PARTNERS
WEALTH MANAGEMENT
Second Quarter 2014 (630) 778-8088/info@partnerswealth.com

You Have Entered The Twilight Zone—Of Taxation

Rod Serling, creator of the classic science-fiction TV series, "The Twilight Zone," could not have come up with a stranger tax structure. You have entered a five-dimensional tax zone, a tax labyrinth so strange it almost seems like science fiction.

There's more to the federal income tax system than just a single calculation. In fact, upper-income taxpayers—especially those generating income from investments—actually must cope with five "dimensions" of taxation: (1) ordinary income tax; (2) capital gains and losses; (3) the alternative minimum tax; (4) the net investment income tax; and (5) a reduction of itemized deductions and personal exemptions. Here's a quick rundown:

1. Ordinary income tax. This is the standard tax calculation we're all familiar with. The income you earn generally is taxed under a graduated rate structure with seven tax brackets: 10%; 15%; 25%; 28%; 33%; 35%; and 39.6%. If you're in the top tax bracket, any extra income you earn is taxed at the 39.6% rate. Tax deductions and credits can be used to offset your tax liability based on these ordinary income rates, but certain special rules may apply (see #5).

Furthermore, under the "kiddie tax," if investment income of a dependent child exceeds an annual threshold ($2,000 in 2014), the excess generally is taxed at the top tax rate of the parents. This can hike the overall family tax bill.

2. Capital gains and losses. The tax law provides separate tax treatment for capital assets such as securities and real estate. Generally, gains and losses from capital assets are used to offset each other. Long-term gains from assets held longer than a year qualify for a maximum 15% tax rate, but the rate increases to 20% for those in the top two ordinary income tax brackets. Qualified dividends also benefit from these preferential tax rates.

In addition, you can use excess capital losses to offset up to $3,000 of ordinary income, and you can carry additional losses over to next year. With that in mind, "harvesting" losses is a common year-end tax strategy.

3. Alternative minimum tax. The alternative minimum tax (AMT) runs on a track parallel to ordinary income tax. This complex calculation involves certain additions and adjustments before subtracting an exemption amount based on your tax filing status. However, the exemption is reduced for high-income earners. There are just two tax brackets—26% and 28%—for taxpayers with AMT liability.

At tax return time, you compare your ordinary income tax result to the AMT result and effectively pay the higher of the two. This "alternative" tax often catches unwary taxpayers by surprise.

4. Net investment income tax. The "net investment income" (NII)

(Continued on page 4)

Forever Striving For Exceptional Client Service

Early in 2014, we welcomed Frank Bonfiglio to the Partners Wealth Management team as COO and Director of Client Services. Frank comes with a wealth of financial and operations' experience. With over 25 years in the consumer/commercial credit and leasing services industry, Frank is well prepared to assist PWM to achieve new heights in client support. His history includes building a successful leasing company that was acquired by a major bank, a company that hit a summit of over a quarter billion dollars in assets.

Frank is well versed in management, operations, and finance. Those attributes, linked with his entrepreneurial outlook, makes Frank aptly armed to assist Partners Wealth Management in its diligent pursuit to forever enhance the client experience.

A graduate of Roosevelt University with a BS/BA in Accounting with a minor in Finance, Frank will add value as the PWM client process evolves. Partners Wealth Management is committed to intelligent growth, adding key personnel to continually heighten our clients' quality of service.

John

Partners Wealth Management offers Securities and Advisory Services through NFP Securities, Inc. Member FINRA/SIPC.
1700 Park Street, Suite 200, Naperville, IL 60563, (630) 778-8088. NFP Securities, Inc. is not affiliated with Partners Wealth Management.

Markets May Not Be Certain, But Experience Is

Have you ever wished you could do it all over again? Experience can be a great teacher, and it's natural to imagine that with the benefit of hindsight you would have made better decisions about everything from raising your children to managing your financial affairs. And while that may or may not be true, what is certain is that you can offer younger family members some of the insight you've acquired along the way.

Here are some thoughts you might pass along:

1. When you get a pay raise or a new higher-paying job, consider earmarking at least part of the additional money for retirement savings. You'll be amazed by what tax-deferred compounding can do to even relatively small sums over the course of several decades. And using raises to increase your contribution to a 401(k) can be relatively painless. Ratchet up your saving rate by a percentage point or two each year and you'll soon reach the maximum for annual pre-tax contributions to 401(k)s and similar employer-sponsored plans—$17,500 in 2014 if you're younger than age 50. Beginning at 50, you'll be eligible to contribute an extra $5,500 a year.

2. Try to resist the siren song of early retirement. Leaving your job in your 50s may be tempting, but it runs counter to several financial realities. Most people have not saved enough to retire comfortably even at the traditional age of 65, and quitting early can mortgage your future in two ways—reducing the amount you can save while extending the time that your savings must support you. By the same token, however, every year you keep working improves your situation. Moreover, as life expectancies increase, more and more people find they want to stay on the job at least part-time, and not only for financial reasons. Working can help keep you engaged and healthy, particularly if you find something you really like to do.

3. Consider postponing Social Security. You can begin receiving benefits as early as age 62, but each year you delay will increase the amount of your monthly payment, and if you wait until age 70, you'll get 76% more than if you had started drawing benefits at 62. And most people will live long enough to get a larger total payout if they begin later.

4. Don't feel like you have to go it alone in making financial decisions. Working with an advisor could help you make sense of complex financial markets and chart a comfortable path toward your goals. The right advisor can assist you in deciding how much to save, how to allocate your investments, how to weigh the pros and cons of buying a home and other major financial choices, and, when the time comes, how to deploy your retirement nest egg. ●

Beware The NII Surtax On Trusts

Tax experts have warned that the new 3.8% Medicare surtax—which applies to "net investment income" (NII)—can be a formidable tax obstacle for upper-income investors. But the NII tax isn't just a concern for individual taxpayers. It also may affect trusts and estates. In fact, the overall impact on estates and trusts with substantial annual income might be even greater than the tax sting felt by wealthy individuals.

First, let's review the basic rules. For 2013 and thereafter, you must pay the 3.8% Medicare surtax on the lesser of your NII or your modified adjusted gross income (MAGI) above an annual threshold—$200,000 for single filers and $250,000 for joint filers. For this purpose, NII is defined to include interest, dividends, capital gains, rents, royalties, nonqualified annuities, income from passive activities, and income from trading financial instruments or commodities. However, certain items—such as wages, self-employment income, Social Security benefits, tax-exempt interest, operating income from a non-passive business, and distributions from IRA and qualified retirement plans—are excluded from the definition of NII.

But the 3.8% Medicare surtax also applies to trusts and estates. In this case, the dollar threshold for single or joint filers is replaced by the dollar figure that begins the top tax rate for trusts and estates. For example, if all of the trust income is NII and the undistributed net investment income exceeds the dollar threshold by $10,000, the trust must pay a Medicare surtax of $380 (3.8% of $10,000).

As you might imagine, the tax cost can become pretty steep for a trust with an annual income of five figures or higher. Going back to our previous example, if the trust's NII

10 Ideas For Better Brainstorming Sessions

Oscar Morales felt that his small manufacturing company needed a boost. With profits flat the past few years, Oscar thought a few new ideas could help reignite growth and make the business more competitive. But he wasn't quite sure how to rally the troops.

Turning to your own employees for ideas can be a winning strategy. They know your operation and it's in their interest to make it better. But simply scheduling a brainstorming session may not be enough. Consider these 10 approaches that could improve the brainstorming process at your company:

1. Create a friendly environment. "There's no such thing as a bad idea" may not always be true, but it's the attitude you need to foster if you want staff members to volunteer their thoughts without fear of ridicule or criticism. A suggestion that appears to be outlandish at first blush could lead to a practical solution of a problem or a new way to generate income. Make sure your employees feel comfortable expressing themselves.

2. Emphasize quantity over quality. In the same vein, a chief goal of brainstorming should be to generate as many ideas as possible without immediately trying to judge any of them on their merits. Don't get caught up in any particular angle or school of thought. If you can get a stream of ideas flowing freely and write down all of them, no matter how silly they may seem, you could come away with the raw material for strong strategies to improve your business.

3. Cycle in and out of groups. Most brainstorming is a collective affair, with the entire group working together or a few groups each coming up with its own list of concepts. However, those approaches can be counterproductive if everyone falls into line with the ideas being floated. One alternative to consider is to work one on one with individual staff members. You could gather the full team later to share ideas with everyone—and perhaps make assignments to individuals to research and develop the most promising possibilities.

4. Experiment with anonymity. Another option if group brainstorming sessions aren't sufficiently productive is to ask employees to submit their ideas anonymously. This can be a good way to get creative juices flowing if some of your staff members seem hesitant to offer their thoughts in front of the group. Here, too, you can conduct a follow-up session to let everyone weigh in on the best submissions.

5. Encourage small ideas. Don't worry if no one offers a top-to-bottom plan for making your company more efficient or profitable. Things that may seem to be mere tweaks to your current operations could add up to transformative improvements. A few well-placed singles may be better than a home run.

6. Give the team a break. Brainstorming can be exhausting, so try to keep your sessions shorter than an hour. If you go longer, you may start to see yawns and a lot of people checking their watches. When a marathon stretch is required, break it up with lunch or by bringing in snacks and drinks.

7. Take the show on the road. Always meeting in your company conference room could discourage out-of-the-box thinking. A change of scenery to an off-site location may help stimulate ideas or provide other inspiration.

8. Bring in outside catalysts. Sometimes you're just too close to a problem to see obvious solutions, or you may let your personal preferences keep the conversation in expected areas when it's important to break the mold. Adding an impartial outsider, perhaps from another part of your operation, could provide fresh perspectives to get the group thinking in new directions.

9. Get everyone involved. You may find your brainstorming sessions turning into a platform for just one or two employees, with everyone else as passive observers. If you can encourage participation by those who have been sitting on the sidelines, you may get a broader range of ideas. You might even consider asking the most vocal participants to sit out a meeting or two.

10. Keep records of your sessions. Although you don't want to slow down the brainstorming process, it is crucial to capture all of the ideas getting tossed around. And these days, the traditional approach of marking up big tablets on easels could be supplemented or replaced by computer software tools that can help record and track ideas in an organized manner. ●

exceeds the upper limit of the top tax bracket by $100,000, the surtax amounts to $3,800 (3.8% of $100,000), on top of the regular income tax.

What can you do about it? Depending on the terms of the trust, you might be able to arrange for distributions to family members in lower tax brackets during years when the 3.8% surtax is minimal or nonexistent for the trust. For example, suppose that you've established a trust to pay for a grandchild's college education and the grandchild is currently in the 10% tax bracket. By paying out distributions over several years while the grandchild is still in the 10% bracket, you might sidestep a hefty NII surtax on the trust when he or she is ready to enter school.

Of course, there are other factors to consider, so this strategy isn't for everyone. But don't ignore the potential tax erosion for a trust if it continues to pile up investment earnings. ●

Crummey Gifts: Spring Into Action

Traditionally, the end of the year is the time when wealthy individuals give gifts to other family members, especially to children who are likely to be in lower tax brackets. Not only does such gift-giving coincide with the holiday season, it also lets you beat the deadline for using the annual federal gift tax exclusion. You now can give as many recipients as you like gifts of cash and property totaling up to $14,000 each without paying federal gift tax. If you give as a couple with your spouse, that amount is doubled to $28,000 per recipient.

And if you exceed the maximum annual gift tax exclusion? You're still likely not to owe any tax on the gift, thanks to a lifetime exclusion that is $5.34 million in 2014. Tapping the lifetime gift tax exemption reduces the amount available to offset possible future federal estate taxes, but the total amount is large enough to leave most people plenty of room to maneuver.

Yet there's no reason to wait until the end of the year to give away assets. Indeed, earlier gifts are usually better. The sooner assets find their way to the accounts of lower-taxed family members, the less tax erosion will undercut potential investment growth of those assets. If, instead, you postpone gifts until December, more of the income will be taxed to you in your higher bracket. An early gift also might help you avoid or minimize the impact of the 3.8% Medicare surtax on net investment income as well as reducing income tax liability on future sales of the property.

Gift-giving can take many forms, but one approach to consider is using a "Crummey trust" (named for the first person to use this technique in a court-approved case). With a Crummey trust, you transfer assets to a trust and name the lower-taxed family member as beneficiary. Typically, the trust provides a small "window" of, say, 30 days, during which the beneficiary has the right to withdraw the funds. If the window isn't opened, the assets become subject to the terms of the trust.

Usually, understanding your intention, the beneficiary won't attempt to use the funds during the 30-day period. But creating this withdrawal power lets the transfer qualify for the annual gift tax exclusion.

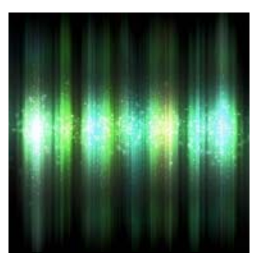
In most cases, a Crummey trust will be able to preserve funds for young family members until they reach the age of majority. Or you could set up the trust to last even longer and provide payments to beneficiaries at predetermined intervals. That could help alleviate concerns about spendthrift children and remove the assets from the clutches of creditors. ●

Twilight Zone Of Taxation

(Continued from page 1)

tax is a new wrinkle that taxpayers have to deal with for the 2013 tax year and beyond. You must pay a 3.8% Medicare surtax on the lesser of your NII or your modified adjusted gross income (MAGI) above an annual threshold—$200,000 for single filers and $250,000 for joint filers. For this purpose, NII is defined to include interest, dividends, capital gains, rents, royalties, nonqualified annuities, income from passive activities, and income from the trading of financial instruments or commodities. But some items, including wages, self-employment income, Social Security benefits, tax-exempt interest, operating income from a non-passive business, and distributions from IRA and qualified retirement plans, are excluded from the definition.

The NII tax is an add-on to the ordinary income tax calculation. Thus, your combined top tax rate can be as high as 43.4%!



5. Reduction of itemized deductions and personal exemptions. Two tax law provisions that were reinstated in 2013 may affect upper-income taxpayers adversely. Under the "Pease rule" (named for the congressman who originated it), certain itemized deductions, including those for charitable donations, state income tax, and mortgage interest, are reduced if your adjusted gross income (AGI) exceeds an annual threshold. For 2014, the threshold is $254,200 of AGI for single filers and $305,050 for joint filers. The total of your itemized deductions covered by the Pease rule is reduced by 3% of the amount above the AGI threshold, but not by more than 80% overall.

A similar rule phases out the tax benefit of personal exemptions. Under the personal exemption phaseout (PEP) rule, exemptions are reduced by 2% for each $2,500 (or portion thereof) of your AGI that exceeds an annual threshold. The PEP thresholds are the same as those for the Pease rule.

Beyond these five, a sixth dimension exists for most taxpayers—state income taxes. ●

Much of the material herein is provided by Advisor Products and is based on data gathered from what are believed to be reliable sources. It is not guaranteed by NFP Securities, Inc. or associates as to accuracy. NFP Securities, Inc. does not provide tax or legal advice and is not a Certified Public Accounting Firm. To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this document is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code, or (ii) promoting, marketing, or recommending to another party any transaction matter addressed herein. Any decisions whether to implement these ideas should be made by the client in consultation with professional financial, tax, and legal counsel

©2014 API