

CUTTING EDGE TAX PLANNING DEVELOPMENTS & OPPORTUNITIES

11.18.2015 | FPA ORANGE COUNTY

MICHAEL E. KITCES

MSFS, MTAX, CFP®, CLU, ChFC, RHU, REBC, CASL

Partner, Director of Research, Pinnacle Advisory Group

Publisher, The Kitces Report, www.kitces.com

Blogger, Nerd's Eye View, www.kitces.com/blog

Twitterer, @MichaelKitces, www.twitter.com/MichaelKitces



Handouts/Additional Materials at: kitces.com/FPAOC15

A NEW ERA OF TAX STABILITY?

- American Taxpayer Relief Act of 2012 (ATRA)
 - “Permanently” ended the fiscal cliff sunsets
- Budget deficits & debt ceiling challenges remain
 - Gridlock = status quo for the foreseeable future?
 - At least until 2016 elections?
 - Corporate tax reform vs individual tax reform
vs “loophole closing”

INDIVIDUAL INCOME TAXES

- ATRA created “new” 7-bracket tax system
 - Compressed 35% tax bracket, more progressive system

Individuals		Married Couples
Taxable Income	Tax Bracket	Taxable Income
Up to \$9,225	10%	Up to \$18,450
Over \$9,225 and up to \$37,450	15%	Over \$18,450 and up to \$74,900
Over \$37,450 and up to \$90,750	25%	Over \$74,900 and up to \$151,200
Over \$90,750 and up to \$189,300	28%	Over \$151,200 and up to \$230,450
Over \$189,300 and up to \$411,500	33%	Over \$230,450 and up to \$411,500
Over \$411,500 and up to \$413,200	35%	Over \$411,500 and up to \$464,850
More than \$413,200	39.6%	More than \$464,850

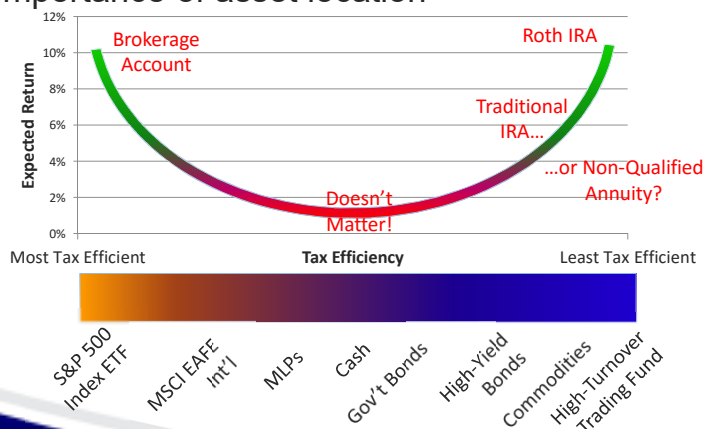
© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

[@michaelkitces](https://twitter.com/michaelkitces)

INDIVIDUAL INCOME TAXES – PLANNING IMPLICATIONS

- Importance of asset location



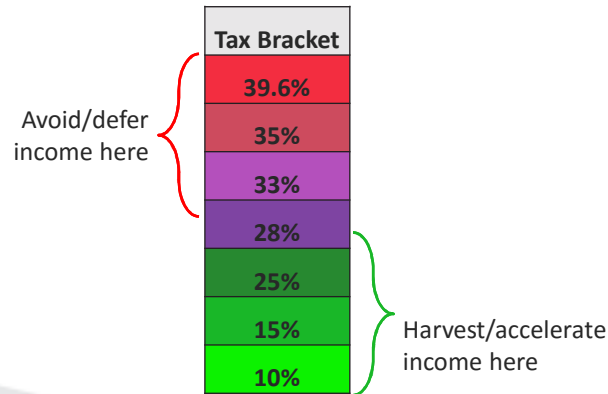
© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

[@michaelkitces](https://twitter.com/michaelkitces)

INDIVIDUAL INCOME TAXES – PLANNING IMPLICATIONS

- Tax Bracket Arbitrage



© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

@michaelkitces

INDIVIDUAL INCOME TAXES – PLANNING IMPLICATIONS

- Tax Bracket Arbitrage – smoothing income over time
 - Roth conversions
 - Capital gains harvesting

Deferring Income

Age 65	Age 66	Age 67	Age 68	Age 69	Age 70	Age 71
39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%
35%	35%	35%	35%	35%	35%	35%
33%	33%	33%	33%	33%	33%	33%
28%	28%	28%	28%	28%	28%	28%
25%	25%	25%	25%	25%	25%	25%
15%	15%	15%	15%	15%	15%	15%
10%	10%	10%	10%	10%	10%	10%

Harvesting Income

Age 65	Age 66	Age 67	Age 68	Age 69	Age 70	Age 71
39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%
35%	35%	35%	35%	35%	35%	35%
33%	33%	33%	33%	33%	33%	33%
28%	28%	28%	28%	28%	28%	28%
25%	25%	25%	25%	25%	25%	25%
15%	15%	15%	15%	15%	15%	15%
10%	10%	10%	10%	10%	10%	10%

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

@michaelkitces

PHASEOUT OF EXEMPTIONS & DEDUCTIONS

- Prior law included phaseout of personal exemptions and itemized deductions for high-income taxpayers
 - Phased out 2006-2009
 - Eliminated 2010-2012
 - (Permanently) returned in 2013

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

PHASEOUT OF EXEMPTIONS & DEDUCTIONS

- “Pease limitation” on itemized deductions
 - Itemized deductions phased out by 3% of income over threshold, up to 80% of total deductions
- Personal Exemption Phaseout (PEP)
 - Personal exemptions phased out by 2% per \$2,500 over threshold, up to 100% of exemptions
- AGI thresholds: \$258,250 individuals, \$309,900 MFJ
 - PEP ends at \$380,751 and \$432,401 respectively
 - Thresholds indexed for inflation going forward

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

PEASE & PEP – PLANNING IMPLICATIONS

- Effective result is to increase marginal tax rates
 - **Pease**: losing 3% of deductions at 33% rate = 1% increase in tax rate
 - **PEP**: marginal impact also approximately = 1% increase in *per exemption*
 - Impact greater as number of exemptions increases

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

PEASE & PEP – PLANNING IMPLICATIONS

- Pease + PEP push up top tax brackets
 - PEP impacts 33% + 35% tax brackets
 - Pease impacts 33%, 35%, & 39.6%
 - Cap rarely reached in practice
- Proper planning accounts for higher tax rates...
 - ...*not* by avoiding deductions (e.g., charitable)!
 - Unless 80% cap has been reached
 - www.kitces.com/PeaseCharitable

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

LONG-TERM CAPITAL GAINS

- ATRA created new top rate for long-term capital gains

Ordinary Income Bracket	L/T Capital Gains Rate
10% or 15%	0%
25%, 28%, 33%, or 35%	15%
39.6%	20%

- Rates are graduated, just like ordinary income

© 2015 Michael Kitces | kitces.com

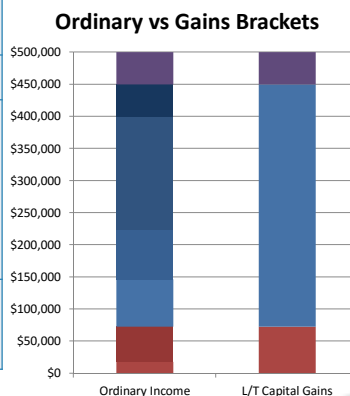
Handouts/Materials: kitces.com/FPAOC15

[@michaelkitces](https://twitter.com/michaelkitces)

LONG-TERM CAPITAL GAINS

- Rates are graduated, just like ordinary income

Tax Bracket	Taxable Income (Married Couple)	L/T Gains Bracket
39.6%	More than \$464,850	20%
35%	Over \$411,500 and up to \$464,850	15%
33%	Over \$230,450 and up to \$411,500	
28%	Over \$151,200 and up to \$230,450	
25%	Over \$74,900 and up to \$151,200	
15%	Over \$18,450 and up to \$74,900	0%
10%	Up to \$18,450	



© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

[@michaelkitces](https://twitter.com/michaelkitces)

LONG-TERM CAPITAL GAINS

- 3 brackets become 4 brackets w/ 3.8% Medicare tax

Income		
Individual	Married Couple	L/T Capital Gains Rate
Up to \$37,450	Up to \$74,900	0%
Up to \$200,000 AGI	Up to \$250,000 AGI	15%
Up to \$413,200	Up to \$464,850	18.8%
Over \$413,200	Over \$464,850	23.8%

- Further adjusted for Pease & PEP!
- Ordinary brackets indexed, Medicare threshold *not*!

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

LONG-TERM CAPITAL GAINS – PLANNING IMPLICATIONS

- Managing the timing of capital gains
 - Deferring *or accelerating* can permanently avoid higher rates
- Harvesting losses vs harvesting *gains*
 - Harvesting gains much easier – no wash sale rules
 - Harvest losses when income is high, gains when it's low
 - Especially appealing at 0% rates – “free” step-up in basis!

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

QUALIFIED DIVIDENDS

- ATRA made qualified dividends *permanent*
 - But still tied to L/T capital gains rates
 - Including the new 3.8% Medicare tax!
- Likely little impact for most investors
 - Limited impact on after-tax yield
 - Cannot control timing of dividends anyway
- Planning opportunities for closely-held C corps
 - *Can* control the timing of dividends
 - Strategic profit distributions to manage family tax brackets?

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

ALTERNATIVE MINIMUM TAX (AMT) RELIEF

- ATRA made numerous *permanent* AMT changes
 - Retroactively patched 2012 AMT exemption
 - \$Up to \$83,400 MFJ & \$53,600 for individuals in 2014
- Resolved “AMT creep” by adding *permanent* inflation-indexing for:
 - AMT exemption amount
 - Exemption phaseout threshold
 - 28% bracket threshold

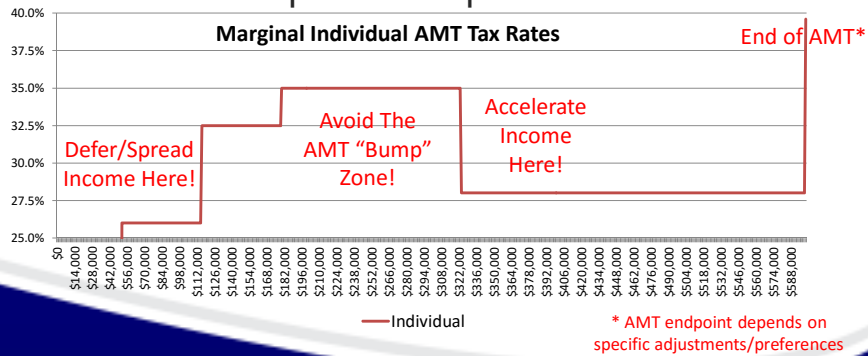
© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

AMT RELIEF – PLANNING IMPLICATIONS

- AMT planning remains relevant
 - *Defer or accelerate* income to manage the AMT exemption “bump”



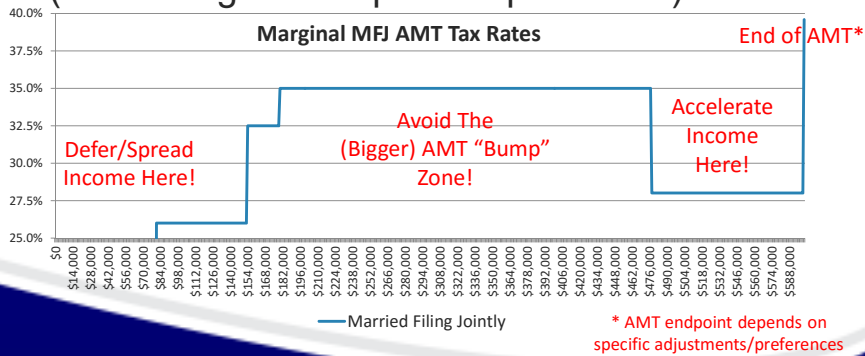
© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

[@michaelkitces](https://twitter.com/michaelkitces)

AMT RELIEF – PLANNING IMPLICATIONS

- AMT planning remains relevant
 - Bigger AMT “bump” zone for married couples (due to larger exemption to phase out)!



© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

[@michaelkitces](https://twitter.com/michaelkitces)

LAPSED TAX EXTENDERS

- Currently lapsed *again*, may be reinstated *again*?
 - \$250 schoolteacher expense deduction
 - Exclusion of discharged mortgage debt
 - Deduction for state and local sales taxes
 - Above-the-line education deduction
 - Section 179 expensing + bonus depreciation
 - Qualified Charitable Distributions from IRAs
 - Do it anyway, and see how it turns out?

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

MARGINAL TAX RATES: MOVING TARGET

- Tax rates exposed to numerous factors
 - Tax brackets
 - Phaseout of exemptions & deductions
 - Long-term capital gains & qualified dividends
 - AMT tax rates
 - AMT exemption phaseout
 - 3.8% Medicare tax
 - Income-related Medicare adjustments to Part B & Part D
 - Taxability of Social Security benefits

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15


 @michaelkitces

MARGINAL TAX RATES: MOVING TARGET

Determining The Marginal Tax Rate For Various Types Of Income In 2014											
Individual income above...	Couple's income above...	Income "type"	Ordinary Income	AMT rate	L/T gains & qual. dividends	Wage earned income	Self-employed earned income	Net inv. income	Itemized deduction phaseout (Pease)	Personal exemption phaseout (PEP)*	AMT exemption phaseout
\$0	\$0	Taxable	10%		0%	7.65%	15.30%				
\$9,075	\$18,150	Taxable	15%								
\$36,900	\$73,800	Taxable									
N/A	\$117,000	Earned	25%			7.65% / 1.45%	15.30% / 2.9%				0%
\$89,350	\$148,850	Taxable		26%							
\$117,000	N/A	Earned						0%	0%	0%	
\$117,300	N/A	AMTI	28%								6.5% / 0%
N/A	\$156,500	AMTI				1.45%	2.90%				6.5%
\$182,500	\$182,500	AMTI									
\$186,350	\$226,850	Taxable			15%						
\$200,000	\$250,000	Earned									7%
\$200,000	\$250,000	AGI	33%								
\$254,200	\$305,050	AGI									
\$328,500	N/A	AMTI		28%					1%	1%	
\$376,700	N/A	AGI				2.35%	3.80%	3.80%		0% / 1%	
\$405,100	\$405,100	Taxable	35%						1.05%	0% / 1.1%	0% / 7%
N/A	\$427,550	AGI									
\$406,750	\$457,600	Taxable		39.6%					1.2%	0%	
N/A	\$487,700	AMTI			20%						0%

Income thresholds based on estimated 2014 inflation adjustments (where applicable).
Where two rates are shown, the first applies to individuals, the second to married couples.
* Phaseout per exemption

© 2014 This chart was originally created by Michael Kitces for the November/December 2012 issue of The Kitces Report.
www.kitces.com

© 2015 Michael Kitces | www.kitces.com **Handouts/Materials: [kitces.com/FPAOC15](http://www.kitces.com/FPAOC15)**  **@michaelkitces**

CONVERTING AFTER-TAX 401(K) \$\$\$

- “Splitting” after-tax 401(k) \$\$\$ for Roth conversion
 - Plan administrators issuing “two checks”
 - Intended when only *one* check is rolled over!
 - IRS indicated pro-rata treatment in IRS Notice 2009-68
- IRS Notice 2014-54 *reverses position*
 - Allows after-tax portion of “two checks” distribution to be allocated *however the taxpayer wishes*
 - Applies going forward, “reasonable” retroactively

CONVERTING AFTER-TAX 401(K) \$\$\$

- Individual has \$250k in a 401(k) plan including \$50k of after-tax contributions
 - Distributes \$50k, deemed \$10k of after-tax (pro-rata)
 - Receives two checks (\$10k & \$40k), sends \$10k to Roth and \$40k to rollover
 - Can choose to allocate all \$10k of after-tax to the \$10k Roth!
- Incentivizes after-tax 401(k) contributions?
 - But watch out for ACP test?

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

NEW 529A(BLE) ACCOUNTS FOR SPECIAL NEEDS

- 2014 Tax Extenders legislation creates new 529A
 - 529-ABLE plans designed for special needs beneficiaries
 - Tax-free qualified distributions for education, housing, health, etc.
 - Specifically for disabled beneficiaries
 - Able to accumulate without disqualifying Federal/state aid
 - May require Medicaid payback
 - Run by states, *must use in-state plan*
 - Still subject to existing 529 plan maximum contribution limits
 - Potential alternative for “simple” special needs trusts?

© 2015 Michael Kitces | kitces.com

Handouts/Materials: kitces.com/FPAOC15

 @michaelkitces

QUESTIONS?

Handouts & additional materials:
www.kitces.com/FPAOC15

Contact: michael@kitces.com