September *MoneyMinute* – Tax Planning You Can Use

By Julie Schatz

October and November are a good time to do your year-end tax planning.

Who should do year-end tax planning? If any of these following situations apply to you, then you would probably benefit from year-end tax planning:

- Did you have an extraordinary gain in 2006?
- Did you receive a large refund in April 2006 and did not adjust your withholding?
- Are you a small-business owner or self-employed?
- Did you exercise employee stock options or sell shares from an employee stock purchase plan in 2006?
- Are you considering gifting either to family members or to a favorite charity?
- Are you interested in doing a Roth conversion in 2006?

Why would you do year-end tax planning?

- So you know what to expect come April 2007.
- To take advantage of any year-end techniques to reduce your liability.
- If there is a potential for penalty due to underpayment – take steps to reduce this.
- If you had an extraordinary gain in 2006, it may push you <u>out</u> of Alternative Minimum Tax (AMT) and your tax strategies would be different than if you were in AMT.
- If you qualify for a Roth conversion it must be completed by Dec. 31, 2006.
- Gifting appreciated assets to your favorite charity -- does it make more sense to do it in 2006 or 2007?
- For small-business owners and self-employed individuals, your retirement plan may need to be set up by Dec. 31, 2006. It can be funded up to the due date of the return including extensions.

<u>Alternative Minimum Tax (AMT)</u>

The AMT is a parallel tax system with different tax rates, income inclusions, and allowed deductions. Every year the amount of income tax you owe is calculated two ways: regular income tax and AMT tax - and you pay whichever is greater. This year, taxpayers earning as little as $62,000 may find themselves subject to this tax. AMT was originally instituted in 1969 to force 155 wealthy individuals into paying taxes. This year 18 million not-so-wealthy taxpayers will likely pay AMT. AMT may cause your current tax planning to backfire because the tax strategies are different. When your ordinary income reaches around $400,000 then you may find yourself <u>out</u> of AMT. Large mortgage interest deductions, large state income tax payments, and other items may trigger AMT.

<u>Investments</u>

If you have significant taxable investments, then aggressive tax-loss harvesting is a strategy that probably makes sense in your situation. This is something we routinely do at ICM, LLC; please consult your financial advisor. (The wash-sale rules preclude you from repurchasing the same security within 30 days.)

<u>Charitable Donations</u>

Do you regularly make donations to your favorite charitable organizations? If so, then you should consider setting up a Donor Advised Funds (DAF). DAFs are an effective way to gift appreciated stocks or mutual funds. A Donor Advised Fund can be set up at Schwab with as little as $10,000. Ideally this $10,000 would be in the form of an appreciated stock or mutual fund. That way, you get to take the full $10,000 deduction on your Schedule A instead of paying capital gains first and then gifting the money. You can gift the money from your Donor Advised Fund over many years to qualified charities.

Roth IRAs: Some New Rules

At Investor's Capital Management, LLC we are huge fans of Roth IRAs. For every year that you qualify, contribute the maximum amount to your Roth IRA. Recent legislation from Congress will eliminate the income limitation on Roth conversions in 2010. If you do not qualify for a Roth IRA and do not currently have a Rollover IRA (or have only a small amount in an IRA), then you have a unique opportunity to take advantage of this new rule, as long as Congress doesn't change the law again before 2010. Open up a Contributory IRA account for yourself (or spouse) and contribute the maximum allowable for every year through 2010. Then in 2010 you can convert this to a Roth IRA and only pay tax on the earnings (your contributions in this case are nontaxable). Please consult with your financial advisor or your tax professional to be sure this is a prudent plan for you.

Kids in College?

If you have children in college (age 18 or older), then consider gifting them highly appreciated stock or mutual funds for them to sell and pay for tuition. This way you can take advantage of their capital gains tax bracket, which may be as low as 5%.

Gifts and Estate Planning

You may gift $12,000 in 2006 to an unlimited number of individuals. If you have more than you need and would like to pass on your wealth to the next generation (or two), then lifetime gifting makes sense and is a tax-wise move.

Flexible Spending Accounts (FSAs) and Open Enrollment Through Your Employer

FSAs are great savings tools offered by many employers that allow earnings to be deducted on a pre-tax basis. The catch is that these funds may only be used for qualified, out-of-pocket expenses for dependents or medical needs. Make sure you spend the full amount of your savings election by Dec. 31 because whatever you don't use…you lose! During your employer's open enrollment periods, make sure you enroll in your FSA, Stock Purchase Plans, and Qualified Retirement plans (i.e., 401k/403b) or Health Savings Accounts. See your HR department for list of benefits and then ask your financial advisor for assistance.

Since we try to keep the *MoneyMinute* brief, we cannot include all of the details in this one e-mail. Please consult with your financial advisor and/or professional tax preparer.

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The articles page on our website covers planning issues from real estate to long-term care, from investment risk to college funding, and more. See the rest at: http://www.feesonly.com/Articles.html

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