

Year-end Tax Saving Tips: Part 1

This year your tax planning involves predicting the future. There's a good chance, according to many, that we will see an increase in taxes next year. Depending upon what the changes are, you could find yourself in a higher bracket. If that happens, strategies such as deferring income and accelerating deductions would be just the opposite of what you should be doing—making it all the more important to discuss with your tax advisor any moves that you might be considering.

With that fact in mind, here's a look at some steps to consider taking before December 31 to keep your tax bill as low as possible.

Defer income

It's usually better to pay taxes later rather than sooner. Following that approach, you should try to postpone receipt of any income that you can until next year. Unfortunately, for many taxpayers there is little room to maneuver.

Professionals and self-employed individuals who operate on a cash basis may be able to push income forward into 2009 by delaying some year-end billings. However, salaried individuals should avoid this approach. The IRS is known to scrutinize bonuses that are payable at year-end but not received until the beginning of the next year.

Two other possibilities: If you have U.S. savings bonds that mature in late 2008, you can defer taxation of that income by waiting until 2009 to cash them. Although the bonds still will earn income, the tax on that income will not be due until April 15, 2010. And, if you have been thinking about taking a nonmandatory withdrawal from your IRA, you will delay paying tax on the withdrawal until 2010 if you wait until the new year to make it.

Accelerate deductions

If your marginal tax rate will be the same next year, paying deductible expenses now allows you to reduce your income (and your taxes) sooner. If you expect to be in a lower bracket next year, taking the deduction in 2008 is worth more to you because it protects income that is taxed at a higher rate.

Homeowners may want to make their January mortgage payment in December. Some states allow you to prepay some property taxes. If you are in the process of buying a home and can close by year-end, you may harvest additional writeoffs if you itemize your deductions.

Some itemized deductions are available only when you cross a certain minimum threshold of expenses, usually measured by your adjusted gross income (AGI). Thus, for example, medical expenses are deductible only to the extent that they exceed 7.5% of AGI; certain miscellaneous

expenses, 2% of AGI.

When you have some degree of control over when you incur and pay these kinds of expenses, you may be able to “bunch” them in a way that allows you to cross the barrier and obtain a deduction for expenses that exceed the threshold. For instance, if your medical expenses are likely to be near the threshold this year, try scheduling routine doctor, dentist or other appointments before year-end. Similarly, bunch miscellaneous expenses—the cost of tax advice, custodial fees, professional dues and other work-related items—when you can.

What about the AMT?

The alternative minimum tax (AMT) was established initially to make certain that the highest-income taxpayers would pay at least some amount of tax. Unfortunately, many taxpayers who are far from “rich” are being hit by the AMT.

Congress has attempted to ease the AMT burden by adjusting exemptions from the tax annually, but, generally, later rather than sooner in the year. This year, the extension of higher exemption amounts was included in the just-enacted financial rescue package.

Because of the complicated nature of the tax, it’s advisable to review your tax planning strategies in light of the AMT rules before making any moves. Your tax advisor will be able to tell if, and how, the AMT may affect your year-end planning.

Expired deductions revived

Certain tax breaks expired on December 31 of last year but, as with the AMT, were just extended through 2008 as well, including:

- The above-the-line deduction for qualifying higher education tuition and fees.
- The choice to deduct either state and local income taxes or state and local sales taxes.
- The above-the-line deduction of up-to-\$250 for certain out-of-pocket expenses for teachers and others in the field of education.

Part 2 will examine year-end tax considerations for your investments, retirement plan contributions and charitable gifts.

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