SEILER LLP
CERTIFIED PUBLIC ACCOUNTANTS

TAX UPDATE

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It's April in July: Time for a Mid-Year Tax Checkup

Once the summer hits, it's tempting to detach from the daily grind and focus on vacations and summer projects. But we want to encourage you to spend 15 minutes with your accountant now, to save time and effort later. Some of these ideas may apply to you, some to family members, and others to your business.

Federal Income Tax Rates

The federal income tax rates for 2015 are the same as last year: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. However, the rate bracket beginning and ending points are increased slightly to account for inflation. For 2015, the maximum 39.6% bracket affects singles with taxable income above $413,200, married joint-filing couples with income above $464,850, heads of households with income above $439,000, and married individuals who file separate returns with income above $232,425. Individuals can also get hit by the 0.9% additional Medicare tax on wages and self-employment income and the 3.8% Net Investment Income Tax (NIIT), which can both result in a higher-than-advertised marginal federal income tax rate for 2015. Finally, you should consider whether you are exposed to the Alternative Minimum Tax (AMT). The AMT is complex, and its exposure impacts the marginal tax rate and the potential loss of certain deductions and credits, especially for taxpayers who live and own residences in California.

California Income Tax Rates

California's nine state income tax rates range from 1 percent to 12.3 percent. The Golden State also assesses a 1 percent surcharge on taxable incomes of $1 million or more, making California's highest marginal rate 13.3%.

Time Investment Gains and Losses

The 2015 federal income tax rates on long-term capital gains are the same as last year: 0%, 15%, and 20%. However, the maximum 20% rate can only affect singles with 2015 taxable income (including long-term gains) above $413,200, married joint-filing couples with income above $464,850, heads of households with income above $439,000, and married individuals who file separate returns with income above $232,425. Individuals also could be hit by the 3.8% NIIT, which can result in an effective marginal federal income tax rate of up to 23.8% (20% + 3.8%) on 2015 long-term gains.

As you evaluate investments held in your taxable brokerage firm accounts, consider the tax impact of selling appreciated securities (currently worth more than you paid for them) before the end of this year. For most taxpayers, the federal income tax rate on long-term capital gains is still much lower than the rate on short-term gains. Therefore, it often makes sense to hold appreciated securities for at least a year and a day before selling in order to qualify for the lower long-term gain tax rate.

Biting the bullet and selling some loser securities (currently worth less than you paid for them) before year-end can also be a tax-smart idea. The resulting capital losses will offset capital gains from other sales this year, including high-taxed short-term gains from securities owned for one year or less. The maximum rate on short-term gains is 39.6%, and the 3.8% NIIT may apply too, which can result in an effective marginal federal income tax rate of up to 43.4% (39.6% + 3.8%). However, you don't have to worry about paying a high rate on short-term gains sheltered with capital losses (you will pay 0% on gains that can be sheltered).

Take Advantage of 0% Rate on Investment Income

For 2015, the federal income tax rate on long-term capital gains and qualified dividends is still 0% when those gains and dividends fall within the 10% or 15% federal income tax rate brackets. This will be the case to the extent your taxable income (including long-term capital gains and qualified dividends) does not exceed $74,900 for married joint-filing couples ($37,450 for singles). While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who will be in the bottom two brackets. If so, consider giving them some appreciated stock or mutual fund shares which they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term as long as your ownership period plus the gift recipient's ownership period (before he or she sells) equals at least a year and a day.

Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 10% or 15% rate bracket, they will be federal-income-tax-free.

- **Warning No. 1:** If you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting capital gains and dividends to be taxed at the parent's higher rates instead of at the gift recipient's lower rates. That would defeat the purpose. Please contact us if you have questions about the Kiddie Tax.
- **Warning No. 2:** Be aware that if you give away assets worth over $14,000 during 2015 to an individual gift recipient, it will generally reduce your $5.43 million unified federal gift and estate tax exemption. However, you and your spouse can together give away up to $28,000 without reducing your respective exemptions.

Sell Loser Shares and Give Away Resulting Cash; Give Away Winner Shares

You may want to make gifts to relatives and/or charities in conjunction with an overall revamping of your holdings of stocks and equity mutual fund shares held in taxable brokerage firm accounts. To get the best tax results from your generosity, *do not* give away shares that are currently worth less than you paid for them. Instead, sell the shares, and take advantage of the resulting tax-saving capital losses. Then, give the cash sales proceeds to the relative or charity.

On the other hand, *do* give away shares that are currently worth more than you paid for them. Because the charitable organization is tax-exempt, it can sell your donated shares without owing anything to the IRS. Your relative might pay lower tax rates than you would pay if you sold the shares. In fact, relatives who are in the 10% or 15% federal income tax brackets will generally pay a 0% federal tax rate on long-term gains from shares that were held for over a year before being sold. For purposes of meeting the more-than-one-year rule for gifted shares, count your ownership period plus the recipient relative's ownership period, however brief. Even if the shares are held for one year or less before being sold, your relative will probably pay a lower tax rate than you (typically only 10% or 15%). However, gains recognized

by a relative under age 24 may be taxed at his or her parent's higher rates under the so-called Kiddie Tax rules (contact us if you are concerned about this issue).

Plan to Avoid or Minimize the 3.8% Net Investment Income Tax

The net investment income tax, or NIIT, is a 3.8% surtax on investment income collected by higher-income individuals. It first took effect in 2013. After filing your 2014 return, you may have been hit with this extra tax for two years, and you may now be ready to get proactive by taking some steps to stop, or at least slow, the bleeding for this year and beyond.

NIIT Basics
The NIIT can affect higher-income individuals who have investment income. While the NIIT mainly hits folks who consistently have high income, it can also strike anyone who has a big one-time shot of income or gain this year or any other year. For example, if you sell some company stock for a big gain, get a big bonus, or even sell a home for a big profit, you could be a victim. The types of income and gain (net of related deductions) included in the definition of *net investment income* and, therefore, exposed to the NIIT, include—

- Gains from selling investment assets—such as gains from stocks and securities held taxable brokerage firm accounts—and capital gain distributions from mutual funds.
- Real estate gains, including the *taxable* portion of a big gain from selling your principal residence or a taxable gain from selling a vacation home or rental property.
- Dividends, taxable interest, and the taxable portion of annuity payments.
- Income and gains from passive business activities (meaning activities in which you don't spend a significant amount of time) and gains from selling passive partnership interests and S corporation stock (meaning you don't spend much time in the partnership or S corporation business activity).
- Rents and royalties.

Are You Exposed?
You are exposed to the NIIT if your Modified Adjusted Gross Income (MAGI) exceeds $200,000 if you are unmarried, $250,000 if you are a married joint-filer, or $125,000 if you use married filing separate status. Since these thresholds are relatively not high, many individuals *are* exposed. The amount that is actually hit with the NIIT is the *lesser* of: (1) net investment income or (2) the amount by which your MAGI exceeds the applicable threshold. *MAGI* is your "regular" Adjusted Gross Income (AGI) shown the last line on page 1 of your Form 1040 plus certain excluded foreign-source income net of certain deductions and exclusions (most people are not affected by this add-back).

Planning Considerations
As we just explained, the NIIT hits the *lesser* of: (1) net investment income or (2) the amount by which MAGI exceeds the applicable threshold. Therefore, planning strategies must be aimed at the proper target to have the desired effect of avoiding or minimizing your exposure to the tax.

- If your *net investment income amount* is less than your excess MAGI amount, your exposure to the NIIT mainly depends on your net investment income. You should focus first on strategies that reduce net investment income. Of course, some strategies that reduce net investment income will also reduce MAGI. If so, that cannot possibly hurt.
- If your *excess MAGI amount* is less than your net investment income amount, your exposure to the tax mainly depends on your MAGI. You should focus first on strategies that reduce MAGI. Of course, some strategies that reduce MAGI will also reduce net investment income. If so, that cannot possibly hurt.

Perhaps the most obvious way to reduce exposure to the NIIT is to invest in tax-exempt bonds via direct ownership or a mutual find. There are other ways, too. Contact us to identify strategies that will work in your specific situation.

Tax-Smart Strategies for Small Businesses

Consider Selling Rather Than Trading in Business Vehicles
Although a vehicle's value typically drops fairly rapidly, the tax rules limit the amount of annual depreciation that can be claimed on most cars and light trucks. Thus, when it's time to replace a vehicle used in your business, it's not unusual for its tax basis to be higher than its value. If you trade the vehicle in on a new one, the undepreciated basis of the old vehicle simply tacks onto the basis of the new one (even though this extra basis generally doesn't generate any additional current depreciation because of the annual depreciation limits). However, if you sell the old vehicle rather than trading it in, any excess of basis over the vehicle's value can be claimed as a deductible loss to the extent of your business use of the vehicle.

Set up Tax-favored Retirement Plan
If your business doesn't already have a retirement plan, now might be the time to take the plunge. Current retirement plan rules allow for significant deductible contributions. Even if your business is only part-time or something you do on the side, contributing to a SEP-IRA or SIMPLE-IRA can enable you to reduce your current tax load while increasing your retirement savings. With a SEP-IRA, you generally can contribute up to 20% of your self-employment earnings, with a maximum contribution of $53,000 for 2015. A SIMPLE-IRA, on the other hand, allows you to set aside up to $12,500 for 2015 plus an employer match that could potentially be the same amount. In addition, if you will be age 50 or older as of year-end, you can contribute an additional $3,000 to a SIMPLE-IRA.

**Take Advantage of Expected Extensions of Important Business Breaks
(But Be Prepared to Act Fast)**
Several very favorable business tax provisions may dictate taking action between now and year-end. As this was written, these breaks had expired. However, Congress may once again extend them through this year. That could happen relatively late in the year, and you may have to move quickly to take advantage.

- ***Big Section 179 Deduction.*** Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions and eligible real property costs. For tax years beginning in 2015, the maximum Section 179 deduction is currently only $25,000. However, Congress will likely increase the maximum allowance for tax years beginning in 2015 to $500,000 (same as for 2010–2014).
  Note: You cannot claim a Section 179 write-off that would create or increase an overall tax loss from your business. Please contact us if you think this might be an issue for your operation.
- ***Section 179 Deduction for Real Estate Expenditures.*** Real property improvement costs are generally ineligible for the Section 179 deduction privilege. However, a temporary exception applied to tax years beginning in 2010–2014. The exception expired at the end of 2014, but we expect it to be extended to cover qualifying real estate expenditures placed in service in tax years beginning in 2015. If that happens, your business could immediately deduct up to $250,000 of qualified costs for restaurant buildings and improvements to interiors of retail and leased nonresidential buildings.
  Note: Once again, you can't claim a Section 179 write-off that would create or increase an overall business tax loss.
- ***50% First-year Bonus Depreciation.*** Above and beyond the Section 179 deduction, your business can also claim first-year bonus depreciation equal to 50% of the cost of most new

(not used) equipment and software placed in service by December 31 of this year—assuming the 50% bonus deprecation break is extended to cover qualifying assets placed in service in calendar-year 2015. We expect that to happen, but it could be late in the year. If so, be prepared to act fast to take advantage.
Note: 50% bonus depreciation deductions can create or increase a Net Operating Loss (NOL) for your business’s 2015 tax year. You can then carry back the NOL to 2013 and/or 2014 and collect a refund of taxes paid in one or both those years. Please contact us for details on the interaction between asset additions and NOLs.

Don’t Overlook Estate Planning

For 2015, the unified federal gift and estate tax exemption is $5.43 million, and the federal estate tax rate is a historically reasonable 40%. Even if you already have an estate plan, it may need updating to reflect the current estate and gift tax rules. Also, you may need to make some changes that have nothing to do with taxes. Contact us if you are considering the update of your estate plan.

About Seiler
For more than 50 years, Seiler LLP has provided tax, advisory and accounting services to some of the world’s most affluent individuals, families, closely held businesses and non-profit organizations. Our clients include prominent business, community and philanthropic leaders, as well as high-net-worth multi-generational families and successful entrepreneurs. Based in Silicon Valley and San Francisco, we deliver the sophisticated solutions, innovative thinking, global capabilities and highly personalized service our clients require to navigate the complexities of their financial worlds, not only for today but for many years to come. Our goal is to exceed our clients’ expectations in every way.

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