MCNEES INSIGHTS
ESTATE PLANNING

Fall 2014

YEAR-END TAX PLANNING 2014

by David M. Watts

Year-end tax planning is especially challenging this year because Congress has yet to act on a host of tax breaks that expired at the end of 2013. Some of these tax breaks may be retroactively reinstated and extended, but Congress may not decide the fate of these tax breaks until the very end of this year (and, possibly, not until next year). These breaks include, for individuals: the option to deduct state and local sales and use taxes instead of state and local income taxes; the above-the-line-deduction for qualified higher education expenses; tax-free IRA distributions for charitable purposes by those age 70-1/2 or older; and the exclusion for up-to-$2 million of mortgage debt forgiveness on a principal residence. For businesses, tax breaks that expired at the end of last year and may be retroactively reinstated and extended include: 50% bonus first year depreciation for most new machinery, equipment, and software; the $500,000 annual expensing limitation; the research tax credit; and the 15-year write-off for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property.

Higher-income-earners have unique concerns to address when mapping out year-end plans. They must be wary of the 3.8% surtax on certain unearned income and the additional 0.9% Medicare (hospital insurance, or HI) tax that applies to individuals receiving wages with respect to employment in excess of $200,000 ($250,000 for married couples filing jointly and $125,000 for married couples filing separately). The surtax is 3.8% of the lesser of: (1) net investment income (NII), or (2) the excess of modified adjusted gross income (MAGI) over an unindexed threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case). As year-end nears, a taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on his estimated MAGI and NII for the year. Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than NII, and other individuals will need to consider ways to minimize both NII and other types of MAGI.

The additional Medicare tax may require year-end actions. Employers must withhold the additional Medicare tax from wages in excess of $200,000 regardless of filing status or other income. Self-employed persons must take it into account in figuring estimated tax. Also, in determining whether they may need to make adjustments to avoid a penalty for underpayment of estimated tax, individuals also should be mindful that the additional Medicare tax may be overwithheld. This could occur, for example, where only one of two married spouses works and reaches the threshold for the employer to withhold, but the couple's income won't be high enough to actually cause the tax to be owed.

We have compiled a checklist of additional actions based on current tax rules that may help you save tax dollars if you act before year-end:

- Realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, then buy back the same securities at least 31 days later. It may be advisable for us to meet to discuss year-end trades you should consider making.

- Postpone income until 2015 and accelerate deductions into 2014 to lower your 2014 tax bill. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2014 that are phased out over varying levels of adjusted gross income (AGI). These include child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2014. For example, this may be the case where a person's marginal tax rate is much lower this year than it will be next year or where lower income in 2015 will result in a higher tax credit for an individual who plans to purchase health insurance on a health exchange and is eligible for a premium assistance credit.

- If you believe a Roth IRA is better than a traditional IRA, and want to remain in the market for the long term, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA, if eligible to do so. Keep in mind, however, that such a conversion will increase your adjusted gross income for 2014.

- If you converted assets in a traditional IRA to a Roth IRA earlier in the year, the assets in the Roth IRA account may have declined in value, and if you leave things as is, you will wind up paying a higher tax than is necessary. You can back out of the transaction by recharacterizing the conversion, that is, by transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA via a trustee-to-trustee transfer. You can later reconvert to a Roth IRA, if doing so proves advantageous.

- It may be advantageous to try to arrange with your employer to defer a bonus that may be coming your way until 2015.

continued on page 4

PENNSYLVANIA MAKES SIGNIFICANT CHANGES TO POWER OF ATTORNEY LAW

by Elizabeth P. Mullaugh and Andrew S. Rusniak

Act 95 of 2014, signed July 2nd by Governor Tom Corbett, made significant modifications to the law governing Powers of Attorney (Chapter 56 of the Probate Estates and Fiduciaries Code, 20 Pa.C.S.A §5601, et. seq.). The changes affect the execution, validity and liability issues surrounding Powers of Attorney and their use by Agents. Because Powers of Attorney used for health care purposes are essentially unchanged by Act 95, this article addresses only financial Powers of Attorney.

Durable General Powers of Attorney (as used in this article, "POAs") are fundamental estate plan documents used to allow a client (the "Principal") to appoint another person or entity (the "Agent") to be a substitute decision-maker as to a broad range of the Principal's financial matters and transactions.

Typically, POAs are used when the Principal is incapacitated or not able to be physically present for the transaction at hand. For elderly persons suffering from dementia or any person struck by a catastrophic event that results in an inability to manage his or her own financial affairs, POAs have been recommended by estate planning attorneys as powerful and cost-minimizing alternatives to court-appointed guardianships.

As noted above, POAs are governed by a state statute based on (but not identical to) a uniform law promulgated by national estate planning and elder law professionals. The original statute enumerated certain powers that could be granted under a POA and has been amended several times, most significantly in the year 2000 to require the addition of a Notice that must be signed by the Principal and an Acknowledgement that must be signed by the Agent before use of the POA.

Unfortunately, POAs have been used by unscrupulous family members, neighbors, and criminals to separate the Principal from his or her assets. Because some of these cases involve intentional theft and others involve misuse of funds by persons caring for elderly relatives and friends, authorities have long sought additional provisions in the statute to combat these abuses. Those efforts have resulted in the changes set forth in Act 95, some of which took effect with the law's enactment and some of which will take effect on January 1, 2015.

Below is a summary of the significant changes.

- POAs executed after January 1, 2015 will need to have revised Notices and Acknowledgements. The revised language includes the new direction (formerly implied but now express) that the Agent acts only in accordance with the Principal's wishes if known by the Agent and, if not known, in the Principal's best interest; and that the Agent acts in good faith and only within the scope of authority of the POA document.
- Powers executed on or after January 1, 2015 must be witnessed by two people and notarized. Previously, unless the POA was being signed by 'mark' by someone unable to sign their own name, the POA did not need to be witnessed or notarized, except to handle real estate matters. The new rules weigh strongly in favor of executing all estate planning documents, and particularly POAs, at an attorney's office where a notary and witnesses are readily available.
- Certain specific powers have become so-called 'hot' powers and must be expressly included in the POA to be authorized. Formerly, only the power to make gifts had to be spelled out, but now powers such as (a) the right to change beneficiary designations on retirement plans, annuities, and life insurance policies; (b) the right to disclaim property; (c) the right to amend or revoke a revocable trust; and (d) the right to create or eliminate a survivorship interest in property (for instance by changing the title of a joint account to tenants in common) require specific authorization and definition of scope.
- The gift power was the original 'hot' power and Act 95 further delineates what gifts may be made by Agents and to whom such gifts may be made. Inclusion of a power to make a gift in a POA should be thoroughly discussed between the client and his or her attorney.
- Finally, Act 95 clarifies and modifies the extent to which POAs may be relied upon by third parties (banks, brokerage firms and the like). While third parties may generally rely upon properly executed POAs, the Act also provides that a third party may (a) ask the Principal's attorney to provide an opinion as to whether the Agent is acting within the scope of authority granted by the POA, (b) request an English translation of the POA, and (c) ask the Agent to certify under penalty of perjury any factual matter regarding the Principal, the Agent, or the POA. The cost of such assurance is to be borne by the Principal. Furthermore, Act 95 also provides that a third party who refuses to accept a POA may be subject to civil liability for harm caused to the Principal's economic interests.

While it is not necessary that all clients get new and revised Powers of Attorney, we recommend the following:

1. All Powers of Attorney executed prior to 2001 should be reviewed for compliance with the current law.
2. Any new Powers of Attorney must be in the revised form set out in the statute.
3. Clients should consider discussing with their attorneys POAs signed since 2001 if they are concerned about their Agent being able to exercise certain 'hot' powers or if they would like to curtail their Agent's use of those powers. ■

Elizabeth P. Mullaugh practices in the Estate Planning, Automotive Dealership Law, and Orphans' Court Litigation groups.
717.237.5243 / emullaugh@mwn.com

Andrew S. Rusniak practices in the Estate Planning and Business Counseling groups.
717.581.3704 / arusniak@mwn.com

HAVE YOU REVIEWED YOUR ESTATE PLAN RECENTLY?

by Vance E. Antonacci

Estate planning has received some recent media coverage with the deaths of celebrities such as Robin Williams, James Gandolfini, and Philip Seymour Hoffman. In the case of James Gandolfini, the coverage focused on his failure to update his plan, which led to unnecessary estate tax liability, among other adverse consequences. The untimely deaths of these celebrities reinforces the point that your estate plan is likely to change over time. Generally speaking, an estate plan should be reviewed and, if needed, updated when your personal circumstances change or there are changes to the tax laws or other laws that impact estate plans. Your personal circumstances may change, for example, as follows:

- Your Last Will and Testament appoints guardians but the guardians are no longer practical since they are older or the circumstances of your children are different (e.g., the guardians are not local and it is important to have your children continue in their current schools).

- Your Last Will and Testament appoints an executor or trustee who no longer is a viable choice for this role. A trustee appointment can last for an extended period of time, and consideration should be given to whether an individual appointed as trustee can serve in this role.

- An executor, trustee, guardian, agent, or beneficiary may have died. Most estate plans account for the possibility of a pre-deceasing fiduciary by providing for alternate appointments. However, the alternate appointments may not make sense with the passage of time. Likewise, most Wills account for the possibility of a pre-deceasing beneficiary (the "per stirpes" language you see in your documents); nevertheless, an untimely death may prompt a client to re-think the disposition of his or her estate.

- A child is going through a divorce or a separation or financial difficulties. In this situation, you may want to update your estate plan to shield the child's inheritance from his or her creditors.

- A child is very successful. If this is your situation, your plan may benefit grandchildren either directly or through a disclaimer by the child.

- You may have acquired real estate in another state. If so, you may want to consider owning the real estate in a Revocable Trust.

Changes in tax laws often lead to changes in estate plan documents. Most notably, the federal estate tax law has changed significantly over the last fifteen years. In 2001, each person could exempt up to $675,000 of property from estate tax at death and your exemption amount could be "wasted" by transferring your property directly to your surviving spouse instead of to a trust for his or her benefit. Currently, the exemption amount is $5,340,000 per person and a decedent's unused exemption amount can be carried over to a surviving spouse. Under the current law the exemption amount will increase annually based on inflation. Common themes for updating estate plans are as follow:

- If your estate plan was prepared between 2001 and 2009, it may incorporate "Disclaimer Trust" planning that may no longer be necessary. Disclaimer Trusts were utilized to address the uncertainty surrounding the amount of property transferred at death that could be exempted from the federal estate tax (the estate tax exemption amount increased between 2002 and 2009 to $3,500,000 but under the law at that time the exemption amount would decrease to $1,000,000 in 2011). Most clients now have no realistic expectation of estate tax exposure due to the increased estate tax exemption amount is $5,340,000 and portability. As a result, you may not want to continue with this type of plan.

- Other clients may have "pour over" Wills and Revocable Trusts that also were prepared when the estate tax exemption amount was much lower. These documents may over-complicate the estate plan given the current tax laws. These plans also rely on spouses owning assets separately.

- "Disclaimer" plans and "Pour Over" plans incorporate separate ownership of assets by spouses. Separate ownership of assets requires the administration of an estate when the first spouse dies. If there is no need for these types of plans, then assets should be jointly titled to avoid the costs and inconvenience associated with settling an estate.

- Some clients may have established an "Irrevocable Life Insurance Trust" to mitigate estate tax exposure. In general, the trust avoids estate tax on the death benefit of the life insurance policy owned by the trust. Clients may consider terminating the trust or reducing the face value of the policy owned by the trust in order to save on premiums.

It is important to remember that every client's situation is unique and that no two estate plans are alike. The tax laws are always changing as are your personal circumstances. A periodic review of an estate plan generally is a good investment to ensure that the plan fits your current needs and the current tax laws. ■

Vance E. Antonacci chairs the McNees Estate Planning group.
717.581.3701 / vantonacci@mwn.com

YEAR-END TAX PLANNING 2014 continued from page 1

- Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2014 deductions even if you don't pay your credit card bill until after the end of the year.

- If you expect to owe state and local income taxes when you file your return next year, consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2014 if doing so won't create an alternative minimum tax (AMT) problem.

- Take an eligible rollover distribution from a qualified retirement plan before the end of 2014 if you are facing a penalty for underpayment of estimated tax and having your employer increase your withholding isn't viable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2014. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2014, but the withheld tax will be applied pro rata over the full 2014 tax year to reduce previous underpayments of estimated tax.

- Estimate the effect of any year-end planning moves on the alternative minimum tax (AMT) for 2014, keeping in mind that many tax breaks allowed for purposes of calculating regular taxes are disallowed for AMT purposes. These include the deduction for state property taxes on your residence, state income taxes, miscellaneous itemized deductions, and personal exemption deductions. Other deductions, such as for medical expenses, are calculated in a more restrictive way for AMT purposes than for regular tax purposes in the case of a taxpayer who is over age 65 or whose spouse is over age 65 as of the close of the tax year. As a result, in some cases, deductions should not be accelerated.

- You may be able to save taxes this year and next by applying a bunching strategy to "miscellaneous" itemized deductions (i.e., certain deductions that are allowed only to the extent they exceed 2% of adjusted gross income), medical expenses and other itemized deductions.

- You may want to settle an insurance or damage claim in order to maximize your casualty loss deduction this year.

- Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retirement plan) if you have reached age 70-1/2. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. If you turned age 70-1/2 in 2014, you can delay the first required distribution to 2015, but if you do, you will have to take a double distribution in 2015 - the amount required for 2014 plus the amount required for 2015. Think twice before delaying 2014 distributions to 2015 - bunching income into 2015 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2015 if you will be in a substantially lower bracket that year.

- Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year.

- If you are eligible to make health savings account (HSA) contributions in December of this year, you can make a full year's worth of deductible HSA contributions for 2014. This is so even if you first became eligible on Dec. 1, 2014.

- Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and estate taxes. You can give $14,000 in 2014 to each of an unlimited number of individuals but you can't carry over unused exclusions from one year to the next. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

- To reduce 2014 taxable income, consider disposing of a passive activity in 2014 if doing so will allow you to deduct suspended passive activity losses.

- If you own an interest in a partnership or S corporation, consider whether you need to increase your basis in the entity so you can deduct a loss from it for this year.

If you have questions about any of these year-end steps, please contact us, and we can tailor a particular plan that will work best for you. ■

David M. Watts, Jr. practices in the McNees Estate Planning group.
717.237.5344 / dwatts@mwn.com

© 2014 McNees Wallace & Nurick LLC
McNEES INSIGHTS is presented with the understanding that the publisher does not render specific legal, accounting or other professional service to the reader. Due to the rapidly changing nature of the law, information contained in this publication may become outdated. Anyone using this material must always research original sources of authority and update this information to ensure accuracy and applicability to specific legal matters. In no event will the authors, the reviewers or the publisher be liable for any damage, whether direct, indirect or consequential, claimed to result from the use of this material.