Business First of Buffalo - October 25, 2004
http://buffalo.bizjournals.com/buffalo/stories/2004/10/25/focus2.html

BUFFALO Business First
Western New York's Business Newspaper

IN DEPTH: YEAR-END INVESTMENT STRATEGIES

From the October 25, 2004 print edition

Yes, it's time to chart 2005's financial plan

Dale English

The frost has barely tinged the pumpkin, All Hallows' goblins have yet to begin their fearsome annual ride and malls are nearly finished decorating themselves for the holidays. Can it be that year-end financial and tax-planning season is upon us?

"Good heavens, not yet!" many might exclaim in mock horror. "Why, it's barely World Series time!"

Too bad, because now is when tax accountants, financial planners and advisers, and even IRS-type folks say annual investment strategies and tax positions should be reviewed and adjusted as necessary to make sure they're doing everything possible to maximize income and minimize tax bite. For some, waiting until Christmas Week may be too late.

The idea is to go over personal financial game plans well before year's end to allow sufficient time to take action. And, one way or another that usually involves taxes.

Tears of regret

"As CPA's, every April 15 we hear story after story from taxpayers who wished they'd known, thought of, or acted upon some basic planning ideas before the end of the year to lessen the tax bill of Uncle Sam and the State of New York," said John Vitello, Tax Advisory Group director at Dopkins & Co. in Williamsville.

That's important "even though there's not a whole lot that's new this year," said Kevin McKeon, an IRS media specialist in New York City. For individuals, recent tax law changes for the most part merely extended old law.

"Don't wait until the last minute to do things because you may run out of time," noted Richard Schroeder, a principal in Schroeder Braxton Vogt, a Williamsville financial planning firm.

Examples he selected were required IRA distributions for those over age 70 - and making tax-free contributions to Section 529 Qualified Tuition Plans for current or future college students. Both are increasingly popular and people may encounter problems completing their deal if they want until Christmas week.

Dawdling doesn't pay

"With IRA's, don't wait until the last week of December to take your distribution; you may not complete it on time. If it doesn't happen you have to pay the tax penalty. The value of the account is fixed on the last day of the previous year, so there's no reason to wait. It's becoming a big thing now that more people have them," Schroeder noted.

"That's very important because there's a 50 percent tax penalty if you don't," added Peter Haag, a district manager at American Express Financial Advisors in Williamsville.

"On 529 college plans you can put in gigantic amounts -- a $5,000 contribution for a single taxpayer to $10,000 per couple, per person for the state tax deduction," Schroeder said. "But it must be done well before December 31 or it might not get processed on time," he added.

Portfolio dogs

"Then, look at your investment portfolio and get rid of losers -- things you no longer have confidence in, where the stock is dropping in value or the company is falling apart. At least turn it into a tax write-off," Schroeder pointed out.

Vitello, at Dopkins, noted that since May 2003 the capital gain tax rate has been 15 percent for assets owned for more than one year, with securities held for less than a year subject to normal graduated income tax rates topping out at 35 percent.

"It may be time to review your portfolio to determine, first, what capital gain or loss transactions have I already recognized in 2004, and second, if I have recognized some gains this year, are there any (losing) securities that may be harvested to offset the gains realized this year," Vitello said.

Short-term capital gains taxed at maximum rates can be offset with long-term losses "provided that you have long-term losses in excess of long-term gains," he added.

"However, watch how much loss you harvest since you cannot currently deduct more than $3,000 of total losses over total gains -- the excess gets carried forward to be used in future years," Vitello continued. That $3,000, however, can offset other income.

"You can sell the account and have an unlimited carry-forward," Haag added.

Washday

Another watch-out-for is the so-called "wash rule" where you sell good stock for a loss and then buy it back "to increase your cost basis in the future," he noted. That way, "when it finally comes time to sell (the gain) won't go through the roof."

If the security is repurchased within 30 days the loss is disallowed. "These 'wash sale' rules extend over a tax year-end so that a loss on a security sold on December 20, 2004 and repurchased on January 15, 2005 will not be allowed," Vitello added.

"People need to establish a plan and evaluate where they are. Most people who start IRA's and 401(k)'s are flying in the dark," said Steve Morgan, principal in Contour Financial Planning on Grand Island.

"People should take a good look at their 401(k). Are their investment choices a match for their time element and risk factor? If the company's stock is offered in the 401(k) it's good to evaluate the wisdom of having so much. If the company runs into difficulty you can lose your retirement benefit. Think Enron," Morgan observed.

Ramping up

He and others advised ramping up contributions to various tax-deferred or tax-sheltered instruments to reduce the 2004 tax bite.

"Look to reducing taxes through IRA's simplified employee option plans, Keogh Plans and others. There are also catch-up provisions for 401(k)'s and 403(b) tax-sheltered annuities, and health savings plans," Haag advised.

"The IRA contribution thresholds are changing. The maximum rate this year is $3,000 and next year it's $4,000. There's also a $500 catch-up provision if you're over 50, and on these you have until April 15," Morgan said.

McKeon, at the IRS, noted that thanks to recent-year changes, taxpayers could make gifts of up to $11,000 per person and exclude the amount from the gift tax. There are also tax-free flexible spending accounts that can lower taxable income amounts and "the IRS has ruled medical spending accounts can be used to purchase non-prescription medication." But, save the receipts.

He also pointed out that a new tax-saving tool, health savings accounts, are available to participants in some high deductible health plans. "It is a tax exempt trust you set up to save money for future medical expenses if you're in a high deductible health plan," McKeon explained. They have deductibles ranging up to $5,000 for single coverage and from $2,000 to $10,000 for a family plan. Contributions are tax-deductible even if deductions aren't itemized and distributions may be tax-free for qualified medical expenses.

Raising deductions

McKeon also reminded taxpayers that "All itemized deductions have to be taken by Jan. 1 -- state and local property taxes, charitable contributions, mortgage interest payments, (and) medical expenses if you're going to be past the 7.5 percent threshold."

To increase deductions, some may wish to boost various income credits or tax deductibles--things like making a 13th monthly payment on the mortgage; pre-pay state/local property taxes due early in '05; perform any number of medical procedures such as laser eye surgery, obesity weight loss programs, acquire or replace eyeglasses and/or hearing aids or some stop-smoking clinics.

Wage earners also can check their tax withholding amounts to make sure enough is being taken out of their paychecks by visiting the IRS' website, www.irs.gov, and following the appropriate wizard. Employers can then adjust withholding properly.

Self-employed persons might wish to take advantage of Section 179 capital investment deductions of up to $100,000 to upgrade/replace equipment such as their computer before year's end. They might also wish to use the post-9/11 bonus depreciation clause for new equipment, which sunsets Dec. 31. In both cases, however, the equipment must not only be purchased but also placed in service before toasting the New Year.

For all those deductions, including medical and charity, it's OK to use plastic for the purchase. "The IRS considers the expense deductible in the year you incur the charge, not in the year that you pay the credit card bill," Vitello said.

Ides of AGI

He cautioned that those trying to maximize deductions and tax-shelter income keep their adjusted gross income, or AGI, in crosshairs because some start phasing out when the AGI exceeds certain limits, or one could trip over the dreaded Alternative Minimum Tax, or AMT.

Those include IRA contributions, earned income credits, child tax credit, education credits, tuition deductions, reductions in allowable itemized deductions, (limited) rental loss deductions and taxation of Social Security benefits.

"The AGI limitations on deductions and credits (phase-outs) vary on the type of credit or deduction you are attempting to secure....Make sure you understand if there are limitations or phase-outs based on AGI. In almost all cases the old adage, 'accelerate deductions and defer income' is tried and true, except for those situations that may befall a taxpayer whose credits or deductions are annually being phased out due to AGI limitations.

"In those situations, it may be best to bunch up the income or deductions in one year in order to obtain claim the benefit of a credit or deduction in a subsequent year," Vitello explained.

Tax outsourcing

This could also be the time to decide whether to be a do-it-yourselfer in preparing your tax return or out-source the chore to someone you've used before or find a new one.

"Now is a great time to select one," according to McKeon at the IRS, because tax accountants, planners, and preparers, tend to get really busy after January 1st. They may have the time now for an exploratory meeting.

Vitello agreed, pointing out that selecting such a person now can have advantages, particularly since the preparer can suggest courses of action before the year's end to avoid pitfalls later.

He also suggested that persons unsure about what to do acquire last year's tax software now--"the rules aren't significantly different" and try out '04 numbers on '03's program "to see what kind of problems may be looming." Such software may be available for little or nothing now and may provide a credit for 2004's version.

McKeon noted that already 55 percent of all taxpayers use a paid preparer. He cautioned that people should employ the same tests in selecting one they would for other personal contractors, such as reputation and the experience of friends and associates. That includes asking the crucial question, "Will the preparer be there later in the year after tax filing season is over to answer questions about the return?"

Taxpayers should also keep a close watch on news development for the rest of the year in case last-minute tax law changes pop up suddenly after a presidential election. Strange things can happen in Congress.

Vitello also noted that because of the presidential election "There is some level of uncertainty as to the future of federal income tax rates," now at a 40-year low.

"If the general (post-election) consensus is that the 2005 rates will be going up, plan on accelerating as much income into 2004 and defer those deductions until 2005."

Flyaway, flyaway

Lastly, "Check your frequent flier mileage that's about to expire and request an award certificate. That can give you another year to use those miles, depending on your program," Schroeder advised.

Then maybe you can leave the whole mess behind and jet off to someplace warm and sunny while your preparer stays up north, totaling your damages.

Dale English is a frequent contributor.