealized gain must be long-term capital gain in order for the entire fair market value (FMV) to be deductible. (The amount of the charitable deduction must be reduced by any unrealized ordinary income, depreciation recapture and/or short-term gain.)

The laws allowing taxpayers age 70½ and older to transfer up to $100,000 directly from their IRA over to a charity, satisfying all or part of the required minimum distribution (RMD) have not been renewed for 2014, however there is legislation pending to do so. We will keep you informed if this IRA-to-charity strategy is passed.

Other Year-End Tax Strategies and Ideas

Make use of the annual gift tax exclusion. You may gift up to $14,000 tax-free to each person in 2014. These "annual exclusion gifts" do not reduce your lifetime gift tax exemption. ***(NOTE**: The annual exclusion gift is doubled to $28,000 per recipient for joint gifts made by married couples or when one spouse consents to a gift made by the other spouse.)*

Help someone with medical or education expenses. There are opportunities to give unlimited tax-free gifts when you pay the provider of the services directly. The medical expenses must meet the definition of deductible medical expenses. Qualified education expenses are tuition, books, fees, and related expenses but not room and board. You can find the detail qualifications in IRS Publications 950 and the instructions for IRS Form 709, which are available for free at www.irs.gov.

Review state gift tax rules. Make sure that any strategies you use also apply to your state. In fact, some taxpayers actually move to another state and establish residency in that state before selling or gifting any property.

Contribute to a 529 plan on behalf of a beneficiary. This qualifies for the annual gift-tax exclusion. Withdrawals (including earnings) used for qualified education expenses (tuition, books and computers) are income tax free. The tax law even allows you to give the equivalent of five years' worth of contributions up front with no gift-tax consequences. Non-qualifying distribution earnings are taxable and subject to a 10% tax penalty.

Make gifts to trusts. These gifts often qualify for the annual exclusion ($14,000 in 2014) if the gift is direct and immediate. A gift that meets all the requirements removes the property from your estate. The annual exclusion gift can be contributed for each beneficiary of a trust. We are happy to review the details with your estate planning attorney.

If possible, prepare a tax projection for 2014 and 2015 to determine if you will have a change in your tax situation. Then consider the following strategies if they apply to your situation.

If your income is higher this year than you expect for next year, consider... **Deferring Income and Accelerating Deductions**	**If your income is lower this year than you expect for next year, consider…** **Accelerating Income and Deferring Deductions**
Asking to receive bonuses next year instead of this year.	Asking to receive bonuses this year instead of next year
Holding off on selling any investments with capital gains (especially those that are short term) that you cannot offset till next year.	Selling any investments with capital gains if you are in the 0% (or maybe even 15%) capital gains rates.
Hold off till January any IRA distributions you can if your tax rate will be lower next year.	Accelerating, if possible, any necessary IRA distributions this year if your tax rate will be higher next year.
Prepaying any deductible bills like property tax (if possible) this year.	Deferring paying any deductible bills like property tax (if possible) to next year.
If applicable, paying your fourth state estimated tax payment in December, rather than in January. This works well for taxpayers who will itemize their deductions and who aren't subject to the alternative minimum tax.	***As always, we suggest that you to talk with your tax preparer prior to using any of the deduction and exemption strategies we have mentioned.***

It is important to note that some itemized deductions (such as state income taxes, real estate taxes and miscellaneous itemized deductions) are not allowed when computing the "Alternative Minimum Tax" ("AMT"). If you are subject to the AMT, it is often best to delay payment on the disallowed deductions and push them off until 2015 or later tax years (when AMT is no longer an issue). It is always possible you might be able to use the deductions next year. Therefore, we suggest that you talk with your tax preparer about AMT prior to using any of the deduction and exemption strategies we have mentioned.

One of our primary goals is to keep clients aware of tax law changes and updates. This report is not a substitute for using a tax professional. A famous comedian once joked that it would be easy to test to see who could grow up to write tax laws at an early age. He suggested that you provide all kindergarten children with lemons and the ones that squeeze out the most juice be considered in the future for writing tax laws.

Please note that many states do not follow the same rules and computations as the federal income tax rules. Make sure you check with your tax preparer to see what tax rates and rules apply for your particular state.

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Tax Facts

✓ **The average taxpayer filing an IRS Form 1040 needs about 23 hours to prepare the return.**

✓ **America spends more than 7.6 billion hours and over $193 billion each year to figure out what taxes we**
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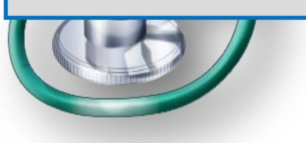
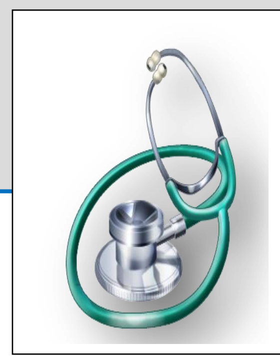
Complimentary Financial Check Up

If you are currently not a client of **Heritage Retirement Advisors**, we would like to offer you a **complimentary, one-hour, private** consultation with one of our professionals at absolutely no cost or obligation to you.

To schedule your financial check-up, please call **Sue Piper at Heritage Retirement Advisor's at (858) 487-1111.**





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