2014 FINANCIAL PLAYBOOK

Strategies for managing new federal tax brackets

by **DAVID J. SCHILLER, JD** *Contributing author*

HIGHLIGHTS

01 When you earn an additional dollar and cross into the next bracket, only that dollar and additional dollars are taxed in the higher bracket, not all income up to the threshold.

02 Any person can gift up to $14,000 per calendar year without being subject to gift taxes and without reporting the transaction on a gift tax return.

How will 2014 tax law changes impact your finances this year and beyond?

Although the top marginal tax bracket was increased to 39.6%, most physicians will have their marginal rate (their last dollar of income) taxed at 28% or 33%, depending on your taxable income.

UNDERSTANDING TAX BRACKETS

Contrary to popular belief, when you earn an additional dollar and cross into the next tax bracket, only that dollar and any additional dollars are taxed in the higher bracket, not income below the threshold. Some people reduce their income for fear of moving into a higher bracket, but only additional dollars are taxed at the higher rate.

Taxes are calculated in two ways, the traditional way and what's known as the "alternative minimum tax" (AMT). The AMT was established for taxpayers who itemize their deductions and take significant write-offs. It can add as much as $5,000 to $10,000 per year to a tax bill. All taxpayers are obligated to calculate their taxes using both methods and to pay the higher amount.

For taxpayers in higher brackets, most long-term capital gains (a category that includes most assets held for more than one year) and qualified dividends are taxed at either 15% or 20% for federal purposes, plus any state or local tax. The tax rate you pay depends on your level of taxable income. The highest tax rate on long-term capital gains and qualified dividends is 20%.

The Affordable Care Act, however, added a 3.8% Medicare tax for taxpayers with adjusted gross incomes over $250,000 if married or $200,000 if single, in addition to the 20% rate mentioned previously. The tax also applies to rental income and other forms of unearned and passive income. Therefore, your capital gains and qualified dividend tax bracket could be as high as 23.8%.

ITEMIZED DEDUCTION PHASE OUT

The government also reinstituted the phase out of itemized deductions and personal exemptions if you are married and your adjusted gross income exceeds $300,000 or if you are unmarried and your adjusted gross income exceeds $250,000.

Essentially, this means that you lose some deductions, such as mortgage interest and charitable donations, and exemptions if your income is higher, effectively raising your taxes further. You lose 3% of the amount by which your adjusted gross

2014 TAXABLE INCOME BRACKETS AND RATES

Rate	Single filers	Married joint filers	Head of household filers
10%	$0 – $9,075	$0 – $18,150	$0 – $12,950
15%	$9,076 – $36,900	$18,151 – $73,800	$12,951 – $49,400
25%	$36,901 – $89,350	$73,801 – $148,850	$49,401 – $127,550
28%	$89,351 – $186,350	$148,851 – $226,850	$127,551 – $206,600
33%	$186,351 – $405,100	$226,851 – $405,100	$206,601 – $405,100
35%	$405,101 – 406,750	$405,101 – 457,600	$405,101 – $432,200
39.6%	$406,751+	$457,601+	$432,201+

Source: Internal Revenue Service

income exceeds the stated thresholds. Although this provision had been in effect previously, it had not applied since 2009 and has now been implemented again.

ESTATE AND GIFT TAXES

Any person can gift up to $14,000 per calendar year to any other person without paying gift taxes and without reporting the transaction on a gift tax return.

For example, a married couple can each give $14,000 to each child and grandchild. Larger gifts can also be given by filing a Federal Gift Tax Return. Such gifts would offset one's lifetime exemption, and usually not result in taxes.

The exemption during an individual's lifetime or upon the person's demise is currently $5.34 million per donor. To the extent that a taxable estate at death exceeds this threshold, there is a federal 40% tax on the excess.

Subject to certain exemptions, there is also a generation-skipping tax that often applies when passing assets to grandchildren, a technique often used to keep them out of the estates of children, where they would be taxed at a higher rate. This should be considered when doing estate planning.

Even if you do not exceed the new high estate tax thresholds, it is important to update your wills and trusts to ensure that your assets are passing to the intended parties whether they be your children, grandchildren, charities or others.

Payroll taxes have also increased, because the Social Security wage base increased to $117,000 this year. Taxes paid on this level of income fund Social Security and Medicare. Although the employer and employee pay both Medicare and Social Security up to the aforementioned wage base, Medicare taxes apply even to wages, exceeding the wage base, and are in addition to the 0.9% surtax that became law as part of the ACA.

STRATEGIES FOR REDUCING TAXABLE INCOME

You can reduce your taxable income by contributing up to $6,450 as a family to a health savings account (HSA), and up to $17,500 to a 401(k) account. In addition, if you are age 50 or older in 2014, you can contribute an additional $5,500 to your 401(k) as a "catch-up" contribution.

You might make sure you are maximizing tax reduction strategies by funding regular or Roth IRAs and 401(k)s, an HSA, utilizing the child care credit, and taking advantage of 529 and Coverdell accounts for your children and grandchildren. ◻

*David J. Schiller, JD, is a tax and estate-planning specialist with Schiller Law Associates in Norristown, Pennsylvania, and a **Medical Economics** editorial consultant.*