Wealth Management

KANE COMPANY

A FEE-ONLY REGISTERED INVESTMENT ADVISOR

Certified Public Accountants and Financial Advisors

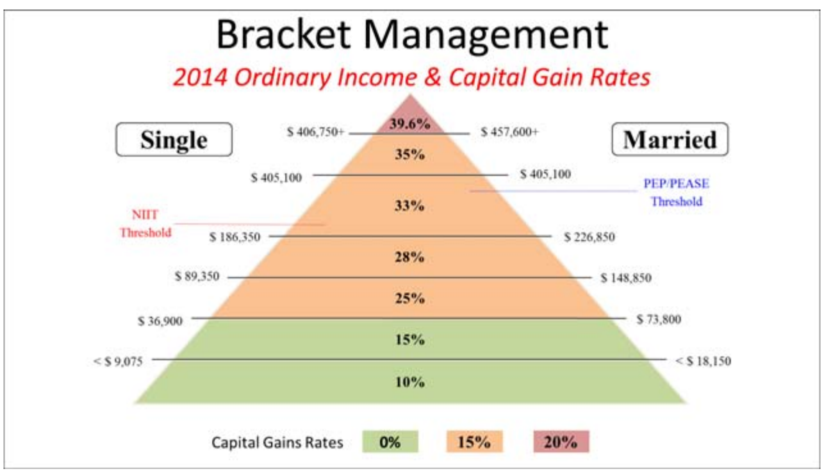
Kane Company, P.C. 515-270-2727 Fall 2014

How To Manage Your Tax Brackets Now And Later

Do you know what tax bracket you're in? Not knowing could stand in the way of your year-end tax planning in 2014. In fact, you'll likely miss out on some unique tax-saving opportunities.

From a planning perspective, it's not just this year's tax bracket that counts. It also matters what bracket you'll be in next year, the following year, and for several succeeding years. After several recent tax law changes, the time horizon for tax planning easily can stretch from five to 15 years.

Let's start with some basic principles. The federal tax system is based on a graduated rate structure, with seven brackets and corresponding tax rates: 10%, 15%, 25%, 28%, 33%, 35%, and a top rate of 39.6%. Once your income rises into any of these brackets, additional earnings for the year will be taxed at your top marginal rate—in other words, your tax bracket.



Consider a married couple filing jointly in 2014. Every additional dollar of taxable income up to $18,150 is taxed at the 10% rate; between $18,151 and $73,800 at the 15% rate; between $73,801 and $148,850 at the 25% rate; and so on. The bracket thresholds are lower for single filers, especially in the lowest brackets. The IRS adjusts tax bracket amounts annually.

Tax bracket management involves stuffing as much taxable income as you can into the lower tax brackets. That requires projecting your annual taxable income before the end of the year. Even a rough estimate can be a valuable guideline for year-end strategies. Depending on the results, you might try to accelerate future taxable income into 2014 or defer some of what you earn into 2015.

For instance, if you expect to have big losses from business activities this year that could mean lower-than-normal taxable income, it might leave room for you to pull in some high-bracket income from 2015 on which you now can be taxed at a lower rate. If you project you'll be in a higher tax bracket five to 15 years in the future—accelerating income now makes even more sense.

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Kane's Secure Client Portal Offers Extra Layer Of Security

One of the reasons we partnered with ShareFile for our secure client portal was their dedication to security. ShareFile safeguards your files with industry-accepted encryption protocols and algorithms in transit and at rest and stores your files in state-of-the-art datacenters equipped to protect against data loss, even in emergencies. Plus, your files are encrypted in transit with a minimum of 128-bit encryption, making it our preferred method to share sensitive documents with you.

Now, there's security on top of security. ShareFile now offers a two-step verification that can be enabled in your account that requires a secondary authentication method, such as an SMS verification code, in addition to a username/password combination. After you log in, you will be asked to enter a verification code that will be sent to your phone via text message (SMS) or voice call.

To opt into the two-step verification process, log into your secure client portal account at https://kanecompanypc.sharefile.com and click **My Settings** in the top navigation bar. Then, click **Two-Step Verification** in the sidebar and select the **Enable** button.

We would also like to announce that Sarah Zimmerman, CPA and Senior Staff Accountant, will be returning on a more regular basis as Jackie Ewalt leaves to pursue other ventures. We wish Jackie all the best and welcome Sarah back!

Steven L. Kane, CPA/PFS, CFP®

Social Security: Taxes In And Out

It seems like the IRS has you coming and going on Social Security. While you are working for a living, you must pay taxes into the system to provide benefits for current retirees. Then, when you finally retire, you're entitled to receive retirement benefits but they might be subject to tax as well.

Don't confuse the two taxes. The Social Security tax you pay as an employee is a payroll tax that applies to wages, commissions, and other compensation as part of the FICA tax. An employee's combined FICA rate for Social Security and Medicare in 2014 is 7.65% on the first $117,000 of compensation and 1.45% (Medicare only) above that. But the tax that may apply to Social Security benefits you get in retirement is a federal income tax that is reported along with other items on Form 1040. It's more complicated than the payroll tax.

Here's how it works: You're liable for tax on Social Security benefits if your provisional income (PI) exceeds certain thresholds in the tax law. For this purpose, PI is the total of (1) your adjusted gross income (AGI), (2) your tax-exempt interest income (for example, from municipal bonds), and (3) one-half of the Social Security benefits you received. For example, if the combined AGI of you and your spouse is $100,000 and you collect $5,000 in municipal bond income and $20,000 in Social Security benefits, your PI is $125,000 ($100,000 + $5,000 + $20,000).

There are actually two thresholds for computing the tax on Social Security benefits.

Threshold 1: For a PI between $32,000 and $44,000 ($25,000 and $34,000 for single filers), you're taxed on the lesser of one-half of your benefits or 50% of the amount by which PI exceeds $32,000 ($25,000 for single filers).

Threshold 2. For a PI greater than $44,000 ($34,000 for single filers), you're taxed on 85% of the amount by which PI exceeds $44,000 ($34,000 for single filers) plus the lesser of the amount determined under the first tier or $6,000 ($4,500 for single filers). Silver lining: You'll never owe tax on more than 85% of your total benefits.

These two thresholds aren't indexed annually for inflation. If your PI exceeds a relatively low level of $32,000 ($25,000 for single filers), you'll owe the tax year in and year out. And you'll get hit with the higher tax rate every year that your PI exceeds just $44,000 ($34,000 for single filers).

What can you do about it? You might lower your PI by harvesting capital losses to offset capital gains or deferring taxable income to the following year. But remember that the income from tax-free municipal bonds counts against you in the calculation of PI. Consider all the relevant factors, including the potential tax implications for Social Security benefits, in your investment decisions. ●

Fly Below The Tax Radar At Year-End

The IRS often zooms in on upper-income taxpayers, especially those who buy and sell a lot of investments, and with good reason: These taxpayers have the most to gain or lose because the stakes are high. However, you can reduce the chances for an unhappy tax landing by flying below the "tax radar."

There are three key tax thresholds to think about in 2014. If you stay below those lines, you're more likely to end up with a reduced tax bill. Let's examine each one:

1. Ordinary income tax rates. Under the graduated tax structure, there are seven tax rates that range from a low of 10% to a high of 39.6%. Even if you're in the top tax bracket, you benefit from the lower brackets, but once your income rises into the top bracket—in 2014, when it exceeds $457,600 as a joint filer or $406,750 as a single filer—any additional taxable income will be subject to the 39.6% rate. Deferring some income to 2015 could help, especially if you expect to be in a lower tax bracket next year.

2. The Pease and PEP rules. Under the Pease rule, named for the congressman who introduced this provision, most itemized deductions are reduced by 3% of the amount that your adjusted gross income (AGI) exceeds a dollar threshold, though the total reduction can't be more than 80%. Personal exemptions are reduced by the PEP (personal exemption phaseout) rule by 2% for each $2,500 (or a portion of that amount) that your AGI goes over the same threshold—$305,050 of AGI for joint filers and $254,200 for single filers.

3. The NII tax. There's now a 3.8% surtax that applies to the lesser of your "net investment income" (NII) or modified adjusted gross income (MAGI) that exceeds an annual threshold. Although NII includes most income items, distributions from IRAs and employer retirement plans are

Why Give Securities To Charity Instead Of Cash?

Want to make a sizable donation to your favorite charity? Of course, you could write out a big, fat check to the organization and claim a current tax deduction for your generosity. But you might fare even better, when taking taxes into account, by donating securities that have appreciated in value. As a bonus, you won't have to sell anything or dip into your cash to pay for the gift.

There's a simple tax incentive for donating stock rather than cash. If you write a check, you generally can write off the exact amount on your federal income tax return, subject to an overall charitable limit of 50% of your adjusted gross income for the year (AGI). However, if you donate securities, you can deduct the fair market value (FMV) of the investments on the date of the contribution and avoid being taxed on the profit you would have made if you'd sold that holding.

In other words, you (and your charity) would benefit from the stock's appreciation without being taxed on it. It's as if your gains never occurred—except for the tax break you would get to enjoy.

But this works only if you've held an investment for more than a year. That's the definition of "long term" for calculating taxes on capital gains. With donations of stock that would have produced a short-term gain if you had sold it, your deduction is limited to your basis in the stock, which is usually what you paid for your shares. So there's no tax reward for giving away stock you've acquired within the year, no matter how much its price may have increased.

Let's take a look at two hypothetical examples to see the tax difference.

Example 1: Suppose you acquired ABC Co. stock nine months ago for $10,000. The stock is now worth $15,000. If you donate the ABC stock to a charity, your deduction is limited to your basis, or $10,000. There's no tax benefit from the $5,000 of appreciation in value. In fact, you would be giving that away for nothing.

Example 2: Suppose you acquired XYZ Co. stock two years ago for $5,000 that is now worth $15,000. In this case, if you donate your XYZ shares to charity, your deduction is based on its FMV, or $15,000. You would get to deduct the entire $15,000 even though you only paid $5,000 for the stock.

These rules lead to rules of thumb that can help you decide which investments to donate. For tax purposes, it's generally best to give the long-term holdings that have gained the most in value. But it makes little tax sense to donate stock that has moved up only a small amount, especially if you've owned it for a year or less. These differences may be especially important to donors in high tax brackets.

If you donate stock that has lost value, your deduction will be based on the stock's FMV. In this case, it usually makes sense tax-wise to sell the stock first and then donate the proceeds to charity. This way, you can claim a capital loss that you could use to offset capital gains from other securities sales.

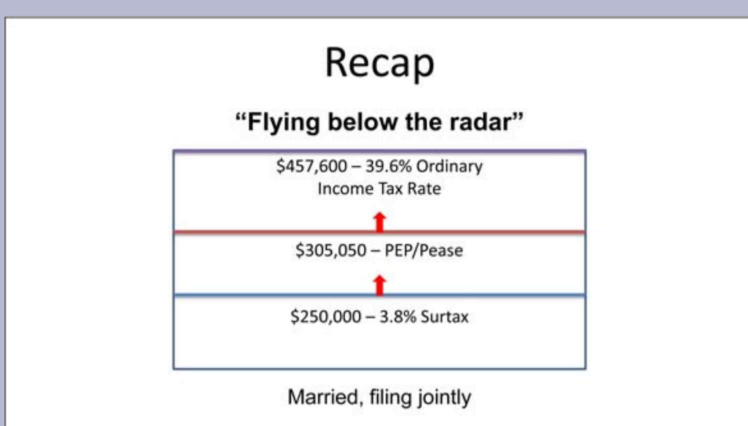
There are a few other tax wrinkles to consider when you're thinking about giving securities to charity. That 50%-of-AGI limit applies only to cash gifts, whereas charitable gifts of property can't amount to more than 30% of your AGI for the year—though you can carry over any excess to subsequent tax years. In addition, some itemized deductions for high-income taxpayers, including those for charitable contributions, may be reduced by the "Pease rule." Generally, this reduction is equal to 3% of deductions exceeding an annual threshold amount (indexed for inflation), but the reduction is capped at 80% of your total deduction. For 2014, the threshold for the Pease rule is $254,200 of AGI for single filers and $305,050 for those who file jointly.

Finally, there's more at stake here than just taxes. Investment factors, too, come into play, and it's usually better to choose stocks that you feel may have reached peak value than those that may continue to rise. You also may want to keep stocks that pay solid dividends. And there could be consequences relating to your estate plan and assets you might want to leave to your heirs instead of donating to charity.

The best approach is to consider all the significant factors before giving securities to a charity. We can help you coordinate your decisions with other aspects of your investment and estate plans. ●

exempt. Nevertheless, the money you take from such plans still increases your MAGI for this calculation. The MAGI limit is $250,000 for joint filers and $200,000 for single filers. And while many tax law provisions rise when inflation does, this one doesn't.

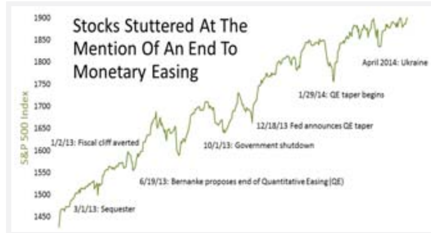
Develop a year-end plan that is geared toward staying below these thresholds or at least as close to them as you can manage. In some cases, such as with the Pease and PEP rules or the NII tax, you may be able to avoid the tax complication altogether. Happy flying! ●



Market Data Bank: 2nd Quarter 2014 Ψ

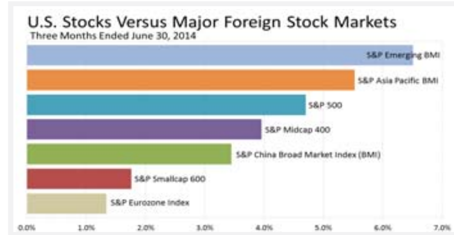
THE BIG PICTURE

It was the sixth year — and sixth quarter — in a row that stocks climbed higher — a bull-market run so strong it is assured a place in history. Five years is a good long stretch. In this case, it was a great stretch. Like all great bull markets, no one saw it coming after the global financial crisis.



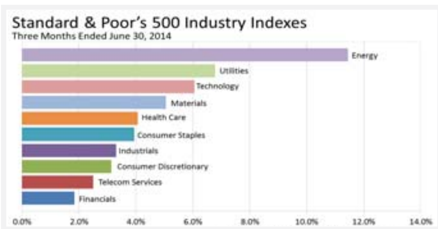
U.S. STOCKS

The unlikely bull run lately overcame fears about Federal Reserve "tapering" its monetary stimulus program. While stocks not long ago sputtered at the mention of tapering, by the end of 2Q14, the market seemed to accept that a world without QE just might be okay.



FOREIGN VS. U.S. STOCKS

Looking at stock markets globally, 2Q14's biggest winners were Emerging Markets (+6.5%) and developed countries in Asia Pacific (+5.5%), compared to the S&P 500's +4.7%. The Eurozone lagged, up just +1.3%. To put this in perspective: it's fantastic!

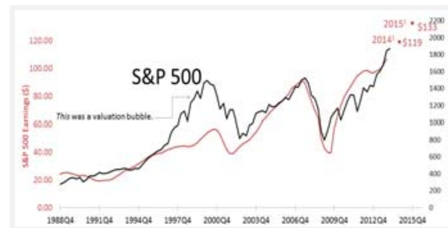


LARGE-CAP U.S. STOCKS BY INDUSTRY

Comparing the stock price performance of S&P 500 10 industry sector indices shows how markets always confound forecasters. Energy distinguished itself by surging with a gain of +11% in 2Q14, followed by utilities (+7%). The financial, telecom, and consumer discretionary sectors lagged.

ASSET CLASSES ±

Looking at 12 asset classes for the year ended June 30, 2014 shows MLPs and the S&P 500 leading, with gains of +26.9% and +24.9%, respectively, followed by global REITs and crude oil with gains of +15.9% and +14.4%. Laggards were U.S. Treasury bonds with a gain of +3.1%, the euro currency with a gain of +4.8%.



S&P 500 INDEX VS. EARNINGS¥

Red squares show expected earnings on the S&P 500 index of blue-chip companies, based on a 6/26/2014 forecast of Wall Street analysts, for $119 per share in 2014 and $133 in 2015. Will stock prices follow the trajectory shown in the markers? No one knows. Events could derail stocks, but the trajectory is positive.

Past performance does not indicate future results. ±Indices and ETFs representing asset classes are unmanaged and not recommendations for any specific investment. Foreign investing involves special risks, including political or economic instability and currency fluctuation. Bonds offer a fixed rate of return while stocks fluctuate. ¥Estimated bottom-up S&P 500 earnings per share as of June 26, 2014 was $119.47 for 2014 and $132.96 for 2015. Sources: Yardeni Research, Inc. and Thomson Reuters I/B/E/S survey of consensus estimates. Standard and Poor's for index price data through March 30, 2014; and actual earnings data through March 2014.

Manage Your Tax Brackets

(Continued from page 1)

One of the best tax bracket management methods is to realize capital gains from selling investments at a profit. Under current law, the maximum tax rate on net long-term capital gain is only 15% for everyone except those in the 39.6% tax bracket—and the 20% you have to pay then is still a pretty good deal. These rates also apply to most dividends.

Even better, the tax law provides a 0% tax rate on long-term capital gains and most dividends for taxpayers in the two lowest tax brackets of 10% and 15%. This means that the portion of your long-term capital gains and qualified dividends falling within the 10% and 15% brackets is taxed at the 0% rate. This creates a unique tax-saving opportunity for investors at year-end.

Another possibility is to convert funds in traditional IRAs to a Roth IRA in a year in which you expect to be in a low tax bracket. This minimizes your liability on the conversion tax—the amount you convert is normally taxed as ordinary income—and sets you up for future tax-free payouts from the Roth.

Note that such tax planning strategies can't be implemented in a vacuum. Your plan should take into account related items such as the Pease and PEP (personal exemption phaseout) rules. The Pease rule reduces most itemized deductions for high-income taxpayers, while the PEP rule provides similar reductions for personal exemptions. For 2014, the thresholds for those reductions are $254,200 of adjusted gross income (AGI) for single filers and $305,050 for joint filers.

Another complication is the 3.8% net investment income (NII) tax for investors. The tax applies to the lesser of NII or the amount by which modified adjusted gross income (MAGI) exceeds $200,000 for single filers and $250,000 for joint filers. The accompanying chart provides a bird's-eye view of the applicable thresholds in 2014.

Suffice to say, you have your work cut out for you as year-end approaches. However, with professional guidance, you should be able to develop a plan accounting for the current year and your personal time horizon. Don't let these tax-saving opportunities go by the board. ●

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