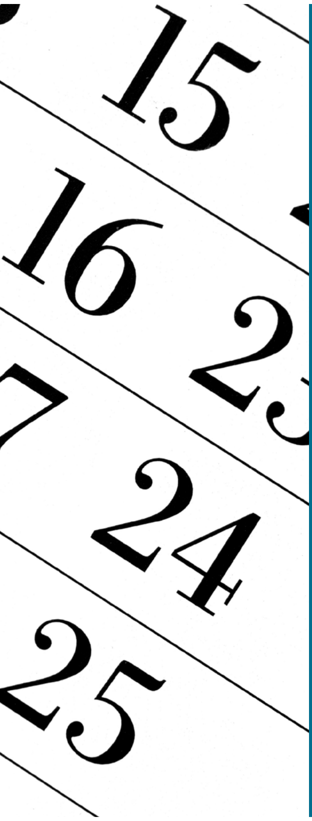
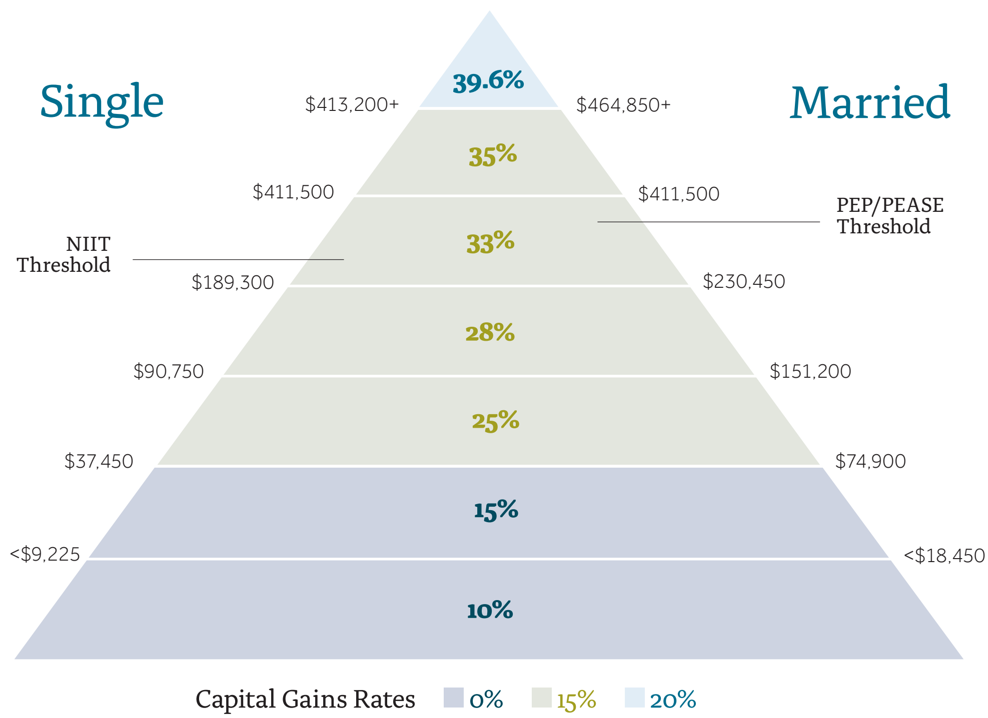


2015 Year End Planning.

Year-end tax planning often seems unnecessary or beyond reach. However, for nearly everyone it is extremely valuable and worthwhile. While some strategies may be complicated, the basic idea of most year-end planning is simple – use income smoothing to obtain the maximum tax rate benefits. Basically, income smoothing strategies involve: (1) reducing taxable income in high income years by maximizing deductions and shifting income to lower income years; and (2) increasing income in low income years by deferring deductions and increasing taxable income to fill up the lower tax brackets.

Bracket management.

In 2015 there are seven different ordinary income tax brackets and three different capital gains brackets. Understanding and managing which brackets apply to you now and in the future is extremely valuable because a prudent tax planner can time income and deductions to produce the best outcome.



Example: Tom and Betty are married taxpayers filing jointly. They expect to have $514,800 of ordinary income in 2015 and $414,800 of ordinary income in 2016. If we assume that tax rates and tax brackets will stay the same in 2015, Tom and Betty can save $2,300 of tax (0.046 x $50,000) if they can smooth out their income so they have $464,800 of income in both years and avoid the 39.6% marginal bracket.

Phase-out of exemptions and itemized deductions.

In smoothing income, the threshold income levels for the phase-out of personal exemptions (PEP) and the overall limitation on itemized deductions (PEASE limitation) should also be taken into account. For 2015, these levels are as follows:

	Single	Head of household	Married
Phase-outs thresholds	$ 258,250v	$ 284,050	$ 309,900

Taxpayers whose Adjusted Gross Income (AGI) remains under these amounts are completely unaffected. However, for those whose AGI is above the thresholds, a cursory understanding of their mechanics is valuable.

The phase-out of personal exemptions (PEP) affects large families most. Generally, each adult and child receives an exemption (essentially a deduction from income) of $4,000 in 2015. PEP reduces a taxpayer's total personal exemption amount by 2% for every $2,500 of income above the applicable threshold amount.

Example: Bill and Ann are married taxpayers filing jointly with three children and AGI of $409,900. Without considering PEP, their exemptions total $20,000 ($3,950 x 5). PEP eliminates 80% of their personal exemption amount [($100,000/$2,500) x .02] and increases their tax bill by $5,280 ($20,000 x 80% x 33%).

That may seem costly already, but the PEASE limitation must also be considered. Deductions subject to the limitation include the most popular: state and local taxes, mortgage interest, and charitable contributions. The amount of the limitation is the amount by which AGI exceeds the applicable threshold amount for the taxpayer's filing status multiplied by 3%, up to a maximum of 80% of the affected deductions.

Example: Consider the same couple who in 2015 paid $4,000 in property tax, $20,000 in state income tax, $5,000 in mortgage interest, and made a $10,000 charitable donation for a total of $39,000 of itemized deductions. These deductions are reduced by $3,000 [($409,900 – $309,900) x 3%] which increases their tax bill by $990 ($3,000 x 33%).

However, some taxpayers have the opportunity to alleviate the burden of this phase-out by bunching deductions in a single year. This is easily done by targeting charitable contributions to a tax year when the deductions will have the greatest effect. Taxpayers often assume that the best year to claim a deduction is the year with the highest income, but due to the phase-out this is not necessarily the case.

Example: Art and Alice are married taxpayers filing a joint return who want to make a $20,000 charitable contribution in either 2015 or 2016. They have no other itemized deductions. Their 2015 AGI is $800,000, but they expect it to decrease to $200,000 in 2016. At first blush, it seems donating in 2015 makes sense because a higher marginal tax bracket applies (39.6% > 28%). However, in 2015 the limitation on itemized deductions would reduce the charitable deduction to $5,297 [$20,000 - ($800,000 - $309,900) x 3%]. Because this is lower than the 2015 standard deduction ($12,600), the donation provides no tax benefit. On the other hand, if they make the contribution in 2015, the phase-out does not apply because their income is lower. The net tax benefit of waiting until 2016, assuming the standard deduction remains the same, is $2,072 [($20,000 - $12,600) x 28%].

Alternative minimum tax.

To complicate things further, the Alternative Minimum Tax (AMT) is calculated in parallel to the regular income tax. The AMT is meant to prevent taking advantage of too many tax benefits in a given year and therefore certain deductions are not allowed by the AMT. This includes very common deductions to income such as personal exemptions and state and local taxes. However, a taxpayer who is required to pay AMT is capturing many tax benefits and therefore has a relatively low rate of income taxation compared to others with similar income. For such people accelerating income might be prudent. In addition those exposed to the AMT might consider carefully timing deductions so a tax benefit is not lost.

Example: Consider a California taxpayer who is usually subject to the AMT because of large state and local tax deductions. However, in 2015 she expects the AMT not to apply because of substantially higher income than usual. This presents a tax planning opportunity because state and local taxes are deductible in the year paid rather than the year assessed. Therefore, the taxpayer could accelerate payment of any state and local taxes to 2015 in order to preserve the tax benefit which would be lost if the AMT applies in 2016.

Net investment income tax and additional Medicare tax.

In addition to the phase-outs and the AMT, taxpayers also have to contend with two surtaxes enacted to fund the Affordable Care Act. These are the 3.8% Net Investment Income Tax (NIIT) and the 0.9% additional Medicare tax. The NIIT is applied to the net investment income (NII) of a taxpayer whose modified adjusted gross income (MAGI) exceeds the applicable threshold level shown below and the 0.9% tax applies to wages and self-employment income of taxpayers that exceeds these levels.

	Single	Head of household	Married, filing jointly	Married, filing separately	Trusts and estates
Tax thresholds	$ 200,000	$ 200,000	$ 250,000	$ 125,000	$ 12,150

For individuals, the amount subject to the NIIT is the lesser of

1. net investment income (NII) or
2. the excess of a taxpayer's MAGI over an applicable threshold amount (ATA) based on the taxpayer's filing status.

Net investment income generally includes interest, dividends, annuities, royalties, rents, income from a business in which the taxpayer doesn't materially participate and gain on the sale of such a business. It doesn't include salary income or income from self-employment.

Investors can avoid the NIIT by reducing their MAGI below the threshold amount applicable to them. Those who need a single year fix can consider shifting income to a different tax year, changing their filing status or making certain oil and gas investments that receive a substantial tax benefit in the form of a large above-the-line reduction in income.

The simplest strategy for married couples is merely changing filing status. On the surface it might appear that it should not make any difference whether married taxpayers file jointly or separately because the threshold after which the NIIT applies is exactly double for joint filers. A closer analysis reveals, however, that the best filing status is fact dependent. If one spouse has most of the NII, filing separate returns may generate significant savings.

Example: Will and Marge are married taxpayers. Will has $200,000 of salary income and no NII. Marge has $125,000 of NII from interest and dividends and no other income. First assume that they file a joint return. The amount subject to the NIIT will be the lesser of NII ($125,000) or MAGI – ATA ($320,000 - $250,000 = $75,000). Thus, if they file jointly $100,000 will be subject to the NIIT and the tax payable will be $2,850 (.038 x $75,000).

Now assume the same facts, except that Will and Marge file separate returns. Although Will has MAGI well above the ATA of $125,000 for a married taxpayer filing separately, he has no income subject to the 3.8% NIIT because he has only salary income and no NII. Although Marge has substantial NII, she isn't subject to the NIIT either because her MAGI is below her ATA. Thus, the couple saves $2,850 of NIIT by filing separately. Note that the 0.9% additional Medicare tax should also be factored into the decision.

Under different facts, filing a joint return might be better from an NIIT perspective.

Example: Jim and Sally are married taxpayers. Jim has $60,000 of salary income and no NII. Sally has $110,000 of salary income and $90,000 of NII. If they file separate returns, Jim will not be subject to the 3.8% NIIT because his income is below the applicable threshold amount of $125,000 for a single filer. Sally, however, will be subject to the NIIT on the lesser of NII ($110,000) or MAGI – ATA ($200,000-$125,000). Thus, $75,000 of her income will be subject to the NIIT and she will pay $2,850. If Jim and Sally file a joint return, no NIIT will be payable. Their NII will be $110,000, but their MAGI will be only $250,000, below the ATA of $250,000 for married taxpayers filing jointly. This means that by filing jointly they can save $2,850 in NIIT.

Investors with perennial exposure to the NIIT who wish to reduce its impact can also consider Roth conversions to reduce future required minimum distributions, installment sales of capital assets to spread out income, life insurance strategies, and funding certain charitable trusts. Also, those with multiple businesses should ask their tax advisor about making a "grouping" election; however this election must be made in the first year the surtax applies to the taxpayer.

Employees and the self-employed hoping to avoid the 0.9% additional Medicare tax may have a difficult time doing so. Employees can work with their employer to spread out bonuses and otherwise shift income to reduce exposure to the tax. In addition to such shifting, the self-employed with income consistently exceeding the threshold amount should ask their tax advisor about the benefits of their business electing to be taxed as an S-corporation. While it may seem odd and somewhat complicated to elect to be taxed as a corporation, such an election can significantly reduce exposure to the additional Medicare and other payroll taxes.

Managing capital gains and losses.

Loss harvesting and gain harvesting are among the best strategies for smoothing out income and reducing taxes.

Loss harvesting.

Loss harvesting means selling assets at a loss and using those losses to offset capital gains realized on other assets. On the surface, it might appear that loss harvesting produces an economic benefit equal to the tax saved in the current year. It is important to recognize, however, that assuming tax rates stay the same, loss harvesting generally only provides a timing benefit.

Example: Carol owns X stock with a basis of $100 and an FMV of $60. In Year 1, she sells the stock, recognizing a $40 loss and repurchases the same stock 31 days later to avoid the wash sale rules. Carol has a basis of $60 in the new stock. By Year 5, the value of the stock has climbed back to $100 and Carol sells it, recognizing a gain of $40. The loss and the gain net out, but the loss has a higher value because it is recognized earlier. If Carol hadn't harvested the loss in Year 1, she would have had a gain of $0 in Year 5 ($100 sale proceeds - $100 basis) and there would have been no timing advantage.

Nevertheless, deferring taxes is valuable. It's therefore important to understand loss harvesting and the ordering rules of how losses offset other income. The steps to determine this are as follows: (1) short-term losses are subtracted from short term gains; (2) long term losses are subtracted from long term gains; (3) if one of the preceding steps is a net gain and the other is a net loss, steps one and two are netted; (4) if there is still a loss, up to $3,000 can be deducted from other income; and (5) any remaining loss can be carried forward 20 years.

The following chart should help determine how to effectively net losses against gains to minimize taxation:

	Short-Term Gain	Long-Term Gain
Short-Term Loss	Neutral	Ineffective
Long-Term Loss	Effective	Neutral

As the chart depicts, a mismatch between long-term and short-term items can either be effective or ineffective. This is due to the difference in rates as mentioned. A taxpayer with a marginal ordinary income tax rate of 25% and a long-term capital gains rate of 15% will save 10% in tax if a long-term loss can be netted against a short-term gain, rather than a long-term gain. Conversely, the same taxpayer would pay an additional 10% in tax if a short-term loss is harvested in order to offset a long-term gain.

Lastly, loss harvesters must be aware of a trap for the unwary called the wash sale rule. This rule prevents taxpayers from recognizing a loss on the sale of a security if they repurchase a "substantially similar security" during the period that begins 30 days before the sale and ends 30 days after the sale. To avoid the wash sale rule, taxpayers generally wait 31 days before the repurchase. The purpose of the rule is to prevent taxpayers from recognizing a loss without changing their investments.

Gain harvesting.

Gain harvesting is a year-end strategy that could potentially save substantial tax. It is useful for those who expect to be in a higher tax bracket in the future than in the current year. The taxpayer simply sells the assets before the end of the current year, pays tax and receives a step-up in the basis of the assets to the sale price. The taxpayer can then repurchase the assets and sell whenever he or she would have sold them if the gain harvesting strategy had not been used. By doing so, the taxpayer shifts recognition of part of the capital gain from the higher bracket future tax year to the lower bracket current tax year.

Example: Harry and Beth are a married couple filing jointly, with total salary income of $150,000 in 2015; however they expect this to increase permanently to $250,000 in 2016. Moreover, they plan to sell stock they own in 2016 which has a basis of $50,000 and a FMV of $150,000. If they carry out this plan, the $100,000 gain will be taxed at 18.8%. Their total income in 2015 would be $350,000 so the $100,000 capital gain would be subject to the 3.8% NIIT, adding $3,800 to their tax bill. By contrast, if they sell the stock in 2015, the NIIT wouldn't apply because Harry and Beth would be below the $250,000 MAGI threshold amount for married taxpayers filing jointly. By selling early the couple will save $3,800 in tax [$100,000 x (18.8% - 15%)].

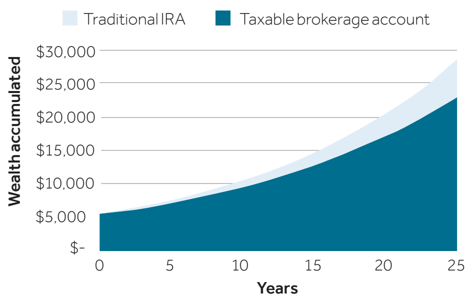
Note that gain harvesting introduces a tradeoff between paying tax at a lower rate and loss of tax deferral. The longer the time period between the gain harvesting sale and the time the taxpayer would otherwise have sold the asset, the greater the benefit of deferral the taxpayer is giving up by harvesting the gain. The best way to analyze these competing benefits is to think about gain harvesting as an investment in the current year to buy tax savings in a later year. This allows for a calculation of the rate of return on this investment.

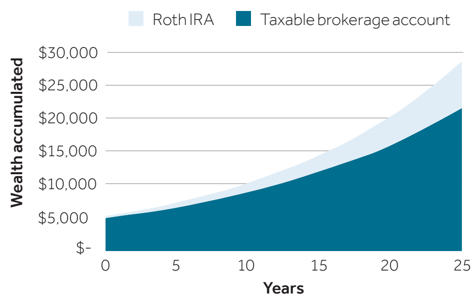
Example: Consider the previous example. Harry and Beth would "invest" the $15,000 of tax paid in 2014 to $3,800 of tax in 2015. This is a simple return on investment of over 25% ($3,800/$15,000)! What if they would have waited 10 years to sell, though? The return on investment is now only about 2.28%.

Most importantly, many taxpayers qualify for a 0% capital gains rate. This 0% capital gains rate applies to taxpayers in the 10% and 15% ordinary income brackets. It is an extremely effective strategy to harvest gains in order to "fill up" this 0% capital gains bracket. By doing so, taxpayers can achieve a basis step-up with no tax cost.

Retirement accounts.

The 401k and IRA have tremendous statutory tax benefits. They enable assets to grow at their pre-tax rate of return instead of their after-tax rate of return. Compare the after-tax value of $5,000 growing in a Traditional or Roth IRA/401k compared to a taxable brokerage account over a significant period of time.[1]





Choosing to fund a tax advantaged retirement account is as easy as it is prudent, however deciding between funding a Traditional IRA or a Roth IRA/401k can be difficult and speculative. The decision is based largely on whether the taxpayer believes his or her marginal tax rate will increase or decrease by the time distributions are received. Those who expect a lower tax bracket to apply at the time of withdrawal should choose to fund a traditional account whereas those who expect an equal or higher tax bracket should generally choose to fund a Roth account. Those who are uncertain may wish to hedge their bets.

Example: Jay, a semi-retired 60-year-old single taxpayer, wants to save $20,000 for retirement. His salary provides taxable income of $50,000. Note that taxable income between $37,450 and $90,750 is subject to a 25% rate and that taxable income less than $37,450 is subject to lower rates. He estimates that the highest tax bracket that will apply to him in retirement is 15%. Jay contributes $12,550 to a traditional 401k and $7,450 to a Roth 401k. This defers the taxation of $12,550 of income currently subject to a 25% rate until after retirement when it will be subject to a 15% rate. Moreover, the amount contributed to the Roth account adds flexibility after retirement without incurring a tax cost.

Required minimum distributions.

While it is prudent to contribute to a 401k or IRA, planning for and taking distributions is best done carefully. There are traps for the nonchalant and great opportunities for the well-advised.

[1]Assumptions: 5% growth rate, 2% yield, 5% annual account turnover, 25% ordinary income tax rate, and a 15% capital gains tax rate. This hypothetical example is for illustrative purposes only. There can be no assurance that any investment will grow over time, and all such investments are subject to risk.

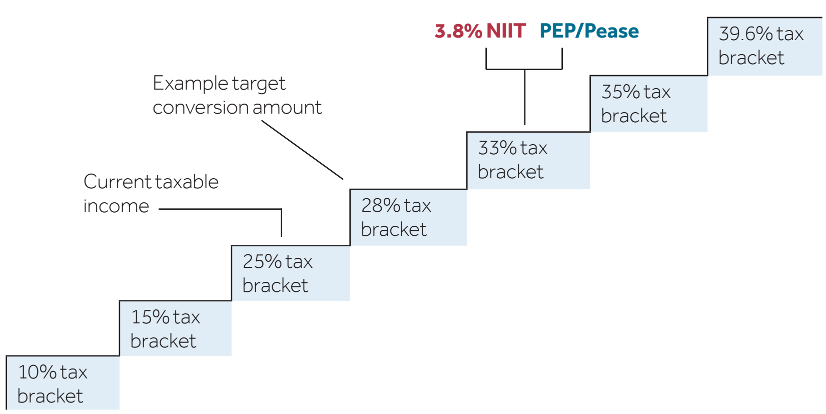
Traditional IRA and 401k account owners must begin taking required minimum distributions (RMDs) in the year following the year they turn 70½. This is called the required beginning date (RBD). Failure to make the distribution results in a stiff penalty equal to 50% of the undistributed amount. It is therefore essential that these deadlines are not missed. For those approaching their RBD, a brief consultation with a qualified tax or finance professional is highly recommended to ensure RMDs are properly taken.

Roth IRA conversions.

Roth IRA conversions can be a good way to smooth income for taxpayers who currently have a lower tax bracket than they expect to have in retirement. Whether a Roth conversion will be favorable for a particular taxpayer, however, depends on individual circumstances. A detailed quantitative analysis is required to determine whether it provides an overall economic benefit. This analysis begins with a comparison of the marginal income tax rate at the time of the conversion and the expected marginal income tax rate when distributions are received. If the tax rate at the time of the conversion is lower, the taxpayer will achieve a better economic result by converting. If the tax rate is expected to be far higher than when distributions are received, the taxpayer will generally be better off not converting. If the tax rate at the time of conversion is expected to be slightly to moderately higher than at the time of distribution, a Roth IRA conversion might still be advisable because of special considerations that favor a Roth IRA.

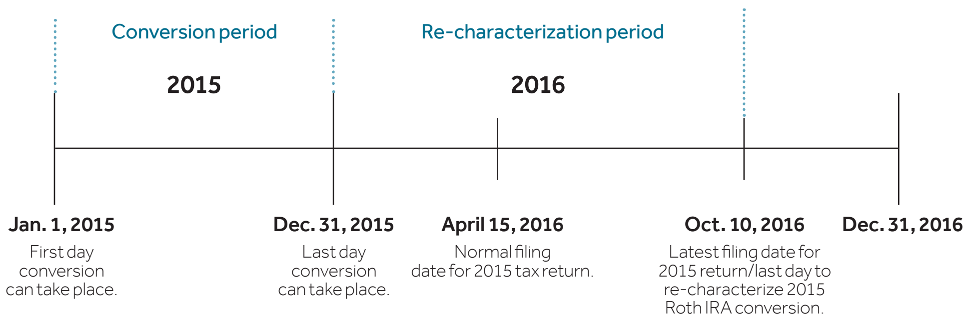
The most important of these special considerations is whether the income tax on the conversion can be paid with funds outside the IRA. In effect, the amount used to pay the tax is moved from a taxable account into the Roth IRA, packing more value into the account. In addition, the Roth IRA is more favorable for a taxpayer who doesn't need the money in the IRA. Because RMDs aren't required from a Roth IRA, the full value of the account can continue to grow tax-free for the benefit of heirs without being diminished by annual distributions.

The next consideration is the amount to convert. Many choose to make a series of conversions over a number of years. This is in order to restrict the conversion to an amount that fills up their current marginal tax bracket or avoids exceeding other thresholds. It should be noted, however, that there may be times when it does make sense to convert more and go into the higher tax brackets. The following chart should aid in understanding the strategy:



The decision to convert may be complicated; however the ability to undo a Roth conversion eliminates much of the risk. If the account assets decline in value after the conversion, the taxpayer can convert the account back to a traditional IRA. Otherwise, conversion tax would be paid for amounts that are no longer in the account.

Taxpayers may "re-characterize" (i.e., undo) the Roth IRA conversion in the current year or by the filing date of the current year's tax return. Thus, re-characterization can take place as late as October 15th of the year following the year of conversion. A taxpayer who has re-characterized a Roth conversion may not effect another Roth conversion until the later of the following two dates: the tax year following the original conversion or 30 days after the re-characterization. Note that re-characterizations are not allowed for Roth 401(k) accounts.



Inherited IRAs.

Wealth grows in a tax-free or tax-deferred environment inside an IRA. This means that for taxpayers who don't need those savings for support, the more slowly the funds are withdrawn the faster wealth can accumulate. This is relatively straightforward during the account owner's life. However, minimizing distributions after the owner's death requires planning.

Essential to after-death planning for IRAs is naming the right beneficiaries in order to prolong dispersing the account over the longest possible period of time. The default advice is to roll the IRA into the name of the surviving spouse after the first death and name the children as beneficiaries thereafter. This strategy is generally effective and avoids losing an excessive portion of the account to income taxation.

However, an account owner who expects his spouse to outlive him by a number of years might consider leaving the IRA directly to children or grandchildren in order to achieve a more favorable result. This is because minimum distributions are generally less for a beneficiary with a longer life expectancy. Nevertheless, a non-spousal beneficiary must be at least twelve years younger than a surviving spouse for this strategy to be effective.

If it is desirable to name multiple beneficiaries, it's important to understand that the size of the required minimum distribution is determined by the age of the oldest beneficiary. Therefore, it's prudent to either split the IRA before death into shares for each beneficiary or arrange for this to be done after death. For example, those who inherit an IRA from someone who died in 2015 have until the end of 2016 in order to split the IRA into separate shares.

Wealth preservation and transfer.

Planning early for the possibility of estate tax exposure is important as it generally only becomes more difficult with time. Moreover, the current law and interest rate environment is extremely conducive to intergenerational wealth transfer, which politics or economics might cause to change suddenly in 2016. Thus, in addition to bracket management, taxpayers should think about estate planning at the end of the year.

Those who die in 2015 with estates less than $5,430,000, or twice that for a married couple, generally have no federal estate tax. This exemption increases at the rate of inflation annually. However, growth of an estate is likely to outstrip increases in the exemption amount.

Example: Consider a couple that in 2015 has $7,000,000 in assets. Because this amount is well below the current $10,860,000 exclusion amount, they believe that estate tax planning is unnecessary. However, if inflation is 2% and their future estate grows at 7%, within ten years the couple will have estate tax exposure.[2]

Given the assumptions made, after ten years the exclusion amount will be $13,240,000 and the value of the estate will be $13,770,060.

There are many complicated ways to solve this problem. For those with estates that exceed or will exceed the exemption amount, consulting an estate tax expert within the next few months is very prudent.

Annual exclusion gifting.

For those who are unsure if they will have an estate tax problem or are otherwise reluctant to do complicated planning, there is a simple step to take annually. Under the annual gift tax exclusion, taxpayers can gift $14,000 to a donee each year ($28,000 for spouses) without paying gift tax or using up any of their applicable exclusion amount (unified credit). These gifts can be made directly, in trust, or through 529 Plans.

Example: A married couple has four children. Each parent can gift $14,000 tax free to each child for a total of $112,000 in 2015.

Although annual exclusion gifts of $14,000 per year may seem insignificant for a taxpayer with a very large estate, these gifts can remove very substantial amounts from the gross estate over a period of time.

[2]Assumptions: 7% growth rate of assets after income tax, 2% annual increase of the basic exclusion amount, spouses die at the same time, and state estate tax is not considered.

Example: Richard and his wife, Mabel, are wealthy taxpayers who have three children and nine grandchildren. They have assets expected to produce a total after-tax return of ten percent/year after tax. Both spouses make annual exclusion gifts to the children, the children's spouses and the grandchildren each year. This makes a total of 30 gifts each year with a total value of $420,000 (30 x $14,000). The following chart shows the amounts removed from the gross estate and the resulting tax savings should be assuming a 40% marginal estate tax rate.

Time Horizon	Total Transfer	Tax Savings
10 Years	$6,693,718	$2,677,487
20 Years	$24,055,500	$9,622,200
25 years	$41,305,765	$16,522,306

It is possible to effectively increase the $14,000 annual amount by transferring discounted assets. The chart below shows the effect of various discount rates on the amount that can be transferred for each annual exclusion gift.

Discount %	Effective Exclusion Amount
20%	$14,000/.8 = $17,500
30%	$14,000/.7 = $20,000
40%	$14,000/.6 = $23,333
50%	$14,000/.5 = $28,000

In addition, it's worth noting that tuition and medical expenses can be paid without incurring gift tax. Tuition must be paid directly to the qualified institution providing the education, and the exclusion does not apply to anything other than tuition, such as room and board. Medical expenses must be paid directly to the provider or insurance company, but does not include cosmetic surgery or general health maintenance (i.e., annual physicals).

Income shifting.

Income shifting can be combined with annual exclusion gifting to produce an even better result. While there are many ways to legally shift income from one individual to another in order to reduce taxation, one of the simplest ways to do so is to gift appreciated assets.

The technique is simple: instead of simply writing a check, gift appreciated stock, for example. The value of the gift for gift tax purposes equals the fair market value of the securities and the basis transfers to the child. The child can then sell the securities and realize the gain on his or her tax return where it's taxed at a lower rate.

Kiddie tax.

Those who make these gifts should be aware of a special tax called the "kiddie tax." This tax essentially causes a child's investment income to be taxed at the parent's highest income tax rate. It applies to all children under 18; 18-year-olds who receive over half of their support from parents; and 19- to 23-year-olds who are full time students and receive over half their support from parents. However, if the 3.8% net investment income tax applies to the parents, it does not necessarily apply to the children via the kiddie tax.

Charitable contributions.

Charitable contributions are an easy way to reduce income to stay out of the higher tax brackets. The tax law encourages charitable giving by providing a deduction against taxable income. This allows people to be more generous than they would be otherwise. By understanding the nuances of the deduction, perhaps the charitably inclined could afford to be even more generous.

However, there are two overarching limits on the deductibility of charitable gifts. The first is the phase-out of itemized deductions which limits the value of a charitable deduction for high income taxpayers. The second is that charitable deductions can never exceed 50% of a taxpayer's AGI.

The tax law divides charitable organizations into two groups: public charities and private foundations. Few people have the opportunity to give to a private foundation and most wouldn't want to, due to their restrictions. Therefore, the following rules focus on gifts to public charities.

The important details of the deduction, for most taxpayers, depend on the type of property donated. There are five categories: cash, property that would generate ordinary income if sold, property that would generate long term capital gains if sold, tangible property that the charity will use, and tangible property the charity will resell. Each category is limited by how the amount of the charitable contribution deduction is determined and by the amount that is deductible relative to the taxpayer's AGI

There are two key takeaways from the above chart: (1) the deduction for the donation of

Type of Property	Deductible Amount	AGI Limitation
Cash	Fair market value	50%
Property, if sold, would generate ordinary income	Lesser of basis or fair market value	50%
Property, if sold, would generate long term capital gain	Fair market value	30%
Tangible personal property charity uses	Fair market value	30%
Tangible personal property charity sells	Lesser of basis or fair market value	30%

property with unrealized income other than long term capital gain is limited to basis, and (2) it is often better to donate property the charity will use rather than resell. The former limitation is straightforward, however the latter requires explanation.

Example: A taxpayer donates artwork to her alma mater which will be displayed in the library and studied by the students. The charitable organization is using the property in furtherance of its charitable purpose and therefore the fair market value of the property is deductible. However, if the charity merely resells the donation to raise operating cash, the taxpayer's deduction is limited to the lesser of basis or fair market value.

In addition, one must consider the AGI limitations. Unlike the property limits, deductions limited by AGI restrictions are not lost. Rather, the disallowed portion of the deduction can be applied over the following five tax years. However, the AGI limitation is tricky because the overall 50% AGI limitation is applied in addition to the property-specific AGI limitations.

Example: A taxpayer donates $100,000 of appreciated publicly traded stock held for many years and $10,000 of cash. Her AGI in the year of donation is $250,000 and therefore only $75,000 of the stock donation is deductible [$250,000 x 30% = $75,000]. However, the $10,000 cash donation remains fully deductible because the total allowable deduction is less than the overall 50% limitation [$75,000 + $10,000 < $250,000 x 50%].

It is important to understand the benefit of donating property with built-in long term capital gains. The advantage is due to the differences in tax rates.

Example: A taxpayer in the 33% marginal tax bracket intends to donate $10,000 worth of stock to charity. He can either donate the stock directly or sell the stock and contribute the sale proceeds. If he donates the stock directly, he will receive a charitable deduction of $10,000 subject to the 30% of AGI limitation. Given his 33% marginal income tax bracket, the economic benefit of the deduction is $3,300. If instead he sells the stock first he will recognize a gain of $8,000 and pay a capital gains tax of $1,200 (.15 x $8,000). This will leave $8,800 to donate to charity, resulting in a charitable deduction of $8,800 and a tax benefit of $2,904.

Financing education.

From a strategic perspective, we all realize college funding begins at birth and includes the efforts of the parents and often grandparents. However, from a tactical perspective annual planning opportunities remain.

Qualified tuition programs (aka 529 Plans).

Qualified Tuition Programs (QTPs) are a tremendous tool for those saving for college. In addition to the benefit of tax-free growth, state-specific annual benefits are significant. These include deductions to state taxable income, credits against state income tax, and matching grants.

Annual exclusion gifts can also be used to fund QTPs. Although the annual exclusion is generally limited to $14,000 per year, per donee, a special rule allows donors to use the next five years of annual gift tax exclusions in order to make an accelerated lump-sum contribution in a single year. Thus, an individual can contribute $70,000 ($14,000 x 5) to a QTP in 2014 for any one beneficiary without incurring gift tax or using up applicable exclusion amount. This allows a significant transfer of wealth to a younger generation in a tax-free environment. On the other hand, completely exhausting five years of exclusions in a single year will mostly preclude additional tax-free gifts over the next four years.

Coverdell ESAs (Education IRAs).

Coverdell ESAs are similar to QTPs. The main benefit of both tax-advantaged accounts is that growth inside the account is income tax-free if spent on "qualified education expenses." Expenses eligible for tax-free ESA and 529 plan distributions include tuition, fees, books, supplies, equipment and, if the student is at least half-time, room & board.

Notwithstanding the above, Coverdell ESAs are severely limited in two ways: (1) the amount that can be contributed annually is only $2,000, and (2) married taxpayers filing jointly with AGI exceeding $180,000 or other taxpayers with AGI exceeding $90,000 cannot contribute to ESAs. Compared to QTPs, which generally have no direct annual limits, ESAs are fairly unattractive.

Nevertheless, ESAs have a unique redeeming quality in that withdrawals can be used for elementary and secondary school expenses (in addition to college expenses). Therefore, ESAs might be a valuable supplement to QTPs for those who wish to send children to private elementary or secondary schools.

Education tax credits.

Capturing the greatest amount of tax benefits over a student's college career can be complicated. There are two income tax credits available when tuition is paid: (1) the American Opportunity Tax Credit (AOTC), and (2) the Lifetime Learning Credit.

These credits cannot be claimed concurrently for the same student, are phased-out for those with higher income, must be carefully assigned to either the parent or student, and can be maximized by managing the payment of tuition in terms of timing, amount, and source from which it is paid.

For those with higher income, education tax credits are subject to certain AGI phase-outs. This means that the value of the credit is reduced from its calculated value to $0 as the taxpayer's AGI increases over a certain range. The ranges for each credit are as follows:

	Married, filing jointly		All others	
	Phase-out		Phase-out	
	Begins	Ends	Begins	Ends
American Opportunity Tax Credit	$160,000	$180,000	$80,000	$90,000
Lifetime Learning Credit	$110,000	$130,000	$55,000	$65,000

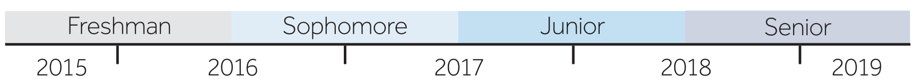
Example: A married couple who can claim the AOTC for their child's tuition with an AGI equal to $150,000 is not subject to the phase-out. However, if the couple's AGI was $170,000, half of the AOTC would be lost to the phase-out, and it would be completely lost if AGI equals or exceeds $180,000.

The credit will accrue to the parents if they can claim the child as a dependent, however it can be waived – which can be beneficial for parents with very high AGI. Conversely, parents with AGIs under the phase-out limits and whose child has little taxable income may want to claim the child as a dependent. In any case, understanding the dependency rules is important to capturing the maximum tax benefit.

The dependency exemption for college students is based on the student's age. Those under age 24 fit into one set of rules, while those age 24 and over fit into another. For the younger group, the student is a dependent if the parents provide at least half of the child's support. For the older group, there is an additional requirement that the child's gross income cannot exceed $4,000 in 2015.

The AOTC is the more generous of the two education tax credits and should be chosen when available. It is equal to 100% of the first $2,000 of tuition paid plus 25% of the next $2,000 per student. In addition to the AGI limitations, it requires the student to be at school at least half-time and working towards a degree or certificate at an eligible post-secondary school.

The limitation on the number of years in which the AOTC can be claimed is complicated. It can only be claimed for the first four academic years of a college student and can only be claimed in four tax years. This dual limitation can make choosing when to claim the credit difficult because tax years and academic years do not align:



Note that even the traditional student has to decide whether to claim the credit in the first or last semester of college. Timing is more complicated when the student has a nonconventional path. Nevertheless, the goal in either case is to claim the credit at the time it will provide the greatest benefit. A small amount of planning can yield thousands of dollars in benefits.

The Lifetime Learning Credit is less generous, but also less restrictive. Unlike the AOTC, the Lifetime Learning Credit can be claimed for an unlimited number of tax years and does not require that the student is seeking a degree or certificate. However, the credit requires greater out of pocket spending in order to capture a smaller benefit: It equals 20% of the first $10,000 in qualified expenses. Moreover, the $10,000 limit is not on a per-student basis like the AOTC, but rather on a per-taxpayer basis.

Example: Parents have two children in college, a 20-year-old sophomore and a 21- year-old junior, and pay $10,000 in tuition for each child. The children are dependents and therefore the parents can claim the tax benefits on their income tax return. The AOTC provides $5,000 in tax credits [($2,000 x 100% + $2,000 x 25%) x 2]; whereas the Lifetime Learning Credit would only provide a tax benefit of $2,000 [$10,000 x 20%].

Also, it's important to note that tuition paid from ESAs or QTPs cannot be used for the purposes of calculating the AOTC or Lifetime Learning Credit. Therefore, it's often prudent to pay a portion of the tuition out-of-pocket so one of the tax credits can be claimed.

Example: Parents have a QTP to pay for their sophomore child's college tuition, room and board. However, they wisely plan to set aside $4,000 of income to pay a portion of the tuition out-of-pocket and to take the $2,500 AOTC. Had the parents paid the tuition purely out of the QTP, the AOTC cannot be claimed that year and, moreover, because the credit is limited to four academic years, an unclaimed credit might be completely lost.

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