



## YEAR-END TAX PLANNING

As the end of the year approaches, it is a good time for you to engage in tax planning. You know your tax picture from earlier in the year and you have a pretty good idea of what it will be for the rest of the year. With that knowledge in hand, you are now in a position to take various actions that may save taxes for this year, next year, or both years.

A recent flurry of tax legislation may have an impact on your year-end tax planning for 2006. For example, there are new tax credits for making certain energy-saving improvements around the house, a new tax credit for buying hybrid vehicles and another new credit for buying an alternative fuel vehicle. Additionally, those individual who have attained age 70-1/2 may exclude up to \$100,000 a year (for 2006 and 2007) for otherwise taxable distributions from an IRA (or a Roth IRA) that are paid directly to a qualifying charitable organization by the IRA trustee.

Year-end planning also may turn out to be more of a “last minute” challenge this year than most because many deductions that expired at the end of 2005 may be retroactively extended by Congress in time for you to capitalize on them before year-end. These expired tax breaks include the above-the-line deduction for educators, the above-the-line deduction for higher education expenses, and the election to deduct state and local general sales taxes instead of state and local income taxes.

We have compiled a checklist of actions that may help you to save taxes if you act before year-end. Not all actions will apply in your particular situation, but you will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make:

- Increase the amount you set aside for next year in your employer’s health flexible spending account if you set aside too little for this year. Don’t forget you can set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids. Also, new rules allow your plan to permit a grace period after year-end for using remaining amounts.
- If you have any capital gains or losses from sales of stock or other capital assets or you have stock or other capital assets that are ripe for sale, it may be advisable for us to meet to discuss how you can best coordinate timing your gains and losses to minimize tax on your gains and maximize the tax benefit from your losses.
- It may be advantageous to try to arrange with your employer to defer your bonus until 2007.
- If you own an interest in a partnership or S corporation you may need to increase your basis in the entity so you can deduct a loss from it for this year.
- Consider using a credit card to prepay expenses that can generate deductions for this year.
- Consider making credit-eligible energy saving improvements to your home, or, if you’re thinking of buying a hybrid vehicle eligible for the credit, purchase it before year-end.
- You may want to pay contested taxes to be able to deduct them this year while continuing to contest them next year.
- Business clients also should consider making expenditures that qualify for the \$108,000 business property expensing option.
- You may want to settle an insurance or damage claim in order to maximize your casualty loss deduction this year.
- You may be able to save taxes this year and next year by applying a bunching strategy to “miscellaneous” itemized deductions, medical expenses and other itemized deductions.
- Those facing a penalty for underpayment of estimated tax may be able to eliminate or reduce it by increasing their withholding.

- Self-employed individuals should consider setting up a self-employed retirement plan.
- You can save gift and estate taxes by making gifts sheltered by the annual gift tax exclusion before the end of the year. You can give \$12,000 in 2006 to an unlimited number of individuals but you can't carry over unused exclusions from one year to the next.
- If you're thinking of donating a used auto to charity, you may want to inquire whether the charity plans to sell the car or use it in its charitable activities; the latter may yield a bigger deduction for you.
- If you are contemplating marriage or divorce consider how marriage penalties could affect you. Marriage penalty relief has been extended for the 15% tax bracket and the standard deduction but other marriage penalties remain.
- If you are receiving Social Security benefits, there are a number of steps you can take to reduce or eliminate tax on your benefits. Consider asking your employer to increase withholding of state and local taxes to pull the deduction of those taxes into this year (but only if doing so won't cause an AMT problem).
- Consider extending your subscriptions to professional journals, paying union or professional dues, enrolling in (and paying tuition for) job-related courses, etc., to bunch into 2006 miscellaneous itemized deductions subject to the 2%-of-AGI floor.
- Depending on your particular situation, you may also want to consider deferring a debt-cancellation event until 2007, electing to deduct investment interest against capital gains, and disposing of a passive activity to allow you to deduct suspended losses.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

**For more information, please contact an attorney in the Armstrong Teasdale Tax Department:**

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