GUNSTER
PRIVATE WEALTH SERVICES

Year-End Update At A Glance
December 8, 2014

Dear Clients and Friends:

As a service to our clients and friends, we have prepared the following summary of income, estate, and gift tax planning opportunities that should be considered by you prior to the end of the year. Although this review is necessarily general in nature, we are happy to discuss any item of specific interest in more detail with you.

There is no such thing as a year without change, change is the only constant, but unlike recent years in which significant, headline-making federal tax law changes occurred, this year we have seen a number of lower profile but significant updates that are important to understand and consider. Even if the US Congress has not recently enacted any significant new tax laws, we have new regulatory tax authority, a Supreme Court case affecting a common financial strategy and our own Florida legislature has recently acted to give us a new planning option, an improved planning option and the need to review a common planning strategy.

***** INCOME TAX, MEDICARE SURTAX, AND AMT PLANNING ISSUES *****

▶ *Income Tax Rates Remain the Same but Brackets Change Slightly*

Unlike the significant increases to the rates for the highest earners, along with the increases to capital gains and qualified dividends, that we saw last year, the federal income tax rates remained stable between 2013 and 2014 – and should remain stable for 2015. Each of the brackets associated with those rates, however, have increased slightly for all taxpayers for 2014 and will also increase in 2015. The continued existence of the significant spread between the ordinary income, capital gains and qualified dividend rates, along with the Medicare surtax, for the highest earners and the next highest bracket means that you should remain mindful of opportunities to divide large income recognition transactions such as asset sales or Roth IRA conversions across multiple tax years to avoid spikes in income. For example, if you are selling an asset and will receive payments over more than one year, you should consider taking advantage of the installment method for recognizing gain in the year in which you receive the payment instead of all in the year of sale. The benefit of spreading income over multiple years is greater today than it has been in decades.

▶ *Year-End Stock and Security Sales*

Additionally, as year-end approaches, one way to reduce overall income is to recognize paper losses on stocks and use them to offset other gains taken earlier this year. If you have stocks in your portfolio that have unrealized losses, you may want to consider selling them before the end of the year. Realized losses will offset realized capital gains and up to an additional $3,000 ($1,500 if married filing separately) of ordinary income. In order for the deduction to be effective, you cannot repurchase the same securities within thirty days of the sale. Also, if you already have net

realized losses over $3,000, which otherwise must be carried forward, you might consider taking enough long-term capital gains to eliminate the excess losses. Taking the gains will not increase your tax. If you own appreciated mutual fund shares held over twelve months and are contemplating selling in any case, you may wish to sell before the December dividend so that the entire gain - including the amount attributable to the upcoming dividend - will be taxed at capital gain rates. You should avoid incurring any short-term capital gains since any gain realized on stocks held for less than twelve months will be taxed at ordinary-income tax rates.

▶ ***Specific 3.8% Medicare Surtax Planning***

The lower your net investment income, the less likely you will pay significant Medicare surtax. Net investment income includes interest, dividends, investment gains, rental income and income from certain types of business activities. Net investment income does not include income generated by an activity in which you materially participate. You might consider whether it would be possible (or worthwhile) to increase your participation in an income generating activity in which you are involved before year-end so as to qualify as a material participant in the activity. Further, if you own interests in a number of passive activities, in order to satisfy material participation requirements, you might consider whether it is possible to treat one or more of those activities as a single activity.

Further, you might consider the following basic Medicare Surtax reduction strategies: (1) changing your investment mix to include municipal bonds, growth-oriented stocks that pay out lower dividends, and investments (such as in real estate, energy, and natural resources) that produce income sheltered by depreciation or depletion; (2) increasing your contributions to qualified retirement plans – distributions from IRAs and 401(k)s are not subject to the Medicare Surtax; (3) use of a like-kind exchange when disposing of rental or business real estate; and (4) gifting income-producing assets to children – even if the "kiddie tax" will apply.

If you are a trustee or a beneficiary of a trust it is important to know that trusts are subject to the Medicare surtax on net investment income in excess of $12,150 (a relatively low threshold). For trust accounting purposes, net investment income is treated like taxable income. If the trust distributes income to a beneficiary, net investment income will also be distributed. Thus, by distributing the net investment income, the trust will not be subject to the additional 3.8% surtax. The beneficiary however, will have to include the net investment income as part of his or her individual income. If the beneficiary's adjusted gross income (AGI) is below $200,000 for single individuals or $250,000 for married couples (much higher thresholds than the threshold for trusts) the beneficiary will not have to pay the 3.8% Medicare surtax. Of course, if the beneficiary's AGI exceeds the applicable amount then the beneficiary will be required to pay the additional 3.8% surtax. We recommend that, as a trustee or beneficiary of a discretionary trust, you consider whether income should be distributed before year end.

▶ ***The Fixed AMT Still Requires Fixing***

Now that the AMT exemption amount is indexed for inflation, fewer taxpayers will theoretically be subject to the AMT. However, a variety of factors can trigger an AMT liability, including large deductions for state and local income or sales tax, a large portion of total income from long-term capital gains, accelerated depreciation, interest paid on a second mortgage, high medical expense deductions, and tax-exempt interest.

If you are continuously subject to AMT because of deductions, you consider the following strategies: (1) if you are planning to exercise incentive stock options, consider exercising and selling those options in the same year so that you'll be subject to the regular tax on the income but not the

AMT; (2) if you plan to either purchase a new residence or make improvements to your current residence, consider obtaining the maximum mortgage available if you might otherwise need to borrow the funds later on; (3) consider accelerating deferred income into the AMT year when your regular tax and AMT would be the same; (4) consider maximizing contributions to your tax-deferred retirement plans; and (5) if you run a business as a sole proprietorship, LLC, partnership, or S corporation, consider prepayment of deductible business expenses near year-end because the deductions are "passed through" to you, resulting in lower AGI and less exposure to the AMT; or consider using your unrealized capital losses to offset capital gains..

▶ ***Planning in Anticipation of a Corporate Inversion***

How many people had heard the term "corporate inversion" or "tax inversion" just a few years ago? They have existed for decades but now most of us are aware and have personally experienced a corporate tax inversion through the ownership of publicly traded securities. There have been a dozen corporate inversions in the last couple of years and there are almost as many planned for 2015 alone. A corporate tax inversion occurs when a U.S. company merges with or is purchased by a company in a foreign country where the corporate tax rate is lower and other tax rules are favorable. After the inversion, the United States can no longer impose taxes on most of the non-U.S. earnings of the corporation. The legal location of the company changes from the United States to another country (usually without changing functional location) and the shareholders of the domestic company typically become shareholders of the new foreign parent company.

If a company's inversion is accomplished through a stock acquisition, in which the overseas corporation purchases significantly all the shares of ownership in the domestic corporation, or if a stock for stock transaction (i.e., a merger) occurs, the existing shareholders face U.S. capital gains taxation at the time of inversion. Of course, how any gain is taxed and the tax rate for an individual or trust shareholder will depend on the holding period and whether or not the taxpayer is a high-income taxpayer and the impact of that gain recognition depends on the circumstances of the shareholder (e.g., whether the shares are held in a taxable account or a tax deferred retirement account; or whether shares are held by a charitable remainder trust or tax exempt charitable organization).

For a shareholder that is particularly concerned about the effect of capital gains treatment resulting from corporate tax inversion, there are limited options. One option is to use the tried and true strategy of harvesting tax losses in his or her investment portfolio to offset the gain. Additionally, for shareholders who are charitably inclined, the contribution of the shares to charity or to a charitable remainder trust prior to shareholder approval of the inversion are other options. The IRS's current position is that the shareholder will not be treated as receiving the capital gains income as long as the recipient charity at the time of the donation is not legally bound to surrender the stock. Admittedly, even if the capital gains may be avoided or deferred, the potential charitable deduction does meaningfully phase-out for high income taxpayers. Finally, properly timed gifts to charities or children will have the added benefit of avoiding additional modified adjusted gross income for Medicare Surtax purposes.

▶ ***Return of Expired Tax Incentives?***

It seemed like a good bet at the beginning of this year that Congress would re-enact many of the multitude of individual tax breaks that expired at the end of last year. Nevertheless, this has been a year of legislative resistance on both sides of the aisle and changing political power structures. Sen. Max Baucus, the longtime member and Chairman of the Senate Finance

Committee, is now the ambassador to China and the November Congressional elections resulted in the predicted change in control of the Senate. When motivated, or simply sufficiently embarrassed, however, Congress can pass legislation quickly, and, on December 3, 2014, the House of Representatives passed legislation that would extend a number of tax breaks for the 2014 tax year. Senate approval of the bill is likely as is the President's signature.

This legislation includes extensions for popular breaks such as: (i) the exclusion from gross income of a discharge of qualified principal residence indebtedness; (ii) treatment of qualified mortgage insurance premiums as interest for purposes of the mortgage interest deduction; (iii) the option to take an itemized deduction for State and local general sales taxes in lieu of an itemized deduction for State and local income taxes - either the actual amount of sales tax paid in the tax year or an amount prescribed by the IRS; (iv) enhanced deduction for contributions of capital gain real property for conservation purposes; (v) the ability of individuals at least 70½ years of age to exclude up to $100,000 from gross income qualified charitable distributions from IRAs in any tax year; (vi) 50% bonus depreciation for property acquired and placed in service during 2014; and (vii) the small business expensing limitation and phase-out amounts in effect from 2010 to 2013 ($500,000 and $2 million) to property placed in service during 2014.

- ***New Simplified Method for Home Office Deduction***

Self-employed individuals and employees who work out of their home are able to deduct business expenses relating to the part of their home that is exclusively used on a regular basis to carry on a trade or business, or, in the case of an employee, the person has no other fixed location to perform his or her job duties. For example, if a taxpayer has in-person meetings with patients, clients, or customers in his or her home in the normal course of business, even though he or she also carries on business at another location, the taxpayer can deduct expenses for the part of his or her home used exclusively and regularly for business or, if a taxpayer uses an extra room to run a business, he or she can take a home office deduction for that extra room. For taxable years starting on, or after, January 1, 2013 (filed beginning in 2014); taxpayers now have a simpler option for computing the business use of their home. Traditionally, the home office deduction requires complex computations and allocations and burdensome recordkeeping. This new simplified option can significantly reduce recordkeeping burden by allowing a qualified taxpayer to multiply the allowable square footage of the office by $5.00, up to 300 square feet, in lieu of determining actual expenses. The maximum deduction under the new rule is $1,500.

***** GIFT TAX AND ESTATE PLANNING ISSUES *****

- ***Gifts Excluded from Gift Tax***

Annual Exclusion Gifts

The "annual exclusion" gift amount for 2014 is $14,000 and this $14,000 amount will remain unchanged in 2015. This means that you may give any one or more persons up to $14,000 (each) during the year (by December 31st) without incurring gift tax. A married couple, however, can effectively double this amount ($28,000) either by: (i) writing a check from a joint account; (ii) writing separate checks from separate accounts; or (iii) consenting to a "gift-split" on a Federal Gift Tax Return. In connection with a "gift-split", one spouse may write the check(s) (up to $28,000 in the aggregate per donee) but both spouses will be treated as having made the gift equally for federal gift tax purposes. The annual exclusion cannot be carried into a succeeding year and 2014 donees must cash any checks given to them on or before December 31, 2014.

Note that the marital deduction is not allowed for gifts made to spouses who are not U.S. citizens. However, the annual exclusion for gifts to non-citizen spouses is $145,000 in 2014 (increasing to $147,000 in 2015) for gifts to non-citizen spouses that would otherwise qualify for the gift tax marital deduction.

Special Rule for Contributions to 529 Plans

Section 529 Plans are tax-advantaged accounts to save for educational expenses. Earnings from 529 Plans are tax-deferred, and distributions are tax-free if used for qualified educational expenses. Unlike tuition payments that are excluded from gifts, 529 Plan distributions can be used for all qualified post-secondary education costs, including room and board; mandatory academic fees; books; supplies (including computers), and certain other expenses. If paid to parties other than the school, such as landlords or grocery stores, such amounts must be within the school-budgeted amount for students. If funds are withdrawn from a 529 plan but not used on an eligible college expense, the withdrawing person is subject to income tax and a 10% federal tax penalty on the earnings attributed to the withdrawal(s).

Although not eligible for the gift tax tuition exclusion, contributions to 529 Plans can be "front-end loaded" by electing to treat a current contribution, for gift tax purposes, as though it had been made over a five-year period. Using the current annual exclusion amount, this means you could contribute as much as $70,000 (5 x $14,000) to the 529 plan, yet use none of your lifetime gift tax exclusion nor incur any gift tax – if you file the appropriate tax return making that five-year election (a separate return is required for each year during the five-year term). If you use this technique and contribute the maximum amount, it means you will have used up all your personal annual exclusion gifts for the plan beneficiary for the next five years. However, if you made the "front-end loaded" gift in 2012 or an earlier year, you may still makes gifts to the 529 Plan this year and the next two years equal to the difference between the annual exclusion in the year of the gift and the current annual exclusion. For example, if you made a $65,000 gift to a 529 Plan in 2012, you could make an additional $1,000 gift to the 529 Plan this year. If you use the five-year averaging method to front-end load a 529 plan, and you do not live beyond the fourth calendar year, your estate will include a portion of any contribution made with that election. Among the attractive features of using 529 plans is that your contributed funds are out of your estate but, because you can remain the owner of the account, the funds are not necessarily out of your control during your life.

Tuition & Medical Expense Gift Tax-Exclusions

Direct payments of medical expenses (including insurance premiums) and tuition (including advance payments) are allowed in addition to the available annual exclusion. The key to these exempt gifts is that they must be made directly to the service provider rather than going through the hands of a third party or given to reimburse otherwise qualified expenses. Only the "tuition" costs paid directly to the educational institution are exempt. Tuition is generally defined to include school fees required for enrollment. Room, board, student health fees, transportation, field trips, books, supplies, equipment, optional school fees, testing costs, etc. are generally outside this exemption.

Direct payment of medical expenses that are excluded from treatment as gifts include expenses for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, or for related transportation. Costs of glasses, contact lenses, dentures, braces and other orthodontic or dental work are also included. Additionally, direct payments of medical and dental insurance premiums, if paid directly to the

insurer, are excluded from treatment as gifts. The medical exclusion does not apply to amounts paid for medical care that are reimbursed to the donee by the donee's insurance.

▶ ***Advanced Gifting Strategies***

Taxable Gifts – Use of Increased Lifetime Gift Tax Exclusion Amount and GST Exemption

In 2014, the lifetime gift (and estate) tax exclusion amount and the GST exemption amount increased to $5,340,000 and will increase again in 2015 to $5,430,000. This $90,000 increase may not seem like much in relation to the large recent increases we have experienced but, historically speaking, an extra $110,000 of lifetime gift tax exclusion amount and GST exemption offers significant gift planning opportunities. Lifetime gifts are particularly beneficial from an estate planning perspective, as all post-gift appreciation accrues outside of the donor's transfer tax base.

Additionally, lifetime gifts can be made through irrevocable trusts that create asset protection benefits for the beneficiaries. You can allocate your GST exemption to lifetime gifts made to a multi-generational trust (i.e., a "Dynasty Trust"). If all the gifts to a Dynasty Trust are covered by an allocation of GST exemption, the Dynasty Trust will not be subject to a GST tax for as long as the property remains in the trust. Under Florida law, a Dynasty Trust could exist for up to 360 years; and certain other jurisdictions, such as Delaware, allow Dynasty Trusts to continue in perpetuity. However, under an Obama Administration proposal, Dynasty Trusts created or funded after the enactment date of new legislation would only be able to maintain their GST tax exemption for 90 years.

Continued Benefit of Historically Low Interest Rates

The Applicable Federal Rates ("AFRs") are the minimum rates of interest that must be charged on loans to avoid interest being imputed for tax purposes. Many estate planning techniques such as grantor retained annuity trusts ("GRATs") and charitable lead trusts ("CLTs") require use of an interest rate equal to 120% of the mid-term AFR (the "Section 7520 Rate"). Although the AFRs have been slowly increasing over the last few years, they remain historically low. The AFRs for December 2014 are 0.34% for short-term (3 years or less); 1.72% for mid-term (more than 3 years but not more than 9 years); and 2.74% for long-term (more than 9 years).

A number of estate planning transactions such as sales to grantor trusts, intra-family loans, GRATs, and CLTs can allow you to take advantage of the low interest rates and transfer appreciation in excess of the required interest rate without incurring any gift tax. For example, if a simple 5-year "zeroed-out" GRAT of $5,000,000 was created using the current AFR and the asset were invested to earn a return of 8% annually, over $1,100,000 could be transferred without any gift tax while consuming, at most, a nominal amount of your lifetime gift (and estate) tax exclusion. The Obama Administration, however, has also proposed to curtail the use of GRATs. The proposal requires that GRATs created after the enactment date of new legislation have a minimum term of 10 years and may not be zeroed-out. This proposal would introduce a risk element to the GRAT far greater than GRATs have now.

The use of grantor trusts (trusts in which the grantor is deemed to own the assets for income tax purposes) and sales of appreciating assets to those grantor trusts are also strategies that the Obama Administration wants to make much less attractive. According to the proposal, assets sold to a grantor trust after the enactment date of new legislation would be subject to estate tax upon the death of the grantor. Also, if the trust ceases to be considered a grantor trust for income tax purposes or if the trust makes a distribution to someone other than the grantor, the grantor would be treated as having made a gift to the trust at that time. If enacted into law, such a proposal would

virtually eliminate the sale to a grantor trust strategy. If you are interested in this strategy, you should consider acting now.

▶ ***Estate Plan Review***

We recommend that you review your estate plan to ensure it is updated taking into account your current family situation, your current asset structure, your dispositive wishes and the tax provisions in effect at this time. You should also check to make sure that your assets are properly titled so that your estate plan operates as intended. If you are married, and have combined assets in excess of $10,860,000, or one of you has assets in excess of $5,430,000, care should be taken to ensure that both you and your spouse will fully utilize your available federal estate tax credits, which may require the gift tax-free transfer of ownership of some assets between spouses (assuming the donee spouse is a U.S. citizen). Although we are not sure whether any of the Obama Administration proposals or other tax deduction extensions will be enacted by Congress, the continued and continuously increasing estate and GST tax exemptions of the American Taxpayer Relief Act of 2012 combined with still depressed asset valuations, historically low interest rates, and the possibility of future legislation curtailing some common estate planning techniques make now an outstanding opportunity for estate planning transactions.

***** U.S. Supreme Court Rules that Inherited IRA Assets Not Retirement Funds *****

It appears that Inherited IRAs are not what we once thought they were. Not only is the Obama Administration proposing to limit the opportunity of non-spouse beneficiaries to stretch out the distribution of IRA assets, the Supreme Court declined to confer "retirement funds" protection to IRA assets that were inherited from a parent. This means that such assets are not exempted under federal bankruptcy law and may be liquidated if the IRA beneficiary is in bankruptcy.

It is important to understand, however, that the Supreme Court was only interpreting federal bankruptcy law protections. Florida is one of many states that have elected to apply its own protections instead of the federal bankruptcy protections. If you have lived in Florida continuously for 24 months, you receive the benefit of Florida's bankruptcy protections, including the 2011 statutory update that makes it clear that inherited IRAs are exempt from the claims of creditors.

It is equally important to understand that even though you may be a resident of Florida and entitled to Florida protections, the beneficiaries of your IRA may not be so fortunate. If a Florida resident dies and his or her IRA is inherited by a relative who resides in another state, the law of that state would apply if that relative were to file bankruptcy. As an alternative beneficiary designation, a trust for the benefit of the intended IRA beneficiary can be used to protect inherited IRAs for out of state beneficiaries. IRA funds that are designated to a trust can receive significant asset protection benefit. When naming a trust for the benefit of a child or relative as a designated beneficiary an IRA, Gunster works with you to form the trust so that the trust beneficiary's remaining life expectancy may be use for purposes of determining required minimum distributions.

***** The Florida Legislature Acts to Add New Trust Technology and Changes LLC Rules *****

Family Trust Company: This year, the Florida legislature, passed a law known as the Florida Family Trust Company Act with an effective date of October 1, 2015. A Family Trust Company is a private, family owned trust company generally formed to manage the wealth of high net-worth families in lieu of individual trustees or financial institutions for a variety of personal, investment, regulatory and tax reasons. By way of example, under a given circumstance, a family trust company may be better suited to handle the administration of family assets such as closely held businesses, agricultural properties, private equity investments or other forms of venture capital.

Directed Trustee Statute: A trust may provide for the appointment of more than one trustee, but confer upon one or more of the trustees to the exclusion of the others, the power to direct or prevent specified actions of the trustees. The Florida law which allows a grantor to exclude a trustee or specifically empower a trustee is referred to as the "directed trustee" statute. Florida has added a new provision to its directed trustee statute that makes it more appealing for trustees to agree to serve under a directed trustee arrangement. A cotrustee that is excluded from a certain power is exonerated from any liability for the action of the empowered co-trustee even if the excluded cotrustee has actual knowledge of willful misconduct by the included cotrustee and regardless of the information available to the excluded cotrustee. Such directed trustee arrangement might be utilized in situations in which the trust holds assets that are difficult to administer such as an interest in a closely held business or an unusual asset.

Revised LLC Act: The limited liability company, or LLC, is an extremely useful tool for our private wealth clients looking to achieve wealth transfer and asset protection. We often use Florida LLCs for these purposes and many of our clients create Florida LLCs even before working with us. On January 1, 2015, every Florida LLC becomes subject to the Florida Revised Limited Liability Company Act. This is the case even if the LLC was created in advance of the enactment of the new statute. This is significant because the revised statute makes several significant changes to Florida LLC law.

Among other important changes, the revised statute does away with the concept of "managing member" for Florida LLCs. On January 1, 2015, any existing Florida LLCs that are managed by "managing members" will automatically convert to "member managed" companies. In some cases, that change can be quite drastic and could very well disrupt existing businesses. The LLC's management structure as agreed upon by the members would be overturned and "control" of the LLC would unintentionally pass to the members of the LLC generally. Virtually all LLCs formed by Gunster are "manager managed" or occasionally specifically "member managed" but if you happen to have an LLC that has a designated "managing member," you should have your company's governing documents reviewed and seek advice as to whether those documents need to be amended to deal with the provisions of Florida's new LLC law.

We hope the information in this letter is helpful to you in your year-end planning. If you have any questions, we would be happy to assist you. Best wishes for a healthy and joyous holiday and New Year.

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In this Year-End Letter, we have deliberately simplified technical aspects of the law in the interest of clear communication. Under no circumstances should you or your advisors rely solely on the contents of this Year-End Letter for legal advice, nor should you reach any decisions with respect to your personal tax or estate planning without further discussion and consultation with your advisors.