A Little Prep Now Will Pay Off Later

Year-End Tax Planning

by Alexandra Armstrong, CFP, and Kelly Wright, CFP

Most people don't think too much about preparing their tax return until March or even later. By that time it's too late to take action to reduce your taxes for this calendar year. Therefore, we recommend you look at your tax situation now and do some year-end tax planning. Here are some suggestions for changes you can make before year-end to reduce this year's tax bill.

Maximize Your Retirement Contributions

Check to see whether you're contributing the maximum you can to your retirement plan. This year you can contribute the lower of $18,000 or whatever you earned to your 401(k) or 403(b) plan. If you're age 50 or older, you can add another $6,000 to that number. Contributing the maximum has two benefits: It lowers your taxable income and the money in the 401(k) compounds on a tax-deferred basis.

These contributions, however, must be made in the form of payroll deductions before year-end. If you request your contributions be increased now, you may still have time to obtain this tax advantage this year.

If your adjusted gross income is below $98,000 as a married person filing jointly or $61,000 as a single/head of household, you can make a tax-deductible contribution of $5,500 — or $6,500 if you're age 50 or older — to an Individual Retirement Account.

If your AGI is below $183,000 if you're married filing jointly, or $116,000 as a single/head of household, you can contribute up to the same limits to a Roth IRA. You don't get a deduction for making the investment, but the money accumulates for you tax-free and it won't be taxed when withdrawn as long as you hold it at least five years and are over the age of 59 1/2 when you take a distribution.

Contributions to the IRA and the Roth IRA for 2015 can be made anytime before the normal filing deadline of April 18, 2016, or when you file your 2015 tax return on extension, whichever date comes first. (Note that the deadline for filing 2015 tax returns on extension is Oct. 17, 2016.)

How Capital Gains Are Taxed

Taking capital losses at year-end is nothing new, but if you pay particular attention to the types of gains and losses you have, you can make the most of the tax savings available to you. Trades done on the last business day of the year count for 2015, even if they don't settle until 2016.

Long-term capital gains on securities — those held for more than one year — are currently taxed at a lower rate of between 0 percent and 20 percent. Taxpayers in the lowest two federal tax brackets, 10 percent or 15 percent, will not be taxed on their long-term gains. All filers in the 25, 28, 33 or 35 percent tax bracket will pay 15 percent on long-term capital gains.

Those in the 33 percent bracket will probably be subject to an additional 3.8 percent net investment income tax, while those in the 35 percent bracket will definitely be subject to the additional 3.8 percent tax. Individuals in the 39.6 percent tax bracket for ordinary income will pay 20 percent on long-term capital gains plus the 3.8 percent net investment income tax.

Gains from the sale of short-term holdings — those owned for one year or less — will be taxed as ordinary income at a federal rate as high as 39.6 percent depending on your other sources of income.

Offsetting Gains With Unrealized Capital Losses

Before reviewing your portfolio for potential tax losses, first compute your year-to-date gains and losses, grouping the short-term and long-term transactions separately. If you don't have this information, ask your financial adviser to provide you with a gain/loss statement for this year to date.

When you look at your capital gains/losses, remember to include carry-forward capital losses from last year's federal tax return in the appropriate short-term or long-term column.

If your overall capital losses exceed your capital gains, you can deduct only up to $3,000 of that excess loss each year, but unused capital losses can be carried forward indefinitely for use in future years. If page 1 of your 2014 tax return shows a capital loss of $3,000, chances are you have a carry-forward loss from last year.

Check your 2014 Schedule D to see how much of your 2014 loss you weren't able to deduct and the amount carried over to 2015.

If you have a net loss in either the short-term or long-term group of transactions, it can offset a net gain in the other group. But if you have a net short-term or long-term gain, you need to see whether you can find an offsetting loss in any of your holdings. Your first priority should be to offset the short-term gain, since it will be taxed as ordinary income.

What if you have a short-term loss in a stock but really think it will recover in the future? In this case, you can double up on your position, wait 31 days (the Internal Revenue Service-required waiting period) and then sell the top costing shares for a loss.

Another approach called "tax loss harvesting" is to sell the stock for a loss, then move into a similar but different stock in the same industry, thus trying to protect yourself from a market recovery. In 31 days you can decide whether to reenter the stock you previously sold or not.

Make Charitable Donations Count

Whether you contribute cash, stock, a vehicle or other assets, it's important to adhere to the year-end deadlines for 2015 charitable contributions. In the case of noncash contributions, it's also important to know how to accurately determine the value of your donation.

If you donate cash to a charitable organization, you can deduct your donation in 2015 as long as you mail your check by Dec. 31. This is true even if the organization doesn't cash your check until 2016 as long as you have adequate cash in your account to cover the check on Dec. 31.

If you charge your donation to your credit card, which is how online donations are accepted, your donation is treated as occurring on the date the charge occurs. This allows you to take a deduction this year and pay for it next year.

If you donate stock or other securities by mailing certificates, the date of mailing is the date of the donation. If you have the shares donated electronically from your brokerage account, which is more commonplace nowadays, the date it leaves the account is shown on your brokerage statement.

Whether you mail the certificates or transfer them electronically, the value of your donation equals the average of the highest and lowest selling prices for that date.

When donating securities at the end of the year, we suggest you allow a couple of weeks for the process to be completed. Be aware that many securities firms won't guarantee that a security will be transferred by year-end unless they receive your instructions in early December. If you donate stocks or other assets that have appreciated in value, note that you must hold them for more than one year to be able to deduct the full market value. If you donate a stock you've held for one year or less, your deduction is limited to the cost of that asset.

The rules for donating cars and other vehicles changed this year. For a vehicle with a claimed value of more than $500, the allowable deduction depends on how the charity uses the vehicle after receiving it. If the charity sells the vehicle, your deduction is generally limited to the sale price, which the charity must provide to you.

If the charity keeps the vehicle rather than selling it, your deduction will be based on the fair market value of the vehicle and is limited to 30 percent of your AGI. The charity must provide you with a written acknowledgement. IRS Publication 4303, "A Donor's Guide to Car Donations," describes these rules.

Donations of clothing, household items and other goods can be deducted based on the fair market value of the goods. This is usually much lower than the price you paid for the items.

You'll need to keep good records to show how you arrived at the value you use. Many charities such as the Salvation Army will give you suggested ranges for valuations of donations. We recommend you make an itemized list and take pictures of your donated items in case your tax return is audited.

If you use your car for charitable purposes, you can deduct a standard mileage rate of 14 cents per mile in 2015. This would be in lieu of deducting your actual expenses, such as for gas and oil. You can deduct parking fees and tolls whether you use the standard mileage rate or your actual expenses. The mileage rate when using a car for deductible business purposes is 57.5 cents per mile, and the rate for medical or moving purposes is 23 cents.

If your charitable contributions are less than 20 percent of your AGI, you don't need to be concerned with the limits on charitable deductions. For contributions constituting a larger percentage of AGI, your tax deduction may be limited.

For cash contributions, your deduction is normally limited to 50 percent of your AGI. Your deduction could be limited to 30 percent in some cases depending on the charity or if a nonfinancial asset is used by the charity. Excess charitable deductions can be carried forward for up to five years. Keep good records of all your charitable donations and deductible expenses. See IRS Publications 526 ("Charitable Contributions") and 561 ("Determining the Value of Donated Property") for more guidance on claiming charitable deductions.

Gifts to Children and Grandchildren

Many people think they can take a tax deduction for a gift to children, grandchildren or other people. Unfortunately, this isn't correct, but you can give as much as $14,000 to any person each year in cash or securities if it's a present-interest gift with no strings attached.

The recipient isn't taxed when receiving the gift and you don't have to pay a gift tax when giving it. If your gift to any one person exceeds the gift tax limit, you'll need to file a gift tax return even if gift taxes aren't due. If you give stocks or other securities, the recipients acquire your cost basis.

We suggest you write the recipient a letter stating the date of your purchase and cost for your shares so that they have this information if they sell the shares. The scheduling of gifts is important because the process must be completed before year-end. Thus, we recommend starting this procedure at least by early December to make sure it's taken care of by year-end.

If your gift is made by personal check, note that the recipient of your gift has to actually cash the check before the end of the year for the gift to count for 2015.

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Helping Non-U.S. Shareholders Seek Recovery of Losses

Investor Advocacy, WFIC and Volkswagen

by Roger H. Ganser, Chairman, NAIC/BetterInvesting Board of Directors

Volkswagen AG has a primary listing on the Frankfurt Stock Exchange, where it is a constituent of the DAX index; has secondary listings on the London, SWISS and Luxembourg exchanges; and is represented by an American depositary receipt in the over-the-counter market in the U.S. (ticker: VLKAY). On Sept. 18, Volkswagen AG was issued a Notice of Violation by the United States Environmental Protection Agency, alleging that the company had programmed vehicles equipped with turbocharged direct-injection, or TDI, diesel engines to only enable their emissions controls during laboratory emissions testing.

This notice resulted in a significant drop in VW's share price and a significant loss for VW shareholders. Subsequently, VW admitted its fraudulent actions. On Oct. 8 the World Federation of Investors formally adopted a program to enable non-U.S. shareholders of Volkswagen stock to seek recovery for the loss in value of VW shares because of the fraud committed by VW, keeping in mind the importance of VW to the German and European economies.

Although class action suits are very common in the U.S., most people don't realize that this investor recourse is not available in other capital markets around the world. Within the European Union, there are two ways to seek redress by investors: legal action by an individual investor or legal action by a Netherlands-based nonprofit entity whose members are the affected shareholders. The first option is beyond the financial reach of any individual investor.

WFIC has not only endorsed the second alternative but also will proactively inform, educate and facilitate individual investor compensation from VW.

About WFIC

WFIC's objectives are:

- *to encourage investment education,*
- *to promote and defend the rights of the individual investor, and*
- *to promote the formation and development of successful national organizations for individual investors and investment clubs.*

WFIC was incorporated in Michigan in 1979 by investor organizations from the U.S., Great Britain, Belgium and the Netherlands. Roger Ganser, chairman of NAIC/BetterInvesting's board of directors, has been chairman of the WFIC for the past six years.

Other board members include current or former officers, directors or advisers of the Berlin Stock Exchange, NYSE, European Confederation of Directors Associations, Swedish shareholders association, French shareholders association, Spanish shareholders association, and U.S. and French regulatory agencies.

WFIC's headquarters are in Ghent, Belgium; its secretary general/president is Dr. Jean-Pierre Paelinck, past secretary-general of the European Stock Exchanges and EuroShareholders Association. WFIC members hail from more than 40 countries from Africa, Asia, Europe, Middle East and North and South America. ■

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We suggest you let recipients know they should cash your check before the end of the year.

If you use a certified check for making your gift, you can avoid this potential problem.

Consulting Your Tax Adviser

This time of year is an excellent time for you to check in with your accountant about your situation. He or she can advise you as to whether you should be making estimated federal or state tax payments by year-end or in January based on the information you provide. By taking some of these steps now, you should be able to reduce your tax bill somewhat. In addition, it'll be easier for you to put together your tax information in January. Good luck! ■

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