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## Year End Tax Planning

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Perhaps "year-end tax planning" is a misnomer, as planning to save on federal income taxes involves year-round action. But this year, more than ever, Florida residents may be able to enjoy some new or extended tax benefits recently enacted by Congress.

**Bunch Itemized Deductions.** The "standard deduction" in 2004 for a single person is \$4,850, for a head of household is \$7,150, and for married couples filing jointly is \$9,700. All of these amounts are anticipated to rise slightly for 2005. It is possible for some persons, who do not regularly itemize, to "bunch" itemized deductions in one year, then take the standard deduction another year. For example, in 2004 itemized deductions include qualified home mortgage interest, real estate taxes, charitable contributions, and state sales taxes paid (or determined according to a schedule the IRS will soon promulgate). Additional deductions include (subject to certain limitations) medical expense payments, medically necessary home improvements to the extent they don't add to the value of a house, investment advisory fees, and professional fees for estate tax planning, tax research, or tax advice in connection with a divorce. Bunching deductions into one year could occur, such as by paying the 2004 real estate tax bill (received by most residents near the beginning of November) in early 2005, then paying the 2005 real estate tax bill in November 2005. Since the newly enacted state sales tax exemption is only in place (under current law) for 2004 and 2005, consider making large taxable purchases all in one year if you are seeking to bunch deductions. Consider bunching charitable contributions, as well, and consider gifts of appreciated property (such as publicly traded stock or stock mutual funds) to avoid eventual capital gains taxes.

**Convert Nondeductible Credit Card Interest To Home Equity Loans.** Consider converting non-deductible credit card and/or auto loan interest into deductible interest by means of a qualifying home equity debt consolidation loan. You need to have sufficient equity in your home for this to occur, and you should carefully consider your ability to repay the home equity loan.

**Contribute to Retirement Accounts.** We cannot stress enough the need to personally save for retirement. Seek to maximize contributions to 401(k), 403(b), and other qualified retirement plan accounts. Also consider your eligibility to fund traditional IRA accounts. All of the foregoing result in "above-the-line" deductions from income, and can result in income tax deferral. If you cannot contribute the maximum this year, plan to set aside one-half of any future pay increases to retirement plan accounts. Also consider contributions to nondeductible Roth IRA accounts if eligible. Consider other pre-tax benefits that may be available from your employer, such as flexible spending accounts.

**Plan To Offset Capital Gains With Losses.** Keeping taxes down on investment returns is an important consideration. Consider realizing capital losses against capital gains each year. Capital losses can also be used to offset up to \$3,000 of ordinary income each year. More importantly, invest tax-efficiently. Properly allocate fixed income and equity (stocks, stock mutual funds) between tax-deferred and taxable accounts. When investing in taxable accounts, consider low cost tax-managed stock mutual funds, seek to not realize long-term capital gains, or if gains are realized seek long-term capital treatment. Lastly, and as we've mentioned often, most taxpayers should avoid variable annuities due to their high costs and often-unfavorable tax implications. (For a special 20-page report detailing our reasons, refer to our web site.)

**Plan To Take Advantage of Tax Credits.** Tax credits exist, subject to varied limitations on adjusted gross income. These include the child tax credit, adoption credit, child and dependent care expenses, Hope Scholarship and Lifetime Learning credits, and contributions to certain retirement accounts.

**Disaster Losses.** Most years we wouldn't write about disaster losses, but after three hurricanes in recent months we have, unfortunately, many clients who have this concern. Casualty losses are generally deductible only in the year the casualty occurred. However, if you have a deductible loss from a disaster in an area that is officially designated by the President of the United States as eligible for federal disaster assistance (i.e. Citrus County and many other counties in Florida), you can choose to deduct that loss on your return for the year immediately preceding the loss year. In other words, you may treat the loss as having occurred in either the current year or the previous year, whichever provides the best tax results for you. If you have already filed your return for the preceding year the loss may be claimed by filing an amended tax return and attaching an election statement to the return. Claiming a qualified disaster loss on the previous year's return may result in a lower tax for that year and produce a cash refund. As always, other rules apply, so study them carefully or seek assistance.

***Tax Planning Is A Year Round Endeavor.*** Should you invest in taxable or tax-exempt bonds or bond funds? Can you plan to accelerate or defer income to seek lower income taxation or reduced taxation of social security benefits? Should you take early distributions from traditional IRA and qualified retirement plan accounts to take advantage of lower marginal tax rates, as opposed to higher rates if your income will likely be greater in future years? What is the best manner in which to structure your investment portfolio so as to reduce the long-term "tax drag" upon investment returns? Is the alternative minimum tax a concern? These and a number of other issues should be addressed with your tax professionals.

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