CLIENT ALERT | 2014 Year-end planning

As 2014 draws to a close, there is time to consider and engage in estate, gift, and income tax planning. In addition, there is still time to save on real property taxes, and enroll in health insurance plans for 2015. This Client Alert outlines several planning options for your consideration.

Estate and Gift Tax Planning

Given the significant increase in the federal estate tax exemption to $5,000,000 per individual ($10,000,000 combined for married persons) beginning in 2011, and as adjusted for inflation for subsequent years, the focus for many has shifted to income tax planning. The federal estate tax exemption for 2015 will be $5,430,000 (or $10,860,000 combined for married persons). The lifetime gift tax exemption amount currently matches the federal estate tax exemption at $5,340,000 for 2014 and $5,430,000 for 2015.

Beginning or Continuing Annual Gifting Programs

The most commonly used method for tax-free giving is the annual gift tax exclusion. The annual gift tax exclusion allows a person to give up to $14,000 (for 2014 and remaining at this level for 2015) to each donee without reducing the donor's lifetime gift and estate tax exclusion amount. A donor may give to an unlimited number of donees. The annual gift tax exclusion is applied on a per-donee basis ($14,000 per individual donee, per calendar year). By so electing on a timely filed gift tax return, spouses may combine their exemptions in a single gift from either spouse, effectively doubling the amount of the exclusion to $28,000 (by sharing in the gift of one spouse). Annual exclusion gifts may also save overall family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the "kiddie tax." Qualifying tuition payments and medical payments may also be made or continued; these amounts are not restricted to the $14,000 annual exclusion limit. If a written valuation is required in connection with an annual gifting program, a single valuation for gifts made in each of December of 2014 and January of 2015 may often be utilized.

Low Interest Rates Signal Opportunities to Transfer Assets

Interest rates remain low, thus very favorable opportunities continue to exist to make transfers intended to shift appreciation out of one's estate for estate planning purposes. If potentially subject to estate tax, the current interest rate friendly environment makes it an opportune time to consider more sophisticated estate planning strategies such as grantor retained annuity trusts, sales to intentionally defective grantor trusts, charitable trust planning, loans to family members, and other planning techniques. These sophisticated planning techniques are only successful when the investment performance achieved exceeds certain interest rate assumptions embedded in the Internal Revenue Code.

Portability

For individuals dying between January 1, 2011 and December 31, 2013, the IRS has extended the deadline for filing an estate tax return making portable one spouse's federal estate tax exemption to the other (including same sex marriages, if valid in a state other than Michigan).

Income Tax Planning

Higher income earners have unique concerns when considering year-end plans. They must be wary of the 3.8% surtax on certain unearned income and the additional 0.9% Medicare tax that applies to individuals with wages in excess of $200,000 (or $250,000 - married couples filing jointly, and $125,000 - married couples filing separately). For income tax planning for all taxpayers, consider the following traditional income tax planning techniques:

- Postpone income until 2015 and accelerate deductions into 2014. To reduce your overall tax liability for 2014, review the overall impact of tax planning for the two year period of 2014 and 2015. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2014 that are phased out over varying levels of adjusted gross income (AGI). Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket in 2015 due to changed financial circumstances. For example, it may be advantageous to try to arrange with your employer to defer a bonus that you may be entitled to until 2015.
- To accelerate and increase your deductions, consider using a credit card to pay deductible expenses before the end of the year, including charitable contributions. This can increase your 2014 deductions even if you do not pay off your credit card until after the end of the year.
- If you anticipate owing state and local income taxes when filing next year, ask your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before the end of the year to permit the deduction of such taxes for 2014.
- Try a bunching strategy to increase "miscellaneous" itemized deductions to exceed the minimum threshold of those deductions that are allowed only if they exceed 2% of adjusted gross income, including medical expenses and other itemized deductions.
- Consider selling capital assets (such as stock investments) for the purpose of generating a capital loss to offset any capital gains that you have already realized for the year.
- When considering year-end tax planning moves it is also important to take into account the potential impact of such planning on the alternative minimum tax for 2014.

Of course, all of these techniques should be coordinated with your trusted professionals, including your CPA, estate planning attorney, and financial advisor.

Retirement Planning for 2014

Tax-saving opportunities continue for retirement planning. A taxpayer still has the ability to convert funds in a traditional IRA (including SEP's and SIMPLE IRAs), §401(a) qualified retirement plans, §403(b) tax-sheltered annuities or §457 government plans into a Roth IRA. You may wish to consider converting money which is currently invested in depressed stocks (or mutual funds) into a Roth IRA if you are eligible to do so.

Further, with respect to IRA conversions, if you converted assets in a traditional IRA to a Roth IRA earlier in the year, and the assets in the Roth IRA account have declined in value, you will pay a higher income tax than is necessary. Instead of keeping Roth IRA accounts that have declined in value, back out of the transaction by recharacterizing or undoing the conversion by transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA by way of a trustee-to-trustee transfer. You can later reconvert to a Roth IRA, if doing so proves advantageous.

Qualified IRA Transfers

Note that Congress has yet to act on a number of tax breaks that expired at the end of 2013, including the tax provision which permitted tax-free IRA distributions of up to $100,000 by individuals age 70 ½ of older to certain charitable organizations. Stay tuned for end of the year tax developments.

Property Tax Planning

Avoid Uncapping of Taxable Value of Residential Real Property

Beginning December 31, 2014, certain transfers of residential real property to one's mother, father, brother, sister, son (by blood or adoption), daughter (by blood or adoption), grandson, or granddaughter or to one's spouse's mother, father, brother, sister, son (by blood or adoption), daughter (by blood or adoption), grandson, or granddaughter, will not result in uncapping the taxable value of property so long as the conveyance of residential real property is not used for any commercial purpose following the conveyance. In addition to outright transfers, this list of new uncapping exemptions also includes certain conveyances involving trusts, estates, and intestate succession. After December 31, 2014, to prevent uncapping, residential real property may not be used for any commercial purpose after the conveyance. Therefore, transferees who receive residential real property such as apartments, rental properties, and vacation rental properties will not benefit from this new law, as the taxable values of these types of properties will still uncap upon transfer of ownership. Until December 30, 2014, however, there is a small window of time in which to transfer these types of properties without the taxable value of the property uncapping.

Health Insurance Planning

It is never too soon to begin planning to purchase health insurance for 2015 through the federally-facilitated Health Insurance Marketplace ("Marketplace"). The open enrollment period for individuals and small businesses to purchase health insurance through the Marketplace for 2015 lasts from November 15, 2014 until February 15, 2015. After February 15, 2015, individuals will only be permitted to purchase a Marketplace insurance plan during a Special Enrollment Period if they have a qualifying life event.

If you shop for health insurance on the Marketplace, consider these two key issues: First, to have health insurance coverage in place for January 1, 2015, you will need to enroll in a health plan by December 15, 2014. Second, you may be eligible for tax credits and subsidies when purchasing insurance through the Marketplace. Your eligibility for tax credits and subsidies will depend on your household size and income. As such, you should have this information available when purchasing a plan through the Marketplace. Note you will incur a penalty if you elect not to purchase health insurance for 2015, whether through the Marketplace, from an independent insurance agent, or through an insurance carrier directly. Penalties in 2015 for not having minimal essential coverage are: $325 per adult, $162.50 per child, and for a family, no more than the greater of $975 or 2% of the family's income.

If you currently have a Marketplace insurance plan, you should carefully review your coverage and evaluate options that may be better for you, your family or your small business. It is possible that new plans may be offered, or that existing plans may have been modified for 2015.

Snowbird Planning

As the holiday season approaches, many Michiganders are preparing for their annual winter relocation to Florida. As part of that preparation, now is the perfect time to evaluate your estate plan to make sure that it protects your interests in the Sunshine State. One important issue to consider is whether you have the appropriate durable power of attorney ("DPOA") documents in place. Most of our estate planning clients already have both a Michigan Durable Power of Attorney and a Michigan Patient Advocate Designation. However, do you also have the Florida equivalents of these important documents?

An agent often makes critical decisions affecting urgent medical treatment, assets, or an estate. These decisions are often incredibly time-sensitive. Although Florida law allows your agent to use your Michigan DPOAs, Florida law also permits someone presented with your Michigan DPOAs to evaluate their validity. Thus, the time it takes to verify the validity of your Michigan DPOAs could drastically alter the outcome of a situation. The good news is that you are permitted to have DPOA documents under both Michigan and Florida law. You can have Michigan DPOAs to address matters in Michigan and Florida DPOAs to protect your interests in Florida. Having both will likely allow your Agent to act quickly, without confusion and delay on the part of third parties, whether you are in Michigan or Florida. Therefore, you should consider adding Florida DPOA documents to your estate plan to provide you with an extra layer of protection while in Florida.

To develop a comprehensive estate plan that protects your multi-state interests, discuss your Florida activities with an attorney licensed in both jurisdictions. To obtain DPOAs for Florida, even if you have left Michigan for the winter, give us a call; we can draft the documents and send them to you for execution in Michigan or Florida.

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This Client Alert is only a general discussion of some potential planning techniques. All such planning needs to be tailored to your unique circumstances; the techniques discussed are not necessarily beneficial for everyone. To further explore potential planning techniques, consult with the Fraser Trebilcock Trusts & Estates Team: Marlaine C. Teahan, Chair, Mark E. Kellogg, Melisa M.W. Mysliwiec and Michael P. James (licensed in Michigan and Florida). We thank you for your business in 2014 and wish you all the best in the coming year.

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