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Year-End Tax Planning

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Introduction

Year-end tax planning is a little like clipping coupons or eating at home . . . no one gives you any money for your efforts. But you know that, somewhere along the way, the savings will have a result, making the hassle-factor somehow worth it. For some of us, tax planning before December 31 amounts to nothing more than planning to get your taxes done by April 15 next year. Others will roughly sketch out their tax liability for the current year, and see where they might rush or delay a deduction. Sometimes that's all it takes.

Below is a summary of some of the easier and more common year-end tactics which can save you some money on your tax bill.

Keep in mind through all of this: each time you shave $1.00 off of your income, you could be saving federal tax of up to $.35, plus an extra $.09 if you are in California. So, if you can reduce your income by $1,000, that's $430 extra in your pocket. Something as simple as making your January mortgage payment in December could save you hundreds.

For Indivduals

First, To Itemize or Not to Itemize?

The standard deduction for a single person (higher for those 65 or older) for 2008 is $5,450; for a married couple it's $10,900; for the head of household it's $8,000.

Hurry Up or Wait

The decision whether to hurry deductions and wait on income, or wait on deductions and hurry up income, depends on many factors. First, if you are close to reaching your standard deduction amount for 2008, then consider rushing medical expenses into 2008 (subject to certain restrictions, see below) or paying a mortgage payment early. So long as you get the check in the mail by December 31, then it's a deduction for 2008, even if you put the payment on your credit card. Other deductions you can shift are state and local income tax payments and gifts to charity (see below).

If you're shifting deductions into 2008, then you're also going to try to delay the receipt of income, if you can, to 2009. For those of you who have control over your income flow, consider not sending out your bills until later in December. Or for those of you who are employees, see if your employer can delay your bonus (lucky you!) to 2009. On the flip side, delay deductions to 2009 and rush income into 2008 if you're going to take a standard deduction and think you might have a bad year next year, with enough deductions in 2009 to itemize.

Are you expecting to be in the same or lower tax bracket next year? If so, then consider deferring income until next year while shifting deductions into 2008. Alternatively, if you expect your income to rise, then accelerate income into 2008, and delay deductions to 2009. With the new administration, think about the fact that we are likely in store for a percentage increase on the personal income tax rates. You may want to rush income into 2008 to avoid that hike next year.

Itemizing Medical Expenses

You need to get very sick to take advantage of itemizing medical expenses. You can deduct those unreimbursed medical expenses which exceed 7.5% of your adjusted gross income. So, if you earn $100,000, you need to have more than $7,500 worth of unreimbursed medical expenses to take advantage of this deduction. Your deduction will be anything over $7,500. The sky's the limit, though, once you get above 7.5%. For sole proprietors, instituting certain medical reimbursement plans may be help to break through the 7.5% floor.

Property Tax

Still planning on itemizing? If so, then you can't take the full amount of your property tax as a deduction. However, you can take up to a $500 deduction ($1,000 for marrieds) for your property taxes anyway.

Got Loss?

You're not alone. If you haven't sold, but are thinking about it, your tax consequence is a loss that can only be used to offset your capital gains. If you run out of capital gains to set off, then $3,000 of the loss can be used to offset ordinary income. Any excess capital loss can be carried forward to other years to offset future gains, but unlike operating losses for businesses (see below), you can not carry them back. Here's the catch: you can't sell to get the loss, then buy it back right away to start over. That's a wash sale, and the wash-sale rule says you need to wait 30 days to buy back the asset in order to get the loss. One suggestion: if you have the funds, buy the new stock now, wait 30 days, then sell the old stock; that way, you don't have to wait.

Higher Education Tuition Deduction

This deduction allows you, where eligible, to deduct the costs of qualified higher education expenses paid during the year for you, your spouse, or a dependent. This deduction can reduce income by as much as $4,000. This deduction has been extended for 2009, giving you the choice of rushing/delaying.

Donations

The short version: Send any checks before December 31, 2008.

For Businesses

Business Loss

Again, you're not alone here. The tax code gives businesses the opportunity to go back in time and apply current losses to better years in the past. So if 2008 wasn't a good year for you, but 2007 or 2006 was, you can use this year's net operating loss to offset your profit from those years, generating a refund for you for those years.

Bonus Depreciation

Depreciation is a tax accounting term; by depreciating an asset, the taxpayer takes a deduction using an established set of rules. Typically, the deduction is a set fraction of the basis (the purchase price) in the asset, taken as a deduction for a certain number of years. For 2008, businesses have been given the chance to take a large fraction, i.e., a 50% "bonus" depreciation deduction for qualifying property. The property, generally, must be purchased and placed in service during 2008.

Expensing

As you know, businesses can deduct their ordinary and necessary business expenses. Deductions for capital assets, i.e., one-time expenditures, do not share the same benefits as ongoing operating expenses. Specifically, capital expenditures generally can't be deducted except through depreciation, expensing, depletion, or amortization deductions. With that said, here's the tip: the Economic Stimulus Act of 2008 increased the amount of deductible expensing for 2008. The enhanced expensing provision applies to business property purchased and placed in service in tax years beginning in 2008. The amount that can be immediately deducted was raised to $250,000 for 2008 (which starts to phase out when it hits $800,000). Currently there is nothing on the books to extend this benefit for 2009; that may change.

California

For our California readers, please be aware that, with the myriad of changes taking place on the federal level, California tax laws do not conform to all of the federal rules. Though that was true before 2008, it is even more so now, as Congress continually pushes emergency this's-and-that's through. Listing the non-conforming items is beyond the scope of this newsletter; just be aware that that's an issue for you.

In Summary

If you've made it this far, I congratulate you! Any attention you give your taxes before the end of the year is better than nothing, and it could provide you with significant savings.

The legal caveat: This article is intended as a general guideline. The rules are complex, and changing continually. Please consult your tax advisor.