Look at Tax Liabilities Before Spending All of Your Holiday Money

Q: Have there been any tax law changes recently and what can I do to save taxes before year-end?

A: Before you spend all of your money on holiday gifts, see if the tax changes will affect you. We had tax rate increases this year and the highest income tax bracket has increased from 35% to 39.6%. The capital gains tax rates remain 0% for 10% and 15% brackets, and 15% for all other brackets EXCEPT the new 39.6% bracket that will pay 20%.

There's a new Medicare investment surtax of 3.8% that applies to net investment income (NII) and another 0.9% Medicare surtax on earned income. This is for taxpayers in the higher brackets.
Start by pulling out last year's tax return and estimating your 2013 tax bill. Review all income, and look at the amount you have withheld or paid in estimated taxes. Review your deductions. (Now is a good time to file for your flexible spending plan reimbursement.) Add together all of your medical expenses, insurance, prescriptions, co-pays, etc. Does it exceed your threshold? Did you pay your property taxes yet? Have you made your charitable contributions? Add up any business expenses that weren't reimbursed by your employer. Did you hire a tax professional? Did you pay your investment advisor? (Commissions aren't tax deductible.)

Did you defer the maximum allowable to your company retirement plan? This year the max is $17,500 for the under 50 year olds and the catch up for the over 50 crowd is $5,500. Every dollar that you defer results in a tax savings at your highest marginal rate. For example, if you're in the 25% tax bracket, you pay 25 cents of tax on the last dollar that you earn. A $10,000 401K deferral can result in $2,500 of tax savings this year. Not to mention the benefit of the tax deferred investment return compounding effect.
Are you 70 1/2 or older? Double-check that you took the correct required minimum distribution (RMD). The penalty is 50%. This year you can transfer your RMD directly to a charity and that move may save tax on your Social Security and possibly other taxes.

Do you have after-tax investments? Review capital gains and losses and try to use losses to offset the gains. Gift! You can transfer appreciated investments. If your niece is in a lower tax bracket, perhaps she would not pay a capital gains tax on an appreciated mutual fund that you transfer to her. It's win-win.

Don't miss out on the 0% capital gains tax rate for the two lowest income tax brackets. Sell and buy back the same day if want to keep the holding, pay zero capital gains tax, and reset the cost basis to the higher level. Wash sales rules don't apply to sales with gains, only losses. For mutual funds check with the fund company as some restrictions may apply under their frequent trading or redemption policies.
Are you able to itemize deductions? If you're on the edge of the standard deduction due to high property taxes and generous charitable contributions, consider "bunching" two years of deductions into one year. "Bunch" every other year and use the standard deduction the other year.

Estimate next year's taxes. Avoid an underpayment penalty. Watch the tax brackets for your Social Security, NII and capital gains. Defer the max you can handle to your 401K. Don't miss opportunities if you're in the lowest tax brackets. Most of all, consult your tax professional and financial advisor. Planning pays off.

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