



Ten Top Year-End Tax Tips

Source: TurboTax.com

In this time of market and economic uncertainty, it seems like adding insult to injury to remember that you'll soon have to pay your taxes to Uncle Sam. The good news is you can save a bundle on your taxes if you make the right moves before the end of the year. But be careful. Some easy-to-follow advice doled out around this time of year can backfire.

Before you do anything, you should follow this example — make up income tax projections at least for this year and next. If your situation is complicated enough, you will need a software program or help from your tax preparer. Once you have the numbers, however, you can see how any actions you take will affect your tax bill each year. With that information in hand, the 10 tips below can help you hang onto your cash.

1. Defer income

Most folks on salary don't have much choice on when they get paid. But if you are one of the lucky ones in line for a year-end bonus, consider asking your employer to give it to you in January. Some companies will be able to help you out, but because of stringent rules, others can't. If you have consulting income, you might want to delay billing so that you will get paid next year.

2. Take last-minute deductions

The holidays may be the season for giving, but you can make it easier on yourself if you donate appreciated stock or property rather than cash from the proceeds of a sale. You may be able to give more to the charity, and you avoid paying capital gains. Be sure to give yourself plenty of time because it can take several weeks to transfer the stock or property.

Young taxpayers who may not have itemized deductions before should try bundling miscellaneous deductions such as tax preparation fees, job-hunting expenses, and professional dues to meet the IRS threshold of 2% of adjusted gross income. Paying some of next year's expenses in December might give you enough to put you over the line.

3. Beware of the alternative minimum tax

Sometimes accelerating deductions can cost you money, if triggers the alternative minimum tax. Originally designed to make sure wealthy people paid their fair share of taxes, the AMT is now creeping into the middle class.

It's hitting more and more taxpayers at lower levels of employment often because of incentive stock options.

And that can be a particular problem for people who are not used to figuring out sticky tax issues.

The AMT is figured separately from your regular tax liability, and you may have to pay it rather than a lower tax bill if your itemized deductions are too high, you have a large state tax liability, you buy incentive stock options, or experience another triggering event. You are more likely to be a candidate if your income is above \$75,000 a year. Maximum AMT rates are 28% for income over \$175,000.

4. Sell loser stocks to offset gains

With the roller coaster stock market this year, you may have a mix of winners and losers in your portfolio. If you have a big capital gain, consider selling some of the dogs. You can erase your tax liability on the gain with a corresponding loss. Then you can apply another \$3,000 in losses against ordinary income. Any additional losses can be rolled over to subsequent years.

5. Do a bond swap

You also can sell bonds that are down to generate a tax loss. Bond prices tend to fall when interest rates are high. It's very easy to sell a bond — corporate, government, or municipal — and then turn around to buy a similar one. You will have essentially the same investment but with a little more money in your pocket. Your broker should charge you only a small transaction fee to do the swap. But you should be sure that your broker understands how to do these deals.

6. Call your mutual fund for the distribution date

What a nasty surprise to find that your mutual fund is down for the year and you still have to pay taxes on large dividends and capital gains. If you sell before the fund's distribution date, you can avoid paying those taxes.

On the other hand, if you intend to buy a fund, wait until after the distribution date. Otherwise, you will end up with a tax bill right away without actually participating in the fund's gains.

7. Contribute the maximum to retirement accounts

There may be no better investment than tax-deferred retirement accounts. They can grow to a substantial sum because they compound over time free of taxes. Company-sponsored 401(k) plans may be the best deal because employers often match contributions. Bump up your 401(k) contribution so that you are putting in the maximum amount of money allowed. If you think you can't afford it, run the numbers. Amazingly enough, these payroll deductions can increase your take-home pay because they reduce your taxable income.

8. Decide whether to convert to a Roth IRA

A Roth can outperform regular IRAs because you don't pay taxes on your withdrawals. The catch is that you can't deduct your contributions. It makes sense to convert to a Roth if you have many years to go before you take out your funds. You also should be in the same or higher income tax bracket when you retire so that you pay taxes when you are in your lowest bracket.

9. Plan IRA distributions

If you have reached 70 1/2, don't forget to take at least the minimum distribution from your IRA or face a 50% penalty on the shortfall. How much you need to withdraw is based on your life expectancy. You can figure it once, which results in the largest mandatory withdrawals. Or you can refigure it every year, which allows you to withdraw less. Fortunately, penalties have been eliminated on annual withdrawals over a certain amount.

10. Update flexible spending accounts

If your company provides flexible spending accounts, sign up before the end of the year. These programs deduct money from your paycheck on a pre-tax basis to pay for a wide range of health care expenses not covered by insurance and for child care or elder care. You typically can contribute a maximum of \$3,000 annually to a health care FSA and \$5,000 annually to a dependent care FSA. The tax exemption in effect produces "savings" of as much as 40% or more.

The catch is that you forfeit any money left in your account at the end of the year. So budget carefully and be sure you use up all the money.