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Year-end Tax Planning May Be Tough, But It Will Pay Dividends

By Robert W. Wood

Do you want to cut your tax bill next April 15? Same question for business filers on March 15? If so, start thinking about deductions now. And get ready to crunch some numbers to figure out what to buy, receive, pay, settle or deduct before the end of the year. More than in most years, a tax-wise end of 2013 is hard to handicap for taxpayers.

The changes between 2013 and 2014 tax rates and rules — let alone the entire economy — make it rough. Given the expiring tax provisions and rate changes, calculators or software are all but essential. A crystal ball wouldn't hurt either. Some provisions set to expire Dec. 31 might be extended by Congress right up to New Years. Taxpayers who are nimble and watching tax news are more likely to benefit.

On top of this, there are two new problems to tack on to the usual list. You need to take into account the 3.8 percent tax surtax on unearned income and the additional 0.9 percent Medicare tax on wages in excess of $200,000 ($250,000 for joint filers and $125,000 for couples filing separately). Here are some ideas to mull over about your facts and to add to the annual push-me-pull-you of whether to take action in 2013 or to push it — whatever it is — into 2014.

Consider triggering losses on stock investments. Investment pros say it's hard to bite the bullet and take a loss, but it can make sense. Grab the loss especially if you can offset it against gains and save taxes.

What if you still like the investment and think it will recover? You could sell your original holding, then buy back the same securities at least 31 days later. This isn't for beginners so get some advice.

If you can — and you almost certainly can to some extent — defer income until 2014 and accelerate deductions into 2013. This isn't just about timing — it's almost always better to claim deductions earlier and receive income later. This is about phase-outs, monitoring your adjusted gross income (AGI) and watching the Alternative Minimum Tax (AMT). Likely candidates for you may include child tax credits, higher education tax credits, the above-the-line deduction for higher-education expenses, and deductions for student loan interest.

Postponing income is usually desirable, especially if you anticipate being in a lower tax bracket next year. But for some, think contra. It may pay to *accelerate* income into 2013, especially if you have already paid large amounts in 2013 that will trigger the AMT and if a little extra income in 2013 might take you back *out* of AMT. It could be worth it to run those numbers.

Ways you might manipulate 2013 v. 2014 income? What about asking your employer to defer a 2013 bonus that may be coming your way until 2014? The same might be done for client payments. If you are owed a consulting fee, what about getting it next year? Given that you are very careful of constructive receipt rules, it's often possible to do more of this kind of planning than you might think.

Consider using a credit card to prepay expenses if they'll generate deductions this year. Remember, credit card payments are like writing a check for tax purposes, even though you might not receive — or pay — the credit card bill until next year.

Will you owe state income taxes when you file your 2013 return in 2014? If so, think about asking your employer to increase your state income tax withholding. Alternatively, just make an estimated tax payment to your state before year-end. But don't write a big check to your state Dec. 31 if it creates an AMT problem.

Estimate your year-end moves on AMT. Run the numbers since many *regular* tax breaks are disallowed for AMT, including: state property taxes, state income taxes (or state sales tax if you elect), miscellaneous itemized deductions, and personal exemptions. If you elect to claim a sales tax deduction instead of a state income tax deduction, consider accelerating big purchases into 2013 in order to assure a deduction for sales taxes. This election is due to expire in 2013, so this may be your last chance to benefit from it.

Own your home? Make energy saving improvements before New Years. Things like energy saving windows and an energy efficient heater or air conditioner can qualify. The $4,000 above-the-line deduction for qualified higher education expenses is due to expire Dec. 31. Thus, consider prepaying eligible expenses if it increases your deduction.

Fighting an old tax bill? Maybe it's time to give up and pay or settle the bill in 2013 so you can deduct it. Not ready to call it quits? Also consider whether you can pay the bill but still keep fighting. Depending on the taxes involved and the situation, that can make sense.

Do you have an outstanding insurance or damage claim? Settle it in 2013 in order to maximize your casualty loss deduction this year.

Here's a longer term idea. Think about purchasing qualified small business stock — often abbreviated as QSBS — before the end of this year. There is no tax on gain from its later sale if it is (1) purchased after Sept. 27, 2010 and before Jan. 1, 2014, and (2) held for more than five years. What's more, such sales won't cause AMT preference problems either. For more about QSBS, see Robert W. Wood, *California Qualified Small Business Stock Tax Break Fixed — Retroactively*, Daily Journal, (October 15, 2013).

Planning for your law firm or company too? Here are some business-oriented ideas. Contemplate making expenditures that qualify for business property expensing. For 2013, the limit is $500,000 and the investment ceiling limit is $2,000,000. Unless Congress acts, the limit drops to $25,000 in 2014.

With that steep $500K to $25K drop between 2013 and 2014, buying machinery and equipment now makes sense. Unlike depreciation, there's no pro-ration for a partial year of service. Computers, servers, copy machines, and furniture are cheaper this year. Bonus depreciation is another expiring benefit. Fifty percent bonus first year depreciation won't be available next year unless Congress extends it.

Also consider a work opportunity tax credit (WOTC) by hiring qualifying workers (such as certain veterans) before the end of 2013. Unless the credit is extended, it won't be available for workers hired after 2013. Make qualified research expenses before the end of 2013 to claim a research credit, which also might not make it past 2013.

If you are self-employed and haven't yet set up a self-employed retirement plan, get started. For that matter, no matter what your business structure, look at retirement plans and benefits. The law is constantly changing and you may be able to put away extra dollars tax-deferred.

If you practice in a partnership (or LLP) or even in an S corporation, ask your accountant whether you have sufficient basis to deduct any loss you might have this year. Before year-end, you may need to increase your basis so you can claim it. Usually you can do this by making a loan to your entity, even if you make it at the very end of the year.

None of this is fun (unless you're an accountant or tax attorney!), but crunch the numbers or have your return preparer do it. This year end — and next April — you won't be sorry.

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