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Uncle Sam is Coming to Dinner – Plan Ahead and Enjoy the Holidays

By Gina M. Barry, Esq.

Year end is soon approaching. As you sit down for your holiday dinner, remember that soon Uncle Sam will be visiting to enjoy his share of your bounty. Despite the hustle and bustle of the holidays, the savvy taxpayer will make room in their overstuffed holiday calendar to complete year end tax planning. Year end tax planning should be completed at least one month before the end of the year so that all tax issues are properly addressed and tax liability is minimized. If you would like to reduce your taxes this year, there are several options to be considered.

If your taxable income needs to be offset, you should consider selling assets that have lost value before the end of the year. Losses will offset gains, and to the extent that the losses are greater than the gains, you may be able to write off the losses against your income this year and in future years. If you are holding an asset that in all likelihood will not go up in value, consider a sale at a loss, which may, in turn, reduce taxable income.

Often, taxpayers borrow additional funds or make additional charitable contributions in order to obtain additional write-offs against their income. An additional write-off is only available if you qualify to itemize deductions. In order to itemize your deductions, you must have deductions that exceed the standard deduction for the tax year. If you are unsure whether your itemized deductions will exceed the standard deduction, it makes sense to calculate your deductions prior to making any additional contributions to ensure that the contributions will have the desired effect on your income tax return. Similarly, if you are considering refinancing your mortgage, and if you are paying points, consider whether you should close on December 31st or January 2nd in order to determine the most beneficial year for taking the itemized deduction of these points.

If you are in need of additional funds, perhaps to pay for all of those holiday gifts and festivities, consider liquidating assets that are subject to capital gains tax as opposed to ordinary income tax. Paying on only the gain may be preferable to liquidating other assets that will be more heavily taxed. For example, if you are in a 28% bracket, additional withdrawals from your IRA or 401k plan will cause these amounts to be taxable at the 28% rate, if not higher. The sale of a capital gain asset (not held in a qualified plan) will trigger a smaller capital gain rate on only the gain, which is the amount over the basis.

If you happen to be self-employed, you may wish to consider making contributions to another type of a retirement plan called a SEP-IRA or a simple IRA. You may also be able to set aside funds in a separate account for employees, if desired. If your business has earned considerable income, and even if you think that it may not earn as much in the following year, you should still consider depositing and funding your SEP-IRA in the current year to reduce taxable income. If the following year does not yield the anticipated economic results, there is no requirement to continue funding the account in future years.

In the event that you have a taxable estate, which means an estate greater than $1 million for Massachusetts purposes and/or greater than $3.5 million for federal purposes, gifting should also be considered. In 2009, you may gift $13,000 to any person without having to file a gift tax return. Systematic gifting each year in amounts that do not exceed the annual exclusion can substantially reduce your taxable estate leaving more for your loved ones. If you hold highly appreciated assets, consider making gifts of these assets; however, note that gifting highly appreciated assets would usually be of greater benefit to the recipient if gifted to charity.

As with all tax issues, competent assistance should be obtained from a tax professional who has the knowledge and the technical expertise to recognize areas where planning may be available to you. The time to plan is now as once Uncle Sam sits down at the dinner table, there is no controlling his appetite.

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