Top 5 Ways to Reduce Your Taxes

If your goal is to reduce taxes, then planning is key. Accordingly, in this issue of the *TS Newsletter*, we discuss five year-end tax planning strategies that can save you money, and we encourage you to contact us if you have any questions.

1. **Manage Your Income** – Do you expect your taxable income to be higher this year or next year? It's a relatively safe bet that income tax rates will remain the same from 2007 to 2008, and this likelihood makes planning easier.

   If you think your taxable income will remain relatively the same or drop significantly in 2008, then you may want to defer as much income into next year as possible. How? Well, if you are a business owner, you may want to consider delaying billing your customers until certain projects are completed, so long as this is consistent with your other billing methods. If you are an employee, you may want to request that your employer issue bonus checks in January rather than before the upcoming December holidays.

   On the other hand, if you think your income will go up in 2008, then you may want to accelerate your earnings for 2007. Business owners may accomplish this by discussing with customers if they'd be willing to prepay you for certain of the services you will be providing next year.[1] Employees may consider requesting that your accrued vacation time be paid out in December in addition to your regular wages; this could be done instead of taking paid time off.

2. **Time Your Expenses** – Nearly everyone can benefit from timing expenses. For business owners, if you account for expenses on the cash basis, then you may generally deduct non-inventory items that your business pays for or charges to a credit card on or before the last day of the year. If you expect to be profitable, and assuming that income tax rates will remain the same from 2007 through 2008, then you may benefit by pre-paying for certain expenses before December 31st.

   If you are not a business owner, you can still benefit by timing your expenses. For example, since state income taxes are generally deductible on your federal return, you may be able to increase your refund or reduce your balance due for 2007 by increasing the state withholding from your paychecks and/or making your final estimated state income tax payment by 12/31 instead of by the January 15th due date.

3. **Map Your Retirement Plan** – Whether you are a business owner, an employee, or retired, year-end retirement planning may help you trim your tax bill.

   For example, if you are an employee who is not covered by a retirement plan at work, you may want to set up and make contributions to an IRA; your contributions made on or before April 15, 2008 may be deductible on your 2007 income tax return, and you may even qualify for a tax credit of up to 50% of your contributions.

   If you are a retiree required to take minimum distributions from a retirement plan, you may want to consider taking higher taxable distributions from now through year-end 2008. This is probably contrary to what you may have heard in the past, but if you are of the opinion that income tax rates will likely rise in 2009, then you might save on taxes overall by taking more now and less in the future.

   If you are a business owner, and you expect your business to generate taxable profits this year, a good first step might be to determine how much of the projected taxable profits you can save long-term without needing access to the cash. You'll also need to consider whether the business should be making retirement plan contributions on behalf of certain employees.

   Generally, defined benefit plans allow the largest potential contributions, thereby yielding the greatest prospective tax savings, but these plans typically cost the most in terms of administrative fees. Therefore, many small businesses opt for 401(k) plans or SEP plans because both plans allow relatively large annual contributions with generally lower administrative costs than defined benefit plans.[2]

4. **Examine Your Investment Portfolio[3]** – In many instances, it's important to consider the tax implications of when and which investments to sell alongside your consideration of market conditions.

   Often times, you will derive the greatest overall tax benefit by offsetting short-term gains (holding period of 12 months or less) with losses. Accordingly, if you have any short-term gains at year-end, you may want to consider selling shares in which you have losses in order to offset the gains. That said, keep in mind that the "wash sale rules" prevent you from using losses to offset gains if you buy back the loss shares within 30 days from the date you sold them.[4]

   Additionally, if you are permitted to specifically identify which shares of a particular security to sell, you can reduce your taxable gains by selling the shares with the highest cost.

5. **Consult a Qualified Tax Professional** – Be aware that any changes you make can have unintended consequences, and for this reason, it's generally a good idea to consult with your tax professional before you take action.

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[1] Your customer may have the ability to fully deduct prepayments for your services so long as you expect to complete providing such services within 12 months from the date your customer issues payment.

[2] Depending on the provider, administrative fees for 401(k) plans vs. SEP plans may be the same or may vary significantly.

[3] This section considers only non-retirement plan securities.

[4] If you are a "trader" with an effective "mark-to-market" election, the wash sale rules do not apply.