14 bright tax ideas for 2014

A sharply divided Congress may be casting clouds of uncertainty over tax law changes, but that shouldn't deter you from year-end planning.

Strategy: Make hay while the sun shines. In other words, take advantage of the tax-saving opportunities already available in the tax law, as we continue to hold out hopes for bluer skies ahead.

Appropriately enough, here are 14 year-end tax strategies that can benefit individual taxpayers in 2014.

1. Harvest capital gains or losses. Traditionally, investors look to realize capital losses from securities sales at year-end. The losses can offset capital gains plus up to $3,000 of ordinary income. Any excess loss is carried over to next year. But you might also take down capital gains that can be sheltered by prior capital losses. What's more, net long-term gains are taxed at a maximum 15% federal rate for most folks (20% for those in the top ordinary income bracket), so plan your securities transactions accordingly.

Tip: Long-term gains are taxed at a 0% rate to the extent they fall into the two lowest ordinary income tax brackets (the 10% and 15% brackets).

2. Reap low rates for dividends. It's not only capital gains that can benefit from preferential tax rates. Similarly, qualified dividends received in 2014 are taxed at a maximum 15% rate for most folks (20% for those in the top ordinary income bracket). This covers most dividends issued through domestic stocks and mutual funds. Other dividends are taxed at ordinary income rates reaching up to 39.6%.

Tip: For mutual funds, you must hold shares of the fund for at least 61 days out of the 121-day period beginning 60 days before the ex-dividend date.

3. Take the Roth plunge. When you convert funds in a traditional IRA to a Roth, you must pay current tax, but you can secure future tax-free payouts. If you've been thinking about a Roth IRA conversion for a while, now may be the time you finally do it, especially if you expect 2014 to be a low-income year. For most taxpayers, the optimal approach is to use a series of installment conversions that maximize the benefits of lower tax brackets over several years.

Tip: If you change your mind, you can reverse a 2014 conversion as late as Oct. 15, 2015.

4. Wrap up charitable gifts. Generally, the full amount of monetary donations made to qualified charitable organizations is deductible if you meet substantiation requirements. In addition, if you donate capital gain property you've owned longer than one year, you can deduct the property's fair market value instead of your basis. Any appreciation remains untaxed forever. But be mindful of other special rules for charitable gifts, including a potential deduction reduction rule.

Tip: If you charge a donation by credit card in 2014, it's deductible in 2014, even if you don't actually pay off the charge until 2015.

5. Shift itemized deduction expenses. Under a phaseout rule, the most popular itemized deductions—including charitable donations, state and local taxes, and mortgage interest—are reduced by 3% of the excess above a threshold amount. For 2014, the thresholds are $254,200 of adjusted gross income (AGI) for single filers and $305,050 for joint filers. When it makes sense, try to move deductible expenses into the tax year they will do the most good (e.g., postponing large charitable gifts to 2015 if the phaseout rule won't affect you next year).

Tip: The reduction of itemized deductions under the phaseout rule can't exceed 80%, but this limit only affects the upper crust of taxpayers.

6. Salvage personal exemptions. The tax benefits of personal exemptions, including dependency exemptions, may be reduced under the personal exemption phaseout (PEP) rule. The reduction is equal to 2% for every $2,500 of AGI (or fraction thereof) above the same thresholds used for the itemized deduction phaseout rule. But there's no 80% limit for the PEP rule, so exemptions may be lost completely. Take steps to keep your AGI as low as possible if exemptions are at risk.

Tip: Generally, you can claim a $3,950 dependency exemption for 2014 if you provide more than half of a relative's support. Plus, a nonchild and older children can't have more than $3,950 in taxable income.

7. Crunch the AMT numbers. Will you have to pay the alternative tax (AMT) in 2014? Make an estimate of your AMT liability after considering certain adjustments, "tax preference items" and an exemption amount based on your filing status. Despite slightly higher exemption amounts for this year, you may still owe the AMT, especially if your exemption amount is reduced under a special rule for upper-income taxpayers. Using these numbers, you may be able to avoid the AMT, perhaps by postponing tax preference items.

Tip: Alternatively, if you're certain to pay the AMT this year, you might accelerate more income into 2014. The top AMT rate is 28% compared to a top regular income rate of 39.6%.

8. Divide family income and conquer. If you're in a high tax bracket in 2014, you might transfer income-producing property to other family members, like young children or grandchildren, who are in much lower brackets. For instance, with a tax rate differential of 29.6% between the top bracket of 39.6% and the lowest bracket of 10%, a family can save $2,960 in tax on $10,000 of earnings shifted from high-bracket to low-bracket members. But the tax savings may be mitigated by the "kiddie tax."

Tip: For 2014, unearned income above $2,000 received by a dependent child under age 19 or full-time student under age 24 is taxed at the parents' top tax rate.

9. Cope with NII surtax. The 3.8% Medicare surtax applies to the lesser of "net investment income" (NII) or modified adjusted gross income (MAGI) in excess of $200,000 for single filers and $250,000 for joint filers. The definition of NII includes interest, dividends and capital gains—but not distributions from qualified retirement plans and IRAs or income subject to self-employment tax. If possible, you can reduce exposure to the 3.8% surtax by adjusting your portfolio. For instance, you might increase your investment in tax-exempt municipal bonds or opt for a tax-deferred annuity.

Tip: Although qualified plan and IRA distributions don't count as NII, they still increase MAGI and can therefore increase your exposure to the 3.8% tax.

10. Prepay state & local taxes. Generally, your next installment of state and local income taxes, as well as

7600 Leesburg Pike, Suite 300, Falls Church, VA 22043-2004 (800) 543-2002

your next property tax bill, are due in January. But you can get ahead of the game by prepaying these taxes in December and then claiming the resulting deductions on your federal return. However, it doesn't make sense to prepay state and local taxes if you expect to be in a higher tax bracket in 2015 than you are in 2014.

Tip: State and local taxes are not deductible for AMT purposes, so don't prepay these taxes if you expect to be in the AMT mode for 2014.

11. Bunch up medical & dental expenses. For 2014, your deduction for medical and dental expenses, if any, is limited to the excess above 10% of your AGI (7.5% if you're 65 or older). When feasible, schedule elective (i.e., nonemergency) expenses, such as physical exams, dental cleanings, and vision care for the end of the year if you expect to clear the 10%-of-AGI mark in 2014. Otherwise, you may as well postpone these visits to 2015 when you'll have a chance at a deduction.

Tip: Don't forget to include amounts you've paid on behalf of dependents when you add up your medical expenses for the year.

12. Sell real estate on installment basis. Usually, income from a sale of property is fully taxable in the year of the sale. However, if you arrange an installment sale of real estate where the buyer's payments are spread out over two or more years, you pay tax on payments in the year they are received. This enables you to defer tax and benefit from lower tax brackets in multiple years.

Tip: Conversely, if it suits your purposes, you can elect out of installment sale treatment when you file your 2014 return in 2015. Electing out makes sense if you are in a lower tax bracket this year or have losses that could shelter all or part of your real estate gain.

13. Find a PIG in a poke. Under the passive activity loss (PAL) rules, you can only use passive losses to offset income from passive activities. Any excess passive loss is suspended until you have enough passive income. To free up suspended PALs from prior years, you may invest in certain partnerships, called Passive Income Generators (PIGs) at year-end. PIGs are designed to throw off current passive income to soak up losses.

Tip: Other special rules apply to rental real estate. Briefly, a limited PAL writeoff may be available, but phases out for upper-income investors.

14. Meet your RMD obligations. After you've attained age 70½, you must begin taking required minimum distributions from your qualified retirement plans and IRAs, whether you want to or not. (Qualified plan distributions may be postponed until retirement for nonowners who are still working.) The penalty for failing to take an RMD is equal to 50% of the required payout, so give yourself plenty of time at year-end to arrange a distribution and meet your 2014 requirement.

Tip: The required amount for 2014 is based on life expectancy tables and your account balances as of Dec. 31, 2013.

It's as simple as 1-2-3

All things being equal, there are three basic tax strategies for individuals to follow in 2014.

1. **Push income into next year.** This gives you at least another year to offset the income. At worst, you defer tax.
2. **Pull deductions into this year.** Reduce your current-year tax liability while you still can.
3. **Keep your options open.** Give yourself enough flexibility to react to late-breaking changes in the law.