

CPA Continuing Education
Society of PA
Russell Valante
President
Madison Bank Building
1767 Sentry Parkway West
Blue Bell, PA 19422
215.619.3920
rvalante@janney.com
www.cpasocietypa.org

Year End Tax Planning

Year-End Tax Planning

What is year-end tax planning?

As the end of the tax year approaches, you can probably get a rough idea of how much you'll owe in taxes. To lower your tax bite, it is wise to take certain steps at year-end.

Numerous strategies exist to help you, including reviewing professionally developed year-end tax checklists, performing a marginal tax rate analysis to ensure that you won't be pushed into a higher tax bracket unnecessarily, and postponing income and accelerating deductions (or vice versa).



Year-end tax planning and investment decision-making may sometimes result in substantial tax savings. Year-end tax planning primarily concerns the timing and the method by which you report your income and claim your deductions and credits. The basic strategy for year-end planning is to time your recognition of income so that it will be taxed at a lower rate, and to time your deductible expenses so that they may be claimed in tax years when you are in a higher tax bracket. In a nutshell, you should try to do the following:

- Recognize income when your tax bracket is lower
- Pay deductible expenses when your tax bracket is higher
- Postpone the payment of tax whenever possible

How can checklists help you?

Tax planners develop checklists to guide taxpayers toward year-end strategies that might help to reduce their taxes. These checklists offer several suggestions and are arranged in categories, such as "Retirement Planning Checklist." The checklists trigger tax-savings ideas that may not have occurred to you. For instance, one suggestion may be to shift income at the year's end to family members who are in lower tax brackets to minimize your overall taxes. Another suggestion might be for a married person to calculate his or her taxes two ways, using both married filing jointly status and married filing separately status, in order to minimize income tax liability.

How can a marginal tax rate analysis help you to save taxes?

A marginal tax rate analysis involves understanding the difference between your marginal tax rate and your effective tax rate. If you know the rate at which your next dollar of income will be taxed, you may be able to engage in planning that will prevent you from being pushed into a higher tax bracket unnecessarily. If a higher tax bracket seems likely, you may be able to undertake certain strategies (such as deferring income and accelerating deductions) to lower your federal income tax burden.

Year-end tax planning and investment decision-making may sometimes result in substantial tax savings.

What should you know about income and deduction strategies?

As stated earlier, you want to time your recognition of income so that it will be taxed at a lower rate, and time your deductible expenses so that they can be claimed in years when you are in a higher tax bracket. In general, taxpayers have a certain amount of control over the timing of income and expenses. Although deferring the recognition of income is usually desirable, there may be occasions when you might want to accelerate the recognition of income. For example, you may want to accelerate the recognition of capital gains if you have capital losses this year and need to offset them with capital gains. Also, you might want to accelerate income and postpone deductions this year if you expect to be in a higher marginal tax bracket next year.



Conversely, there are several reasons why you might want to postpone income and accelerate deductions this year. For instance, you might expect to be in a lower tax bracket next year because of retirement or unemployment. Also, if you lower your income enough this year, you may pay tax at a lower rate if you position yourself into a lower marginal tax bracket.

Appropriate Checklists for Year-End Tax Planning

What are appropriate checklists for year-end tax planning?

Tax planners often develop checklists to guide taxpayers toward year-end strategies that might help reduce taxes. Typically, suggestions are grouped into several different categories, such as "Filing Status" or "Employee Matters," for ease of reading.



When year-end approaches, it might be wise to review each suggestion under the categories that may apply to you.

Filing status and exemptions

- If you're married (or will be married by the end of the year), you should compare the tax liability for yourself and your spouse based on all filing statuses that you might select. Compare the results when you file jointly and when you file married separately. Determine which results in lower overall taxation.
- Determine whether you're entitled to claim a dependency exemption for a parent or other relative. You will need to have contributed more than half of that individual's support during the year, and other conditions may also apply.
- If you're claiming a dependency exemption for a child who is 19 or older (age 24 or older if a full-time student) you must make sure that the dependent's gross income doesn't exceed \$3,650 in 2009 (up from \$3,500 in 2008).
- If you and several other people financially support someone but none of you individually qualifies to claim the individual as a dependent, you should consider making an agreement with all of the other parties to ensure that at least one of you can claim the individual as a dependent.

Family tax planning

- Determine whether you can shift income to family members who are in lower tax brackets in order to minimize overall taxes.

Tip: *The kiddie tax rules apply to: (1) those under age 18, (2) those age 18 whose earned income doesn't exceed one-half of their support, and (3) those age 19 to 23 who are full-time students and whose earned income doesn't exceed one-half of their support.*

- Consider making annual gifts of up to \$13,000 (2009 figure, up from \$12,000 in 2008) per per-

son. Use assets that are likely to appreciate significantly for optimum income tax savings.

- Take advantage of tax credits for higher education costs if you're eligible to do so. These may include the Hope credit (renamed the American Opportunity tax credit for 2009 and 2010) and the Lifetime Learning credit. Note that these credits are based on the tax year rather than the academic year. Therefore, you should try to bunch expenses to maximize the education credits.

Tip: *If you have qualified student loans (and meet all necessary requirements), you may be entitled to take a deduction for the interest you paid during the year. The maximum amount you can deduct is \$2,500.*

Employee matters

- Self-employed individuals (who generally use the cash method of accounting) can defer income by delaying the billing of clients until next year. You may also be able to defer a bonus until the following year.
- Use installment sale agreements to spread out any potential capital gains among future taxable periods.
- Employees can deduct their business expenses as long as these expenses exceed 2 percent of annual adjusted gross income (AGI). Therefore, attempt to bunch as many of these business expenses as possible during the current year in order to maximize the deductions.

Business income and expenses

- Accelerate expenses (such as repair work and the purchase of supplies and equipment) in the current year to lower your tax bill.
- Increase your employer's withholding of state and federal taxes to help you avoid exposure to estimated tax underpayment penalties.
- Pay last-quarter taxes before December 31 rather than waiting until January 15.
- Make sure that you meet the required threshold percentages of your AGI to deduct expenses by "bunching" miscellaneous expenses into the same year.
- If you have significant business losses this year, it may be possible for you to apply them to the prior year's returns to receive a net operating loss carryback refund. If you had significant income in prior years, you should maximize the

current year's losses by deferring income, if possible.

- In certain circumstances, it may be possible for the full cost of last-minute purchases of equipment to be deducted currently by taking advantage of Section 179 deductions.
- Generally, you are able to make a contribution to your retirement plan at any time up to the due date (plus extensions) for filing a given year's tax return.

Financial investments

- Pay attention to the changes in the capital gains tax rates for individuals and try to sell only assets held for more than 12 months.
- Consider selling stock if you have capital losses this year that you need to offset with capital gain income.
- If you plan to sell some of your investments this year, consider selling the investments that produce the smallest gain.



Personal residence and other real estate

- Make your early January mortgage payment (i.e., payment due no later than January 15 of next year) in December so that you can deduct the interest paid in the current year.
- If you want to sell your principal residence, make sure you qualify to exclude all or part of the capital gain from the sale from federal income tax. If you meet the requirements, you can exclude up to \$250,000 (\$500,000 for married couples filing jointly). Generally, you can exclude the gain only if you used the home as your principal residence for at least two out of the five years preceding the sale. In addition, you can generally use this exemption only once every two years. However, even if you don't meet these tests, you may still be able to qualify for a reduced exclusion if you meet the relevant conditions.
- Consider structuring the sale of investment property as an installment sale in order to defer gains to later years.
- Maximize the tax benefits you derive from your second home by modifying your personal use of the property in accordance with applicable tax guidelines.

Retirement contributions

- Make the maximum deductible contribution to your IRA. Try to avoid premature IRA payouts to avoid the 10 percent early withdrawal penalty (unless you meet an exception). Contribute the full amount to a spousal IRA, if possible. If you meet all of the requirements, you may be able to deduct annual contributions of \$5,000 to your traditional IRA and \$5,000 to your spouse's IRA. You may be able to contribute and deduct more if you're at least age 50.
- Set up a retirement plan for yourself, if you are a self-employed taxpayer.
- Set up an IRA for each of your children who have earned income.
- Minimize the income tax on Social Security benefits by lowering your income below the applicable threshold.

Charitable donations

- Make a charitable donation (cash or even old clothes) before the end of the year. Remember to keep all of your receipts from the recipient charity for all donations.
- Use appreciated stock rather than cash when contributing to charities. This may help you avoid income tax on the built-in gain in the stock, while at the same time maximizing your charitable deduction.
- Use a credit card to make contributions in order to ensure that they can be deducted in the current year.

Itemized miscellaneous and medical expenses

- Take advantage of the adoption tax credit for any qualified adoption expenses you paid. In 2009, you may be able to claim up to \$12,150 (up from \$11,650 in 2008) per eligible child (including children with special needs) as a tax credit. The credit begins to phase out once your modified AGI exceeds \$182,180 (up from \$174,730 in 2008), and it's completely eliminated when your modified AGI reaches \$222,180 (up from \$214,730 in 2008).
- Maximize the use of itemized miscellaneous expenses and/or medical expenses by bunching such expenses in the same year, to the extent possible, in order to meet the threshold percentage of your AGI.
- Make sure that you have applied for Social Security numbers for all new dependents. Otherwise, the dependency exemption on your income tax return may be disallowed.

Year-End Investment Decisions

What are year-end investment decisions?

Year-end investment decisions may sometimes result in substantial tax savings. Tax planning may allow you to control the timing and method by which you report your income and claim your deductions and credits.



The basic strategy for year-end planning is both to time your income so that it will be taxed at a lower rate, and to time your deductible expenses so that they may be claimed in years when you are in a higher tax bracket. In terms of investment planning, investing in capital assets may increase your ability to time the recognition of some of your income and may help you to take advantage of tax rates that are lower than the ordinary income tax rates. You have the flexibility to control when you recognize the income or loss on many types of investment assets. In most cases, you determine when to sell your capital assets. In some cases, however, shifting potential capital gain income to other taxpayers through gifting may be an appropriate strategy.

How do you use the capital gains tax to lower your taxes?

Capital gains and losses are accorded special tax treatment. Currently, the top long-term capital gains tax rate is 15 percent (for most types of assets), while the top ordinary income tax rate is 35 percent—that's a difference of 20 percent. As a consequence, by converting some of your ordinary income to long-term capital gain income, it may be



possible for you to reduce your federal income tax liability.

Caution: Under the Jobs and Growth Tax Relief Reconciliation Act of 2003 (2003 Tax Act) and the Tax Increase Prevention and Reconciliation Act of 2005, long-term capital gains tax rates are 15 percent for taxpayers in tax brackets higher than 15 percent, and zero percent (in 2008-2010) for taxpayers in the 15 percent or 10 percent tax brackets. Prior to May 6, 2003, long-term capital gains tax rates were 20 percent and 10 percent, respectively. Beginning in 2011, long-term capital gains tax rates will revert back to these pre-2003 Tax Act levels.

The basic strategy for year-end planning is both to time your income so that it will be taxed at a lower rate, and to time your deductible expenses so that they may be claimed in years when you are in a higher tax bracket.

Timing your capital gain recognition

Careful timing of when you sell capital assets may help you to reduce your federal income tax liability. For example, if it's late in the year and you want to sell a capital asset, you can wait until January to sell it so that you realize your



capital gain or loss next year (assuming that you have a calendar tax year). This strategy is particularly useful if you are in a higher marginal tax bracket in the current year and expect to be in a lower one in the following year. Timing can also be important because capital gain income increases your adjusted gross income (AGI). Itemized deductions and personal exemptions may be phased out or decreased if your AGI in a given year exceeds a specified threshold.

Plan your year-end capital gain and loss status

Planning the time when you recognize capital losses may also be important. If you expect to recognize a capital gain this year, you should review your portfolio for possible capital losses that can be used to offset the gains. If you have any capital loss carryforwards, you should review your portfolio for capital gain opportunities to make use of such carryforwards. In general, net capital losses are deductible dollar-for-dollar against net capital gains. Excess losses are allowed to offset up to \$3,000 (\$1,500 for individuals filing married filing separate tax returns) of ordinary income per year. Losses over and above the limit may be carried forward indefinitely.



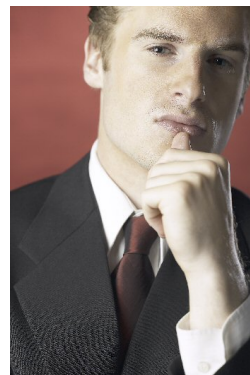
The following strategies may be appropriate:

- Sell capital gain property before the end of the year if you have already realized capital losses for the year that exceed the sum of any capital gains you have realized plus \$3,000 (\$1,500 for individuals filing married filing separate tax returns).
- If you have gains for the year that exceed your losses, sell property with built-in losses to offset the excess gains.
- If your other allowable deductions for the year exceed your income, you should, to the extent possible, avoid realizing any further capital losses for the year.
- If you've held a capital asset for close to 12 months and want to sell it, wait awhile (if possible). You can take advantage of the lower long-term capital gains rates if you hold the asset for over 12 months before selling it.

How do you select investments to control income?

You can select investments likely to produce ordinary income such as interest, or income that is taxed at reduced rates (certain qualifying dividends or long-term capital gains). You can also select investments likely to produce ordinary or capital losses. You can control when your investment earnings are taxed, bearing in mind that income distributions are

generally not taxed until you receive them (assuming that you use the cash method of accounting). By knowing the tax rules, you can lower your taxes.



What about shifting income?

It may be possible to shift potential capital gains to other taxpayers through gifts. If you are in a 25 percent or higher individual marginal tax bracket, the zero percent long-term capital gains tax rate for those in the 10 or 15 percent bracket (in 2008 through 2010) may provide an incentive for you to transfer appreciated assets to relatives in those lower tax brackets.



By knowing the tax rules, you can lower your taxes.

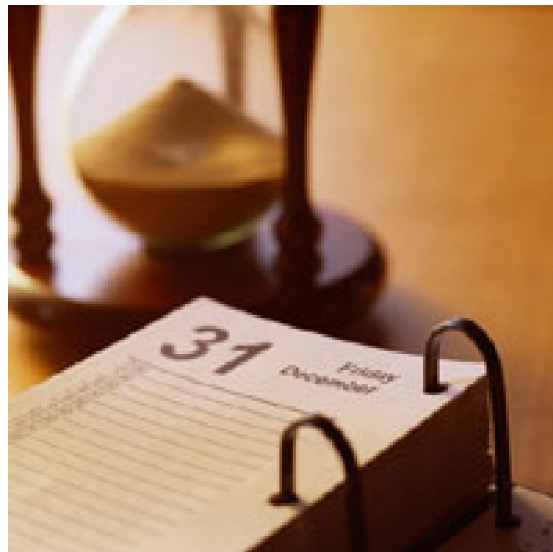
Accelerating Deductions/Postponing Income

If you'll be in a lower tax bracket next year, you may wish to accelerate your deductions into this year and postpone your income into the following year.

You can accelerate your deductions into this year by:

- Making next year's charitable contributions this year instead
- Prepaying deductible interest
- Paying estimated tax installments in December instead of January
- Accelerating capital losses
- Taking advantage of flexible spending accounts, Archer MSAs, and cafeteria plans
- Making January's alimony payment in December
- Prepaying next spring's college costs in December (if it qualifies you for education tax credits)

Higher tax bracket



DECEMBER 31



Lower tax bracket

You can postpone your income into the following year by:

- Delaying the collection of any debts that you are owed
- Deferring compensation
- Deferring year-end bonuses
- Delaying the exercise of incentive stock options (ISOs)
- Transferring funds to bank certificates and Treasury bills in order to delay tax on the interest
- Setting up a tax-deferred annuity or retirement account
- Deferring the sale of capital gain property, or taking installment payments rather than a lump-sum payment
- Postponing receipt of distributions that are over the required minimum from retirement accounts
- Increasing your contributions to your company's 401(k) plan or other tax-deferred plans

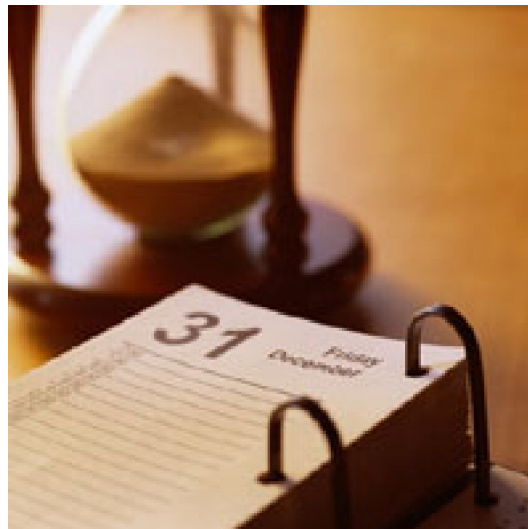
Accelerating Income/Postponing Deductions

If you'll be in a higher tax bracket next year, you may wish to accelerate your income into this year and postpone your deductions into the following year.

You can accelerate your income into this year by:

- Collecting any debts you are owed
- Taking distributions from your IRA or retirement plan if you will not incur an early withdrawal penalty
- Collecting accounts receivable if you're self-employed and use the cash method of accounting
- Arranging to receive dividends
- Settling lawsuits, insurance claims, etc.
- Selling any assets that would result in a capital gain
- Redeeming any Series EE savings bonds (also called Patriot bonds) that you have elected to defer taxes on until they are redeemed
- Convert a traditional IRA to a Roth IRA

Lower tax bracket



DECEMBER 31

Higher tax bracket

You can postpone your deductions into the following year by:

- Postponing charitable gifts
- Paying December's deductible expenses on January 1
- Delaying the payment of deductible interest
- Scheduling nonemergency dental and doctor's visits for the following year
- Delaying the realization of deductible capital losses

CPA Continuing Education
Society of PA
Russell Valante
President
Madison Bank Building
1767 Sentry Parkway West
Blue Bell, PA 19422
215.619.3920
rvalante@janney.com
www.cpasocietypa.org

Janney Montgomery Scott LLC Financial Consultants are available to discuss the suitability and risks involved with various products and strategies presented. We will be happy to provide a prospectus, when available, and other information upon request.

Please note that the information provided includes reference to concepts that have legal, accounting and tax implications. It is not to be construed as legal, accounting or tax advice, and is provided as general information to you to assist in understanding the issues discussed. Neither Janney Montgomery Scott LLC nor its Financial Consultants (in their capacity as Financial Consultants) give tax, legal, or accounting advice. We would urge you to consult with your own attorney and/or accountant regarding the application of the information contained in this letter to the facts and circumstances of your particular situation.

Janney Montgomery Scott LLC, is a full-service investment firm that is a member of the NYSE, the FINRA and SIPC.



Trusted Advisors for Generations