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Tax Topics

11/24/14

2014-11

IRS releases 2015 inflation-adjusted numbers

Last month, the IRS released its 2015 inflation-adjusted numbers (see Revenue Procedure 2014-61 and IR-2014-99). Here is a selected run-down of these numbers, along with other points to keep in mind:

Income tax – top brackets. The top two rate brackets ***for individuals*** are 35% and 39.6%, which will apply to taxable income in excess of the following amounts:

	35%	39.6%
Married filing jointly, surviving spouses	$411,500	$464,850
Heads of households	$411,500	$439,000
Single taxpayers	$411,500	$413,200
Married filing separately	$205,750	$232,425

The income ranges for the 10%, 15%, 28% and 33% rate brackets all differ (and yes, there really is only a $1,700 difference between the 35% and 39.6% rate for single taxpayers).

Trusts and estates have extremely compressed rate brackets, and are not eligible for the 35% rate; they hit the 33% and 39.6% rates if their taxable income exceeds the following amounts:

33%:	$ 9,050
39.6%:	$12,300

"Kiddie tax." The "kiddie tax" applies to children under age 18 and, as of 2008, to children who don't earn more than half of their own support and are age 18 or full-time students, ages 19-23. This means that if these children have more than $2,100 of unearned income (up from $2000 in 2014), it will effectively be taxed at their parent's top rate. ("Unearned income" refers to items such as interest income, dividends and capital gains.) Note that if parents elect to report their child's unearned income on their own income tax return, that income will factor into the parents' calculation for the 3.8% tax on net investment income (see below).

AMT Exemption. The alternative minimum tax (AMT) is a parallel tax system that originally targeted a relative handful of wealthy taxpayers. It now reaches deep into the middle class, and affects over four million taxpayers. Thanks to legislation passed at the beginning of 2013, the AMT exemption is now permanently indexed for inflation (prior to that, Congress continually "patched" the exemption, usually annually, and typically at the 11th hour.)

The 2015 AMT exemption amounts are as follows:

Married filing jointly:	$83,400
Heads of households & single taxpayers:	$53,600
Married filing separately:	$41,700
Estates and trusts:	$23,800

AMT brackets. The 26% AMT rate applies to alternative minimum taxable income (AMTI) up to the threshold amounts below; the 28% rate applies to AMTI above these amounts:

Married filing jointly, single taxpayers, estates & trusts:	$185,400
Married filing separately:	$ 92,700

Standard deduction. The standard deduction reduces a taxpayer's taxable income, and is used when a taxpayer does not "itemize" deductions for things such as state and local income tax payments, charitable contributions and mortgage interest. As with many itemized deductions, the standard deduction does not count against the AMT. The 2015 standard deduction is as follows:

Married filing jointly & surviving spouses	$12,600
Heads of households	$ 9,250
Single taxpayers & married filing separately	$ 6,300

Personal exemption and phase-out. Taxpayers get a personal exemption for themselves and for each of their "dependents" (usually, their children). Regardless of filing status, the 2015 personal exemption is $4,000. Yet taxpayers whose adjusted gross income (AGI) exceeds a threshold amount will see those exemptions phased out – and disappear completely – if they have "too much" AGI (the phase-out is 2% for every $2500 of AGI over the threshold amount). **PEP** (the personal exemption phase-out) will apply as follows in 2015:

	AGI Threshold: Phase-out Begins	AGI: Exemptions Fully Eliminated
Married filing jointly, surviving spouses	$309,900	$432,400
Heads of households	$284,050	$406,550
Single taxpayers	$258,250	$380,750
Married filing separately	$154,950	$216,200

"Pease limitation." Taxpayers with "too much" AGI can see most of their itemized deductions reduced by the lesser of 3% of AGI over the PEP threshold amounts listed above or 80% of those itemized deductions. This limitation applies to all itemized deductions *except* those for medical expenses, investment interest, and casualty, theft and wagering losses; in other words, "Pease deductions," such as those for state and local taxes, mortgage interest and charitable contributions may get a "haircut." Note, however, that unless a taxpayer's AGI is exponentially higher than her Pease deductions, that haircut will likely be limited to 3%.

Contributions to retirement accounts in 2015:

- **IRAs.** The contribution limit for IRAs will still be $5,500. Taxpayers who are ***at least 50*** can make ***"catch-up" contributions*** of $1,000 (this number is frozen and is not indexed for inflation).

- **Roth IRAs.** Roth IRAs are funded with after-tax dollars, and have the same contribution limits as the IRAs mentioned above. Taxpayers can't contribute to a Roth, however, if they have "too much" MAGI (modified adjusted gross income, which is generally the same as "adjusted gross income" (AGI)). In 2015, contributions will be phased-out at the following income levels:

Married filing jointly:	$183,000 to $193,000
Heads of households & single taxpayers:	$116,000 to $131,000
Married filing separately (not indexed):	$ 0 to $ 10,000

  Note: as of 2010, any taxpayer – regardless of income level and filing status – can convert a "traditional" IRA into a Roth, a move that may trigger significant current income tax.

- **401(k) contributions and other elective deferrals.** The contribution limit for deferred plans such as 401(k)s increases to $18,000 (from $17,500), and ***catch-up contributions*** for taxpayers who are ***at least 50*** increase to $6,000 (from $5,500).

Estate and gift taxes in 2015:

- **Basic exclusion amount.** The basic exclusion amount protects transfers from gift and estate taxes, and will rise to $5.43 million from $5.34 million in 2014 (a $90,000 increase); this means that a married couple can protect a total of $10.86 million from gift and estate taxes.

- **Generation-skipping transfer tax (GST) exemption.** The GST exemption protects transfers to people such as grandchildren from GST, an additional transfer tax. Because the GST exemption equals the basic exclusion amount, it too will rise to $5.43 million in 2015. This means that with proper planning, a married couple will be able to protect $10.86 million from GST in 2015.

- **Annual exclusion gifts.** These gifts remain at ***$14,000 per donee***, or $28,000 if the taxpayer's spouse joins in the gift. (Such gifts do not erode the basic exclusion amount.)

- **Annual exclusion gifts to non-citizen spouses.** These gifts rise to $147,000 (up from $145,000).

Other things to remember for the waning days of 2014:

- **Charitable IRA rollovers.** Congress has not yet acted on an "extenders" bill to continue various temporary tax benefits that expired at the end of 2013, including charitable IRA rollovers. As discussed in the 10/23/14 edition of *Tax Topics*, this provision has allowed taxpayers who are at least 70½ to give up to $100,000 from their IRA directly to a public charity, provided that certain requirements are met. Eligible taxpayers who have not yet taken their "required minimum distribution" (RMD) for this year and wish to make a charitable gift in this amount could still consider giving their RMD to directly to charity: if Congress does not renew charitable IRA rollovers, this "direct" contribution nevertheless would be eligible for a charitable deduction, just like any other charitable contribution.

- **Being "current" with tax payments.** To avoid interest and penalties on underpayments of income tax, taxpayers must be current with their tax obligations. This means that taxpayers must either pay in 90% of their current year's liability (through a combination of withholding and quarterly estimated tax payments) OR avail themselves of the so-called "safe harbor": paying in 100% of their prior year's income tax liability (or 110% if their prior year adjusted gross income (AGI) exceeded $150,000 (or $75,000 if they are married and file their taxes separately)).

  High-income taxpayers have seen their taxes go up since 2013 because of the return of the top income tax rate of 39.6%, the 20% rate for most long-term capital gains and qualified dividends (this rate applies to taxpayers in the 39.6% bracket), and PEP and Pease (see above). As of 2013, there is also the ***3.8% tax on "net investment income"*** (such as interest income, dividends, capital gains and royalties), as well as the ***additional 0.90% (90 basis points) Medicare tax*** on wage income in excess of $250,000 (married couples filing jointly), $200,000 (single taxpayers) or $125,000 (married couples filing separately). Although employers must withhold the additional 0.90% Medicare tax once an employee's compensation exceeds $200,000, regardless of the employee's marital status, there is no automatic withholding for the 3.8% tax, which can take people by surprise: it can apply if the taxpayer's "modified adjusted gross income" (AGI plus otherwise excluded foreign income) exceeds the same $250,000/$200,000/$125,000 threshold amounts that apply to the 0.90% Medicare tax – thresholds that are *not* indexed for inflation. High-income taxpayers therefore may want to review where they currently stand with respect to their projected 2014 tax obligations.

  ***Same-sex married* couples** now have one tax filing season behind them. Recall that on June 26, 2013, the Supreme Court decided *Windsor,* and invalidated Section 3 of the Defense of Marriage Act, which defined marriage as only between a man and a woman (see the 08/30/13 *Tax Topics* for more on *Windsor*). As of September 16, 2013, same-sex married couples are treated as married for *all* federal tax purposes, regardless of where they live. In other words, if the couple lives in a state that doesn't recognize their marriage, they probably still file as unmarried individuals for state purposes, even though they file as married – either jointly or separately – for federal purposes. The "marriage bonus" may reduce the couple's federal taxes if the spouses have a significant income disparity, but the "marriage penalty" could significantly increase the couple's taxes if they have similar amounts of income; in addition, the couple is more likely to be caught by the 3.8% net investment tax. (If same-sex spouses were still treated as legal strangers, they could have household income of $400,000 ($200,000 each) and not be subject to the net investment income tax; as a federally recognized married couple, however, they could be subject to the 3.8% tax at $250,000 of household income – see above.)

- **Avoid the wash sale rule.** The end of the year is often when taxpayers look carefully at their investment portfolios and "harvest losses" to offset realized gains. So if Mom, for example, is selling stock or securities that are worth less than her "adjusted basis" (generally, what she paid for the asset), she'll be caught by the wash sale rule if she repurchases those same assets within 30 days before or after the sale (even if she repurchases them in her IRA). If the wash sale rule applies, Mom can't take the current loss – it's added to the cost basis of the repurchased stock or security and is thereby deferred (there's no problem if Mom is merely selling winners and "harvesting gains").

Things to remember for year-end gifts:

- **Gifts to individuals.** Time is running out for 2014 annual exclusion gifts of $14,000 to family and friends ($28,000 for a married donor whose spouse agrees to the gift). Cash gifts may be given up to 11:59 p.m. on December 31st and still count as a 2014 gift. Checks, however, must be cashed *before* January 1, 2015 to count as 2014 gifts (p.s.: the generous donor must also stay alive until the bank makes good on the check).

  In addition to annual exclusion gifts, generous donors can make direct payments for tuition, medical expenses and health insurance premiums – none of which count against the donor's $5.34 million basic exclusion amount.

- **Gifts to charities.** For last-minute gifts to charities to qualify as a 2014 deduction, the check must be sent *before* January 1, 2015 (it need not be cashed before then, however).

Last chance for late "portability" filing

"Portability" took effect in 2011. It refers to the ability of a surviving spouse to effectively "inherit" the predeceased spouse's unused exclusion amount, which protects transfers from gift and estate tax (see the "basic exclusion amount" above). To elect portability, a decedent's executor must timely file an estate tax return for the decedent's estate, even if the estate is under the filing threshold ($5.34 million in 2014). ("Timely" means that the return is filed within nine months of the decedent's death, unless the return is on a six-month extension.) Once the executor elects portability, any leftover exclusion from the predeceased spouse carries over to the surviving spouse, who then adds it to her own exclusion amount.

To illustrate, suppose that Dad dies in 2014. He leaves his entire $3,000,000 estate to Mom, who's a U.S. citizen. Thanks to the marital deduction, Dad's estate passes estate-tax free, yet his $5.34 million exclusion is unused. To salvage Dad's exclusion and claim portability, Mom (Dad's executor) files a timely estate tax return for his estate. Result: she adds Dad's $5.34 million exclusion to her own, and can now protect over $10 million from gift or estate tax.

This scenario is how portability is supposed to work, but married couples with smaller estates might not have heard of it. Similarly, same-sex married couples couldn't even claim portability until September 16, 2013, when they commenced being treated as married for *all* federal tax purposes.

To address these two situations, the IRS issued Rev. Proc. 2014-18 on January 27, 2014. In a nutshell, this revenue procedure gives the executor of the predeceased spouse an opportunity to elect portability by filing an estate tax return no later than December 31, 2014 (yes, this permits an "untimely" return). Certain requirements must be satisfied, including the following: 1) the predeceased spouse was a U.S. citizen or resident who died in 2011, 2012 or 2013, and had a surviving spouse; and 2) the predeceased spouse's estate was under the filing threshold for the year of death and NO prior estate return has been filed for the predeceased spouse's estate. For those wishing to take advantage of this provision, December 31st will be here soon.

December 7520 rate

The IRS has issued the December 2014 applicable federal rates: the December 7520 rate has dropped 0.20% (20 basis points) to 2.0%, from November's 2.2% 7520 rate. The December mid-term rates are: 1.72% (annual), 1.71% (semiannual and quarterly), and 1.70% (monthly). The November mid-term rates were: 1.90% (annual), 1.89% (semiannual and quarterly), and 1.88% (monthly).

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