

YEAR-END TAX PLANNING TIPS

Although it's too early to know what your taxable income will be in 2005, it's not too late to plan strategies to lower it by means of legitimate tactics that can impact your total income, the expenses you may deduct against it, or both.

You might want to hold down your taxable income for 2005 by deferring income to 2006 and accelerating expenses when you have the opportunities—especially if you expect to be in a lower tax bracket next year. But you would want to do the opposite—accelerate income and defer expenses—to lift your 2005 taxable income if you expect to be in a higher bracket next year.

Even if you expect your tax bracket to be the same, it would be smart to consider other moves to hold down your tax bills. To determine which strategies are suitable for you, consider them in the sequence in which topics appear in IRS Form 1040, starting with Line 7, “Wages, salaries, tips, etc.”

Salary reduction. There is usually little that you can do about the compensation portion of your taxable income with one very important exception: putting more money into a tax-deferred retirement plan:

- Sign up to participate in your employer's 401(k) plan, if you have not already done so.
- Raise the portion of compensation that you may defer and have invested in a 401(k), if you have not already authorized your employer to withhold the maximum for this purpose (\$14,000 this year, \$15,000 next year).
- Invest additional money in an IRA, if you meet the income requirements, so that you can deduct it on Line 25. The contribution for traditional IRA's will be fully deductible if your income is \$70,000 or less if you are married filing jointly, or \$50,000 or less if filing individually. The contribution amount for a traditional IRA is \$4,000 or \$4,500 if you are 50 or older.

Taxable and tax-exempt interest. If you are now or plan to be invested in taxable bond funds or individual bonds outside a tax-deferred retirement plan, determine whether you would be better off in tax-exempt bonds or bond funds. Calculate whether your income from tax-exempt securities would be more, or less, *than your after tax return on income from taxable issues*. To make your determination meaningful, be sure to compare funds and bonds of comparable credit quality and maturities.

Dividends. You may have no control over whether dividends which you receive from equity funds or stocks are classified as “ordinary” or as “qualified,” which are taxed at a lower rate. If you get the latter, be sure to confirm that you are differentiating these amounts on your return. Locate the amount in your payers' Forms 1099—DIV the amount to use in Line 9b of your Form 1040. Whichever class of dividends you get, avoid “buying dividends” by not buying stocks or funds just before their year-end distributions.

Income from a Business. If you operate a business from your home and report your receipts and expenses on Schedule C, you may also be able to deduct a portion of your home's insurance, repairs and maintenance and utilities costs. You can report them on its Form 8829 attachment.

Capital Gains and Losses. If you want to sell individual securities or fund shares on which you have gains and which you have owned for less than a year, you have a choice: hold them until you have owned them for more than a year and pay taxes at the long-term capital gains rate or swallow the higher short-term rate. If you own securities which are worth less than they cost or their adjusted basis, you may want to sell them in order to take a loss to offset the gains. Capital losses are netted against capital gains. If you have more realized losses than gains, you can take an additional \$3,000 of loss to offset your ordinary income. More than that and you will need to rollover that loss to be used in future years. If you do sell a security to realize a loss to offset a gain, note that you must not buy back that security for 30 days to avoid disallowing the loss. Note also that you are allowed to use losses to offset the capital gains on the sale of your home as well as the sale of securities.

Deductions. If you itemize deductions and you expect income to be higher next year, you may have some opportunities to defer or accelerate expenses before year end or defer outlays to 2006. Among them: costly medical and dental procedures, real estate tax payments due early next year and charitable contributions. Or vice versa if you are looking to accelerate expenses into the current year. Paying January's mortgage payment in December will add mortgage interest to your deductions. If an individual is subject to AMT the early payment of property taxes is not effective in reducing taxable income.

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