Year End Savings

13 steps to ease your tax burden

by Neal Frankle, CFP®

How much time did you spend planning your last vacation? What if you could invest one-tenth that amount of time and, as a result, earn more than enough money to pay for your next vacation? Sounds interesting, doesn't it? Give yourself a gift before year's end, and take some small steps to plant a few seeds now that may reap huge tax savings come spring.

1. Let's start with retirement contributions. Have you contributed the maximum allowable amounts? Every dollar you contribute to your retirement accounts can save you 40 cents or more in taxes.
If you're eligible, your annual IRA contribution of $4,000—or $5,000 if you're 50 or older—is deductible. This is one of the best ways to reduce your taxable income, and therefore, reduce your taxes due next spring.

2. If you are covered by an employer plan, there are maximum limits to 401(k) contributions each year. Generally, your 401(k) contributions must be made throughout the year, but some plans allow for "catch-up" contributions. If you haven't contributed the maximum allowable amount, give yourself a terrific Christmas gift and fund the balance of your 401(k). If your employer matches some of your catch-up contributions, you're in even better shape. Check first with your human resources manager or your company's benefits administrator, because not all plans allow for "catch-up" contributions.

3.Do you have a flex spending plan at work? These are plans that allow you to put aside tax-free earnings to cover medical and dental expenses through a plan offered by your employer. If you do have such a plan, make sure you use up the deposits before year end or they will be lost. Make doctor's appointments now and buy necessary medical supplies that are covered in the plan.

4. Prepay your state and/or local taxes. If you believe that your tax bracket next year will be no higher than this year, and you won't be bothered by any alternative minimum tax issues, consider making those state/local tax payments before the end of this year. Since you will owe

those payments anyway, why not get the deduction this year?
Even if you are a W-2 wage earner and expect a state/local tax balance due, you can use a state/local prepayment voucher and make your tax payment before the end of the year to take advantage of this deduction.

5. Before you put your checkbook away, it probably makes sense to pay property taxes before the end of the year. By doing so, you can use the deduction to reduce your federal tax bill.

6. Do yourself some good by doing good for others. If you have appreciated stock that you've held for more than one year, you can donate the stock. You'll avoid paying capital gains tax, but will still be able to deduct the full value of the stock. A win-win for you and the charity.
If you still love the stock and want to maintain a position in the shares after your charitable contribution, you can always buy new shares in the company—and reset your basis to the higher amount.

7. If you have year-end deductible expenses (such as business expenses, medical expenses, miscellaneous itemized deductions, etc.), make the purchases now by using your credit card. This way, you'll take the deduction this year, and pay your credit card bill next year. The IRS considers the expense deductible in the year that the charge is incurred, not necessarily when you pay the credit card charge.

8. Lets look at your investments. Now is the time to harvest any tax losses. Examine your portfolio. If you are holding a stock or fund that is worth less than your purchase price, you could sell it now to create a "realized loss" which can help reduce (or eliminate) gains from other transactions. And, at least as far as mutual funds are concerned, don't worry about missing out on the growth. While you must wait 31 days to repurchase the same fund, you can always buy a similar fund immediately. This way, you can have your tax cake and eat it, too.

9. Be careful about buying an actively managed mutual fund. They often pay out capital gains toward the end of the year. Check the distribution schedule and if it's late in the year, wait before buying the fund.

10. Contact all your mutual fund companies. Ask them what they expect to pay out in capital gains and when. If you have a mutual fund (that you've held for longer than one year) that you think may have a large capital gains pay out, think about selling those shares prior to the payout date.
Why? Because the share price of the mutual fund will generally drop by approximately the amount of the dividend. So, if you sell the fund before the payout date, you'll lose the (taxable) dividend, but you'll get the higher sales price on your shares. A wash for you but you still get a significant tax savings. This higher sales price will be treated as long-term capital gains. Presto! You've just converted ordinary income into long-term capital gain income and saved yourself some taxes.

11. Here's a tip that can help now and into the coming year: If your income will be lower next year compared to this year, or if you received a large tax refund check this past spring, reduce your withholding payments. You gain nothing by overpaying your estimated taxes because the government pays no interest on tax refunds.

12. Defer income. Unless you have reason to believe that next year will bring you a higher income and move you into a higher personal income tax bracket, you may want to defer income until after the first of the year. If you are self-employed, for example, send the last invoices out late in December so you will more likely receive payment in January.

13. Tax Credit Planning. According to Kary Bartmasser, CPA, and a tax expert in Beverly Hills, California, tax credits are much more valuable than deductions. Don't overlook any of them.
Here are just a few of the most common credits:
Child Tax Credit: A tax credit of $500 per qualifying child under the age of 17. The credit is phased out when your modified Adjusted Gross Income (AGI) exceeds $110,000 for married joint filers, $55,000 for married separate filers, and $75,000 for all other taxpayers.
The HOPE Credit: This is a credit of up to $1,650 per student for qualified tuition and fees paid by the student, or on behalf of the student.
The Lifetime Learning Credit: This is a credit of up to $2,000 per tax return. Full-time, as well as part-time, students qualify. Also, the education does not necessarily have to be for the acquisition of a post-secondary degree or specific business purpose.
Child and Dependent Care Credit: If you pay someone else to care for your child under age 13 to allow you to work, this credit is available to you. The credit is on an inverted scale with respect to your AGI, which means the higher your income, the lower your credit.

These 13 action points are a small sampling of the easy steps you can take now in order to reduce your tax liability. Of course, before taking action you should speak to your tax professional. This is not meant to be tax or financial advice.

Having said that, there is very little you can do after December 31st to reduce your taxes for the current year. So, take stock of your tax issues before the end of the year to see what you can do about them—how you can pay our friends at the IRS only your fair share... and not a penny more.

Neal Frankle is the author of “Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity.” He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, do the same thing for their clients. www.wealthresourcesgroup.com.

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