Wealth Advisor

8 To-Do Items for Year-End Income and Estate Tax Planning

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This is the time to reflect on the past year and make plans for the year to come. Here are some income and estate tax planning items to consider before the year-end:

1. Increasing your charitable gifts can lower your tax bill.

Taxpayers of a charitable mind can reduce their tax bills by making donations to public charities before year end. Checks to charities must be in the mail on or before 12/31/2014 in order to be deductible in 2014. Alternatively, donations may be charged to a credit card by 12/31/2014 even if the credit card bill is not paid until 2015. Cash donations to public charities are limited to 50% of a taxpayer's AGI (Adjusted Gross Income), but the excess can be carried forward to future tax years.

2. Pre-paying expenses can lower your tax bill.

If you are required to make any state estimated income tax payments, consider making payments due 1/15/2015 on or before 12/31/2014. State tax payments are deductible when paid, not when due. The same applies to any property taxes due in early 2015, if they can be paid early. However, taxpayers subject to the AMT (Alternative Minimum Tax) in 2014 may not get a benefit from the early payment.

Mortgage interest can be deducted if the January 2015 payment is made on or before 12/31/2014. Taxpayers subject to the AMT in 2014 would lose the benefit on interest paid for a home equity line if the proceeds were not used to improve the home.

3. Contributions to a qualified retirement plan reduce your taxable income.

Self-employed individuals can open and fund a retirement plan and deduct the amount contributed to the plan. Some of the less complicated plans include a SEP (Simplified Employee Pension), a "Solo-401(k)" Plan, or a SIMPLE (Savings Incentive Match Plan for Employees) IRA Plan. The maximum contribution varies depending on the plan and your age (some plans allow bonus contributions if you are over 50). Some of these plans need to be established before 12/31/14, although they could be funded in 2015 with the amount contributed treated as a deduction in 2014.

Employees, whether or not covered by a retirement plan at work, can generally open and fund an IRA (Individual Retirement Account) for 2014, prior to April 15, 2015. Deductibility of the IRA Contribution may be limited.

4. Year-to-date losses can offset year-end gains and year-to-date gains can be offset by year-end losses.
Capital losses can offset capital gains plus an additional $3,000 of ordinary income. Before the year-end, review the performance of your investment portfolio. If you have sold securities and have a net loss to-date, consider locking-in gains in other securities by selling them. You can even buy back the same positions if you think that the securities will continue to grow. If you have net gains to-date, consider selling some of the losing positions in the portfolio. But don't be too quick to buy back stock after recognizing a loss – wait at least 30 days, or invest the proceeds in different securities.

5. Consider giving annual exclusion gifts every year to reduce your taxable estate
Everyone is allowed to give $14,000 per year per recipient, to anyone (family or friend); married taxpayers can double-up and give $28,000 to each recipient. This amount is free of any gift tax and is annually indexed for inflation. Gifts can be cash or check payments, as well as direct transfers of stock or other property. Transfers to a trust must qualify as a "present interest" – the gift must be accessible now, not just a future benefit.

A married couple with two children and four grandchildren can annually give away (free of gift taxes) $168,000 — $28,000 each to those six descendants. Six years of such gifting would eliminate more than $1,000,000 from the couple's taxable estate.

6. Fund Section 529 plans for your child or grandchild's education and reduce your taxable estate.
Parents or grandparents can help children or grandchildren prepare for the ever-rising costs of higher education. Section 529 plans (named after a part of the Internal Revenue Code) are popular accounts for income tax-free savings for future education. Gifts can be made to Section 529 accounts, and will qualify as present interests.

Section 529 plans have one additional benefit: donors can give five years' worth of gifts in one year, and treat the gift as if made equally over five years. That means one can give $70,000 to a Section 529 plan without gift tax consequences, and married taxpayers can give $140,000.

7. Give from your excess wealth now to reduce your taxable estate and transfer future appreciation to your descendants.
Gifts up to $14,000 are gift tax free, but larger gifts may still not cause an immediate gift tax payment. Taxpayers are allowed to gift up to $5,340,000 during their lifetimes (a total of $10,680,000 for married taxpayers). This is an increase from the $5,250,000 that applied to the 2013 tax year. This amount is known as the lifetime exemption and is annually indexed for inflation. Gift tax isn't paid to the IRS until all gifts made during one's lifetime exceed the lifetime exemption.

Taxpayers who fully utilized their lifetime exemption in 2013 and prior years have an additional $90,000 to gift in 2014. Other taxpayers with a large portion of the lifetime exemption remaining should consider making sizable gifts.

Gifts can be made to descendants and heirs in the form of cash, real estate, business interests or any other asset. Gifts can be made outright, in trust and through one of many sophisticated methods.

8. Review your important documents.
Any time of the year is a good time to review important tax and estate planning documents: your will, any living trusts, health care proxies, powers of attorney, retirement plan beneficiary designations, or life insurance documents. Has there been a birth or death in the family? A wedding or divorce? Take the time now to review plans before it's too late to make changes! Consider working with a tax and accounting expert if you desire help in navigating these complicated waters.

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