American National Bank

Year-end tax-saving tips for 2007: Part two

In Part One of this discussion, we took a look at some of the basic tax-saving steps to consider prior to the end of the year—chiefly, deferring income and accelerating and "bunching" your itemized deductions. Now let's take a look at some of the other opportunities that may help reduce your 2007 tax bill.

Review your portfolio

If you have realized any capital gains during the year, take some time to review your portfolio with an eye toward selling some of your losers.

First step: Sell enough of those losers to shelter all of your gains for the year, wiping out any tax that you might owe. The next step is to sell off additional property, realizing losses up to $3,000. Why that amount? The tax code allows you to deduct a maximum of $3,000 in capital losses against your ordinary income. Additional losses may be claimed on future tax returns.

Are you considering a mutual fund at year-end? That's the time when many funds distribute dividends and capital gains. If you are making an investment in a taxable fund, it's possible that you could receive a portion of your investment back fairly quickly, as a taxable distribution. Solution: Check into the fund before making your purchase to find out if a taxable distribution will be forthcoming before year-end. Then you can decide either to wait until after the distribution to invest, or, if you believe that the potential for gain outweighs the tax consequences, you can go forward with your purchase.

Make charitable gifts

Making donations to favored charities at year-end is a sound strategy. Whether it's fulfilling a pledge or responding to a natural disaster or to a philanthropic impulse, your generosity may be rewarded by way of an income tax deduction. Naturally, the gift is worth more to you if you make the gift before year-end. Your deduction reduces your 2007 taxable income. Make the gift after December 31, and you have to wait a whole year before you can write it off.

There is an additional tax advantage when you make a gift of appreciated property instead of cash. You can avoid having to pay capital gains on the sale of the appreciated property, a win-win proposition for both you and the charitable organization that you wish to benefit. Here's an illustration: Philanthropist has made a $10,000 pledge to his alma mater this year. Because he is in the 35% tax bracket, his charitable deduction will be worth $3,500. If he sends in a check by year-end, his after-tax cost for the gift will be $6,500.

Now suppose that Philanthropist owns a block of stock worth $10,000 that he acquired years ago at a cost of $3,000. If he were to sell the stock, he'd owe a capital gains tax of $1,050 (multiplying his $7,000 capital gain by the 15% maximum rate on long-term capital gains). If he decides to donate the stock, he's entitled to the same $3,500 charitable deduction. But because of that $1,050 saving on the capital gain, the total after-tax cost of Philanthropist's gift drops to $5,450.

Take note, too, that is not too late to take advantage of a tax provision that was introduced in the Pension Protection Act of 2006 and, at this writing, is set to expire at the end of this year. The law permits IRA and Roth IRA owners to make tax-free charitable distributions of up to $100,000 as long as they are at least age 70 1/2.

Take advantage of tax-deferred investing

Are you a participant in a 401(k) plan? You are entitled to contribute a maximum of $15,500 for this year. (If you are at least age 50, your maximum is $20,500.) If you have not "maxed out," consider making additional contributions from your salary before year-end. The contributions are made "pretax," meaning that no federal income tax is paid on the amount contributed (and won't be until the money is withdrawn). And, of course, earnings on the money are tax deferred as well.

Are you self-employed? If so, and you haven't already, you can set up a Keogh plan anytime up to December 31 and defer some of your year 2007 earnings. You have as late as April 15, 2008, the date that your tax return is due, to actually make your contribution.

Similarly, if you are eligible to make a tax-deductible contribution to a traditional IRA or an after-tax contribution to a Roth IRA, you will have until April 15, 2008, to make that contribution. The maximum allowable contribution for 2007 is $4,000 ($5,000 if you are age 50 or older).

A final note

As thoughts turn from an old year to a new, it's a good idea to reflect on all aspects of your financial life that might need attention.

For instance, have you reviewed your will and estate plan lately? There may be changes to your family, business or investment circumstances that merit taking another look at your strategies. Be sure to review your will to make certain that it is in sync with the current federal estate and gift tax rules.

We would be glad to assist you and your advisors with a comprehensive review of your will and estate plan.

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